CHAPTER 1
INTRODUCTION

1.1 INTRODUCTION:

Banking is a very important tool in the construction of economic structure of any country. Any business, whatever may be the nature, has to transact with bank at some time or the other. Without a sound and effective banking system it cannot have a healthy economy. The banking system of India should not only be hassle free but it should be able to meet new challenges posed by the technology and any other external and internal factors. For the past three decades India’s banking system has several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitan or cosmopolitans in India; In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India’s growth process.

Bank provides wide range of financial services. Banking made it possible for businessman to transact with their counterparts on entire globe. The financial transactions have shifted from transactions in coins to introduction of credit cards and microchips. Financial transactions of business have become so simple and manageable that businessman can leave this part entirely to bank and concentrate on other important aspects.” Today, Banking and Financial services have become the life blood, the veins and the arteries of the national as well as the international monetary system.”¹

¹ Whittlesey, C.R.; “Principles and Practices of Money and Banking” (1954) p.17
In a developing country like India, bank also has social responsibilities like uplifting the weaker sections and financing the social projects. In addition to providing finance to industry and business, banking industry in India has been playing a pivotal role in rebuilding the Indian economy by extending its network to the backward and rural areas, financing agriculture, small industries, weaker sections of the society etc. “Bank are both manufacturers and also the traders of the nation’s money and to monetary system.”

Banking in India has its origin as early as Vedic period. Banking system was in existence in the crudest form during Vedic period in India. During the Ramayana and the Mahabharata eras, banking had become a full-fledged business activity. The members of the vaish community carried on the business of banking. Manu smrati and Kautilya’s Arthashastra bear testimony to the existence and effective working of a banking system in India early in history. It is believed that the transactions from money lending to banking must have occurred even before Manu, the great Hindu furriest, who has devoted a section of his work to deposit & advances and laid down rules relating to the rate of interest. During the mogul period, the indigenous banker played a very important role in lending money and financing foreign trade & commerce.

Though Banking industry has its roots ever since 1688, in India it is only after 1939 that the industry has achieved subsistence after initial setbacks and failures. There were

4. Ibid p. 287.
many small banks mushrooming until 1936 with a very high rate of failures. During the days of the East India Company it was the turn of agency house to carry on the banking business. The East India Company started commercial banks in Calcutta and Bombay, which were known as “Agency Houses”. These Agency Houses were similar to the indigenous bankers\(^6\). The general bank of India was the first joint stock bank to be established in the year 1786. The other which followed was the Bank of Hindustan & Bengal Bank. The Bank of Hindustan is reported to have continued till 1906, while other two failed in the meantime. In the first half of the 19\(^{th}\) century the East India Company established there banks, The Bank of Bengal in 1809, The Bank of Bombay in 1840 and The Bank of Madras in 1843. These three banks, also known as the Presidency banks, were the independent units and functioned well. These three banks were amalgamated in 1920 and new bank, The Imperial Bank of India was established on 27\(^{th}\) January 1921.

In the wake of Swadeshi Movement, Number of banks with the Indian Management was established in the country namely, Punjab National Bank Ltd., Bank of India Ltd., Bank of Baroda Ltd. and Canara Bank Ltd. On 19 July 1969, 14 major banks of the country were nationalized and on 15\(^{th}\) April 1980, six more commercial private sector banks were taken over by the government.

The origin of State Bank of India goes back to the first decade of the 19\(^{th}\) century with the establishment of The Bank of Calcutta in Calcutta on 2\(^{nd}\) June 1806\(^7\). Three years later the bank received its charter and was redesigned as the Bank of Bengal on 2\(^{nd}\)

\(^6\) D.S. Savarkar, "Joint Stock Banking in India", Popular Book, 1930, p. 6
\(^7\) “Resource” Monthly Magazine, HRD Cell, LHO, Chennai, July, 2004, p. 4
January 1809. The Bank of Bombay on 15th April 1840 and The Bank of Madras on 1st July 1843 followed the Bank of Bengal. These three banks were governed by Royal Charter, which were revised from time to time 8.

These three banks received the exclusive rights to issue paper currency in 1861 with the Paper Currency Act, a right they retained until the formation of the Reserve Bank of India. By 1876, The Bank of Bengal had 18 Branches including its head office, seasonal branches and sub agencies, the Bank of Bombay and Madras had fifteen each 9.

The Presidency Bank Act, which came in to operation on 1st May 1876, brought the three presidency banks under a common statute and the banks involved themselves in the financing of every trading, manufacturing and mining activity in the sub-continent. But the three banks were rigorously excluded from any business involving foreign exchange, as it was feared that these banks enjoying government patronage would offer unfair competition to the exchange banks, which had by then arrived in India. This exclusion continued till the creation of the Reserve Bank of India in 193510.

The Presidency Bank of Bengal, Bombay and Madras with their 70 branches were merged on 27th January 1921 to form The Imperial Bank of India 11. When India attained freedom, the Imperial Bank had a capital base of (including reserves) of ₹118.5 crore, deposits and advances of ₹275.14 crore and ₹72.94 crore respectively and a network of 172 branches and more than 200 sub offices extending all over the countries 12.

11. Ibid
12. Government of India, Annual Survey (various issues)
In 1951, when the First Five Year Plan was launched, the development of rural India was given the highest priority. The commercial banks of the country including the Imperial Bank of India had till then confined their operations to the urban sector and were not equipped to respond to the emergent needs of economic regeneration of the rural areas. In order, to serve the economy in general and the rural sector in particular, the All India Rural Credit Survey Committee recommended the creation of a state-partnered and state-sponsored bank by taking over the Imperial Bank of India, and integrating with it, the former state-owned or state-associate bank. An act was accordingly passed in Parliament in May 1955 and the State Bank of India was constituted on 1st July 1955.¹³

Later, the State Bank of India (Subsidiary Banks) Act was passed in 1959, enabling the State Bank of India to take over eight former state-associated banks as its subsidiaries (later named Associates). On September 13, 2008, State Bank of Saurashtra, one of its associate banks, merged with State Bank of India.

An important phenomenon during this period is that individual banks have come up in place of indigenous bankers. Table ‘A’ (on page 6) depicts the number of banks, their internal resources, deposits and advances during 1939 to 1948. The table also shows a steady & continuous increase in capital, deposits & advances of scheduled banks.

The number of scheduled banks came down from seventy five in 1951 to fifty seven in 1969. The number of non-scheduled banks had come down from 469 to 14 during this period. A detailed picture of these particulars is presented in Table ‘B’ on page no. 7

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¹³. Website of SBI, www.statebankofindia.com
# Table - A

Banking Industry in India during 1939-48

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Source: compiled from various issues of statistical tables relating to banks in India published by Reserve Bank of India
Multiple amalgamations and liquidation have taken place during this period. Initially eleven banks went in to voluntary liquidations and four scheduled banks in Bengal were amalgamated with Union Bank of India Ltd. As such there was a rapid decline in the number of both scheduled & non-scheduled banks.

➢ OBJECTIVE OF THE STUDY:

The researcher’s main objects of the study are the working of State Bank of India particularly the financial efficiency over the period taken in study. The main objectives of the study are –

- To examine the effectiveness of various activities which are undertaken by SBI,
- To study & analyze the various items of income & expenditure of SBI,
- To study & analyze the position of deposit mobilization & lending policies of SBI regarding advancing of loans,
- To study & analyze the position of human resources and their & productivity of SBI,
- To analyze & evaluate the causes responsible for poor profitability and poor recovery of loans,
- To make broad suggestions to improve the working and efficiency of SBI.

➢ HYPOTHESIS:

The main hypotheses on which the proposed study will be based are as follows –

- The level of the business activity of the commercial bank and its financial performance are subject to the general economic conditions in the country,
• There are two major types of risks that commercial banks is exposed to in the course of its financial operations, viz. credit risk & market risk,

• Condition of capital market & money market has a direct bearing on the financial performance in a commercial bank,

• The bank administration has to take decision regarding financial performance with the parameters of government directives,

• Like other public sector banks financial performance of SBI requires improvement.

➢ RESEARCH METHODOLOGY :

The proposed study is based mainly on the published information available in the various issues of annual reports of State Bank of India & RBI Bulletin i.e. secondary data. Various published books, authentic journals, newspapers, reports and studies is also be used on the points of conceptual framework and statistical base. Although primary data is also be used to make the study meaningful. The researcher is sure that the conclusion drawn will give a true and fair picture of the working and financial performance of State Bank of India.

In the matter of carrying out research on the working of any financial institution the availability of purposeful data is of immense value. In this study the data for ten years beginning from 2003-04 is used. It will be the effort of the researcher to make out standardized result oriented and pin-pointed study of the working of State Bank of India. In this study the statistical techniques like measures of central tendency, simple tabular
analysis, percentage and diagrams are used to quantify the study more scientific & meaningful.

➢ LIMITATIONS:

The State Bank of India is one of the largest banks of India with regard to capital, branches, deposits, investments and customers in all over India as well as abroad. Therefore the researcher, with the limitations of time and resources, has used secondary data and random sampling of a small segment of stakeholders of the bank.

1.2 INDIAN ECONOMY:

The Economy of India is the seventh-largest in the world by nominal GDP and the third largest by purchasing power parity (PPP). The country classified as Newly Industrialized Country, one of the G-20 major economies, a member of BRICS and a developing economy with approximately 7% average growth rate for the last two decades. India's economy became the world's fastest growing major economy from the last quarter of 2014, replacing China’s.

The long-term growth prospective of the Indian economy is moderately positive due to its young population, corresponding low dependency ratio, healthy savings and investment rates and increasing integration into the global economy. The Indian economy has the potential to become the world's 3rd-largest economy by next decade and one of the largest economies by mid-century and the outlook for short-term growth prospective is also good as according to IMF, the Indian economy is the "bright spot" in the global landscape. India also topped World Bank’s growth outlook for the year 2015-
16 for the first time with economy grown 7.3% in 2014-15 & expected to grow at 7.5-8.3% in 2015-16.

India is one of the fastest growing service sectors in the world with annual growth rate of above 9% since 2001, which contributed to 57% of GDP in 2012-13. The Indian economy grew at 7.3 % in 2014-15 due to improvement in the performance of both services as well as manufacturing sectors. According to the data release by the Central Statistics Office (CSO), the economic growth was 6.9 % in 2013-14. The Gross Value Added (GVA), a new concept introduced by CSO to measure the economic activity, rose by 7.2 % in 2014-15 as compared to 6.6 % in the previous fiscal year. It further said that per capita income at current prices during 2014-15 rose by 9.2 % to ₹ 87,748 as against ₹ 80,388 in the previous fiscal year. It was ₹ 64,316 in 2011-12 and ₹ 71,593 in 2012-13.

India’s Economic Scenario

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<td>GDP Growth</td>
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<td>8.30%</td>
<td>8.40%</td>
<td>8.50%</td>
<td>8.60%</td>
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<tr>
<td>Industrial Production Growth</td>
<td>6.00%</td>
<td>7.50%</td>
<td>7.90%</td>
<td>7.90%</td>
<td>7.90%</td>
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<tr>
<td>Unemployment Rate</td>
<td>9.80%</td>
<td>9.60%</td>
<td>9.30%</td>
<td>8.90%</td>
<td>9.90%</td>
</tr>
<tr>
<td>Consumer Price Inflation</td>
<td>8.50%</td>
<td>8.40%</td>
<td>7.90%</td>
<td>7.50%</td>
<td>6.70%</td>
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<tr>
<td>Short-term Interbank Rate</td>
<td>9.90%</td>
<td>9.30%</td>
<td>12%</td>
<td>11.80%</td>
<td>11.80%</td>
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<tr>
<td>Government Balance (% of GDP)</td>
<td>-5.2%</td>
<td>-4.7%</td>
<td>-5.0%</td>
<td>-4.30%</td>
<td>-3.90%</td>
</tr>
</tbody>
</table>

(Source: Economist Intelligence Unit)
PHASES OF INDIAN ECONOMIC HISTORY:

India’s economic history is commonly divided into four periods, roughly: independence to 1965, 1966 to 1980, 1981 to 1991, and post 1991. The periods are defined as such because they mark clear breaks in economic policies in India and can be identified with shifts in economic growth rates (Table C). The first period is tied to Nehru’s reign as president. Under Nehru’s leadership, state-centered economic planning reigned. Planners sought to combat economic stagnation and extreme poverty through state driven policies. The top-down economic model helped sustain relatively stable economic growth for two reasons. First, India was undergoing a phase of rapid industrialization and recovering from years of economic suppression under the British. Second, and more importantly, Nehru was largely able to implement his economic programs because the powerful Indian Congress Party dominated the country politically and held sufficient power to ensure that the plans reached the micro economy.

Table C
Indian Economic Performance (Growth Rate)

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Phase I</th>
<th>Phase II</th>
<th>Phase III</th>
<th>Phase IV</th>
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<tr>
<td>Compound Annual Growth Rate**</td>
<td>4.0%</td>
<td>3.5%</td>
<td>5.0%</td>
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<tr>
<td>Growth Rate Standard Deviation</td>
<td>2.4%</td>
<td>3.7%</td>
<td>2.1%</td>
<td>2.3%</td>
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</tbody>
</table>

*data included to 2009, **GDP data is based on prices since 1951 and base year of 1999-00 (Sources: Reserve Bank of India Statistical Database)
On the basis of the observed patterns of growth and structural changes, the economic growth in post-Independence India can be divided into the following four phases, each with its distinguishing features –

❖ **Phase1. Independence to Mid - 1960s:**

This period saw a significant acceleration in the growth rate over the past decades marked by a high growth of industry, and a significant structural change with a large increase in the share of non-agricultural sector, especially of the industry in the national output.

❖ **Phase2. Mid-1960s to 1980s:**

This period was marked by a slower growth of GDP, accompanied by a deceleration in the growth of industry, a slower pace of structural shift from agriculture to non-agriculture and a very small increase in the share of industry.

❖ **Phase3. 1980 to early 1990s:**

This period saw a sharp acceleration in growth rate, mainly contributed by services. Structural changes were also swift with a large decline in the share of agriculture but very little increase in the share of industry - services picking up the major share of the shift.

❖ **Phase4. Easy 1990’s Onwards:**

Growth continued at similar rate as 1980’s but declined during 2000 - 2004. Structural changes continued at an accelerated pace with share of agriculture sharply declining and services emerging as the major sector and with very small increase in the share of industry. Within this phase, period 2005 - 10 has seen a
sharp acceleration in growth rate despite a slowdown in 2008 - 09. Share of agriculture has declined from around 20 to 16 percent, that of services has increased from 54 to 59 percent and that of industry has stagnated.

1.3 BANKING STRUCTURE IN INDIA:

Though the history of banks in India spans over the last 100 years, the first bank in India, though conservative, was established in 1786. From 1786 till today, the journey of Indian banking system can be segregated into three distinct phases. They are mentioned as below:-

- Early phase from 1786 to 1969 of Indian Banks.
- Nationalization of Indian Banks and up to 1991 prior to Indian Banking Sector Reform.
- New phase of Indian Banking System with the advent of Indian Financial & Banking Sector Reforms after 1991.

- **Phase 1** -
  
  During the first phase the growth was very slow and banks also experienced periodic failure between 1913-1948. There were approximately 1100 banks, mostly small. To streamline the functioning and activities of commercial banks, Government of India came up with The Banking Companies Act, 1949 which was later changed to Banking Regulation Act, 1949 as per amending act of 1965 (Act no 23 of 1965). Reserve Bank of India was vested with extensive powers for the supervision of banking in India as the Central Banking Authority.
Phase 2 –

Government took major steps in the Indian Banking Sector Reform after independence. In 1955, it nationalized Imperial Bank of India with extensive banking facilities on a large scale especially in rural and semi-urban areas. It formed State Bank of India to act as the principal agent of RBI and to handle banking transactions of the Union and State Government all over the country. Seven banks forming subsidiary of SBI was nationalized in 1960. On 19 July 1969, major process of nationalization was carried out. It was the effort of then Prime Minister of India, Mrs. Indira Gandhi. 14 major commercial banks in the country were nationalized. This step brought 80% of the banking segment in India under government ownership. The following are the steps taken by the Government of India to regulate the banking institutions in the country:

1949 - Enactment of Banking Regulation Act
1955 - Nationalization of State Bank of India
1959 - Nationalization of SBI Subsidiaries
1961 - Insurance cover extended to deposits
1969 - Nationalization of 14 major banks
1971 - Creation of Credit Guarantee Corporation
1975 - Creation of RRBs
1980 - Nationalization of seven banks with deposits over 200 crore
- **Phase 3 –**

This phase has introduced many more products and facilities in the banking sector in its reforms measure. In 1991, under the chairmanship of M. Narasimham, a committee was set up by his name which worked for the liberalization of banking practices. The country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and Net banking is introduced. The entire system became more convenient and swift. Time is given more importance then money. The financial system of India has shown a great deal of resilience. It is sheltered from any crisis triggered by any external macroeconomics shock as other East Asian Countries suffered. This is all due to a flexible exchange rate regime, the foreign reserves are high, the capital account was not yet fully convertible and banks and their customers have limited foreign exchange exposure.

**INDIAN BANKING STRUCTURE:**

The structure of Indian banking system that developed during the pre-independence period was without any purposive control and direction. There were no comprehensive banking laws except the Bank Charter Act 1876 which regulated the three presiding bank and the Indian Companies Act 1913 provided some safe guards against bank failures.
1.4 DEVELOPMENT OF BANKING IN INDIA:

(A) ANCIENT INDIA:

The origin of banking in India dates back to the Vedic period. The Vaish community, who conducted banking business during this period, accepted deposits from the public, granted loans against pledges and personal security, granted simple open loans, acted
as bailee for their customers, subscribed to public loans by granting loans to Kings, acted as treasurers and bankers to the state and managed the currency of the country. Still later, that is, during the Buddhist period, banking business was decentralized. Consequently, Brahmins and Kshatriyas, who were earlier not permitted to take to banking as their profession except under exceptionally rare circumstances, also took to it as their business.

(B) MUSLIM PERIOD:
Indigenous banking which by the time of the Buddhist period had become fairly well developed received a setback during the Muslim period since the Muslim rulers believed in the Quran injunction of charging interest as "Haram' or a great sin. Moreover, the unending wars and royal succession feuds of this period greatly hampered the development of trade and commerce on which the development of banking and money lending dependent. Further, during the Jahangir's reign, private banking further developed and it is recorded that there were many enterprising bankers functioning in the country at this time. During Shahjahan's reign also banking prospered without interruption and large banking houses were established as important trading centers in the country.

(C) BRITISH PERIOD:
The seventeenth century witnessed the coming of the English traders into India. The English traders established their own agency houses, houses at the port towns of Bombay, Calcutta and Madras. These agency houses, apart from engaging in trade and commerce, also carried on the banking business. The indigenous bankers being in
conversant with the language and trade practices of the former could not take advantage of the expanding business in the hands of the English merchants. Further, the unification of the currency in 1835, gave a further blow to the indigenous bankers as it deprived them of the profitable business of money changing.

The development of the means of transport and communication causing deflection of trade and commerce along new routes, changing the nature and structure of trade activities in the country were the other factors which also contributed to the downfall of the indigenous bankers. The first Joint Stock Bank established in the country was the Bank of Hindustan founded in 1770 by the famous English agency house of M/s Alexander and Company. This bank failed in 1832 with the coming to grief of the firm of Alexander and Co. The Bengal Bank and the Central Bank of India were established in 1785. The Bank of Bengal, the first of the three Presidency Banks, was established in Calcutta in 1806 under the name of Bank of Calcutta. It was renamed in 1809 on the grant of the charter as the Bank of Bengal.

The two other presidency banks, namely the Bank of Bombay and the Bank of Madras, were established in 1840 and 1843 respectively. All the Presidency Banks were also empowered to issue notes. After the Paper Currency Act of 1862, however, the right of the note issue was taken away from them. After repeated efforts, the three Presidency Banks were fused into a single bank under the name of the Imperial Bank of India in 1921. At the time of the amalgamation, the three Presidency Banks had a total of 70 branches, total paid up capital of ₹3.75 crore and reserves totaling ₹3.5 crore.

Besides, the three Presidency Banks, some other joint stock banks established in the latter half of the 19th Century included the Allahabad Bank (1865), the Punjab National
Bank (1894) and the People's Bank of India (1901). The last two banks owned their origin and development to the untiring efforts of Lala Harkishan Lal. Around the turn of the 20th Century, a great spurt was witnessed in the commercial banking activity in the country. With the spread of the Swadeshi Movement in the country in 1906 the number of banks with capital and reserves of over ₹5 lakh, doubled from 9 to 18 in the short period of seven years from 1906 to 1913. These banks claimed the total deposits of ₹22 crore while their total paid up capital and reserves exceeded ₹4 crore.

The number of smaller commercial banks started during this period was much larger. Among the banks established during this period were now famous Banks of India, Central Bank of India, Bank of Baroda, Bank of Mysore, etc. Soon after this 'banking boom', followed a period of crisis, which gave a rude shock to banking development in the country. During the short period of eleven years from 1913 to 1924, as many as 161 banks came to grief involving a loss of about ₹7 crore in the form of paid up capital. Of these banks, 15 had paid up capital each of over ₹5 lakh and above; 20 had paid up capital each of over ₹1 lakh but less than ₹5 lakh while the rest 126 had paid up capital each of less than ₹1 lakh.

1.5 Emergence of State Bank of India:
The Bank of Bengal submitted a proposal in 1867 before the East India Company government for a big bank, but the government refused the proposal. Afterwards, the government proposed in 1899 to amalgamate three Presidency Banks into one as a Central Bank. But this time the Presidency Banks disfavored the idea14. However, the

1st World War emphasized the need for a unified banking institution. As a result the Imperial Bank of India was established on 27th January 1921 by the amalgamation of the three Presidency Banks in pursuant of the Imperial Bank of India Act no XIVII of 1920, with the 70 branches. At the time of amalgamation, the three Presidency Banks and 70 branches had total paid up capital of ₹ 3.75 crore and reserves totaling ₹ 3.5 crores. The Imperial Bank of India performed the routine functions of a commercial bank and was also called a “Banker to the Government.” The basic idea was to develop Imperial Bank into a full- fledged Central Bank. But, in 1926, the Hilton Young Commission recommended the creation of a separate bank, to be called the R.B.I. (Reserve Bank of India) to perform central banking functions, so as to leave the Imperial Bank of India entirely free to perform the commercial banking business. The Reserve Bank of India Act was passed in 1934. Reserve Bank of India was established on 1st April, 1935. The central bank functions were transferred to it. However, at places where the Reserve Bank had no offices, Imperial Bank of India acted as the Reserve Bank’s agent to transact government’s banking business and maintains currency chests on behalf of the Reserve Bank of India.

15. Ibid, p. 10
17. Ibid, p. 3
18. Narendra Prasad, op. cit, p.12
19. Ibid, p.12
During the period of war, it witnessed considerable growth in the number of banks in the country. Worth mentioning, new banking companies were the Bharat Bank Ltd., the Hindustan Commercial Bank Ltd., the United Commercial Bank Ltd. and the Travancore Bank Ltd. The establishment of the first three banks was due to the initiative shown by the three well-known industrial houses of Dalmia, Singhania and Birla. Of these three banks, the Bharat Bank Ltd was merged with the Punjab National Bank Ltd in 1951 while the other two still continue with the United Commercial Bank being considered among the ‘Big Five’.21

Thus, during the period of 1939 to 1945 many more commercial banks were established in the country with a total of 4820 branch offices with ₹ 1050 crore deposits and ₹ 480 crore advance.22 Soon after independence in 1947, there was a general demand for the nationalization of key and basic industries, the R.B.I. and the Imperial Bank of India. This demand was made due to the bank’s peculiar and strong position in Indian banking system and as foreigners and the management managed it was highly bureaucratic.23

India launched its first five year plan in 1951 for the development of rural area. It was constituted in it that about 80 % of the country’s population resided in the rural areas so rural India was given the highest priority.

Commercial banks including the Imperial Bank of India were prospering in the urban sector and were not equipped to respond to the emergence needs of economic regeneration of rural areas. Therefore, to serve the economy in general and rural sector

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in particular the All India Rural Credit Survey Committee recommended the creation of a state
partnered and state sponsored bank by taking over the effective control over the Imperial Bank of
India which was the biggest commercial bank in the country.\footnote{N. K. Thingalya, “Banking
Development in India Since Independence”, Print well Publication, Jaipur, 1985, p. 33}

There was also a demand in the country for the nationalization of the bank.\footnote{S. N. Sen, “The
Indian Economy, Its Growth and Problems”, Bookland Pvt. Ltd. Sankar Ghose Lane, Calcutta-6, 1972,
chap. 41, p. 430} The Government of India accepted the recommendation of All India Rural Credit Survey Committee and the decision to establish a State Bank of India was announced in the Lok Sabha by Shri C.D. Deshmukh, the then Finance Minister.

The Government of India introduced the State Bank of India bill in the Lok Sabha on 16th April 1955 and it was passed by the parliament and got the President’s assent on 8th May 1955. The act came into force on 1st July 1955 and from this date the whole of the undertaking of the Imperial Bank of India within the country was transferred to the State Bank. Thus, the erstwhile Imperial Bank of India was nationalized from July 1, 1955 and rechristened as “State Bank of India”.\footnote{T. R. Manaktala : Economic Development and Monetary Management”, Vera & Co.

Later, the State Bank of India (Subsidiary Banks) Act was passed in 1959 and received the assent of the President on 10th September 1959. According to the provision of the Act the following seven state subsidiary banks were taken over by the State Bank of India as its subsidiaries\footnote{Eastern Economists, weekly, New Delhi Dated 21-8-1959, p. 28}
<table>
<thead>
<tr>
<th>Bank</th>
<th>Date</th>
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</thead>
<tbody>
<tr>
<td>State Bank of Hyderabad</td>
<td>1st Oct. 1959</td>
</tr>
<tr>
<td>State Bank of Bikaner</td>
<td>1st Jan. 1960</td>
</tr>
<tr>
<td>State Bank of Mysore</td>
<td>1st Mar. 1960</td>
</tr>
<tr>
<td>State Bank of Indore</td>
<td>1st Mar. 1960</td>
</tr>
<tr>
<td>State Bank of Travancore</td>
<td>1st Mar. 1960</td>
</tr>
<tr>
<td>State Bank of Patiala</td>
<td>1st Apr. 1960</td>
</tr>
<tr>
<td>State Bank of Saurashtra</td>
<td>1st May 1960</td>
</tr>
</tbody>
</table>

Later State Bank of Bikaner and the State Bank of Jaipur were merged and formed one bank the State Bank of Bikaner and Jaipur. The separate entity of these banks was retained in the forms of subsidiaries, now, known as associates, to enable them to serve the local needs in their respective areas.

### 1.6 Historical Perspective: State Bank of India

The origin of the State Bank of India dated back to 1806 when the Bank of Calcutta (later called the Bank of Bengal) was established. In 1921 the Bank of Bengal and two other presidency banks (Bank of Madras and Bank to Bombay) were amalgamated to form the Imperial Bank of India. In 1955, the RBI acquired the controlling interest of the Imperial Bank of India and State Bank was created by an Act of Parliament to succeed the Imperial Bank of India.

Over the years, the Bank has expanded rapidly and today commands one fifth of the Indian Banking business. Under the State Bank of India (subsidiary banks) Act 1959, the State Bank of India took over eight former State associated banks as its subsidiaries. As a result of merger of two of these subsidiaries got merged with each other and remaining seven banks remained subsidiaries of the State Bank of India.
These are: State Bank of Bikaner and Jaipur, State Bank of Indore, State Bank of Mysore, State Bank of Patiala, State Bank of Saurashtra, State Bank of Travancore and State Bank of Hyderabad. Today, the State Bank Group comprising State Bank of India, seven associates, one banking subsidiaries and eight non-banking subsidiaries have resulted in a super market.

The SBI group has diversified in activities into insurance, credit cards, factoring, leasing, mutual funds, merchant banking, home finance, securities, trading etc. In 2000-01, the bank launched India Millennium Deposit (IMD) which was remarkably successful. The bank mobilized ₹ 2571 crore which in return helped the country in meeting the challenge of rising oil price provided strong support to the Rupee and reinforcing the country’s self confidence in the aftermath of US sanction.\(^\text{28}\) The State Bank group is having nearly 13941 branches with global deposit of ₹ 542409 crore.

1.7 Trends and Progress Profile of SBI:

To study the growth of State Bank of India, various indicators i.e. Capital fund, Deposits, Advances, Investments, Fixed assets, Profits, No. of Branches, No. of Employees etc. have been selected. The year 2003-04 has been selected as base year. Here, an attempt has been made to study the trend of financial performance of various items under study during the study period to draw conclusion about the direction and extent of change in the items over the years.

\(^{28}\) Indian Bank’s Association, Indian Banking Year Book-2003, p.441, 442
Branch Network:

The State Bank of India is the largest bank of India having a huge branch network all over the India. The branches of SBI have been exhibited in table 1.1 and in chart 1.1

Table 1.1
Classification of Branches of SBI (2013-14)

<table>
<thead>
<tr>
<th>Classification of Branches as on</th>
<th>Rural</th>
<th>Semi-Urban</th>
<th>Urban</th>
<th>Metropolitan</th>
<th>Foreign</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>31.03.2013</td>
<td>5661</td>
<td>4173</td>
<td>2631</td>
<td>2351</td>
<td>186</td>
<td>15002</td>
</tr>
<tr>
<td>Branches added during 2013-14</td>
<td>397</td>
<td>230</td>
<td>264</td>
<td>177</td>
<td>4</td>
<td>1072</td>
</tr>
<tr>
<td>Branches merged/closed</td>
<td>2</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>0</td>
<td>15</td>
</tr>
<tr>
<td>31.03.2014</td>
<td>6056</td>
<td>4399</td>
<td>2890</td>
<td>2524</td>
<td>190</td>
<td>16059</td>
</tr>
</tbody>
</table>

(Source: Annual report of SBI 2013-14)
SBI has the largest branch network in India and abroad with 16059 branches. It reveals the fact that the least number of branches i.e. 1.18 percent are located in foreign countries while the highest numbers of branches i.e. 37.71 percent are located in rural area. In Comparison of semi-urban, urban and metropolitan; metropolitan has the least number of branches in India i.e. 15.72 percent only.

**Capital Fund:**
Table 1.2 and chart 1.2 present the position of Capital Fund in State Bank of India during the study period 2003-04 to 2012-13. Capital is the life blood of any business, without it business cannot survive. Here, capital fund is the composition of paid up capital and reserves. It showed an upward trend during the study period.

**Table 1.2**

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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>20231</td>
<td>24072</td>
<td>27644</td>
<td>31298</td>
<td>49032</td>
<td>57948</td>
<td>65949</td>
<td>64986</td>
<td>83951</td>
<td>98884</td>
</tr>
<tr>
<td>% Change</td>
<td>18.99</td>
<td>14.84</td>
<td>13.22</td>
<td>56.66</td>
<td>18.18</td>
<td>13.81</td>
<td>(0.01)</td>
<td>29.18</td>
<td>17.86</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
In State Bank of India, Capital Fund has increased from ₹20231 crore in 2003-04 to ₹24072 crore in 2004-05. It gave about 18.99 times growth over the base year. The “trend of percentage increase over previous year” had witnessed fluctuating trend during whole the study period. In 2004-05, it was 18.99 percent while in the next year it was only 14.84 percent. In the year 2007-08, it increased to 56.66 percent but in the immediate subsequent year, it declined to 18.18 percent. In 2011-12, it improved to 29.18 percent and went down to 17.86 percent in 2012-13. It decline in 2005-06 and 2006-07 and reached to 14.84 percent and to 13.22 percent respectively. But, it went down to (0.01) percent in 2010-11.

**Deposits:**

Table 1.3 and chart 1.3 exhibit the position of Deposits in SBI. It showed an upward trend during the study period, 20003-04 to 2012-13.

**Table 1.3**

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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>318619</td>
<td>367048</td>
<td>380046</td>
<td>435521</td>
<td>537404</td>
<td>742073</td>
<td>804116</td>
<td>933933</td>
<td>1043647</td>
<td>1202739</td>
</tr>
<tr>
<td>% Change</td>
<td>15.2</td>
<td>3.54</td>
<td>14.6</td>
<td>23.39</td>
<td>38.08</td>
<td>8.36</td>
<td>16.14</td>
<td>11.75</td>
<td>15.24</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
In State Bank of India, Deposits increased from ₹ 318619 crore in 2003-04 to ₹ 367048 crore in 2004-05. It gave 15.2 times growth over the base year. The trend of “percentage increase over previous year” showed fluctuating trend during the study period. The trend of “percentage increase over previous year” ranged between 14.6 % in 2006-07 to 38.08 % in 2008-09.

**Advances:**
Table 1.4 and chart 1.4 showed position of advances in SBI during the study period. Overall trend of advances is marked being upward during the study period in all the units under study.

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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>157934</td>
<td>202374</td>
<td>261642</td>
<td>337337</td>
<td>416768</td>
<td>542503</td>
<td>631914</td>
<td>756719</td>
<td>867579</td>
<td>1045616</td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
In the beginning of the study period, the advances of SBI were ₹ 157934 crore. It increased to ₹ 1045616 crore at the end of the study period, 2012-13. It gave 84.89 percentage growths to the advances. Its “percentage increased over previous year” remained the highest 30.17 % in 2008-09 while the lowest 14.65 % in 2011-12. Its overall trend remarked fluctuating during the study period.

**Net Profit:**

Table 1.5 and chart 1.5 exhibit positions of profits in SBI. Profit is the indicator of efficiency. It is the surplus of incomes over expenditures.

**Table 1.5**

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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>3681</td>
<td>4305</td>
<td>4407</td>
<td>4541</td>
<td>6729</td>
<td>9121</td>
<td>9166</td>
<td>8265</td>
<td>11707</td>
<td>14105</td>
</tr>
<tr>
<td>% Change</td>
<td>16.95</td>
<td>2.37</td>
<td>3.04</td>
<td>48.18</td>
<td>35.55</td>
<td>0.49</td>
<td>(9.83)</td>
<td>41.65</td>
<td>20.48</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
In SBI profit showed fluctuating trend during the study period. It was ₹ 3681 crore in 2003-04. It rose to ₹ 4305 crore in 2004-05 giving the growth at the rate of 16.95 percent over previous year but in 2005-06 it increases to ₹ 4407 crore. It declined at the rate of (9.83) percent in the year 2010-11. It increased to ₹ 6729 crore with growth rate 48.18 percent over previous year in 2007-08 but by the year 2010-11 it rolled down to ₹ 8265 crore. Then onward, it started improving. It was ₹ 11707 crore, which was 51.48 percent more over the previous year, and compared to previous year profit, it peaked up at the rate of 51.48 percent. It continued to zoom to ₹ 14105 crore with growth of 20.48 percent over previous year profit. It moved up to ₹ 4305 crore in 2004-05, to ₹ 4407 crore in 2005-06 and to ₹ 4541 crore in 2006-07 giving growth rates of 16.95 percent, 2.37 percent and 3.04 percent respectively over previous year.

**Number of Branches:**

Table 1.6 and chart 1.6 exhibit positions of number of branches of SBI. Number of branches indicates network expanded all over India.
State Bank of India had 9039 branches all over India in 2003-04, which increased to 9102 branches in 2004-05 and slightly increased and stood at 9177 branches in 2005-06 and rose to 9231 in 2006-07. “Index on the basis of the year 2003-04” constantly increased and reached to 0.99 percent in 2005-06 but, it declined slightly in 2009-10 and stood at 9.51%. But, it increased to 10.26 % in 2007-08. “Percentage increase over
previous year” ranged between 0.72 % in 2006-07 to 10.26 % in 2007-08. In the year of 2008-09 the number of branches reaches at the highest as 12.37 %.

**Number of Employees:**

Table 1.7 and chart 1.7 exhibit the numbers of employees in SBI during the study period 2003-04 to 2012-13. SBI showed fluctuating trend for number of employees during the study period. They ultimately decrease number of employees compared to the beginning years of the study period.

**Table 1.7**

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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>207039</td>
<td>205515</td>
<td>198774</td>
<td>188985</td>
<td>179205</td>
<td>205896</td>
<td>200299</td>
<td>222933</td>
<td>215481</td>
<td>228296</td>
</tr>
<tr>
<td>% Change</td>
<td>-</td>
<td>(0.74)</td>
<td>(3.28)</td>
<td>(4.92)</td>
<td>(5.16)</td>
<td>14.89</td>
<td>(2.71)</td>
<td>11.3</td>
<td>(3.34)</td>
<td>5.95</td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
In SBI, numbers of employees were 207039 in 2003-04. From 2004-05, it remarked decreasing trend up to the year 2007-08. It decreased to 205515 employees in the year 2004-05, 198774 employees in 2005-06, 188985 employees in 2006-07 and 179205 employees in the year 2007-08. In the year 2008-09 it rose to 205896 employees with a growing percentage of 14.89 %. The "percentage increase over previous year" remained the highest 14.89 % in 2008-09 and the lowest (0.74) % in 2004-05.

**Investments:**

Table 1.8 and chart 1.8 exhibit the investments of SBI during the study period 2003-04 to 2012-13.

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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>185676</td>
<td>197098</td>
<td>162534</td>
<td>149149</td>
<td>189501</td>
<td>275954</td>
<td>285790</td>
<td>295601</td>
<td>312198</td>
<td>350927</td>
</tr>
<tr>
<td>% Change</td>
<td>6.15</td>
<td>-17.54</td>
<td>-8.24</td>
<td>27.05</td>
<td>45.62</td>
<td>3.56</td>
<td>3.43</td>
<td>5.61</td>
<td>12.41</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
Investments of SBI were ₹ 185676 crore in 2003-04. It registered an upward movement up to 2004-05 and reached to ₹ 197098 crore with a growth of 6.15 times over the base year 2003-04. It decreased to ₹ 162534 crore at the end of the period 2005-06 and showed an increase of 45.62 percent in 2008-09 as compared to 27.05 percent in 2007-08. After this period it fluctuates from 2009-10 to 2011-12 by showing the fluctuating trend of 3.56, 3.43 and 5.61 percent respectively.

**Fixed Assets:**

Table 1.9 and chart 1.9 show the Fixed Assets of SBI during the study period, 2003-04 to 2012-13.

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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>2645</td>
<td>2698</td>
<td>2753</td>
<td>2819</td>
<td>3373</td>
<td>3838</td>
<td>4413</td>
<td>4764</td>
<td>5467</td>
<td>7005</td>
</tr>
<tr>
<td>% Change</td>
<td>2.00</td>
<td>2.04</td>
<td>2.40</td>
<td>19.65</td>
<td>13.79</td>
<td>14.98</td>
<td>7.95</td>
<td>14.76</td>
<td>28.13</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
Fixed Assets of SBI was ₹2645 crore in 2003-04, which showed an upward movement during the study period and reached to ₹3373 crore in 2007-08. It showed an upward movement from 2007-08 to 2012-13 and showed ₹7005 crore of the fixed assets at the end of the study period. "Percentage increases over previous year" ranged between 2.00 percent in 2004-05 to 28.13 percent in 2012-13.

**Conclusion:** From the above analysis it is clear that this study has a great importance in itself. Although the deposits, profits, lending, number of branches are in a good position, but still general perception about SBI is not up to the aspiration of banking sector of India as well as stakeholders. The significance of the study is that this study will be a milestone for future studies in this field and will provide a new benchmark for the researchers not only in the field of State Bank of India but also in nationalized banking sector of the country.
CHAPTER 2
REVIEW OF LITERATURE

Financial Appraisal:

“Financial Appraisal is a scientific evaluation of profitability and financial strength of any business concern”.¹According to accounting point of view, financial statements are prepared by a business enterprise at the end of every financial year. According to Howard and Upton, “Financial Statements are end products of financial accounting”.² They are capsulized periodical reports of financial and operating data accumulated by a firm in its books of accounts-the general ledger. According to Kennedy and McMillan “Financial Statement Analysis attempts to unveil the meaning and significance of the items composed in Profit and Loss Account and Balance Sheet. So as to assist the management in the formation of sound operating Financial Policies”.³

For proper interpretation of financial statement, users must have a basic understanding of the conceptual framework and principles underlying their preparation. Otherwise users will not recognize the limits of financial statements. The financial statement analysis facilitates a sufficient guideline about the behavior of financial variables for measuring the performance of different units in the industry; it also facilitates to indicate the current scenario of improvement in the organization.

An academic study on the financial performance of the nationalized banking sector in India is very important and pertinent in the context of its structural existence. Before taking up such an exercise, an attempt is made in this section to present a review of the available studies in the relevant area. Organized or formal research in banking and related areas is of recent origin in India. The research studies conducted in this field relate mostly to institutional, functional and developmental activities of bank.

O.B. Sayeed in his Ph.D. research examined the correlation of organizational health productivity and effectiveness in the State Bank of India. The study is related to productivity and effectiveness. It is focused on the psychological aspect. There is neither a single comprehensive study on “Critical Evaluation of Indian Banking Sector (with reference to Private Sector and Public Sector Banks)” (1998-99 to 2002-03) nor any attempt has been made to analyze contents of its profitability, productivity and financial efficiency after the new generated private banks arrived. Hence present study is a humble effort to bridge the gap in the existing literature & will be benefited to the society.

The study conducted by O. B. Sayeed is based on human factor. It is a psychological study which shows the correlation between organizational health productivity and effectiveness in State Bank of India.

Mathur\(^5\) in his book 'Public Sector Banks in India's Economy - A Case Study of State Bank of India' has evaluated the role of the public sector banks as an instrument for the rapid growth of the Indian economy. In the process of analyzing that role he has made a thorough study of the working of the State Bank of India and its seven subsidiaries.

Mathur in his book has tried to evaluate the role of SBI (public sector banks) for the growth of Indian economy. According to him there is a great role of public sector banks in the development of the economy.

Divatia\(^6\) and Venkatachalam in their study of operational efficiency and profitability of banks proposed to create a composite index, which would explore certain indicators that would suitably represent varied aspects of banks performance. They recognized the problems in creating such a composite index. The indicators chosen for the study were divided into three parts viz. (a) Operational efficiency in terms of productivity (b) Operational efficiency in terms of social objectives and (c) Profitability.

Divatia and Venkatachalam in their study try to make some specific parameters that would represent the various aspects of bank performance. For this purpose he has selected some of the indicators like productivity, profitability and social objectives.

The Committee on the Functioning of Public Sector Banks\(^7\) appointed by the Reserve Bank of India in 1977 has made a broad evaluation of the performance of

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Public sector banks in the country covering the spheres of branch expansion, deposit mobilization, credit disbursal, priority sector lending, efficiency, management - employee relations and so on and made recommendations to ensure improvement in the efficiency of their operations and to restore their financial health. The Committee made a pragmatic evaluation of the actual performance and functioning of the public sector banks during the period 1969 to 1977. It collected data from banks, bank staff, other financial institutions, commercial associations and so on.

The committee appointed by Reserve Bank of India did her work on different aspects covering the spheres like branch expansion, deposit mobilization, management – employee relations and so on and make her recommendations to improve the efficiency of the working of the employee. It did not work on the financial aspects.

Shah in various papers discussed bank profitability and productivity. He disapproved the attitudes of banks that higher profitability can result from increased spread and that innovations have a limited role. He emphasized also on reduction of costs, creation of a team spirit, improvement in the management for improving bank profitability and productivity.

This study denied the attitude of the bank that innovations have limited role to make higher profitability. He also differ from the bank’s view that increased spread could earn good profits but he emphasized on cost reduction, team spirit etc. to improve profits and productivity.

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Varde and Singh\textsuperscript{9} in a study of profitability of commercial banks over a period of fifteen years gave consideration to two types of factors that affect interest rate levels, i.e., external factors like monetary policy, fiscal policy, interest rate policy etc. and internal factors including operational and managerial efficiency of individual banks. This study shows that profitability is affected by external as well as internal factors which include different types of policies for the development of economic growth as declared by RBI from time to time and managerial efficiency of the bank.

Agarwall\textsuperscript{10} in his book 'Management of Nationalized Commercial Banks in India with Reference to their Social obligations' has assessed the performance of nationalized banks in discharging the various social obligations. There being no absolute line of measurement in this regard, an effort has been made to evaluate the performance of the nationalized banks in discharging the various social obligations on the basis of a comparison with the performance of other bank groups. For the assessment of the individual performance, the line of assessment adopted was the average performance of all the nationalized banks.

In his study H. N. Agarwall tries to evaluate the performance of the bank with reference to their social responsibilities. For this purpose there was no actual parameters was set but the average performance of all the nationalized banks was taken. In this study the financial aspects was ignored.

\textsuperscript{10} Agarwall. H.N., Management of Nationalized Commercial Banks in India with Reference to their Social Obligations, Inter-India Publications, Delhi, 1979.
Seshadri\textsuperscript{11} in her book 'Banks since Nationalization' has analyzed the achievements of the nationalized banks with those that were left in the private sector. The progress achieved by these banks in the sphere of branches, deposits, advances etc. were analyzed with secondary data available from various banks, the Reserve Bank of India and so on. The efficiency and profitability of the nationalized banks too were analyzed. Agarwall\textsuperscript{12} in his book 'Commercial Banking in India after Nationalization - A Study of their Policies and Progress' analyzed the performance of commercial banks in India after nationalization. It was neither an empirical study nor the study of a particular aspect of commercial banking. It was only a study of banking development in the light of nationalization. Annual reports of banks, periodical reports of the Reserve Bank of India, personal discussion with bank officials and so on were the major sources relied on for the study. Jain\textsuperscript{13} in his research study has made an attempt to examine and analyze the funds have been acquired and utilized by banks since nationalization to achieve the stipulated objectives. Various published sources such as The Reserve Bank of India Bulletins, Statistical Tables relating to banks in India, Trends and Progress of Banking in India, Report on Currency and Finance, Annual reports of nationalized banks, Indian Banks Association publications etc. provided the required data for the study. Chawla\textsuperscript{14} in his book 'Nationalization and Growth of Indian Banking' has investigated the

\textsuperscript{11} Seshadri, I.J.H., Banks since Nationalization, Birla Institute of Scientific Research, New Delhi, 1981.
\textsuperscript{13} Jain, Mohinder Kumar, Funds Management in selected Nationalized Banks, Ph.D. Thesis, Kurukshetra University, 1984.
development and growth of banking activities in India with particular reference to the state of Punjab. The analysis was carried out with the help of different types of growth rates; indices of changes were also calculated. Certain statistical tools like co-efficient of variation and rank correlation too were used in the study.

The study conducted by the above writers/researcher reflects the growth of banks after nationalization. From where the funds have been acquired by the banks and where they were utilized to achieve the stipulated targets. For this purpose the secondary data was used and different types of statistical tools like co-efficient of variation and rank correlation were also used. None of the writer/researcher tries to show financial health of the banks under study.

**Angadi**\(^{15}\) in his paper puts forth a proposition that operational efficiency of a bank is inversely related to the responsiveness of operating costs to the changes in output. The ratio of proportionate change in operating cost due to proportionate change in output is treated as a measure of responsiveness of operating costs. Recognizing the external and internal factors that affect productivity, he expressed the view that operating cost measures most of them. In his opinion efficiency is an important yardstick for measuring bank performance. While commenting on the operational efficiency of banks the **Chakravarthy Committee**\(^{16}\) expressed their view that the concept of operational efficiency of commercial banks in India is associated with such diverse aspects of its operations as cost effectiveness, profitability, customer services, priority sector lending,


mobilization of deposits and deployment of credit. Operational efficiency in banks has attained a wider connotation. The committee again observed that there is a need to introduce some element of price competition among banks. The ‘controlled competition’ was recommended by the committee in this regard.

These statements give emphasis to the operating cost. According to it efficiency of a bank is affected by operating cost, customer services etc. It takes only efficiency as an important yardstick for measuring bank’s performance, it does not take in to account the financial area of the bank to measure its performance.

Prasad in his study examined the entire activities and operations of the State Bank of India with particular emphasis on the various aspects viz. deposits, growth, credit expansion, branch expansion, merchant banking and so on. The study also made an appraisal of the performance of the entire nationalized commercial banks.

This study although try to examine the entire activities and operations of the State Bank of India but fail to examine the financial activities of the bank.

Hussain in 'A Study of New Roles of the Public Sector Commercial Banking in India' analyses the major problems faced by the public sector banks in India. As national public sector institutions, they are required to face new challenges. How can the new developmental, organizational, managerial and functional problems be solved? How best can they serve the priority sectors for economic regeneration and what should be

the strategy for dynamic commercial banking policy in India - were some of the basic problems discussed in the book.

In this statement the author discussed the new challenges faced by public sector banks like developmental, organizational, managerial and functional problems. Here the author did not discuss about financial problems (performance) faced by the banks.

Ojha\textsuperscript{19} in his paper gave a detailed description of the concepts, productivity and profitability of public sector banks and outlined the difficulty of measuring those concepts. He studied these aspects with a number of indicators and outlined that the profitability of the banks has not been improving despite increases in productivity. On an international comparison our public sector banks showed very low level of productivity and profitability. He emphasized that a more comprehensive and multi–dimensional approach has to be adopted to increase productivity and profitability.

In this paper the emphasis is given on productivity and profitability. Here this statement outlined that profitability has not improved according to the productivity. He suggested that a more comprehensive and multi -dimensional approach should be adopted to increase productivity and profitability.

Varde\textsuperscript{20} in his conference paper distinguished between effectiveness, efficiency and productivity. He classified the efficiency of a bank into four categories, i.e., (1) manpower efficiency (2) operational efficiency (3) commercial efficiency and (4) efficiency of ancillary business. Efficiency under each category can be measured

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separately, and measure of efficiency can be considered as productivity. In his paper the researcher emphasize only on the aspect of efficiency in different ways like manpower, operational, commercial and ancillary business; there is no any discussion about financial efficiency at all.

R. Ravimohan\textsuperscript{21} in his article on making Indian banks more competitive in the global environment suggests that the areas one would prioritize to engage the attention of the management of the Indian banks would be -:

1. Increasing the productivity of the staff of the Indian banks,
2. Enhancing the technological delivery capability of the Indian banking system,
3. Adopting more vigil on assets quality,
4. Improving the coverage of services through product innovation and,
5. Taking a more objective view on lending, costing & recovery of advances.

The Narasimham Committee\textsuperscript{22} observed that the productivity and efficiency of banking system have suffered, its profitability has been eroded and its portfolio quality has deteriorated. Customer service has been poor, work technology out dated and transaction costs are high. In the process several banks have themselves become weak financially and unable to meet the challenges of a competitive environment. The committee added that branch is the cutting edge of banking industry where there is direct interface with the depositor and credit customer. It is the functioning of the branch that shows the measurement of efficiency in respect of customer services.


Banks should therefore need to give attention to the organization, staffing, work technology, work culture and attitude of bank staff.

R. Ravi Mohan and the Narasimham committee observed that the banking system have suffered from various types of problems like poor customer service, outdated work technology, high transaction costs etc. The committee added that to open that branch is only a medium to interact with the customer. For the smooth working and proper operations the banks should give proper attention on its working style as well as the attitude of the bank staff.

**Bose**\(^\text{23}\) in her study on 'Trend and Progress of Banking in India ' has tried to analyze the connection between banking and economic development during the first three five year plan periods. The problem was studied under two aspects, viz. the impact that economic development had on banking in India and secondly, the role the banking system could play in economic development. To study the problem, she analyzed the changes in the volume, character and composition of bank deposits and loans. This statement tries to show the interrelationship between economic development and banking and the impact of these two aspects on each other, but left behind the financial relationship and impact on banking as well as on economic development.

**Amandeep**\(^\text{24}\) attempted to estimate profit and profitability of Indian Nationalized banks and to study the impact of priority sector lending, credit policies, geographical

expansion, industrial sickness, competition, deposit composition, establishment
expenses, ancillary income, spread and burden on bank profitability. For this purpose,
trend analysis, ratio analysis and regression analysis were used.
Here the researcher, with the help of different tools like trend analysis, ratio analysis
and regression analysis try to estimate the profit and profitability of banks and studied
the impact of different aspects on it, but did not considered the financial aspect of the
banks.

Jagwant in his book Indian Banking Industry: Growth and Trends in Productivity'
examines the trends in productivity in public sector banks excluding the six banks
nationalized in 1980. He has analyzed the trends and changes in productivity, with
particular emphasis on labor productivity and branch productivity. The trends, changes
and differentials in productivity in different banks and bank groups are examined in
detail based on seventeen indicators. The main source of data for the study was
Financial Analysis of Banks published by Indian Banks Association and Annual reports
of banks.

In this statement the main source of data for the study was Financial Analysis of
Banks published by Indian Banks Association and Annual reports of banks for the
purpose of analyzing the trends and changes in productivity with reference to labor
productivity and branch productivity but ignore the financial productivity of the bank.

Sreedharan analyzed the performances of Indian baking industry for the year 1995

25. Singh, Jagwant, Indian Banking Industry: Growth and Trends in Productivity, Deep and
Week, 6.51, (December 16-22, 1996), pp.10-13
and 1996. The analytical exercise was carried out with reference to net worth, liabilities, assets, income, expenditure, profitability and efficiency of different groups in the banking system. It was revealed that by and large, the public sector banks lagged far behind the foreign and private sector banks in respect of all the variables analyzed. The researcher suggested that the programs and policies regarding commercial banks should be redefined in such a way that there exist a co-ordination between the commercial viability and social responsibility of the public sector banks.

Here the exercise was carried out to analyze the performance of different banks with reference to different aspects of banking system and the result was that the public sector banks are much poor in comparison to foreign and private sector banks. It tries to touch the financial aspects of the banking system.

**C. Rangarajan** in an evaluation of the Indian experience in financial sector reforms published in the RBI Bulletin gives stress to the view that the sustained improvement of the economic activity and growth is greatly enhanced by the existence of a financial system developed in terms of both operational & allocational efficiency in mobilizing savings and in channelizing them among competing demands.

This statement clarifies that improvement and growth of the economic activity is due to a sound financial system. This statement, therefore, try to state that growth of economy can be achieved only through a sound financial system that can mobilize the savings and channelize them among the competitive market.

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Jayanthi Jain & K. Balachandran\textsuperscript{28} in an article opines, with the liberalization of the economy in general and the financial sector in particular, the risk dimensions facing the Indian commercial banks have multiplied. Banks which were familiar only with the credit risk relating to non-payment earlier are now facing multi financial risk in the form of credit risk relating to non-payment & non-performing risks, interest rate risks, maturity gap risks and technology risks. M. R. Tambe\textsuperscript{29} in an article on the role of commercial banks in the new economic set up states that in order to cope with the new challenges, the commercial banks will have to abandon their traditional work style and adopt new dynamic work culture. The banks must also guard themselves against the situation of excessive risk and competition. Bimal Jalan\textsuperscript{30} in his keynote address to the economist's conference points out that excessive risk aversion can have adverse effects on the profitability of the banking system as it will restrict the credit growth in the economy.

The above articles say that with the liberalization of the economy, especially in financial sector, banks are facing multi – dimensional risks. It added that if the banks want to sustain in the market they will have to abandon their traditional work style and adopt new dynamic work culture.

\textsuperscript{30} Bimal Jalan, “Towards a more Vibrant Banking System”, Yojana vol.43 No. 3 (March1999) p.5-9
V.K. Bhatasana\textsuperscript{31} studied the appraisal of financial performance of State Bank of India (1980 – 1995) particularly productivity and profitability of State Bank of India during the study period, he observed adequacy of capital fund, growth in deposits, branch expansion in rural area and less borrowing from Reserve Bank of India. In this study period of State Bank of India improved the productivity & profitability of State Bank of India among public sector banks.

This study shows that State Bank of India has improved the productivity and profitability among other public sector banks in terms of capital fund, growth in deposits and branch expansion.

Radha T\textsuperscript{32} in her Ph. D Thesis, titled, “Impact of banking sector reforms on the performance of commercial Banks in India” in Andhra University, Visakhapatnam, was to critically evaluate the impact of Banking Sector Reforms on the performance of Commercial Banks in India. In this Study, she analyze the magnitude of deposits and borrowings, and trends in branch expansion, advances and investments, trends of income and expenditure and also studied the magnitude of achievements in priority sector advances, capital adequacy, CD ratio, staff position in different bank groups and individual banks within the group. This study covered the period 1989-90 to 1998-99. Simple statistical techniques like percentages and growth rates were used in this study. Major findings of the study are..: (i) Total Deposits of all Commercial Banks put together may be divided as SBI (21.5 per cent), Associate Banks (6.6 per cent), Nationalized


Banks (58.6 per cent), Private Banks (6.9 per cent) and Foreign Banks (6.3 per cent) respectively, (ii) In the total borrowings of SCBs, Nationalized banks, on an average, accounted for 39.42 per cent followed with 22.77 per cent by Foreign Banks, 23.54 per cent by SBI, 7.76 per cent by Private Banks and 3.47 percent by associate banks, (iii) In Branch expansion, Indian Private Sector Banks, registered 21.36 per cent growth rate which is highest amongst SCBs, during the study period, followed by Foreign Banks with 16.96 per cent, Associate Banks with 12.77 per cent, Nationalized Banks with 11.36 per cent, SBI with 6.23 per cent, (iv) Total investments of Commercial Banks in India increased to ₹ 346271 Crore in 1998-99 from ₹ 97,199 Crore in 1989-90, (v) Priority Sector advances as proportion of net bank credit after exceeding the target of 40 percent in 1991 has been continuously falling short of target up to 1999, (vi) Foreign Banks in India as a group achieved highest capital adequacy ratio among all groups of SCBs, (vii) Among all Indian banking groups, Indian private sector banks recorded highest CD ratio with 67.06 'per cent.

In this statement some of the financial aspects of the bank like deposits, advances, income and expenditure is taken to evaluate the impact of banking sector reforms on the performance of commercial banks in India. Total deposits and borrowings of SBI were high in comparison to other banks.

**SBI Research Department**

“Performance analysis of 27 Public sector banks”

Economic Research Department of State Bank of India, is to analyze the Performance of 27 Public Sector Banks for the year 1999-2000 Vis-a-Vis the preceding year.

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Selecting four different categories of indicator – Business Performance, Efficiency, Vulnerability and labor productivity indicators carried out the analysis. Altogether 39 indicators were selected for this purpose. For the purpose of analysis, 27 PSBs disaggregated into four groups, namely, the SBI, ABs (7), the SBGs (8) and the NBs (19).

During 1999 - 2000, the PSBs exhibited better show in terms of several parameters studied above. Nevertheless, the problems of NPAs and capital adequacy remain to be taken care of. Researcher in this paper has opinioned that greater operational flexibility and functional autonomy should be given to PSBs especially to strengthen their capital base. Further, they felt that since net interest margin will continue to remain compressed in a deregulated interest rate regime, a lot of effect would have to be made to mitigate this through generation of non-interest income. As far as NPAs are concerned, they believe' that, the outdated laws and regulations that pose hindrance to banks in getting back their dues need to be suitably amended.

Here the study clarifies the problem of NPA & capital adequacy norms to be taken care of. To recover NPA the outdated laws and rules & regulations must be changed. In this study the financial performance of the bank is ignored.

Prashanta Athma34 “Performance of Public Sector Banks – A Case Study of State Bank of Hyderabad” made an attempt to evaluate the performance of Public Sector Commercial Banks with special emphasis on State Bank of Hyderabad. The period of the study for evaluation of performance is from 1980 to 1993-94, a little more than a

decade. In this study, Athma outlined the Growth and Progress of Commercial Banking in India and analyzed the trends in deposits, various components of profits of SBH, examined the trends in Asset structure, evaluated the level of customer satisfaction and compared the performance of SBH with other PSBs, Associate Banks of SBI and SBI. Statistical techniques like Ratios, Percentages, Compound Annual rate of growth and averages are computed for the purpose of meaningful comparison and analysis. The major findings of this study are that since nationalization, the progress of banking in India has been very impressive. All three types of Deposits have continuously grown during the study period, though the rate of growth was highest in fixed deposits. A comparison of SBH performance in respect of resource mobilization with other banks showed that the average growth of deposits of SBH is higher than any other bank group. Profits of SBH showed an increasing trend indicating a more than proportionate increase in spread than in burden. Finally, majority of the customers have given a very positive opinion about the various statements relating to counter service offered by SBH.

This study made an attempt to show the growth and progress of State Bank of Hyderabad. Here the researcher take some of the aspects of financial nature like deposits, profit, assets and compared with other PSBs, associate banks of SBI and SBI. The results were good in case of deposits as well as FDs. There was also a positive response with reference to customer service.

R.Narasimhan\textsuperscript{35} in a study relating to the public sector banks points out the “true reasons” for the crisis in public sector banks. These are as follows-

\textsuperscript{35} Narasimhan R., “Public Sector Banks in a Pressure Cooker”, The Hindu, 29 march 2000.
a) Problems encountered by the banking industry globally and the response by the central bank,

b) Prudential norms introduced by the RBI in 1993 and their impact on the banking system in India, and

c) The transformation of banks and the banking business due to forces unleashed by the IT revolution.

In this statement it is told that banking system is suffering with many problems, some of them related to global competition and the others are due to the norms of the RBI. This study shows the above reasons for lagging behind the banking system as a whole.

Balasubramaniam\textsuperscript{36} in “Non-performing assets and profitability of commercial banks in India: assessment and emerging issues” said that the level of NPAs is high with all banks currently and the banks would be expected to bring down their NPA. This can be achieved by good credit appraisal procedures, effective internal control systems along with their efforts to improve asset quality in their balance sheets. However, maintaining profitability is a challenge to commercial banks especially in a highly competitive era and opening up of banking business to NBFC and foreign banks in general.

This statement throws light basically on high NPA, and because of high NPA the profitability of the banks is deteriorated. Another aspect for the less profitability is competition and to open the banking business to NBFC & foreign banks.

Rao\textsuperscript{37} concluded that the international regulations are forcing the Indian banks to adopt

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better operational strategies and upgrade the skills. The system requires new technologies, well-guarded risk and credit appraisal system, treasury management, product diversification, internal control, external regulation as well as skilled human resources to achieve the international excellence and to face the global challenges.

Muniappan\textsuperscript{38} focused on two areas - firstly, challenges faced by the Indian banks and secondly, the management of these challenges. Every aspect of the banking industry, be it profitability, NPA management, customer service, risk management, HRD etc., has to undergo the process of transformation of aligning with the international best practices. He concluded that the future of Indian banking system needs a long-term strategy, which should cover areas like structural aspects, business strategies, prudential control systems, integration of markets, technology issues, credit delivery mechanism and information sharing, etc. Vashisht\textsuperscript{39} examined the latest international developments, which has distorted the environment in which commercial banks drive. Globalization has expanded economic interdependence and interaction of countries deeply. Under the administration of globalized environment, the financial performance of the commercial banks has altered and the commercial banks will face new challenges and opportunities in the future.

The above statements focused on international rules & regulations/best practices. To follow these changes or in other words to achieve the international excellence and to face the global challenges the banking industry is required to make changes in every

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aspect of the banking industry, be it profitability, NPA management, customer service, new technology, external regulations, HRD etc. But these statements do not focus on financial aspects of banking industry.

A. P. J. Abdul Kalam\textsuperscript{40} in his address to the Banker’s Conference discussed the dynamics of banking in relation to national development. He is happy that fortunately India is blessed with two resources – natural and human, what is needed today is a proactive partnership of bankers in the national development missions. He concludes by saying one of the very important ingredients for success of the vision of transforming India in to a developed nation by 2020 is the evolution of creative leaders. The higher the proportion of creative leaders in the banking sector, the higher the potential success of vision of developed India.

This statement gives focus on creative leaders. It added that the higher the proportion of creative leaders in the banking sector, the higher the potential success of vision of developed India. It does not discuss anything about financial performance of the banks.

Dr. Ramchandra Reddy B. and Dr. Yuvaraja Reddy\textsuperscript{41} In the study entitled “Financial Performance of State Bank of India: An Analysis”. The researchers made an attempt to study the financial performance of State Bank of India. The study focuses on the responsibility areas like deposit mobilization, credit deployment, non-performing assets, profitability and productivity. The study found that, in the changing banking scenario, the


State Bank of India is one of the leading banks which welcomes the radical changes and make the organization fit for the changes without much difficulty.

In this study the researcher tries to analyze the financial performance of SBI. Here the study comprise only the responsibility area of finance like deposit mobilization, NPA, profitability etc. under these scenario SBI makes it comfortable with the changes.

Singla H.K. 42 “financial performance of banks in India” has examined that how financial management plays a crucial role in the growth of banking. It is concerned with examining the profitability position of the selected sixteen banks of banker index for a period of six years (2001-06). The study reveals that the profitability position was reasonable during the period of study when compared with the previous years. Strong capital position and balance sheet place, Banks in better position to deal with and absorb the economic constant over a period of time.

Although in this statement, the financial performance of the bank has examined but it is concerned only with the profitability aspect of the bank. The study shows that the profitability position was good during the period of study. It neglects the other essential aspects of finance.

Raju D.N.M. 43 conducted study on “Evaluation of the performance of State Bank of India with special reference to Non–Performing Assets (NPAs)” The study reveals that magnitude of NPA has a direct impact on the bank’s profitability as legally they are not

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allowed to book income and on same time banks are forced to make provision on such assets as per RBI guidelines. The focus of the study is to evaluate the financial and operating performance of State Bank of India in the light of changing conditions emerging out of the implementation of financial sector reforms. Another aspect covered in depth is the changing picture of non-performing assets (NPAs) of the bank. The study brings out a number of suggestions for improving the performance of SBI; strengthening the recovery position of NPAs, prevention and reduction of NPAs.

This study is related with the performance of SBI with special reference to NPA. The study reveals that NPA affect the profitability. The study takes only NPA as a parameter and neglects the other aspects to judge the financial profitability of the bank.

**Uppal** in his research paper evaluated the performance of public, private and foreign banks in India and analyzed the target achievement by them during 2006-07. He found that priority sector advances of public and private sector banks were higher than foreign banks. He observed that public sector banks were unable to achieve the target of priority sector, while private sector banks have achieved the target. Private sector banks could not achieve the target for weaker section. Foreign banks could achieve the targets for priority sector, small scale industries sector and export sector. He further, found that NPAs of public sector banks was highest followed by private sector banks and foreign banks. Main reason for more NPAs in public and private sector banks was found to be more NPAs in agriculture sector. He examined various issues related to priority sector like, low profitability, more NPAs, Government interference, high transaction costs etc.

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He also suggested various strategies to overcome these issues.

This study shows that the NPAs of public sector banks were highest in comparison to private sector banks and foreign banks. The main reason for high NPA was agriculture sector.

Uppal⁴⁵ analyzed the performance of major banks in terms of productivity and profitability in the pre and post e-banking period and concluded that performance of all the banks under study is much better in post-e banking period and further foreign banks are at the top position, whereas the performance of the public sector banks is comparatively very poor.

This statement takes pre & post e-banking period as the key factor and analyzed the banks performance in this reference. It concludes that the performance of the public sector banks was very poor.

Gupta⁴⁶ in her study A Comparative Study of Non-Performing Assets of SBI and Associates & Other Public Sector Banks had concluded that each bank should have its own independence credit rating agency which should evaluate the financial capacity of the borrower before than credit facility. An effective committee can be formed for management of NPA comprising of financial experts who have wide knowledge in this field. Banks can appoint professionals to identify the genuine borrowers & can analyze their profile. NPA can be considered as a crucial rating factor for any bank; it should

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continuously monitor the borrowers a/c to prevent NPA. The credit rating agencies should regularly evaluate the financial condition of the clients. Special accounts should be made of the clients where monthly loan concentration report should be made. This study tries to touch the financial aspect (NPA) of State Bank of India. It suggests that before giving loan banks should analyze the profile of the borrowers to prevent NPA. This study talks about only a single aspect of financial performance and left behind many of the essential aspects of financial performance of the bank.

Gudadhe\textsuperscript{47} discussed about the customer perception towards products and services of State Bank of India. The article discussed about the SBI Bank Group wise perception and satisfaction level of customers, the availability and use of products and services given by the bank. The author concluded by stating that the customer expect higher quality services from banks which, if fulfilled, could result in significantly improved customer satisfaction levels. 99.27\% customers expressed their satisfaction towards the services.

The statement discuss about customer satisfaction towards the products and services provided by SBI. 99.27 \% customers are satisfied by the services provided by the bank. It did not talk about financial performance of the bank.

\textbf{Conclusion}: By studying the above statements/researches/studies it is clear that there are few of the researchers who take only one or two aspects of financial nature with

\footnotesize{47. Gudadhe P.S.(2013), “Customer perception towards products and services of State Bank of India with Special Reference to Yavatmal District, (M.S.) India”, IRACST - International Journal of Commerce, Business and Management (IJCBM), ISSN: 2319 - 2828. Vol. 2, No.4, August, 1-8}
reference to SBI, but there is neither a single comprehensive study nor any attempt has been made to analyze all the contents as deposit mobilization, lending policies, investment pattern, profitability aspects, capital fund, deposits, advances, net profit, investments, fixed assets etc. of State Bank of India. Hence the present study is a humble effort to bridge the gap in the existing study & literature. That is why this researcher takes the topic as “Financial Appraisal of State Bank of India” because there is hardly any study on this topic.
CHAPTER 3

DEPOSIT MOBILIZATION & LENDING POLICIES OF STATE BANK OF INDIA

3.1 INTRODUCTION:

Among the factors determining the rate of growth in a developing economy, capital investment occupies a premier position and a major portion of the requisite capital must come out of the savings of the people. Bank deposits are the heart of the banking industry as they are the raw material with which the bank function.\(^1\) Deposits constitutes a major source of funds for financing economic development and growth.

Bank mobilizes deposits as their primary source of funds. Deposit mobilization is the first and foremost function of any bank. Deposits are the mainstay of bank funds. Deposit means a credit to an individual or to a firm\(^2\). Having optimal deposits level, bank shall be able to lend the funds to generate interest on lending. In addition to lending, the deposit fund can be placed in certain investment avenues which suits the banks’ or the deposits’ objectives. Deposit mobilization is a continuous function for a bank to ensure the sum total of deposits at any time adequate to maintain the current level of lending and investments especially to compensate the withdrawals made by depositors.

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Usually, the deposit level is kept slightly or certain percentages above the lending and investments level to ensure that bank has adequate cash reserves to meet expected withdrawals and also recurring withdrawals. The cash reserves are called Liquidity Reserves. Deposits bring costs to the bank, either on the maintenance of the deposits and its transactions or on the interest payout onto the deposits upon deposit maturity. Other activities of bank are mostly dependent on the deposits mobilized by it. The deposits mobilized on the macro level do not only cultivate the habit of saving and thrift among the masses but they also create investment potential at the macro level which in turn can have an effect of multiplying the saving and accelerating the investments. Further through their earning power they can help in the process of general uplift of the people. It is due to the significant place, which is engaged by deposits in the banking portfolio in the economy.

3.2 Composition and Classification of Bank Deposits:

Broadly, Bank Deposits are classified into two categories i.e. Demand Deposits and Time Deposits. Demand Deposits are those deposits, which may be withdrawn by the depositors or transferred to someone else at any time without previous notice to the bank. The demand deposits are further classified in to two categories viz. Current Deposits and Savings Deposits. Current Deposits cater the needs of industrialists and of businessmen mainly for transaction purposes. The number of withdrawals permitted

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under current account is very liberal, means the withdrawals can be made many times; hence no interest is paid on them. On the other hand savings deposit accounts cater to the saving needs of households and other to meet their household expenditure and limited withdrawals are permissible from saving deposits accounts and a little interest is also paid on them.

Time Deposits are also known as fixed or term deposits. These are long term deposits with bank, generally for a period ranging from 45 days to 5 years and above; notice of withdrawal must be a part of a contract between the holder and the bank. These deposit accounts are of various maturities from 45 days to above 5 years. Different interest rates are paid on different maturity periods. These deposits cater to the long term saving needs of households and others. The most important characteristics of such deposits are better liquidity than any other long-term financial assets, payments at market rates of interest and high degree of security. The composition of deposits underwent change after 1969 in favor of fixed deposits.

3.3 Deposits as Key Liquidity Indicator:

Bank receives deposits from individuals, organizations and businesses; initially by opening an account with the bank itself. Based on the types of deposits, minimum initial deposits are set together with the rules and regulations governing the accounts. Subsequent deposits can be made into the account, except for time deposits where the amount is fixed until deposit maturity. Depositors maintain deposits with specific bank due to many factors, but in particular trust and confidence with the bank are the major factors. Once these are established, the bank continuously attracts depositors and deposits by providing convenience banking, quality services, excellent brand
association and higher interest payout. However, there are instances where depositors put their money into the bank mainly for security purposes, i.e. the bank to protect their money from loss and theft and also warrant the deposits from investment loss.

Deposits are made mainly in cash, the most liquid asset for bank. Once withdrawal requests are made by depositors, bank must immediately provide cash for that particular purpose. As compared to other liquidity components such as short term investments which take time to be converted into cash, it is rather wise for a bank to simply get more deposits beyond the withdrawal amount. However, the percentage of the cash reserves must be kept at optimum level. Idle cash does not create profit, but in fact, brings additional costs in terms of storage and insurance. Therefore, by maintaining cash reserves at optimal level enables bank to generate maximum profits from lending and investment activities. The costs for cash reserves are mainly on the storage and insurance. The storage of cash reserves involves the requirement for adequate vault rooms, cash in-transit security and cash handling at branches. The insurance costs are to cover the amount of cash available anytime at branches or in-transit from loss, fire and theft. It generally covers the maximum cash amount allowed at branches or in-transit.

3.4 Determinants of Deposit Growth:

Factors that determine the growth of deposits may be broken down structurally into two parts viz. supply-side and demand-side components. One further differentiation level is of duration: while some factors have a relatively long-term, other factors have an only short-term impact on their growth.
Supply

In this context, supply is to be understood in the sense of “supply of deposits from depositors”. From a theoretical standpoint the following factors could have an influence:

— One assumption would be that as incomes rise, deposits with bank do so as well.

— Inflation/Interest rates: As inflation accelerates, deposits become less attractive, depending on the interest rate. In this case, the assumption would be that as deposit interest rates rise, deposits would increase in principle as well. The narrower the spread between deposit rates and inflation, the less attractive it should be to hold deposits above the required level.

— Risk-reward profile of investment alternatives: The assumption would be that the relative attractiveness of deposits falls if investment alternatives offer more favorable risk-reward profiles.

— Demography: The life-cycle hypothesis assumes that deposits increase in the course of a person’s lifetime, only to decrease as the person reaches old age. So with a population generally ageing, one would have to expect an overall decline in deposits.

— Trust in the banking sector and its stability: The assumption would be that given pronounced trust in the banking sector the volume of deposits would tend to increase. Credible guarantee systems (deposit guarantees, bank bail-out funds) could be helpful in this case.
Demand

In this context, the term Demand means the banks’ demand for deposits. The following factors could have an impact on demand:

— **Regulation:** The regulatory regime changes the relative attractiveness of assets. In respect of deposits, Basel III and some laws on bank levies are of relevance. In some laws on bank levies, deposits have the impact of reducing the contributions levied. Under Basel III, household deposits have a lower weighting in the liquidity ratios than other liabilities. This could boost demand for deposits, since the relative attractiveness of deposits increases.

— **Competition:** Strong competition in the banking sector could necessitate higher interest rates being offered to attract deposits. From the banks’ point of view, this could reduce the attractiveness of deposits as a funding instrument. At the same time, depositors would find them more attractive.

— **Costs and availability of alternative funding instruments:** Their availability and costs hinge on national legislation, collateral, competition, the bank’s rating and the rating of the country in which it is domiciled

### 3.5 Perspectives of Deposits Mobilization:

Mobilization of deposit is one of the main functions of banking business and so an important source of working fund for the bank. State Bank has to increase their financial resources by way of deposit mobilization. Deposit mobilization is an indispensable factor to increase the source of the bank to serve effectively. The importance of deposits of the banking structure is to provide satisfactory service to any program of
agricultural production and industrial manufacturing hardly needs to be over emphasized. Several committees and commissions have stressed that State bank must tap deposits from urban and rural areas so that it may be able to provide funds in large amounts to primary societies for farm and non-farm development. The success of the banking greatly lies on the deposit mobilization performance of the bank as the deposits are normally considered as a cost effective source of working fund. The State Bank operates various deposit schemes such as current, savings, fixed, recurring and other special schemes to meet the varying requirement of the customers. One of the important objectives of the bank is the mobilization of rural savings. It helps to expand loaning operations. The All India Rural Credit Survey Committee (1954), Mehta Committee (1960) and Banking Commission (1972) have recommended that the State Bank could engage in the mobilization of deposits for improving the internal resources. Contrary to this principle, the concessional finance available to the bank from the RBI made them indifferent to the function of mobilization of deposits. To mobilize deposits, State Bank is given some encouragement by the apex institutions such as subsidy for branch expansion, states’ participation in share capital, and application of deposit insurance scheme.

Avadhani (1987)\(^5\) studied the performance of rural branches of some commercial banks in order to identify the factors influencing deposit mobilization in rural areas in different states. They came out with the opinion that there existed sufficient relationship between the deposits of a rural branch and its age. The growth of deposits is at a faster

rate in the first six years and tapers off subsequently. The growth rate in deposits of commercial banks cannot be explained in terms of price differentials as co-operatives offer high rates of interest. Therefore product differentials would offer a better explanation of the disparate growth rates in deposits. This relates to difference in customer services, liquidity, attitude of the manager and the bank staff and their local involvement. It is to be noted that there was no special schemes for deposit mobilization or any incentives given to bank staff. Yet each branch management had evolved its own strategy to mobilize deposits in order to achieve the targets fixed by the Head office.

The Mahajan Committee has made its observation as (1) since the interest offered by the bank on public deposits is quite attractive, the state bank must offer competitive rate of interest. It must review the present rates and bring them in line with the rates prevailing in the money market, and (2) the local bodies, educational institutions, trust, etc. should be permitted to make deposits of their funds with the bank. In the post liberalization scenario, the number of players in banking industry has increased considerably which developed competition in bank marketing. ‘The survival of the fittest’ has made applicable for the bank. To enhance profitability, State Bank take steps to minimize the interest paid expenditure and so bank is forced to mobilize low cost deposits.

Shetty⁶ critically examined the extent to which the banking system in India has been able to achieve the objectives set before it initially by the scheme of social control and

---

subsequently by the nationalization of bank. It was observed that no major structural change has occurred in the composition of deposits and the bank have failed to improve their credit-deposit ratio over the time.

3.6 Relationship between Deposit Mobilization & Investment:

Investment and capital growth in the country are dependent on the ability of the financial intermediaries to mobilize deposits from saver and prudently lending them to firms and individual borrowers. This section examines the relationship between deposits, investment and capital growth. One of the arguments in favor of capital account liberalization is widening the scope within which State Bank can mobilize more resources for investment. National savings are largely retained in the home country where they increase domestic investment and these are left with the local institutions to mobilize more deposits to increase savings. The argument now is whether investment increases capital formation and growth which will necessitate the bank’s efforts for more deposits for investment. The neoclassical theorist of the 1960s and 1970s argue there is no causality between investment and long term growth and attribute growth to technological innovations. They, however, admit that capital formation affects growth in the transition stages of economic development. Above all, empirical evidence from the East Asia and Latin American economies indicate strong links between gross domestic investment ratios and long term growth performance.
Table D

Relationship of Deposits and Investment with G.D.P., Per Capita Income, Gross National Income and Net National Income of Scheduled Commercial Banks of India

<table>
<thead>
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<tbody>
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<td>2003-04</td>
<td>15044.16</td>
<td>6775.88</td>
<td>2777813</td>
<td>24143</td>
<td>2757120</td>
<td>2466093</td>
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<tr>
<td>2004-05</td>
<td>17001.98</td>
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<td>27131</td>
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<td>2629198</td>
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<td>2005-06</td>
<td>21090.49</td>
<td>7174.54</td>
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</tr>
<tr>
<td>2006-07</td>
<td>26119.33</td>
<td>7915.16</td>
<td>3564364</td>
<td>35825</td>
<td>3534849</td>
<td>3149149</td>
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<td>2007-08</td>
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<td>9717.15</td>
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<td>40775</td>
<td>3879457</td>
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<td>2008-09</td>
<td>38341.1</td>
<td>11664.1</td>
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<td>4133292</td>
<td>3664388</td>
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<tr>
<td>2009-10</td>
<td>44928.26</td>
<td>13847.52</td>
<td>4516071</td>
<td>54021</td>
<td>4488314</td>
<td>3966408</td>
</tr>
<tr>
<td>2010-11</td>
<td>52079.69</td>
<td>15016.19</td>
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<td>4882249</td>
<td>4310195</td>
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<tr>
<td>2011-12</td>
<td>59090.82</td>
<td>17377.87</td>
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<td>4572075</td>
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<tr>
<td>2012-13</td>
<td>67504.54</td>
<td>20061.05</td>
<td>5503476</td>
<td>74920</td>
<td>5416659</td>
<td>4728776</td>
</tr>
<tr>
<td>CAGR</td>
<td>118.2%</td>
<td>112.8%</td>
<td>107.9%</td>
<td>113.4%</td>
<td>107.8%</td>
<td>107.5%</td>
</tr>
</tbody>
</table>

(Source: Reserve Bank of India, CSO)
### Table E
Relationship of Deposits and Investment with G.D.P., Per Capita Income, Gross National Income and Net National Income of State Bank of India

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>2003-04</td>
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<td>185676</td>
<td>2777813</td>
<td>24143</td>
<td>2757120</td>
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<td>3149149</td>
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<tr>
<td>2008-09</td>
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<td>4158676</td>
<td>46249</td>
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<td>3664388</td>
</tr>
<tr>
<td>2009-10</td>
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<td>285790</td>
<td>4516071</td>
<td>54021</td>
<td>4488314</td>
<td>3966408</td>
</tr>
<tr>
<td>2010-11</td>
<td>933933</td>
<td>295601</td>
<td>4937006</td>
<td>61855</td>
<td>4882249</td>
<td>4310195</td>
</tr>
<tr>
<td>2011-12</td>
<td>1043647</td>
<td>312198</td>
<td>5243582</td>
<td>67839</td>
<td>5196848</td>
<td>4572075</td>
</tr>
<tr>
<td>2012-13</td>
<td>1202739</td>
<td>350927</td>
<td>5503476</td>
<td>74920</td>
<td>5416659</td>
<td>4728776</td>
</tr>
<tr>
<td>CAGR</td>
<td>115.9 %</td>
<td>107.3 %</td>
<td>107.9 %</td>
<td>113.4 %</td>
<td>107.8 %</td>
<td>107.5 %</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India, CSO

**Formula of Compound Average Growth Rate (CAGR)**

\[
[(\text{End Value/ Start Value}) ^ (1/ (Periods-1))]
\]

It is clear from the above table that as the ‘Per Capita Income’, ‘Gross Domestic Product’, ‘Gross National Income’ and ‘Net National Income’ of the country increases, the Deposits and the Investments of the commercial banks as well as of the State Bank
of India shows an upward movement accordingly in the same direction. Similarly the compound average growth rates (CAGR) also have a positive sign of growth in whole of the study period. The CAGR with reference to SCBs deposits & investments is 118.2 % and 112.8 % respectively whereas in case of SBI’s deposits & investments it is 115.9 % and 107.3 % respectively. It shows that the CAGR with reference to deposits & investments of State Bank of India is being lesser than SCBs during the study period. Similarly the CAGR with reference to SCB’s & SBI’s GDP, Per Capita Income, Gross National Income and Net National Income is 107.9 %, 113.4 %, 107.8 % and 107.5 % respectively. If we compare the contribution of deposits of SCB & SBI on the basis of GDP (CAGR), than we can say that SBI with 93.09 % has made more deposits than SCB with 91.29 %. Similarly in case of investments, SBI with 99.44 % has more investments than to SCB with 95.66 %. Now on the basis of per capita income the deposits are 95.94 % and 97.84 % respectively of SCB & SBI and investments are 100.53 % and 105.68 % respectively of SCB & SBI.

In the same way the deposits and investments on the basis of Gross National Income of SCB are 91.20 % and 95.57 % whereas of SBI are 93.01 % and 100.97 % respectively. Again on the basis of Net National Income the deposits & investments of SCB are 90.95 % and 95.30 % whereas in case of SBI it is 92.75 % and 100.19 % respectively. So we can say that the financial performance of bank is subject to the general economic conditions in the country. Now there is an analysis of Deposits & Investments with GDP & per capita income and with gross national income & net national income of SCB and SBI respectively.
By the observation of the above tables we can say that the deposits & investments of SCB have achieved good performance with GDP and Per Capita Income as indicated by their respected CAGR. Similarly the Gross National Income and Net National Income are showing an upward movement on year to year basis in whole of the study period and the CAGR is 107.8 % & 107.5 % respectively. If we compare the year to year growth of deposits & investments, it also shows an upward movement during whole of the study period.

Further we can say that the annual growth rate of investments of SBI is less in comparison to the GDP and Per Capita Income. The deposits have shown a remarkable annual growth rate over whole of the study period and also in year to year comparison it shows a good growth trend. In the year 2007-08 the State Bank has achieved a handsome amount of deposits with 23.39 % growth similarly in the year 2008-09 also it has a good amount of deposits with 38.08 % growth. So the SBI is able to maintain a good growth rate of deposits in whole of the study period.

### 3.7 Trends and productivity of Deposits:

#### Trends of Deposits:

Table 3.1 and chart 3.1 exhibit the position of deposits in SBI during the study period, 2003-04 to 2012-13.

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>318619</td>
<td>367048</td>
<td>380046</td>
<td>435521</td>
<td>537404</td>
<td>742073</td>
<td>804116</td>
<td>933933</td>
<td>1043647</td>
<td>1202739</td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
Deposits in SBI registered an upward trend during the study period. It was ₹ 318619 crore in the base year 2003-04 which rose to ₹ 367048 crore in 2004-05 to ₹ 380046 crore in 2005-06, to ₹ 435521 crore in 2006-07 to ₹ 537404 crore, in 2007-08, to ₹ 742073 crore in 2008-09, to ₹ 804116 crore in 2009-10, ₹ 933933 crore in 2010-11 and to ₹ 1043647 crore in 2011-12. It reached to the highest point of ₹ 1202739 crore at the end of the study period, 2012-13. It shows that it has increased at considerably high rate during the study period and registered 2.77 times growth over the base year.

**Productivity of Deposits :**

Productivity of Deposits has been measured with basic input number of employees and number of branches. They are depicted as:

(i) Deposits per Employee and

(ii) Deposits per Branch.
(i) **Deposits per Employee:**

Deposits per employee are the part of productivity ratio. It is the relationship of the output deposits to the input employee. It measures human resource efficiency in case of output deposits.

Deposits per employee are the proportion of deposits to no. of employees. The following formula is applied for calculation of the ratio.

\[
\text{Deposits per Employee} = \frac{\text{Deposits}}{\text{No. of Employees}}
\]

Table 3.2 and chart 3.2 presents the data of deposits per employee of SBI during the study period i.e. 2003-04 to 2012-13.

**Table 3.2**

<table>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>1.54</td>
<td>1.79</td>
<td>1.92</td>
<td>2.30</td>
<td>2.99</td>
<td>3.60</td>
<td>4.01</td>
<td>4.19</td>
<td>4.84</td>
<td>5.27</td>
</tr>
</tbody>
</table>

(Source: Calculated by researcher himself from table no. 1.3 & 1.7)
Deposits per employee of SBI were worked out to ₹ 1.54 crore for the base year 2003-04, which rose to ₹ 1.79 crore in 2004-05. It continued moving up during the study period and reached to ₹ 5.27 crore at the end of the year 2012-13. It jumped to ₹ 2.99 crore in 2007-08. From 2006-07 it started gaining the position of more than ₹ 2 crore. It reached to ₹ 3.60 crore and to ₹ 4.01 crore in the years 2008-09 and 2009-10 respectively. It reached to ₹ 4.19 crore in 2010-11, to ₹ 4.84 crore in 2011-12 and to ₹ 5.27 crore in 2012-13. It reached to the highest point of ₹ 5.27 crore at the end of the study period, 2012-13. Aggregate of deposits per employee was worked out to ₹ 32.45 crore, which indicates that SBI collected on an average ₹ 3.245 crore deposits per employee during the study period.

(ii) Deposits per Branch:

Deposits per branch are the part of productivity ratio. It measures the productivity of branch. Here, the input is branch and output is deposits. It is the relationship between inputs no. of branches to output deposits. It is calculated as follows:

\[
\text{Deposits per Branch} = \frac{\text{Deposits}}{\text{No. of Branches}}
\]

Table 3.3 and chart 3.3 presents the data related to deposits per branch of SBI for the study period 2003-04 to 2012-13.

<table>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>35.04</td>
<td>40.09</td>
<td>41.11</td>
<td>46.76</td>
<td>52.33</td>
<td>64.30</td>
<td>63.63</td>
<td>68.18</td>
<td>73.13</td>
<td>80.17</td>
</tr>
</tbody>
</table>

(Source: Calculated by researcher himself from table no. 1.3 & 1.6)
Deposits per branch of SBI registered an upward movement during the study period. It was worked out to ₹ 35.04 crore for the base year 2003-04 which reached to ₹80.17 crore at the end of the study period, 2012-13. It is the highest deposits per branch among deposits per branch under study. Average of deposits per branch was worked out to ₹56.47 crore for the study period.

### 3.8 Problems of Deposit Mobilization:

#### 3.8.1 Outreaching Rural Savers –
State Bank is facing with many challenges in their desire to mobilize more deposits. More than 60% of the population lives in the rural areas in isolated villages. It therefore become cost ineffective to have bank branches that can conveniently provide door step financial services to the rural inhabitants. Bank therefore battle with the problem of how to effectively harness the large volume of deposits left in the rural areas.
3.8.2 Regaining Confidence in the Banking Sector - The State Bank has not fully regained the confidence that many customers lost; thus making deposit attraction difficult. This could be due to partly the attitude of bank staff towards customers and the government action of controlling the operations of the bank. In the early 1980s most depositors had their deposits frozen because of the government’s decision fear of suffering similar action. In other instances depositors have been subjected to bank official’s brutalities.

3.8.3 Unstable Macroeconomic Conditions - Another problem against deposit mobilization is the unfavorable macroeconomic environment with high inflation and reserve requirement and their associated low returns on deposits. In a period of high inflation, hedging is inevitably a prudent measure depositors pursue in order to enjoy future appreciation of value.

3.8.4 Insufficient Instruments - Currently, the main instruments used to attract deposits from the simple savings and current accounts that require unaffordable initial deposits, money remittances business, branch expansion, corporate imaging, negotiable interest rates, promotion and advertisements, overdrafts and loan facilities to complex internet, telephone and ATMs. These instruments in the first place are not sufficient to cater for the financial needs of all the settlements. They favor regular and formal service income earners than the informal workers such as artisans, farmers and other small scale operators who are the majority. Customers require literacy to utilize these instruments which majority of the population especially the rural inhabitants do not have.
3.9 Role of Bank Deposits in Economic Development:

Economic growth of any country depends on the savings and investment made by its people. This growth is reflected through rise in per capita income. Economic growth is associated with so many factors like technology, socio-cultural factors, psychological factors and attitudes of the people. Economic growth implies a long term rise in per capita national output and whatever the pattern of growth, the basic conditions determining the rate of growth are three, viz., Effort, Capital and Knowledge. Capital is an essential input for production and it is a means of development. The capital formation involves three distinct interdependent activities viz., savings, finance and investment. Financial System is an organized mechanism which performs the activities of savings, finance and investment in a systematic way. They are important organs of the Indian financial system whose role is commendable in capital formation.

Bank is an essential instrument of accelerated growth in a developing economy. In fact bank is nerve centers of the economy. The primary task of banking institutions is to mobilize the diffused and thinly scattered savings of a poor and populous community and to direct them into productive investment. Among the financial institutions that have been mobilizing savings and investments, bank has created a nucleus for the process of economic growth. They are both the repositories of community savings and purveyors of credit for economic development.

A developing economy needs a high rate of capital formation to accelerate the tempo of

saving. In underdeveloped countries, savings is very low. However, potential saving is also unrealized due to underdevelopment or lack of banking. Hence, by mobilizing the community savings and diverting them into productive channels and by credit creation, the bank, which command huge financial resources, expand the tempo and volume of aggregate economic activity in the country.

Deposits are the major source of funds and they help the bank to supply the funds to the economic activities. Bank receives deposits which they have to repay according to the promise and make them available to those who really need them. The bank is actually distributing its deposits between borrowers and its own vaults. As lending and investment operations of a bank are influenced by the magnitude of deposits, their composition and ownership, a banker always thinks of ways and means of increasing deposits.

Moreover, bank plays a significant role in the economic growth of country. Through their intermediation function bank play a vital role in the efficient allocation of resources of country by mobilizing resources for productive activities. They transfer funds from those who don't have productive use of it to those with productive venture. In addition to resource allocation good bank performance rewards the shareholders with sufficient return for their investment. When there is return there shall be an investment which, in turn, brings about economic growth. On the other hand, poor banking performance has a negative repercussion on the economic growth and development. Poor performance can lead to runs, failures and crises. Banking crisis could entail financial crisis which in

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turn brings the economic meltdown as happened in USA in 2007. That is why governments regulate the banking sector through their central banks to foster a sound and healthy banking system which avoid banking crisis and protect the depositors and the economy (Shekhar and Shekhar, 2007). Thus, to avoid the crisis due attention was given to banking performance.

**(Lending Policies of SBI)**

**3.10 Meaning of Loans and Advances:**

The term ‘loan’ refers to the amount borrowed by one person from another. The amount is in the nature of loan and refers to the sum paid to the borrower. Thus, from the viewpoint of borrower, it is ‘borrowing’ and from the viewpoint of bank, it is ‘lending’. Loan may be regarded as ‘credit’ granted where the money is disbursed and its recovery is made on a later date. It is a debt for the borrower. While granting loans, credit is given for a definite purpose and for a predetermined period. Interest is charged on the loan at agreed rate and intervals of payment.

‘Advance’ on the other hand, is a ‘credit facility’ granted by the bank. Bank grant advances largely for short-term purposes, such as purchase of goods traded in and meeting other short-term trading liabilities. There is a sense of debt in loan, whereas an advance is a facility being availed of by the borrower. However, like loans, advances are also to be repaid. Thus a credit facility- repayable in installments over a period is termed as loan while a credit facility repayable within one year may be known as advances. However, these two terms are used interchangeably.
3.10.1 Utility of Loans and Advances:

Loans and advances granted by bank are highly beneficial to individuals, firms, companies and industrial concerns. The growth and diversification of business activities are effected to a large extent through bank financing. Loans and advances granted by bank help in meeting short-term and long term financial needs of business enterprises. We can discuss the role played by bank in the business world by way of loans and advances as follows:-

(a) Loans and advances can be arranged from bank in keeping with the flexibility in business operations. Traders may borrow money for day to day financial needs availing of the facility of cash credit, bank overdraft and discounting of bills. The amount raised as loan may be repaid within a short period to suit the convenience of the borrower. Thus business may be run efficiently with borrowed funds from bank for financing its working capital requirements.

(b) Loans and advances are utilized for making payment of current liabilities, wage and salaries of employees, and also the tax liability of business.

(c) Loans and advances from bank are found to be ‘economical’ for traders and businessmen, because bank charge a reasonable rate of interest on such loans/advances. For loans from money lenders, the rate of interest charged is very high. The interest charged by bank is regulated by the Reserve Bank of India.

(d) Bank generally do not interfere with the use, management and control of the borrowed money. But it takes care to ensure that the money lent is used only for business purposes.
(e) Bank loans and advances are found to be convenient as far as its repayment is concerned. This facilitates planning for future and timely repayment of loans. Otherwise business activities would have come to a halt.

(f) Loans and advances by bank generally carry element of secrecy with it. Bank is duty-bound to maintain secrecy of their transactions with the customers. This enhances people’s faith in the banking system.

3.10.2 Borrowing Rate and Lending Rate:

People make their funds available to the bank by depositing their ‘savings’ in various types of accounts. In other words, bank funds mainly consist of deposits from the public, though bank may also borrow money from other institutions and the Reserve Bank of India. Bank thus mobilizes funds through its deposits. On public deposits the bank pay interest and the rate of interest vary according to the type of deposit. The borrowing rate refers to the rate of interest paid by a bank on its deposits. The rates which the bank allows depend upon the nature of deposit account and the period for which the deposit is made with the bank. No interest is generally paid on current account deposits. The rate is relatively lower on savings account deposits. Higher rates ranging from 6% to 12% per annum are paid on fixed deposit accounts according to the period of deposit. Bank also borrows from other institutions as well as from the Reserve Bank of India. When the Reserve Bank of India lends money to the bank, the rate of interest it charges for lending is known as ‘Bank Rate’. The rate at which bank make funds available to people is known as ‘Lending-rate’. The lending rates also vary depending upon the nature of loans and advances. The rates also vary according to the purpose in view. For
example if the loan is sanctioned for the purpose of activities for the development of backward areas, the rate of interest is relatively lower as against loans and advances for commercial/business purposes. Similarly for smaller amounts of loan the rate of interest is higher as compared to larger amounts. Again lending rates for consumer durables, e.g. loans for purchase of two-wheelers, cars, refrigerators, etc. are relatively higher than for commercial borrowings. However, the Reserve Bank of India from time to time announces changes in the interest-rate structure to regulate the lending of funds by bank. Different rates of interest are prescribed for various categories of advances, such as advances to agriculture, small scale industries, road transport, etc. Graded rates of interest are prescribed for backward areas.

3.10.3 Lending of Money:

This function is not only very important but is the chief source of profit for bank. Bank thus, help their clients to meet their needs with the money lent to them and return the money with interest as per agreed terms. The advances of a bank can take the form of loans, cash, credits, bills purchase / discount facilities.\(^{10}\)

(a) Loans – Loan is the amount borrowed from bank. The nature of borrowing is that the money is disbursed and recovery is made in installments. While lending money by way of loan, credit is given for a definite purpose and for a pre-determined period. Depending upon the purpose and period of loan, each bank has its own procedure for granting loan. However the bank is at liberty to grant the loan requested

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or refuse it depending upon its own cash position and lending policy. There are two types of loan available from bank:

(i) Demand loan, and (ii) Term loan

(I) A **Demand Loan** is a loan which is repayable on demand by the bank. In other words, it is repayable at short-notice. The entire amount of demand loan is disbursed at one time and the borrower has to pay interest on it. The borrower can repay the loan either in lump sum (one time) or as agreed with the bank. Such loans are normally granted by bank against security.

(II) **Term Loan**: Medium and long term loans are called term loans. Term loans are granted for more than a year and repayment of such loans is spread over a longer period. The repayment is generally made in suitable installments of a fixed amount. These loans are generally secured against the mortgage of land, plant and machinery, building and the like.

**(b) Cash credit**: Cash credit is a flexible system of lending under which the borrower has the option to withdraw the funds as and when required and to the extent of his needs. Under this arrangement the banker specifies a limit of loan for the customer (known as cash credit limit) up to which the customer is allowed to draw. It is normally sanctioned for a period of one year and secured by the security of some tangible assets or personal guarantee.

**(c) Overdraft**: Overdraft facility is more or less similar to ‘cash credit’ facility. Overdraft facility is the result of an agreement with the bank by which a current account holder is allowed to draw over and above the credit balance in his/her account. It is a short-period facility. This facility is made available to current account holders who
operate their account through cheques. The customer is permitted to withdraw the amount of overdraft allowed as and when he/she needs it and to repay it through deposits in the account as and when it is convenient to him/her. Overdraft facility is generally granted by a bank on the basis of a written request by the customer. Sometimes the bank also insists on either a promissory note from the borrower or personal security of the borrower to ensure safety of amount withdrawn by the customer. The interest rate on overdraft is higher than is charged on loan. The following are some of the benefits of cash credits and overdraft:-

1. Cash credit and overdraft allow flexibility of borrowing, which depends upon the need of the borrower.

2. There is no necessity of providing security and documentation again and again for borrowing funds.

3. This mode of borrowing is simple and elastic and meets the short term financial needs of the business.

**{(d) Discounting of Bills:}** Apart from sanctioning loans and advances, discounting of bills of exchange by bank is another way of making funds available to the customers. Bills of exchange are negotiable instruments which enable debtors to discharge their obligations to the creditors. Such Bills of exchange arise out of commercial transactions both in inland trade and foreign trade. When the seller of goods has to realize his dues from the buyer at a distant place immediately or after the lapse of the agreed period of time, the bill of exchange facilitates this task with the help of the banking institution.
Bank invests a good percentage of their funds in discounting bills of exchange. These bills may be payable on demand or after a stated period. In discounting a bill, the bank pays the amount to the customer in advance, i.e. before the due date. For this purpose, the bank charges discount on the bill at a specified rate. The bill so discounted is retained by the bank till its due date and is presented to the drawee on the date of maturity. In case the bill is dishonored on due date the amount due on bill together with interest and other charges is debited by the bank to the customer’s account.

3.10.4 Principles of Bank Lending:

Safety of a loan or advance is directly related to the basis on which the decision to lend is taken, the type and amount of credit to be provided, and the terms and condition on which the advance will be made available. A banker consequently adopts a two-pronged approach to ensure the safety of each loan and advance –

(a) Pre sanction appraisal to determine the ‘bank ability’ of each loan proposal; and

(b) Post sanctions control to ensure proper documentation, follow-up and supervision.

Tailoring a credit appraisal exercise to suit a pre-conceived decision on a credit demand is fraught with risks. Such a situation takes the borrower for granted who in turn takes the credit decision for granted. Bank, in the past, have suffered heavy loan losses on this style of decision making. A pre-sanction appraisal need not justify the credit demand of a customer. It has to be an objective exercise no matter how well known the
customer is \(^{11}\). The credit appraisal, in brief, should reveal whether a loan proposal is a fair banking risk, means should it to be lent to the borrower or not? Post-sanction control to large extent depends upon the findings of pre-sanction appraisal. The post-sanction control involves proper documentation of the facility and the ‘after care’ or follow-up and supervision through monitoring of transactions in the loan amount, scrutiny of periodical statements submitted by the borrower, physical inspection of the securities and books of accounts of the borrower, periodical reviews and renewals etc. Successful lending, thus depends upon careful selection of the customer, proper appraisal of his credit needs and adequate control to ensure that his dealing with the bank are above-board and that he is complying with the terms and condition on which credit has been sanctioned to him.

In order to provide an incentive for lending to small borrowers the Reserve Bank, in 1971, set up the Credit Guarantee Corporation of India Ltd. (now known as the Deposit Insurance and Credit Guarantee Corporation) to administer a comprehensive credit guarantee scheme for loans by bank to individual small borrowers in the priority sector and other neglected sector.

The Prime Minister announced the New 20 – Point program on 14\(^{th}\) January, 1982. At the meeting of the Finance Minister with the Chief Executives of bank held on 15 February, 1982, it was decided that the bank should actively participate in the implementation of the new 20- Point program and for this purpose RBI was required to set up a working group. In pursuance to this decision the Reserve Bank appointed a working group under the chairmanship of its Deputy Governor, Shri A. Ghosh. On the

\[^{11}\text{Arun chatterjee, Bank Lending Law & Practice, published by skylark publications, pp. 1}\]
basis of the recommendations of the group, the Reserve Bank revised certain sub-targets of priority sector advances and the definition of weaker sections of the community. The targets and sub-targets are given below -:

1. Main Targets :

   a) **Priority Sectors:** The advances to priority sectors should reach a level of at least 40% of the total credit by March, 1985.

   b) **The 20-point program:** With in the overall target fixed for priority sector advances, a significant proportion should be allocated to beneficiaries.

   c) **Direct Agricultural Advances:** Direct advances to agriculture should reach a level of at least 15% of the total credit by March, 1985 and 16% by March, 1987.

   d) **Weaker Section:** The advance to weaker section should reach a level of at least 25% of total priority sector advances by March, 1985.

2. Other Targets :

   a) **Credit-Deposit Ratio in Rural and Semi-Urban Branches:** The credit-deposit ratio of the bank at their rural and semi-urban branches should not be less than 80%.

   b) **DRI Scheme:** The bank should lend at least 1% of their total advances at the end of the previous year under the Differential Rate of Interest Scheme. Within this not less than 40% of the DRI advances should be given to SC and ST and not less than 66 2/3% of DRI advances should be granted through rural and semi-urban branches. The share of women beneficiaries shall not be less than 30%.
c) **Advances under IRDP:** The bank should not lend at least 30% of their IRDP advances to SC and ST.

**Weaker Section –**

Weaker section comprise the beneficiaries of the following categories –

1. Small and marginal farmers with land holding of 5 acres or less, landless laborers, tenant farmers and share coppers;

2. Artisans (irrespective of location) or small industrial activity (viz. manufacturing, processing, preservation and servicing) in villages and small towns with a population not exceeding 50,000;

3. Beneficiaries of Integrated Rural Development Program (IRDP)

4. SC and ST;

5. Beneficiaries of Differential Rate of Interest (DRI) scheme, and


### 3.11 Trends and Productivity of Advances (Lending):

**(#) Trends of Advances:**

Table 3.4 and chart 3.4 exhibits trend of advances in SBI during the study period, 2003-04 to 2012-13.

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<tbody>
<tr>
<td>Amount (in crore)</td>
<td>157934</td>
<td>202374</td>
<td>261642</td>
<td>337337</td>
<td>416768</td>
<td>542503</td>
<td>631914</td>
<td>756719</td>
<td>867579</td>
<td>1045616</td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
Advances of SBI registered an upward movement during the study period. It was ₹157934 crore in the base year which rose to ₹202374 crore in 2004-05, ₹261642 crore in 2005-06, ₹337337 crore in 2006-07, ₹416768 crore in 2007-08, ₹542503 crore in 2008-09, ₹631914 crore in 2009-10, ₹756719 crore in 2010-11, ₹867579 crore in 2011-12 and reached to the peak point of ₹1045616 crore at the end of the study period, 2012-13. Index on the base year was worked out to 562.06 percent at the end of the study period, 2012-13, which indicates that advances of SBI increased by 5.62 times over its base year.

(#) Productivity of Advances:

Productivity of Advances has been measured with basic input: number of employees and number of branches. They are depicted as:

(i) Advances per Employee

(ii) Advances per Branch
(i) Advances per Employee:

Advances per employee are productivity ratio. It measures the productivity of employee as input for advances as output. In other words, it is the relationship between advances and no. of employees. The following is the formula for calculation of advances per employee:

\[
\text{Advances per Employee} = \frac{\text{Advances}}{\text{No. of Employees}}
\]

Table 3.5 and chart 3.5 provides the data of advances per employee of SBI for the study period i.e. 2003-04 to 2012-13.

**Table 3.5**

**Advances per Employee**

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<tbody>
<tr>
<td>Amount (in crore)</td>
<td>0.76</td>
<td>0.98</td>
<td>1.32</td>
<td>1.78</td>
<td>2.33</td>
<td>2.63</td>
<td>3.15</td>
<td>3.39</td>
<td>4.03</td>
<td>4.58</td>
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</table>

(Source: Annual Reports of SBI)
Advances per employee of SBI were ₹ 0.76 crore for the base year 2003-04. It showed upward movement during the study period. It reached to ₹ 0.98 crore, ₹ 1.32 crore, ₹ 1.78 crore, ₹ 2.33 crore and ₹ 2.63 crore in the years 2004-05, 2005-06, 2006-07, 2007-08 and 2008-09 respectively. It reached to ₹ 3.15 crore in 2009-10 to ₹ 3.39 crore in 2010-11, to ₹ 4.03 crore in 2011-12 and reached at the peak point of ₹ 4.58 crore at the end of the study period, 2012-13. Aggregate of it was worked out to ₹ 24.95 crore which indicates that SBI advances on an average ₹ 2.495 crore during the study period.

(ii) **Advances per Branch:**

Advances per branch are productivity ratio. It measures the productivity of branch as input to advances as output. Thus, it is the relationship between advances and branch. The following formula is applied for calculation of the ratio:

\[
\text{Advances per Branch} = \frac{\text{Advances}}{\text{No. of branches}}
\]

Table 3.6 and chart 3.6 provides the data of advances per branch of SBI for the study period from 2003-04 to 2012-13.

**Table 3.6**

**Advances per Branch**

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<tbody>
<tr>
<td>Amount</td>
<td>17.36</td>
<td>22.10</td>
<td>28.29</td>
<td>36.22</td>
<td>40.58</td>
<td>47.01</td>
<td>50.00</td>
<td>55.24</td>
<td>60.80</td>
<td>69.70</td>
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<tr>
<td>(in crore)</td>
<td></td>
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</table>

(Source: Calculated by researcher himself from table no. 1.4 & 1.6)
Advances per branch of SBI were ₹ 17.36 crore for the base year, 2003-04, which registered upward movement during the study period i.e. 2003-04 to 2012-13. It reached to ₹ 22.10 crore in 2004-05, ₹ 28.29 crore in 2005-06, ₹ 36.22 crore in 2006-07, ₹ 40.58 crore in 2007-08, ₹ 47.01 crore in 2008-09, ₹ 50.00 crore in 2009-10, ₹ 55.24 crore in 2010-11, ₹ 60.80 crore in 2011-12 and reached to the peak point of ₹ 69.70 crore at the end of the study period, 2012-13. Average of the ratio was worked out to ₹ 42.73 crore for the study period, which indicates that the bank made advances of ₹ 427.3 crore aggregately for the study period.

3.12 Advances:

Advancing of loans is the second important function of bank which facilitates the flow of credit to economic activities. Bank generates the major portion of their income through advancing of loans. A loan is defined as an arrangement in which a lender gives money or property to a borrower and the borrower agrees to return the property or repay the money, usually along with interest, at some future point(s) in time. Usually, there is a predetermined time for repaying a loan, and generally, the lender has to bear the risk...
that the borrower may not repay a loan (though modern capital markets have developed many ways of managing this risk).\textsuperscript{12} The credit deployed by bank is based on the deposits mobilized from the public. After keeping a portion of deposits in cash reserve and highly liquid assets, bank deploy the residual funds in various sources or in profitable avenues. They give short term loans, long term loans to the public and invest some funds in money market.

3.13 Credit-Deposit Ratio:

The flow of credit is one of the key instruments to regulate various economic activities. The amount of credit deployed by bank is based on the deposits mobilized from the public after keeping some portion for statutory requirements prescribed by RBI from time to time. Credit Deposit Ratio (CDR) is the ratio between the deposits and advances made by the bank during a given period expressed in terms of percentage.\textsuperscript{13} In 1980, Reserve Bank of India (RBI) first advised bank to achieve a CDR of 60 per cent in their rural and semi urban branches on a continuing basis.\textsuperscript{14} The CDR has become more important after nationalization of bank to assess the extent of deployment of credit by bank to benefit the economy in general and targeted group in particular. In the words of RBI Governor D. Subbarao in January 2011 highlighting the need for lower incremental CD ratio, “We told their boards that they must increase their deposits, must restrain their credit and that credit and deposit growth have to be aligned.”\textsuperscript{15}

\begin{itemize}
\item[\textsuperscript{12}] http://www.investerwords.com/2858/loan.html#ixzz28LJMmTIO
\item[\textsuperscript{13}] Kanagasabai.S, op. cit., Dec1999. Pp-159
\item[\textsuperscript{14}] Thorat Y.S.P. and Graham A.N. Wright, The Credit-Deposit Ratio-Time for a Re-Think? , Micro Save India Focus Note3, www.Microsave.org
\item[\textsuperscript{15}] Sunny Verma, Reserve Bank wants to reduce C-D ratio, Financial Express, 29.04.2011.
\end{itemize}
3.14 Loanable Funds:
The supply of credit could be considered to be an increasing function of bank deposits. Increase in bank reserves would prompt bank to advance more credit. In India, the demand on resources of the bank is a complex mixture of statutory, administered and normal.

Under the direction of the RBI, the bank is required to maintain two reserve ratios, viz. Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). For CRR the bank have to hold a specific part of their deposits in the form of cash balances with the RBI. Up to 1970s the CRR was around 5 % but since then up to the introduction of financial sector reforms, there have been steep increase and it reached 15 % in 1991, CRR was 4.5 % on June 14, 2003 and SLR was 25 %. For SLR the bank have to hold a specific portion of their deposits in the form of government and other approved securities. By law the upper limit of SLR is 40 %. The SLR increased from 25 % in 1970 to 38.5 % in 1991. At the time of implementation of financial sector reforms, fifty three rupees out of every one hundred rupees deposits were required to be maintained as statutory reserves (in the form of CRR and SLR) which carried considerably lower interest rates than were available on commercial advances and they could barely cover even the cost of funds. After statutory pre-emption, from the remaining amount of about ₹ 47, out of every hundred rupees the bank was directed to lend a sizable part of their lending to certain priority sectors at concessional rates of interest, it being 33 % of total advances in the

initial period and 40% in subsequent period. From the balance of ₹ 47, 40% (or about ₹ 18.80) of total lending is required to lend to the priority sectors or preferred sectors at concessional rates of interest. Food credit and export credit claimed ten rupees more. The bank therefore was left with only about ₹ 18 to be lent at will. Thus, a sizable portion of bank resources was virtually taken out as bank discretion regarding deployment of funds.17

3.15 Comparative Study of Deposits and Advances:

Bank provides loans and advances from deposits only. Here, comparative study of deposits and advances is significant to measure the efficiency of bank.

Table 3.7 and chart 3.7 exhibits comparative study of deposits and advances, ratio of advances to deposits of SBI during the study period 2003-04 to 2012-13.

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</thead>
<tbody>
<tr>
<td>Deposits (in crore)</td>
<td>318619</td>
<td>367048</td>
<td>380046</td>
<td>435521</td>
<td>537404</td>
<td>742073</td>
<td>804116</td>
<td>933933</td>
<td>1043647</td>
<td>1202739</td>
</tr>
<tr>
<td>Advances (in crore)</td>
<td>157934</td>
<td>202374</td>
<td>261642</td>
<td>337337</td>
<td>416768</td>
<td>542503</td>
<td>631914</td>
<td>756719</td>
<td>867579</td>
<td>1045616</td>
</tr>
<tr>
<td>Ratio of Adv-Dep (in %)</td>
<td>49.56</td>
<td>55.13</td>
<td>68.84</td>
<td>77.46</td>
<td>77.55</td>
<td>73.11</td>
<td>78.58</td>
<td>81.02</td>
<td>83.13</td>
<td>86.94</td>
</tr>
</tbody>
</table>

Deposits and advances (individually) of State Bank of India registered an upward movement during the study period. Deposits were ₹ 318619 crore while advances were only ₹ 157934 crore in the base year. The ratio of advances to deposits was worked out to 49.56%, which indicates that against ₹ 100 as deposits, the bank provided advances of ₹ 56 only in the base year. For the subsequent year 2004-05, the ratio was worked out to 55.13 %. The ratio of advances to deposits went up in the subsequent year to 68.84 % in 2005-06, 77.46 % in 2006-07, 77.55 % in 2007-08, and 73.11 % in 2008-09 and to 78.58 % in 2009-10. It moved up to 81.02 % in 2010-11, to 83.13 % in 2011-12 and to 86.94 % in 2012-13. Average of the ratio was worked out to 73.13 % for the study period, which indicates that against aggregate deposits of ₹ 100 SBI provided advances on an average of ₹ 73 only.

3.16 Problems of Lending:
1) Cost - In addition to interest various fees may be charged. Such fees differ between types of loan and depend upon the lender’s assessment of the risk they are accepting in lending the money. A range of fees may be charged. Possibilities include:
➢ Arrangement fees for making the relevant facility available,
➢ Commitment/non-utilization fees for allocating funds to the facility which might otherwise have been used elsewhere
➢ (For large loans) syndication fees to the agent bank, arranger, bank underwriting & lending fees and to their professional advisers engaged to advice in relation to the facility
➢ Prepayment fees for repaying the loan early
➢ Drop-dead fees covering the expenses of a prospective lender (such as professional fees) whether or not a facility is provided

The likely overall level of cost should be carefully considered. In broad terms the lower the cost the less flexible the facility is likely to be, but a more flexible arrangement may be more appropriate for the borrower. Such flexibility may justify the additional cost.

2) Repayment Terms - The period for repayment should match the requirements and abilities of the borrower. Where the borrower opts for a term facility, the repayments required under it should coincide with the security. The stability of the funding is also relevant here. The more easily the lender can call in the loan the more carefully the proposed repayment profile needs to be considered. If the borrower anticipates that there may be circumstances when he would wish to repay a term loan early, early repayment can occur under the terms of documentation.

3) Security - The lender (bank) may (and these days probably will) require some form of security. It will differ depending upon the status of the borrower and the prospective lender’s attitude to risk. The most common security required by lender is a charge over
the borrower’s assets. This means that all the assets of the borrower are potentially available to the lender to be sold, should the loan not be repaid as required. In many cases borrowers will have few assets and will be assessed by the lender as a poor credit risk. Accordingly, the lender would commonly then ask for additional personal security in the form of guarantees or security over personal assets, such as home or life policies.

4) Undertakings - Depending upon the nature of the facility (loan), extensive representations, warranties and covenants may be included. A warranty is a contractual promise that the documents are true. A representation is a promise that the lender can rely on when deciding whether to lend. In both cases the lender can sue the borrower, should such a warranty or representation turn out to be untrue.

5) Default - Put simply, a default is a breach of the terms of the agreement. While a default could relate to any breach, in most cases the documentation specifically sets out what will constitute an event of default. Chief amongst these will be breaches of the undertakings and restrictions imposed on the borrower. Once an event of default has occurred the agreement will prescribe what action the lender may then take to protect its position.

3.17 Role of Bank Advances in Economic Development:

The lending funds are by far the most important among all the portfolio items of a bank. The advances constitute the backbone of the banking system. The strength of the banking system primarily depends upon the soundness of the advances. Bank lending is very much important to the economy as it makes possible financing in different
productive activities of the economy of the country. Advances also play an important role in the gross earnings and net profits of the bank & also in promoting economic development of a country since there can be no development in the absence of finance\(^{18}\). The basic function of credit is to enable borrowers to purchase goods and services ahead of their ability or desire to pay. Demand for credit arises because of time-consuming nature of the productive and distributive processes. Consumer demands for credit to acquire goods in advance for which they are able to pay in future. The major role of bank is, indeed deployment of savings of the community for its benefits as also for increasing productivity, production and employment. The loans are given to industries mainly for working capital needs and partly for fixed investment purposes. Moreover, bank plays a significant role in the economic growth of country. Through their intermediation function bank play a vital role in the efficient allocation of resources of country by mobilizing resources for productive activities. They transfer funds from those who don’t have productive use of it to those with productive venture.

**Conclusion:** Capital is an essential input for production and it is a means of development. The capital formation involves three distinct interdependent activities viz., savings, finance and investment. For a developing economy capital formation at a high rate is must, but capital formation depends upon the rate of saving.

From the above study it is clear that deposits in State Bank of India registered an upward trend during the study period. It was ₹ 318619 crore in the base year 2003-04 which rose to ₹ 1202739 crore at the end of the study period 2012-13.

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It shows that it has increased at considerably high rate during the study period and registered 2.77 times growth over the base year. Also the deposits per employee and deposits per branch have consistently a high growth rate. Similarly the advances showed an increasing rate during the study period. It was ₹ 157934 crore in the base year which rose to ₹ 1045616 crore at the end of the study period, 2012-13. Increasing by 6.62 times growth over the base year in advances shows that the SBI is performing a significant role in this regard. Advances per employee and advances per branch also show an upward movement during the study period.

Deposits and advances (individually) of SBI registered an upward movement during the whole of the study period. Deposits were ₹ 318619 crore while advances were only ₹ 157934 crore in the base year. The ratio of advances to deposits was worked out to 49.56%, which indicates against ₹ 100 as deposits, the bank provided advances of ₹ 56 only in the base year. In addition the deposits & investments of SBI were contributing in the same direction to the general economy of the country.
CHAPTER 4

INVESTMENT PATTERN OF STATE BANK OF INDIA

4.1 INTRODUCTION:

If deposit mobilization is priority as well as number one function and aim of every bank, no less important is its investment pattern. After holding up funds in its stock and abiding by the periodically fixed levels under CRR and SLR (as directed by the central bank, meaning thereby the Reserve Bank of India, in case of India) every bank is unsparingly and unexceptionally required its residual funds in ventures that need such investment as per the social, economic, commercial and industrial-cum-infrastructural needs of the country.

The term investment is to be of economic sense. Economically investment means to lay money for the purpose of development. However, the bankers, monetary authorities & students of banking describe it as a part of assets of bank. Investments are in the nature of procurement of funds for productive purpose. “In a way, investment is the planned, need-based, target-based, often clear-vision, balanced and directional channelization of bank. It is needful, operational and result oriented”¹ A Banking Sector performs three primary function in economy; the operation of the payment system, the mobilization of savings and the allocation of saving to investment products²

1. S. Subramanian; “Investment Pattern of Commercial Banks in India”, southern economist, September 2001, p.14
Investments of bank deposits are the channel that serve industry, agriculture and serves the best needs of economic growth and national prospects. As dry patches of cultivatable land need timely water for irrigation at the proper time with sumptuous quantity, so do industry, infrastructure and growth-avenues need investment for their production function in terms of progress and stability.

It goes undisputed that even the most fertile, congenial and growth-prone patch of cultivatable land may be, with the passage of acme, go churlish and sterile for want of much needed timely investment in terms of water, seed and cultivation. Proper calculated, planned and well-directed investment of bank deposits in furrows that grow up to bumper crops of economic growth, progress and stability serves the best of the economy. The objective of investment of a commercial bank is to provide the bank with safety of funds. More so LIC, GIC, UTI, Commercial banks and Merchant Bankers are playing an important role in the investment portfolio management and strengthening the capital market to of the country promote financial growth.

The investment portfolio of bank as depicted by their published accounts, consist of mainly government securities and other domestic investments. Government securities comprise both domestic government securities & foreign government securities issued by the central government, state government, treasury saving, deposits certificates and postal obligations. Other domestic investment include other trustee securities, fixed deposits with other banks, shares and debentures of corporate bodies, real estate, bullion, Units of UTI and other such types of investments.
4.2 FINANCIAL & ECONOMIC MEANING OF INVESTMENT:

Investment is the employment of funds with the aim of achieving additional income or growth in value. The essential quality of income is that, it involves ‘waiting’ for a reward. It involves the commitment of resources which have been saved or put away from current consumption in the hope that some benefits will occur in future. The term ‘investment’ does not appear to be simple as it has been defined. Investment has been categorized by financial experts and economists. It has also often been confused with the term speculation. Investment is the allocation of monetary resources to assets that expected to yield some gain or positive return over a given period of time. These assets range from safety investment to risky investment. Investments in this form are also called ‘financial investment’.

According to some of the economists, ‘investment’ means the net addition to the economy’s capital stock which consists of goods and services that are used in the production of other goods and services. In this context the term investment implies the introduction of new and productive capital in the form of new construction, new producers’ durable equipment such as plant and equipment, inventories and human capital are included in the economist’s definition of investment. In simple words investment means buying securities or other monetary or paper (financial) assets in the money market or capital markets, or in fairly liquid real assets, such as gold as an investment, real estate or collectibles. Types of financial investments include shares or other equity investment, bonds etc. These investment assets are then expected to
provide income or positive future cash flows, but may increase or decrease in value giving the investor capital gains or losses.

4.2.1 OBJECTIVES OF INVESTMENT:

In recent years, the development banks have acquired an important place in our financial system, while commercial banks, LIC, UTI etc. have been channelizing savings from household, government and corporate sector. They long with other development banks make funds available through their investing and lending corporate activities to borrower individuals, corporate sector and to the governments. In so doing they facilitate both the flow of goods and services from producers to consumers and the financial activities of governments. Thus they accelerate the process of development and growth of the economy. The objective of investment of bank is to provide the bank with safety of funds, more importantly; assets of investment must meet a liquidity test. A bank’s investment policies are influenced by the growth rate of the economic and monetary policy of the country. In other words the main objectives of investment portfolio are:-

a) To provide a steady income ;
b) To ensure recovery of the principal amounts and interest their on
c) To maximize return on investment ;
d) To obtain modern capital gains ;
e) To aid the process of economic development.
4.2.2 IMPORATNCE OF INVESTMENT:

Some factors that have made investment increasingly important and useful in the context of present day conditions are -:

a) **Longer life expectancy** – People retire between the ages of 50 - 60 years, and the trends show longer life expectancy. People should put away a portion of the earnings from employment as savings which must be invested in such a way that after retirement they are able to have a stable income. Increase in working population, proper planning for life span and longevity have ensured the need for balanced investment.

b) **Increasing rate of taxation**: Taxation is a crucial factor which introduces an element of compulsion in a person’s savings. Various forms of savings outlets used as investment help in bringing down the level of taxation by offering deductions in personal income. Benefits in taxes accruing from investments in units of UTI, ULIP, LIC, NSC, KVP etc.

c) **Interest rates**: An investor has to include in his portfolio several kinds of investments. For a sound investment plan, the high level of interest rates is as important as stability of interest. Interest rates may vary between risky and safe investments, as also due to different benefits schemes offered by the investments. An investor must consider these aspects before allocating any amount for investment and ensure that he is getting an acceptable return commensurate with the risks that are taken.
d) **Inflation:** The investor will have to find out an outlet which gives him a high return to cover any reduction in interest due to inflation, and which will also ensure safety of principal. Besides, an investor has to always bear in mind that increased return through investment should not unduly increases his tax burden. Otherwise, the benefits derived from increased return will be neutralized by an increase in taxation.

e) **Income:** The general increase in employment opportunities in India after independence has given rise to both male and female working class. More income and more avenues of investment have led to the ability and willingness of the people to save and invest their funds.

f) **Investment channels:** The economic development of the country has led to the introduction of vast array of investment outlets and investors have the choice of a variety of instruments. The investor in his choice of suitable investment channels will have to try to achieve a proper mix between high rate of return and stability of return to reap the benefits of both.

**4.2.3 INVESTMENT POLICY OF BANK:**

A bank makes investments for the purpose of earning profits. First it keeps primary and secondary reserves to meet its liquidity requirements. This is essential to satisfy the credit needs of the society by granting short-term loans to its customers. Whatever is left with the bank after making advances is invested for long period to improve its earning capacity. Before discussing the investment policy of a bank (including all SCBs
as well as SBI) it is instructive to distinguish between a loan and an investment because the usual practice is to regard the two as synonymous. The bank gives a loan to a customer for a short period on condition of repayment. It is the customer who asks for the loan. By advancing a loan, the bank creates credit which is a temporary source of fund for the bank. An investment by the bank, on the other hand, is the outlay of its funds for a long period without creating any credit. A bank makes investments in government securities and in the stocks of large reputed industrial concerns, while in the case of a loan the bank advances money against recognized securities and bills. However, the goal of both is to increase its earnings. The investment policy of a bank consists of earning high returns on its resources. But it has to keep in view the safety and liquidity of its resources so as to meet the potential demand of its customers. Since the objective of profitability conflicts with those of safety and liquidity, the wise investment policy is to strike a judicious balance among them. Therefore, a bank should lay down its investment policy in such a manner so as to ensure the safety and liquidity of its funds and at the same time maximize its profits. This requires adherence to certain principles. In compliance of the instructions issued by the Reserve Bank of India, the revised Investment Policy of the Bank will be as under:

1. **Mandatory Investment:** In terms of mandatory requirement of Banking Regulation Act, it is compulsory to invest minimum 3% as Cash Reserve Fund (CRR) & 25% as Statutory Liquid Reserve (SLR). Investment in Govt. & other asset will be treated normal. Up to 31.03.2011, SLR will be 15% and from 01.04.2011, it will be necessary to maintain up to 25%.
2. **Loans & Advances**: Bank can invest up to 75% of their own funds and up to 70% of total deposits in loans & advances, out of which after observing the prescribed norms for priority sector & weaker section of the society, remaining portion can be advanced as per Loan Policy of the Bank keeping in view the ceiling of maximum amount of advance to a single person, similar type of business & on similar type of securities to minimize the risk involved.

3. **Investment with other Citizen Co-operative Banks**: Bank will not make any investment with these Banks except undertaking normal transactions in the accounts opened for clearing and transfer of funds purpose.

4. **Investment in other Banks**: Bank may invest its surplus funds in any commercial, private & cooperative Banks but if any such bank provides considerably higher rate of interest then its financial position has to be analyzed. Investment of the liquid surplus funds from time to time has to be made in such a way that there should not be any difficulty in meeting out the funds requirement for daily clearing adjustment as well as payment of the deposits on due dates of maturity.

5. **Investment in NON- SLR Debt Securities**: In compliance of the instructions issued by the Reserve Bank of India from time to time and also keeping in view the additional income on investment and safety of surplus funds, investment may be made in Liquid Funds enjoying good market credit rating and also trading in Government Securities. In this connection Board of Directors keeping in view the circumstances prevailing at that time may fix a limit for the purpose, take a decision in the matter of investment and delegate powers to the Managing Director for
investment to a certain extent at one time. Investment will be made with the institutions which are enjoying AAA credit rating. Such investment will not exceed 10% of the total deposits of the Bank.

6. **Investment in other Institutions, Corporations & Companies:** Bank will not invest its surplus funds in any other institution, company, corporation etc. whatsoever be the attractive rate of interest.

7. **Investment in Share Money of Cooperative Institutions:** Bank may invest 2% of its personal funds in the share money of the Cooperative Institutions but it will be in accordance of the directives of the Reserve Bank of India.

8. **Investment in Private Companies:** Bank will not make any investment in private companies or in the Shares / Debentures of other institutions other than Cooperative Institutions.

9. **Investment in Government Securities:** “Government Securities” will mean securities issued by the Central & State Governments.

10. **Cash Management:** Except in abnormal conditions, cash balance in the Bank will be kept within the fixed limit as excess cash is useless and will affect the profitability of the bank.

11. Besides the above day to day asset, liability management should be prepared in such a way that after complying with the mandatory requirements of RBI, Bank should earn maximum profit.
12. No amendments/ modification in the provisions of the sanctioned Investment policy will be made without the Board of Directors.

13. In the process of investment, in no circumstances provisions of the Reserve Bank of India will be violated.

4.3 IMPACT OF CAPITAL MARKET & MONEY MARKET ON INVESTMENT POLICY OF BANK:

- CAPITAL MARKET:

  Capital markets are perhaps the most widely followed markets. Both, the stock and bond markets are closely followed and their daily movements are analyzed as proxies for the general economic condition of the world markets. As a result, the institutions operating in capital markets - stock exchanges, commercial banks and all types of corporations, including non-banking institutions such as insurance companies and mortgage banks; are carefully scrutinized.

  The capital market actually consists of two markets. The first market is the primary market, where new issues are distributed to investors; and the second one is secondary market where existing securities are traded. Both of these markets are regulated so that fraud does not occur and in India SEBI is in charge of regulating the capital market.

- CAPITAL MARKET AND ECONOMIC GROWTH:

  In principle, the capital (stock) market is expected to accelerate economic growth, by providing a boost to domestic savings and increasing the quantity and the quality of
investment. The market is expected to encourage savings by providing individuals with an additional financial instrument that may better meet their risk preferences and liquidity needs. Better savings mobilization may increase the saving rate. The capital market also provides an avenue for growing companies to raise capital at lower cost. In addition, companies in countries with developed stock market are less dependent on bank financing, which can reduce the risk of credit crunch. The capital market therefore is able to positively influence economic growth through encouraging savings among individuals and providing avenues for firm financing.

Based on the performance of capital market in accelerating economic growth, government tends to have keen interest in its performance. The concern is for sustained confidence in the market and for a strong investor’s protection arrangement. Economic growth is generally agreed to indicate development in an economy, because it transforms a country from a five percent saver to a fifteen percent saver. Thus it is argued that for capital market to contribute or impact on the economic growth, it must operate efficiently. Most often, where the market operate efficiently, confidence will be generated in the minds of the public and investors will be willing to part with hard earned funds and invest them in securities with the hope that in future they will recoup their investments.

In another exposition, capital market requires a lot of local and foreign investments to attain sustainable economic growth and development. The capital market provides a means through which this is made possible. Capital market provides the opportunities for the purchase and sale of existing securities among investors thereby encouraging the populace to invest in securities fostering economic growth.
Capital markets influence economic growth through a number of channels such as liquidity, risk diversification, providing information for companies, corporate governance and the mobilization of savings. Countries with developed capital markets have shown greater GDP growth compared with countries without capital markets. Risk index and the level of income of a country are the best indicators of functioning capital market. The higher the risk index and the lower level of income, the more dysfunctional will be the capital market and vice versa.

The capital market plays a very important role in promoting economic growth through the mobilization of long-term savings and the savings get invested in the economy for productive purpose. This enables to bridge the gap between investment and savings and paves the way for economic development. The capital market in India is a well-integrated structure and its components include stock exchanges, developed banks, investment trusts, insurance corporations and provident fund organization. It caters to the varied needs for capital of agriculture, industrial and trading sectors of the economy.

- **FLUCTUATIONS OF STOCK MARKET:**

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<th>Low</th>
<th>Close</th>
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<td>21222.19</td>
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<td>9720.55</td>
<td>17530.94</td>
<td>8047.17</td>
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<td>2008</td>
<td>20325.27</td>
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<td>3383.85</td>
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(Source: http://www.moneycontrol.com/stocks/histstock.php)

**MONEY MARKET:**

The money market is often accessed alongside the capital markets. While investors are willing to take on more risk and have patience to invest in capital markets, money markets are a good place to "park" funds that are needed in a shorter time period - usually one year or less. The financial instruments used in capital markets include stocks and bonds, but the instruments used in the money markets include certificates of deposits, bankers' acceptance, repurchase agreements, commercial paper, collateral loans and bills of exchange to name a few. Institutions operating in money markets are central banks, commercial banks and acceptance houses among others.

Investors, on the other hand, use the money markets to invest funds in a safe manner. Unlike capital markets, money markets are considered as low risk market; risk-adverse investors are willing to access them with the anticipation that liquidity is readily available. Older individuals living on a fixed income often use the money markets because of the safety associated with these types of investments.
**- THE INDIAN MONEY MARKET:**

Money Market is a mechanism whereby on the one hand borrowers manage to obtain short-term loanable funds and on the other hand, lenders succeed in getting credit worthy borrowers for their money. In Money Market, bank is the most important lenders. These bank are not merely lenders of money, they also create credit. Now the Indian Money Market is perhaps one of the most organized Money Market, in spite of all its limitations and defects. The reserve Bank of India is the apex organization in the Money Market. Since it is the controller of Money Market, it has great responsibility in respect of smooth functioning of the Financial Market.

**- GROWTH OF MONEY MARKET IN INDIA:**

While the need for long term financing is met by the capital market, money market is a mechanism which deals with lending and borrowing of short term funds. Post reforms period in India has witnessed tremendous growth of the Indian money markets. Bank and other financial institutions have been able to meet the high expectations of short term funding of important sectors like industry, services and agricultural sector. Functioning under the regulation and control of the Reserve Bank of India (RBI), the Indian money markets have also exhibited the required maturity and resilience over the past about two decades. Decision of the government to allow to the bank to operate has provided much needed healthy competition in the money markets, resulting in fair amount of improvement in their functioning.³

³ www.euroasiapub.org
CRR AND SLR: AN INTRODUCTION

Under the direction of the RBI, the bank is required to maintain two reserve ratios, viz. Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). For CRR the bank have to hold a specific part of their deposits in the form of cash balances with the RBI and for SLR the bank have to hold a specific portion of their deposits in the form of government and other approved securities.

The main reason to maintain the CRR is to keep a bank liquid at any point of time. Whenever bank keeps low CRR it increases the availability of the money with the bank for credit in the system. This eases the pressure on interest rates and interest rates goes down. And also when the money is available with the bank and if it is ready to give the loan to the different industries at lower interest rate it directly adds fuel to the economy growth. Whenever the RBI increases CRR the amount at the bank comes down automatically. Generally CRR is maintained by RBI to control the liquidity in the market and to control the inflation. If there is any increase is CRR it slows down the growth of the economy.

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<tr>
<td>CRR</td>
<td>Min 4.50</td>
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Source: (www.allbankingsolutions.com/Banking-Tutor/Chronology-CRR-Rate-India.shtml)
The table shows that to maintain the liquidity at all the time in the bank, RBI changes the CRR from time to time. The main reason to maintain the CRR is to keep a bank liquid at any point of time. From the period 2003-04 to 2012-13 it is changed by RBI several times. In the base year i.e. 2003-04 the minimum CRR rate was 4.5 % and the maximum rate was also the same. In the year 2004-05 it was 4.75 to 5.00, while in the immediate next year there was no change in CRR.

In the year 2007-08 the RBI changed the CRR many times like 5.50, 5.75, 6.00, 6.25, 6.50, 7.00 & 7.50 %. The minimum rate of CRR was 5.50 %& the maximum rate was 7.50 % as shown by the table. Similarly in the year 2008-09 it was 7.75, 8.00, 8.25, 8.50, 8.75, 9.00, 7.50, 6.50, 6.00 and 5.50 %. In this year the minimum rate of CRR was 5.50 % and the maximum rate of CRR was 9.00 %.

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<td>SLR</td>
<td>Min</td>
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| Source: (www.allbankingsolutions.com/Banking-Tutor/Chronology-SLR-Rate-India.shtml)

Statutory Liquidity Ratio (SLR)is the ratio up to which the bank has to hold a specific portion of their deposits in the form of government and other approved securities. Prior to the year 2008-09 the SLR was changed in the year 1997-98 on 25 October 1997. In the year 2008-09 it was 24 % and in the year 2009-10 it increased to 25 %. There was no change in SLR in the year 2010-11, while in the year 2011-12 and 2012-13 it was 23 % and 22.5 % respectively.
- **IMPACT OF CRR ON INDIAN ECONOMY:**

1. **Impact on Interest Rates:** Interest rates are the cost of the loan. If there is any hike in the CRR the bank must deposit more amount of cash with RBI, or if there is any decrease in CRR the bank will deposit less amount of cash with RBI. Due to the changes in CRR bank may have more or less cash for lending.

2. **Impact on the Investment:** Firms operating in the economy needs money for expansion and for various purposes. If interest rates are high due to increase in CRR, the firms may not get money from the bank. Due to this, growth of the economy slows down.

3. **Impact on Common Public:** Public might take loan for availing some services. Due to high interest rates public may consume less. If CRR is increased the public will consume less and will have direct impact on GDP.

4. **Impact on Exports and Imports:** If interest rates are high firms will consume fewer amounts and they reduced their expansion plans, it makes the production of goods and services low. Since the production has decreased, People will purchase from foreign markets to get their desired products. Imports will increase and exports decreases, ultimately put downward pressure on GDP by reducing Exports.

- **IMPACT OF CRR ON STOCK MARKETS:**

Hikes in CRR leading to raise interest rates have several implications including slowing down the overall growth in the economy; this effectively means that demand for goods
and services and investment activity gets adversely affected. Since some investors tend to leverage and invest in the stock markets, higher interest rates increase the expectation of returns from the stock markets; this has the impact of lowering current stock prices.

In Indian equity markets there are three levels of macro risk; a high P/E, a relatively overvalued rupee and interest rates that have stayed relatively low considering the level of economic growth, and we associate these things with growth. The P/E multiples are high because growth is strong, the rupee has been firm because strong growth has attracted capital and that capital has helped keep interest rates low. With CRR hike, RBI is about to end the growth parity and if growth begins to slow down then it is likely to have a lower P/E, a low rupee and a potentially higher interest rates.

A cut in CRR would lead to a fall in interest rate. A fall in interest rates would make savings in bank unattractive. Thus, depositors may move to the stock market. Thus a reduction in CRR would boost the securities prices and players are also expecting the Government to align the savings rate to the same structural levels.

- **INTEREST RATES:**

How many of us would invest in stock markets if our bank would pay 12% interest in fixed deposits? Many of us will prefer to deposit money in that bank than invest in stocks (as well as mutual funds). Why? Because, we have the opportunity to earn high returns at very low risk. As a result, funds move out of stock market affecting the stock markets adversely.
- THE IMPACT OF HIGHER AND LOWER INTEREST RATES:

After reading the above paragraph, some of the persons might have thought that it would be great to get a 12% risk free return annually. Unfortunately, that’s not the case. If the bank is paying 12% interest, it would have to charge its customers anywhere from 15% to 18% on their loans. (Here Customers means anyone who borrows money from bank including big corporates, small and medium enterprises, farmers and individuals). This, in turn, will result in higher borrowing costs for them and thereby disturbs the overall profitability. A drop in profits would result in stock prices coming down. If interest rate continues to rise for a longer duration then it will have an all-round negative impact on the economy, leading it into a recessionary mode. For example – farmers who borrow money at higher interest rates to buy land, fertilizers, seeds, tractors etc. would find it difficult to improve agricultural productivity to match up with the rising costs. Since agriculture is the backbone of Indian economy, high interest rate would act as a roadblock to the entire growth process.

When the interest rate is very low, the persons would be obviously saving less and consuming more. The fixed deposits are no longer attractive. This would leave the bank with much lower money to lend out to the borrowers, and their profit margins would also be affected by lower interest rate. Thus there would be fall in consumption & investment activities in the economy. The government in this situation would resort to printing of currency to infuse more money in the economy. This would lead to inflationary situation in the country. Also, FIIs pace their decision on the basis of difference in interest rates between economies among other things. At very low interest rate the inflows are likely to be reduced.
So, what a country like ours needs is a balance between high and low interest rates. Interest rates can’t go high and it cannot be very low. A moderate inflation & interest rate over a period of time will keep the bank, business community and the consumers happy.

- INTEREST RATES AND STOCK MARKETS:

Having explained so far, it clears about the relation between interest rates and stock markets. They are inversely related. As the interest rates go up, stock market activities tend to come down. The following points are also worth taking note-

- Capital intensive industries would be most affected by high interest rates but when the interest rates are lower than they would be gaining the most. It is better to avoid investments in sectors such as real estate, automobiles etc. when the interest rates are rising.

- Companies with a high amount of loans in their balance sheets would be affected very seriously with high interest rates. Interest cost on existing debt would go up affecting their EPS and ultimately the stock prices. But during low interest rate these companies would stand to gain.

- Sectors like Pharmaceutical and IT are less affected by the change in interest rates. The IT sector is more influenced by factors such as currency rate fluctuations, rising attrition level, visa restrictions, competition from the large global players and margin pressures. Certainly, IT sectors are not interest rate-sensitive. Pharmaceutical is considered as the defensive sector and investors can invest here during uncertain and volatile market conditions.
• In a high interest rate scenario, companies with zero or near zero debts in their balance sheets would be kings. FMCG or Fast Moving Consumer Goods is one of the sectors that are considered as a defensive sector due to its low debt nature.

• Banking sector is likely to benefit most due to high interest rates. The Net Interest Margins (It is the difference between the interest they earn on the money they lend and the interest they pay to the depositors) for bank is likely to increase leading to growth in profits & the stock prices.

4.4 PRINCIPLES OF INVESTMENT POLICY OF BANK:

Investment is the sacrifice of certain present value for the uncertain future reward. It entails arriving at numerous decisions such as type, mix, amount, timing, grade etc. of investment and disinvestment. Further such decision making has not only to be continuous but rational too. The financial position of a bank is reflected in its balance sheet. The balance sheet is a statement of the assets and liabilities of the bank. The assets of the bank are distributed in accordance with certain guiding principles. These principles underline the investment policy of the bank. They are discussed below:

1. Liquidity: In the context of the balance sheet of a bank the term liquidity has two interpretations. First, it refers to the ability of the bank to honor the claims of the depositors. Second, it connotes the ability of the bank to convert its non-cash assets into cash easily and without loss. It is a well-known fact that a bank deals in funds belonging to the public. Hence, the bank should always be on its guard
in handling these funds. The bank should always have enough cash to meet the demands of the depositors. In fact, the success of a bank depends to a considerable extent upon the degree of confidence it can instill in the minds of its depositors. If the depositors lose confidence in the integrity of their bank, the very existence of the bank will be at stake. So, the bank should always be prepared to meet the claims of the depositors by having enough cash. Among the various items on the assets side of the balance sheet, cash on hand represents the most liquid asset. Next come cash with other banks and the central bank. The order of liquidity goes on descending. Liquidity also means the ability of the bank to convert its non-cash assets into cash easily and without loss. The bank cannot have all its assets in the form of cash because each is an idle asset which does not fetch any return to the bank. So some of the assets of the bank, money at call and short notice, bills discounted, etc. could be made liquid easily and without loss.

2. **Profitability:** A bank by definition is a profit hunting institution. The bank has to earn profit to earn income to pay salaries to the staff, interest to the depositors, dividend to the shareholders and to meet the day-to-day expenditure. Since cash is the least profitable asset to the bank, there is no point in keeping all the assets in the form of cash on hand. The bank has got to earn income. Hence, some of the items on the assets side are profit yielding assets. They include money at call and short notice, bills discounted, investments, loans and advances, etc. Loans and advances, though the least liquid asset, constitute the most profitable asset to the bank. Much of the income of the bank accrues by way of interest charged
on loans and advances. But, the bank has to be highly discreet while advancing loans.

3. **Safety or Security:** Apart from liquidity and profitability, the bank should look to the principle of safety of its funds also for its smooth working. While advancing loans, it is necessary that the bank should consider the three ‘C’s of credit character, capacity and the collateral of the borrower. The bank cannot afford to invest its funds recklessly without considering the principle of safety. The loans and investments made by the bank should be adequately secured. For this purpose, the bank should always insist on security of the borrower. Of late, somehow or other the bank have not been paying adequate importance to safety, particularly in India.

4. **Diversity:** The bank should invest its funds in such a way as to secure for itself an adequate and permanent return. And while investing its funds, the bank should not keep all its eggs in the same basket. Diversification of investment is necessary to avoid the dangerous consequences of investing in one or two channels. If the bank invest its funds in different types of securities or makes loans and advances to different objectives and enterprises, it shall ensure for itself a regular flow of income.

5. **Salability of Securities:** Further, the bank should invest its funds in such types of securities as can be easily marketed at a time of emergency. The bank cannot afford to invest its funds in very long term securities or those securities
which are un-saleable. It is necessary for the bank to invest its funds in government or in first class securities or in debentures of reputed firms. It should also advance loans against stocks which can be easily sold.

6. **Stability in the Value of Investments:** The bank should invest its funds in those stocks and securities the prices of which are more or less stable. The bank cannot afford to invest its funds in securities, the prices of which are subject to frequent fluctuations.

7. **Principles of Tax-Exemption of Investments:** Finally, the investment policy of a bank should be based on the principle of tax exemption of investments. The bank should invest in those government securities which are exempted from income and other taxes. This will help the bank to increase its profits.

Of late, there has been a controversy regarding the relative importance of the various principles influencing the investment policy of a bank particularly between liquidity and profitability. It is interesting to examine this controversy.

Let us examine what happens if the bank sticks to the principle of liquidity only. It is true that if the bank pays importance to liquidity, it can easily meet the demands of the depositors. The bank should have adequate cash to meet the claims of the depositors. It is true that a successful banking business calls for installing confidence in the minds of the depositors. But, it should be noted that accepting deposits is not the only function of a bank. Moreover, the bank cannot afford to forget the fact that it has to earn income to pay salaries to the staff, interest to the depositors, dividend to the shareholders and
meet the day-to-day expenditure. If the bank keeps all its resources in liquid form, it will not be able to earn even a rupee. But profitability is a must for the bank. Though cash on hand is the most liquid asset, it is the least profitable asset as well. Cash is an idle asset.

Hence, the banker cannot concentrate on liquidity only. If the bank attaches importance to profitability only, it would be equally disastrous to the very survival of a bank. It is true that a bank needs income to meet its expenditure and pay returns to the depositors and shareholders. The bank cannot undermine the interests of the depositors. If the bank lends out all its funds it will be left with no cash at all to meet the claims of the depositors. It should be noted that the bank should have cash to honor the obligations of the depositors.

Otherwise, there will be a ‘run’ on the bank. A run on the bank would be suicidal to the very existence of the bank. Loans and advances, though the most profitable asset, constitute the least liquid asset. It follows from the above that the choice is between liquidity and profitability. The constant tug of war between liquidity and profitability is the feature of the assets side. According to Crowther, liquidity and profitability are opposing or conflicting considerations. The secret of successful banking lies in striking a balance between the two.

4.5 SUCCESS IN INVESTMENT:

Success in most things is relative, and not less so in the field of investment. Success in investment means earning the highest possible return with the constraints imposed by the investor's personal circumstances like age, family needs, liquidity requirement, tax position and acceptability of risks. If possible, performance should be measured against
alternative investments or combination of investments available to the investor within those constraints. Genuine success also means winning the battle against inflation, against the fall in the real value of savings and capital.

To be a successful investor, one should strive to achieve not less than the rate of return consistent with the risk assumed. But is this risk? If markets are efficient, abnormal returns are not likely to be achieved, and so the best one can hope for return consistent with the level of risk assumed. The trick is to assess the level of risk we wish to assume and make certain that the collection of the assets we buy fulfills our risk expectations. As a reward for assuming this level of risk, we will receive the returns that are consistent with it. If however, we believe that we do better than the level of return warranted by the level of risk assumed, than success must be measured in these terms.

4.6 INVESTMENT PATTERN:

This analysis is based on the survey results conducted by RBI. The investment includes:

1. Investment in central & state government securities,
2. Investment in securities approved by the Indian Trust Act, 1882,
3. Shares, bonds & debentures of Indian joint stock companies,
4. Fixed Deposits with the banks,
5. Domestic Securities,
6. Foreign Securities.

Reserve Bank of India conducted the annual survey of the investment of scheduled commercial banks as on 31st March 1998 and 31st March 2004. The survey covered all
Indian commercial banks other than RRBs operating in India and foreign banks operating in India. The types of investment covered in the survey are as under -

(i) Central and state government securities,

(ii) The securities, other than Central and state government securities approved for the purpose of investment under Indian Trust Act, 1882,

(iii) Shares, bonds & debentures of Indian joint stock companies,

(iv) Fixed Deposits with the banks,

(v) The domestic deposits which are not eligible as trustee securities such as initial contribution of UTI, share capital in Regional Rural Banks,

(vi) Foreign securities and other foreign investment

A Bank’s investment decision depends on a number of factors. It is therefore pertinent to note the developments in the policy framework of bank investments.

a) Excess provisions towards depreciation of investment held under reserves and surplus became eligible for inclusion in tier – II Capital.

b) The ratio of permanent and current investment in approved securities.

c) Bank are allowed to book income on accrual basis on securities of corporate bodies/public sector undertaking in respect of which the payment of interest and repayment of principal are guaranteed by the central bank & state bank are allowed to book income from dividends on accrual basis provided that the corporate bodies declared dividends on the shares in its Annual General Meeting and the owner’s right to receive payment was established.
d) Bank are required the value of the government securities in current categories as per market quotations as on the last day of March and to use the yields indicated by RBI for valuation of government securities where market quotations are not available.

e) With a view of adopting prudent accounting standards and move towards ‘Marks To Market Valuation’ of the investment portfolio, bank are required to classify a minimum 70% of their securities as current investment. The proportion of current investment has been further raised to 75% of the year ended March 31.

f) Government/approved securities would have to be provided for a risk weight of 2.5% by the year ending March 31, on account of 20% for securities of government of the market borrowing program would be introduced in the financial year.

g) With view to removing the anomaly of zero risk weight for investment of bond/securities of some of the public financial institutions (PFIs) due to their status as ‘approved securities’ and 100% for investment in certain other PFIS, investments in bonds/debentures of a corporate guaranteed by a public financial institution and not to the corporate consequently, the exposure of the bank to public financial institutions would be given a uniform risk weight of 20%.

h) Investment by bank in bonds or debentures of a corporate guaranteed by a public financial institution would be treated as an expense to the public financial institution and not to the corporate consequently, the exposure of the bank to
public financial institutions would be 100% whereas the exposure by the public financial institution to the corporate would be to the extent of 50%.

4.7 THE INVESTMENT PROCESS (STAGES IN INVESTMENT):

The investment process is generally described in four stages. These stages are as follows:-

- **Investment policy:** The first stage determines and involves personal financial affairs and objectives before making investment. It may also be called preparation of the investment policy stage. The investor has to see that he should be able to create an emergency fund, an element of liquidity and quick convertibility of securities to cash. This stage may, therefore, be considered appropriate for identifying investment assets and considering the various features of investment.

- **Investment analysis:** The next step is to analyze the securities available for investment. A comparative analysis is required of fixed and variable securities. The primary concern at this stage would be to form beliefs regarding future behavior of prices and stocks, the expected returns and associated risks.

- **Valuation of investments:** The third step is perhaps most important consideration of the valuation of investments, investments value, in general, is taken to be the present worth to the owners of the future benefits from investments. The investor has to bear in mind the value of these investments.
Appropriate sets of weights have to be applied with use of the forecasted benefits to estimate the value of the investment assets. Comparison of the value with the current market price of the asset allows a determination of the relative alternatives of the assets. Each asset must be valued on its individual merit. Finally the portfolio should be constructed.

- **Portfolio construction:** As discussed under features of investment program, portfolio construction requires knowledge of the different aspects of securities. Consisting of safety and growth of principal, liquidity of assets after taking in to account the stages involving investment timing, selection of investment and allocation of saving to different investments.

  The success of every investment decision has become increasingly important in recent time. Making sound investment decision require both knowledge and skill. Skill is needed to evaluate risk and return associated with an investment decision. Knowledge is required regarding the complex investment alternatives available in the economic environment.

### 4.8 THE INVESTMENT PATTERN OF SBI:

The investment pattern of the State Bank of India is wide and varied. The investment pattern covers the social, domestic and individual, institutional, economic, infrastructural and industrial needs of national life. After the Reserve Bank of India which is the purely government’s bank with no private dealing and accounting, the SBI is the largest public sector-cum-semi government bank. It is different from the central bank in one important sense -while the central bank i.e. the RBI, deals only with government funds,
government monetary accounts and dealings, deposits, foreign exchange reserves as a part of the national monetary policy which alone is authorized to adopt and declare for its subordinates banks and for the monetary control as well as adjustments of the country’s monetary resources, the state bank deals with private customers, dealers, depositors and loan seekers, besides abiding by governments directives and guidelines as to the dealings of monetary resources in the country.

While the conditions and compulsions under CRR and SLR do not apply to the central bank, because it alone is authorized to control, direct and regulate liquidity in the country according to the needs of the economy price-level, inflation-level; all the subordinate banks are compelled under law to abide by the directions and the instructions of the central bank.

State bank of India’s investments are canalized into diversified areas of public, private, social, consumptive, interest-earning, future securing life. One by one these avenues of investments are described as under :-

A. HOME-LOANS – SBI’s investment of its loanable funds is the form of home-loans is very popular. The SBI is quite smart in investing in home loan to any person who covers to it for the purpose and fulfills the required conditions. The purpose of loan is mainly for purchase, extension, renovation, and land development.

B. SBI CAR LOAN – SBI car loan is a popular source of investment, lending in which 85 % financing of the cost of the car being purchased by a customer is
possible. Low interest rates, increasing income levels of people are the factors for growth in this sector. Even for second hand car finance is available.

C. SHUBH NIVESH – It is a unique investment plan under “Happiness Hamesha” with triple benefits of savings, income and insurance. About SBI Shubh Nivesh it says –

“We believe that every person has different needs and hence should choose his/her own financial goals. This plan protects you, your savings and comes with an option to leave a portion of your wealth for your children/grand children, you also have the choice of taking your benefits in the form of an income over a specified period of your choice.

D. SCHOLAR LOAN SCHEME – SBI’s investment for the progress of education in the country has proved to be admirably fruitful for the budding scholar, in particular, whose ambition to pursue higher education in various hi-tech disciplines would have a mere dream had the SBI not patterned its investment plans towards this end. For the budding scholar who has sought admission in any institute of national or international repute but needs prohibitive fees to take admission, the SBI has planned investment in education loans at the lowest EMI with an assurance to the “you worked hard far and mission we make financing easy”.

E. SBI LIFE –‘GOLD GAUGE’ – This particular type of investment pattern is for the soldiers and army man fighting for the safety, honor of the country on its
borders and is serving the country from the evil design of the enemy. This type of investment loan is for the safety of the soldiers and his family. In a way, the plan is only for army soldiers and officers.

F. SBI LIFE SMART POWER INSURANCE – About this particular plan, SBI says – “whatever be the market scenario, your smile will stay intact”. In this policy the investment risk in investment portfolio is borne by the policy holder. About this plan, the SBI says “we present to you, smart power insurance, a non-participating unit linked insurance plan which takes care of your insurance as well as investment needs. The product comes to you at affordable premium and is in tune with the current investment scenario”. It is a flexible product, which also takes care of your liquidity needs. Additional protection requirement, due to changing personal and/or financial circumstances, is also taken care by this product.

G. SBI LIFE SMART MONEY BACK GOLD – It is a saving plan with added advantage of life cover and cash inflow (money back) at regular intervals. It is participating traditional money back plan, meeting your various financial obligations at crucial time.

4.9 CREDIT DEPLOYED BY SCB & SBI:

Bank accepts deposits to lend the same at a higher rate of interest to them who is need of the money. Bank is the dealers of money and suppliers of credit. They are the active participants in the process of deposit mobilization and credit creation. The year-wise
credit supplied by the scheduled commercial banks & State Bank of India is furnished in Table & chart 4.1.

### Table 4.1

**Credit Deployed By Scheduled Commercial Banks & SBI**

<table>
<thead>
<tr>
<th>Years</th>
<th>Amount of SCB (in crore)</th>
<th>% increase over previous year</th>
<th>Amount of SBI (in crore)</th>
<th>% increase over previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>840785</td>
<td>-</td>
<td>157934</td>
<td>-</td>
</tr>
<tr>
<td>2004-05</td>
<td>1100428</td>
<td>30.88</td>
<td>202374</td>
<td>28.14</td>
</tr>
<tr>
<td>2005-06</td>
<td>1507077</td>
<td>36.95</td>
<td>261642</td>
<td>29.28</td>
</tr>
<tr>
<td>2006-07</td>
<td>1931190</td>
<td>28.14</td>
<td>337337</td>
<td>28.93</td>
</tr>
<tr>
<td>2007-08</td>
<td>2361913</td>
<td>22.3</td>
<td>416768</td>
<td>23.54</td>
</tr>
<tr>
<td>2008-09</td>
<td>2775549</td>
<td>17.51</td>
<td>542503</td>
<td>30.17</td>
</tr>
<tr>
<td>2009-10</td>
<td>3252341</td>
<td>17.18</td>
<td>631914</td>
<td>16.48</td>
</tr>
<tr>
<td>2010-11</td>
<td>3773428</td>
<td>16.02</td>
<td>756719</td>
<td>19.75</td>
</tr>
<tr>
<td>2011-12</td>
<td>4338752</td>
<td>14.98</td>
<td>867579</td>
<td>14.65</td>
</tr>
<tr>
<td>2012-13</td>
<td>4875554</td>
<td>12.37</td>
<td>1045616</td>
<td>20.52</td>
</tr>
</tbody>
</table>

(Source: Database from RBI & Annual Reports of SBI)
The data in Table 4.1 reveals that the Indian Scheduled Commercial Banks have been successful in performing the credit creation function. It shows an upward movement during whole of the study period, although if we look at the percentage change over the previous year than there is a declining trend during the study period. On the other hand the credit deployed by State Bank of India has a fluctuating trend in terms of percentages during whole of the study period. Analysis showed that the credit deployed by SCB has 5.8 times growth from the base year to the end of the study period i.e. 2012-13, whereas SBI has attained a growth of 6.62 times in the same period. In 2004-05 it was 28.14 %, next year it increase to 29.28 % than it decreases in 2006-07 & 2007-08. On the basis of the running average of last nine years, credit deployed by the SCB & SBI shows that the State Bank of India has deployed much credit in comparison to Scheduled Commercial Bank (23.49 % > 21.81 %)

4.10 INVESTMENT MADE BY SCB & SBI:

Investment as a window of deployment of funds was given more emphasis than lending. The year-wise investments made by the scheduled commercial banks & State Bank of India is presented in Table 4.2.

<table>
<thead>
<tr>
<th>Years</th>
<th>Amount of SCB (in crore)</th>
<th>% increase over previous year</th>
<th>Amount of SBI (in crore)</th>
<th>% increase over previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>677588</td>
<td>-</td>
<td>185676</td>
<td>-</td>
</tr>
<tr>
<td>2004-05</td>
<td>739154</td>
<td>9.09</td>
<td>197098</td>
<td>6.15</td>
</tr>
<tr>
<td>2005-06</td>
<td>717454</td>
<td>-2.94</td>
<td>162534</td>
<td>-17.53</td>
</tr>
</tbody>
</table>
From Table 4.2 it is clear that the Scheduled Commercial Banks have been quite successful as far as investment is concerned. During the period under reference, the bank has been able to mark a rising trend in investment. It shows an upward movement during the study period, except in the financial year 2005-06. But if we talk about the State Bank of India, there is a mode of depression with regard to investment made by the bank. In whole of the study period it reflects the fluctuating trend. Analysis showed that the investment made by SCB has 4.19 times growth from the base year to the end of the study period i.e. 2012-13, whereas SBI has attained a growth of 1.89 times only.
in the same period. In the year 2005-06 & 2006-07 it shows a negative trend with a growth of -17.53 & -8.24 % respectively. In 2007-08 & 2008-09 it converts itself from negative to positive with a growth rate of 27.05 & 45.62 % but after that it shows a very slow growth rate. On the basis of the running average of last nine years, investment made by the SCB & SBI shows that the State Bank of India has less investment in comparison to Scheduled Commercial Bank (17.68 % < 8.67 % ). Hence we can say that SBI is unsuccessful as far as investment is concerned.

### 4.11 CREDIT-DEPOSIT RATIO & INVESTMENT DEPOSIT RATIO OF SCB & SBI:

Bank credit implies loans and advances. The Credit Deposit Ratio of the bank indicates the creation of credit out of the deposits. In other words it tells that how much money has been lent out of deposits made by the bank.

Investment-Deposit Ratio is calculated by the investments made by the bank, which is divided by the aggregate deposits of the bank. The year-wise Credit-Deposit Ratio and Investment-Deposit Ratios are presented in Table 4.3 with a diagram presentation.

**Table 4.3**

<table>
<thead>
<tr>
<th>Year</th>
<th>Credit Deposit Ratio (in %)</th>
<th>Investment Deposit Ratio (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SCB</td>
<td>SBI</td>
</tr>
<tr>
<td>2003-04</td>
<td>55.9</td>
<td>49.57</td>
</tr>
<tr>
<td>2004-05</td>
<td>62.6</td>
<td>55.13</td>
</tr>
<tr>
<td>2005-06</td>
<td>70.1</td>
<td>68.84</td>
</tr>
</tbody>
</table>
By the observation of the above table it is clear that Scheduled Commercial Bank & State Bank of India both have been successful in performing the credit creation function against their deposits. It shows an upward movement during whole of the study period. It ranges between 55.9 % to 81.48 % in case of SCB and 49.57 % to 86.94 % in case of SBI.

But if we talk about the investment – deposit ratio of SCB as well as SBI than it shows a fluctuating trend in whole of the study period. In the first year i.e. 2003-04 the investment-deposit ratio of SBI is 58.27 % and comes down to 29.17 % at the end of the study period. Similarly in case of SCB it was 45 % in 2003-04, 47.3 % in the next year.
and falls down up to 34.6 % in the year 2011-12. So we can say that with regard to investment-deposit ratio SCB & SBI are not successful.

**Conclusion:** Investment is the employment of funds with the aim of achieving additional income or growth in value. The main objective of investment is to provide a steady income and to maximize return on investment. A bank should lay down its investment policy in such a manner so as to ensure the safety and liquidity of its funds, but keeping the statutory requirements in mind. If the condition of the capital market is favorable, CRR and SLR rates are low, interest rates are affordable than only a bank can lay down its investment policy in such a manner so as to ensure the safety and liquidity of its funds and at the same time maximize its profits.

To maintain the liquidity at all the time in the bank, RBI changes the CRR from time to time. The main reason to maintain the CRR is to keep a bank liquid at any point of time. From the period 2003-04 to 2012-13 it is changed by RBI several times. In the base year i.e. 2003-04 the minimum CRR rate was 4.5 % and the maximum rate was also the same. In the year 2004-05 it was 4.75 to 5.00, while in the immediate next year there was no change in CRR. In the year 2007-08 the RBI changed the CRR many times, the minimum rate of CRR was 5.50 %& the maximum rate was 7.50 %. Similarly in the year 2008-09 the minimum rate of CRR was 5.50 % and the maximum rate of CRR was 9.00 %.

Statutory Liquidity Ratio (SLR) is the ratio up to which the bank has to hold a specific portion of their deposits in the form of government and other approved securities. Prior to the year 2008-09 the SLR was changed in the year 1997-98 on 25 October 1997. In the year 2008-09 it was 24 % and in the year 2009-10 it increased to 25 %. There was
no change in SLR in the year 2010-11, while in the year 2011-12 and 2012-13 it was 23 % and 22.5 % respectively.

On the basis of the running average of last nine years, credit deployed by the SCB & SBI shows that the State Bank of India has deployed much credit in comparison to Scheduled Commercial Bank (23.49 % > 21.81 %) on the other hand investment made by the SCB & SBI shows that the SBI has less investment in comparison to Scheduled Commercial Bank (17.68 % < 8.67 %).

So it is clear from the above study that Condition of capital market and money market as well as CRR & SLR has a direct bearing on the financial performance in a bank. There has been a revolutionary change in the working style of the bank. Bank is now more customer focused and is providing innovative products to their customers. Introduction of risk management practices and implementation of Basel II recommendations have brought in more professional approach in credit delivery process which is now more risk focused to the bank.

To talk about the investment pattern of SBI it covers the social, domestic and individual, institutional, economic, infrastructural and industrial needs of national life. SBI’s investments are canalized into diversified areas of public, private, social, consumptive, interest-earning, future securing life.
CHAPTER 5

PROFITABILITY ASPECTS OF STATE BANK OF INDIA

5.1 INTRODUCTION:
Profitability has been considered as one of the important objective / motto of any commercial activity. The justification for the survival of a business is profit and profit earning capacity in future. The principle motivating force behind undertaking a business is profit.¹ Perhaps, the most important reason for keeping accounts, so far as the management of the business is concerned is that the information contained in them provides the means of measuring the progress of the business for testing its pulse and indicating when and where remedial action, if necessary, shall be taken. Profit is a signal for the allocation of resources and a yardstick for judging managerial efficiency.

Bank plays a vital role in the economic resource allocation of country. They channel funds from depositors to investors continuously. They can do so, if they generate necessary income to cover their operational cost they incur in the due course. In other words for sustainable intermediation function, bank need to be profitable. Beyond the intermediation function, the financial performance of bank has critical implications for economic growth of country. Good financial performance rewards the shareholders for their investment. This, in turn, encourages additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative impact on the economic growth.

In a country where the financial sector is dominated by bank, any failure in the sector has an immense implication on the economic growth of the country. This is due to the fact that any bankruptcy that could happen in the sector has a contagion effect that can lead to bank ruins, crises and bring overall financial crisis and economic tribulations.

5.2 Concept: ‘Profit’ and ‘Profitability’:

The word ‘Profit’ has had French / Latin origin in ‘Proficere’ (being useful or proficient), ‘Profectus’ and ‘Profectum’ (to make progress). Thus, profit is in index of proficiency or progress, as typified by ‘the gain resulting from the employment of capital’, the excess of returns over expenditure; procuniary gain in any transaction / occupation.

Profit means excess of income over expenditure in given period of time. Hence, the excess of output over input factors expressed in monetary term represents profit. The profit of a business may be measured by studying the profitability of investment in it. The term profitability simply indicates the profit earning capacity of a firm. The ability is also referred to the earning power or operation capacity of the concerned investment.

The term profitability may be defined as the ability of a given investment to earn a return from its use. Profit is the soul of the business without which it is lifeless. In other words, profit is the cream of the business without it; it may not serve the purpose. Western and Brighan opined that “to the financial management, ‘Profit is the test of efficiency and a measure of control’; to the owners, ‘a measure of the worth of their investment’; to the creditors, ‘the margin of safety’; to the government, ‘a measure of taxable capacity and a basis of legislative action’ and to the country, ‘Profit is an index of economic progress,

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national income generated and the rise in the standard of living." The income (output) as compared to the capital employed (input) indicates profitability of a firm.³ Profitability is the ability of the firm to generate earning.⁴

The concept of profitability may be defined as the ability of a given investment to earn a return from its use.⁵ Thus; profitability is a relationship of the earning to the total resources. Profitability is an indication of the efficiency with which the operation of the enterprise is carried on. Thus, profitability indicates the capacity of management to generate surplus in the process of business operations. Sometimes, the terms ‘Profitability’ and ‘Profit’ are used synonymously but there is difference between the two. Profitability has a sense of relativity, whereas the term profit is used in absolute sense. Profitability is the result of financial as well as operational efficiency. It is the outcome of all business activities. Measurement of profitability is a multi-stage concept. A measure of profitability is the overall measure of efficiency. Profitability is a concept based on profits but since it is a relative concept, profits are to be expressed in relation to some other variables.

The state of profitability is a variable thinking like temperature and humidity of a day. A meteorologist can even link the definition of profitability, by an accountant or an analyst, to temperature reading and a study of humidity. The present weather of a day is recorded so that prospects can be forecasted.

The degree of profitability helps in establishing a quantitative relationship between profit and volumes of sales or the level of investment. The measurement of profitability is as essential as the earning of profit itself for a business concern. Some managerial decisions like network expansion, rising of additional finance, problems of bonus and dividend payments rest upon this particular measurement. Financial appraisal provides essential data for measuring profitability of a business concern.

When the profitability aspect of a public sector enterprise is analyzed, the analyst should have to be doubly careful, due to being the conflicting objectives of these units. The basic objective behind establishment of public sector enterprise is not only to earn profit but also to fulfill the social objective. However this particular reason cannot be taken for granted when the funds are miss-utilized because of which an organization is not earning profit. As far as possible, these public sector enterprises should utilize the funds available to meet the social objectives and to earn profit. Hence profitability analysis is also an important aspect of a public sector enterprise irrespective of the conflicting objectives. Whether the bank is private, public, semi-state or nationalized, whatever the type or ownership of the banking organization, its prime objective for survival will be the achievement of a financial surplus from its trading activities.

The measurement of profitability requires calculation of several inter connected ratios which vary according to the purpose of analysis. Profitability can be measured according to the utility of the ratio. The utility of profitability for a creditor, for management and for the shareholders should definitely be different. Here, the question can be rose and the views of stakeholders should also be placed on defining what realistic level of surplus is?
In view of the many uncontrollable and semi-controllable factors such as legislation, world money market rates, it is realistic for a bank to plan for a profit within a range of say + or – 5 to 10 %, planning at the same time not to exceed or fail to achieve levels of profitability that are likely to stimulate serious adverse reaction from important groups of stakeholders i.e., to see that the profit objective and achievement is justifiable.  

Bank is commercial ventures. The main objective of any commercial venture is to earn profit and to enlarge profit by making the most efficient use of the resources available to them. The same thing is applicable in case of bank also. Bank adopts all types of methods and services to develop their business to maximize their earning. In India, the profit objective has not remained a dominant element for bank. The bank are not run with the object of earning maximum profit as they have to make their due contribution towards the fulfillment of the socio-economic objective laid down by the Reserve Bank of India. This does not, however, mean that there should not be any profit motive at all. Nationalization does not absolve the bank from their obligation to maintain proper financial and monetary discipline. In India, public sector bank provide a variety of social services that cannot be undertaken on the basis of pure profit consideration. The pre-nationalization trend of banking growth in the country proves the adage, “where enterprise leads, finance follows.” The emergence of sectorial regional and state wise imbalance was quite obvious. The basic objective of State Bank is not to maximize their profit but to earn reasonable profit in order to maintain sound financial health.

8. M.C. Chhipa, Regional disparities on commercial banking development in India, Print well Publication, Jaipur, 1992, p. 60
5.3 Profitability and Efficiency:

Profitability is not synonymous with efficiency though it is an index of efficiency; it is regarded as a measure of efficiency and management guide to greater efficiency. No doubt, profitability is an important yardstick of efficiency, but the extent of profitability cannot be taken as a final proof of efficiency. Sometime satisfactory profits can make inefficiency and conversely a proper degree of efficiency can be accompanied by an absence of profit. The net profit figure simply reveals a satisfactory balance between the value received and value given. The change in operational efficiency is merely one of the many factors on which profitability of an enterprise largely depends between cost and profitability. Moreover, there are many other factors besides efficiency, which affects the profitability.

Dangwal and Kapoor evaluated the financial performance of nationalized banks in India and assessed the growth index value of various parameters through overall profitability indices. The data for 19 nationalized banks, for the post-reform period from 2002-03 to 2006-07, was used to calculate the index of spread ratios, burden ratios, and profitability ratios. They found that while four banks had excellent performance, five achieved good performance, four attained fair performance and six had poor performance.⁹

5.4 Bank Performance Indicators:

Profit is the ultimate goal of a bank. All the strategies designed and activities performed thereof are meant to realize this grand objective. However, this does not mean that bank have no other goals. Bank could also have additional social and economic goals.

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However, the intention of this study is related to the first objective, profitability. To measure the profitability of the bank there are variety of ratios used of which Return on Asset, Return on Equity and Net Interest Margin are the major ones.

**a) Return on Equity (ROE)** – ROE is a financial ratio that refers to how much profit a company earned compared to the total amount of shareholder equity invested or found on the balance sheet. ROE is what the shareholders look in return for their investment. A business that has a high return on equity is more likely to be one that is capable of generating cash internally. Thus, the higher the ROE the better the company is in terms of profit generation. It is further noted that ROE is the ratio of Net Income after Taxes divided by Total Equity Capital. ROE reflects how effectively a bank management is using shareholders’ funds. Thus, it can be deduced from the above statement that the better the ROE the more effective the management in utilizing the shareholders capital.

**b) Return on Asset (ROA)** - ROA is also another major ratio that indicates the profitability of a bank. It is a ratio of Income to its total asset. It measures the ability of the bank management to generate income by utilizing company assets at their disposal. In other words, it shows how efficiently the resources of the company are used to generate the income. It further indicates the efficiency of the management of a company in generating net income from all the resources of the institution. Wen (2010), state that a higher ROA shows that the company is more efficient in using its resources.
c) **Net Interest Margin (NIM)** - NIM is a measure of the difference between the interest income generated by bank and the amount of interest paid out to their lenders (for example, deposits), relative to the amount of their (interest earning) assets. It is usually expressed as percentage of what the financial institution earns on loans in a specific time period and other assets minus the interest paid on borrowed funds divided by the average amount of the assets on which it earned income in that time period (the average earning assets). The NIM variable is defined as the net interest income divided by total earnings assets.

Net interest margin measures the gap between the interest income the bank receives on loans and securities and interest cost of its borrowed funds. It reflects the cost of bank intermediation services and the efficiency of the bank. The higher the net interest margin, the higher the bank's profit and the more stable the bank is. Thus, it is one of the key measures of bank profitability. However, a higher net interest margin could reflect riskier lending practices associated with substantial loan loss provisions.

### 5.5 Determinants of Bank Performance:

The determinants of bank performance can be classified into bank specific (internal) and macroeconomic (external) factors. These are stochastic variables that determine the output. Internal factors are individual bank characteristics which affect the bank’s performance. These factors are basically influenced by internal decisions of management and the board. The external factors are sector-wise or country-wise factors which are beyond the control of the bank and affect the profitability of bank.
Studies have shown that bank specific and macroeconomic factors affect the performance of bank.

A. Bank Specific Factors/Internal Factors – As explained above, the internal factors are bank specific variables which influence the profitability of bank. These factors are within the scope of the bank to manipulate them and that they differ from bank to bank. These include capital size, size of deposit, liabilities, size and composition of credit portfolio, interest rate policy, labor productivity, and state of information technology, risk level, management quality, bank size, ownership and the like. CAMEL framework often used to proxy the bank specific factors. CAMEL stands for Capital Adequacy, Asset Quality, Management Efficiency, Earnings Ability and Liquidity. Each of these indicators is further discussed below.

➤ Capital Adequacy: Capital is one of the bank specific factors that influence the level of bank profitability. Capital is the amount of own fund available to support the bank’s business and act as a buffer in case of adverse situation. Bank capital creates liquidity for the bank due to the fact that deposits are most fragile and prone to bank runs. Moreover, greater bank capital reduces the chance of distress. However, it is not without drawbacks that it induce weak demand for liability, the cheapest sources of fund Capital adequacy is the level of capital required by the bank to enable them withstand the risks such as credit, market and operational risks they are exposed to in order to absorb the potential loses and protect the bank’s debtors. According to Dang (2011), the adequacy of
capital is judged on the basis of capital adequacy ratio (CAR). Capital adequacy ratio shows the internal strength of the bank to withstand losses during crisis. Capital adequacy ratio is directly proportional to the resilience of the bank to crisis situations. It has also a direct effect on the profitability of bank by determining its expansion to risky but profitable ventures or areas.

➢ **Asset Quality:** The bank's asset is another bank specific variable that affects the profitability of a bank. The bank asset includes among others current asset, credit portfolio, fixed asset, and other investments. Often a growing asset (size of assets) is related to the age of the bank. More often, loan is the major asset of bank from which they generate income. The quality of loan portfolio determines the profitability of bank. The loan portfolio quality has a direct bearing on bank profitability. The highest risk facing a bank is the losses derived from delinquent loans. Thus, nonperforming loan ratios are the best proxies for asset quality. It is the major concern of the bank to keep the amount of nonperforming loans to low level. This is so because high nonperforming loan affects the profitability of the bank. Thus, low nonperforming loans to total loans shows that the good health of the portfolio a bank. The lower the ratio the better the bank performing.

➢ **Management Efficiency:** Management Efficiency is one of the key internal factors that determine the bank profitability. It is represented by different financial ratios like total asset growth, loan growth rate and earnings growth rate. Yet, it is one of the complexes subject to capture with financial ratios. Moreover, operational efficiency in managing the operating expenses is another dimension for management quality. The performance of management is often expressed
qualitatively through subjective evaluation of management systems, organizational discipline, control systems, quality of staff, and others. Yet, some financial ratios of the financial statements act as a proxy for management efficiency. The capability of the management to deploy its resources efficiently, income maximization, reducing operating costs can be measured by financial ratios. One of this ratios used to measure management quality is operating profit to income ratio. The higher the operating profits to total income (revenue) the more the efficient management is in terms of operational efficiency and income generation. The other important ratio is that proxy management quality is expense to asset ratio. The ratio of operating expenses to total asset is expected to be negatively associated with profitability. Management quality in this regard, determines the level of operating expenses and in turn affects profitability.

➢ Liquidity Management: Liquidity is another factor that determines the level of bank performance. Liquidity refers to the ability of the bank to fulfill its obligations, mainly of depositors. According to Dang (2011) adequate level of liquidity is positively related with bank profitability. The most common financial ratios that reflect the liquidity position of a bank according to the above author are customer deposit to total asset and total loan to customer deposits.

B. External Factors/ Macroeconomic Factors – The macroeconomic policy stability, Gross Domestic Product, Inflation, Interest Rate and Political instability are also other macroeconomic variables that affect the performances of bank. For instance, the trend of GDP affects the demand for
bank’s asset. During the declining GDP growth the demand for credit falls which in turn negatively affect the profitability of bank. On the contrary, in a growing economy as expressed by positive GDP growth, the demand for credit is high due to the nature of business cycle. During boom the demand for credit is high compared to recession. The same authors state in relation to the Greek situation that the relationship between inflation level and bank’s profitability is remained to be debatable. The direction of the relationship is not clear.

5.6 Exposure of Credit Risk & Market Risk:

Risk is all pervasive and is prevalent in every activity, be it a manufacturing or trading or service related. Human beings always attempt to manage the risks faced by them in their day-to-day activities of life. Keeping inflammable material away from fire, saving for possible future needs, creation of a legal protection etc. are some of the attempts at managing the Risks. Every Industry strives to arrest the Risks with a view to minimize its losses and make optimum revenue. Banking Industry, primarily dealing with financial services can be no exception and thus encounters with many related Risks. It is imperative that bank have to identify and measure various Risks faced by them and initiate suitable remedial measures to mitigate them.

There has been tremendous transition in the role of bank as a financial intermediary. Before liberalization all the activities of bank were regulated and hence operational environment was not conducive to risk taking. Now, bank has grown from being a financial intermediary into a risk intermediary. Bank is exposed to severe competition and hence is compelled to encounter various types of financial and non-financial risks. Risks and uncertainties form an integral part of banking which by nature entails taking
risks. Bank are now required to clearly discriminate avoidable and unavoidable risks and are required to focus on the extent to which such risks can be taken by bank.

The banking reforms and policy changes during the years have gradually changed banking landscape and credit market in India. First visible change is that bank are now more customer focused and are providing innovative products at fast pace, Second change is that deregulation has made the bank free to formulate their own schemes and products as per their market segment and risk appetite, redesign business process and lending policies and procedures to meet changing expectations of the customers and the market. Third, introduction of risk management practices and implementation of Basel II recommendations have brought in more professional approach in credit delivery process which is now more risk focused and has made pricing of loan-products dependent on risk perception of the borrower and likely hood of default. Fourth visible change is that bank are moving from so called lazy banking to busy banking by aggressively expanding credit to retail, agriculture and small and medium enterprises. Fifth visible change is that bank are gradually becoming super market where they will not only lend but also offer whole gamut of financial products including third party products so that customer gets opportunity to select best product at competitive price.

All these changes are on the one hand creating new business opportunities and on the other hand also creating new challenges, which bank will have to face boldly and proactively.

Banking risk results into Expected and Unexpected losses. Bank relies on their capital as a buffer to absorb such losses. According to experts bank need to maintain enough capital for prudential corrective action to prevent any risk. The efficiency of capital plays
a major role in this exercise and bank is advised to adopt risk management practices. Bank is required to develop the system which involves minimum risk exposure. Credit risk in bank represents the most important type of risk.

- **Credit Risk:**

As stated by Reserve Bank of India (RBI, 2005), Credit Risk is the major component of Risk Management system and this should receive special attention of the Top Management of a Bank. Credit Risk is considered as the major risk inherent in a Bank’s banking activities. Any mismanaging of this risk may lead a Bank into great trouble or even Bankruptcy. Managing Credit Risk in Bank is a herculean task as robust Risk Management strategies and practices are needed for identifying, measuring, controlling and minimizing the impact of Credit Risk.

Credit risk is defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms, or in other words it is defined as the risk that a firm’s customer and the parties to which it has lent money will fail to make promised payments is known as credit risk.

- **New Approaches to Credit Risk Measurement and Management:**

In recent years, a revolution has been brewing in risk as it is both measured and managed. Contradicting the relatively dull and routine history of credit risk, new technologies and ideas have emerged among a new generation of financial engineering professionals who are applying their model-building skills and analysis to this area. The question arises: Why now? There are at least six reasons for this sudden surge in interest. These are –
1. Structural increase in bankruptcies
2. More competitive margins
3. Declining and volatile values of collateral
4. The growth of off-balance-sheet derivatives
5. Technology
6. The BIS risk-based capital requirements

- **Factors Responsible for Credit Risk:**

The factors that cause credit risk which in turn has an adverse impact of the bank’s credit standards and bank’s profitability are: Discrepancies occurring during the loan proposal appraisal, inconsistency during the assessment of financial stability of borrowers or counter-party to gauge their creditworthiness, lacking clarity in lending policies and procedures, following liberal standards during the sanction of loan, no sufficient background check being done on the borrowers or counter-party, insufficient value of the collaterals pledged to the bank to obtain the loan facilities, high exposure limits sanctioned for individuals at par with the business community, insufficient knowledge and skills of the operating personnel during the process of loan proposals, insufficient knowledge on the current market scenario and economy’s performance, no proper coordination between the different department in the bank which are in-charge of the activities relating to credit risk, organization structure with respect to responsibility and authority have not been clearly defined, no good system to rate credit risk and no reliable data is available to manage credit risk.
• Non-Performing Assets:

Non-Performing Assets in banking industry has become a subject of intense importance and discussion. It has assumed greater significance in the world of banking & bank. It has become a barometer of the health of bank and discussion on any bank is incomplete without the mention of NPA. NPA has now become heart of the banking industry, which in turn, is the heart of finance and economy of a nation.

Assets of a bank generally, consist of cash, investment, loans & advances, fixed assets and miscellaneous assets. The resources of a bank are deployed in these assets. The resources consist of capital & reserves, deposits, borrowings and other liabilities. These liabilities are carried at a cost and hence its deployments into various assets should generate enough income to serve the cost of the liabilities. In other words, the assets in which the liabilities are deployed should perform in such a way that it generates income to cover the cost of resources and also a surplus, which is a profit of the bank. Thus the performance of assets reflects the health of the banking industry.

In the early time the buzzword in the banking industry was deposits as it is the basic raw material for the banking industry. The status of the bank was determined on the volume and size of its deposits. The career of bankers used to depend on the level of deposits achieved by him. Bank was not bothered about the performance of their assets. But from 1991 a sea change was made in the way that income of the bank was recognized. With the ‘first generation economic and finance sector reforms’ coming into being, the method of income recognition in the banking sector was changed from accrual basis to cash basis. An income will be carried to profit and loss account only if it is realized in cash in 90 days. All along, they were simply doing an accounting exercise in debiting a
loan account and credit the income account without bothering to see whether it is actually paid by the borrower or not. Thus the performance of an asset was defined for the first time in Indian Banking Industry.

This change of income recognition compelled the bank to unrecognize the incomes if the interest is not received in cash from the borrowers. Not only is this, depending upon the quality of the assets, various provisions now required to be made on such non-performing assets. This has compelled bank to declare loss for the time in history of banking. This had ominous portents for the entire banking industry. This also resulted in dwindling flow of credit of trade and industry. Thus NPA has the potential to directly affect the economy of the country. Our country also now having a large portion of bank credit locked in NPA’s and hence NPA is receiving a greater importance.

NPAs CLASSIFICATION: NPA have been classified into following four types:-

(i) **Standard Assets**: A standard asset is a performing asset. Standard assets generate continuous income and repayments as and when they fall due. Such assets carry a normal risk and are not NPA in the real sense.

(ii) **Sub-Standard Assets**: All those assets (loans and advances) which are considered as non-performing for a period of 12 months.

(iii) **Doubtful Assets**: All those assets which are considered as non-performing for period of more than 12 months.

(iv) **Loss Assets**: All those assets which cannot be recovered. These assets are identified by the Central Bank or by the Auditors.
TYPES OF NPA -:

- **Gross NPA:** Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI Guidelines as on Balance Sheet date. Gross NPA reflects the quality of the loans made by bank. It consists of all the non-standard assets like sub-standard, doubtful and loss assets. It can be calculated with the help of following ratio: Gross NPAs / Gross Advances

- **Net NPA:** Net NPAs are those type of NPAs in which the bank has deducted the necessary provision regarding NPAs. Net NPA shows the actual burden of bank. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the bank have to make certain provisions against the NPAs according to the central bank guidelines. It can be calculated by following ratio: Gross NPAs – Provisions / Gross Advances – Provisions

CAUSES FOR NON-PERFORMING ASSETS:

A strong banking sector is important for a flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. The Indian banking system, which was operating in a closed economy, now faces the challenges of an open economy. On one hand a protected environment ensured that bank never needed to develop sophisticated treasury operations and Asset Liability Management skills. On the other hand a combination of directed lending and social banking relegated profitability and competitiveness to the background. The net result was unsustainable NPAs and consequently a higher effective cost of banking services.
One of the main causes of NPA into banking sector is the directed loans system under which bank are required a prescribed percentage of their credit (40%) to priority sectors. The cause for non-performing assets in bank is not only due to the lack of strict prudential norms but

- The legal impediments and time consuming nature of asset disposal proposal,
- Postponement of problem in order to show higher earnings,
- Manipulation of debtors using political influence.

**IMPACT OF NPA ON THE OPERATIONS OF BANK:**

- **Profitability** NPA means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the prodigality of bank decreases not only by the amount of NPA but NPA lead to opportunity cost also as that much of profit invested in some return earning project/asset. So NPA does not affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity.

- **Liquidity** Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for shortest period of time. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.

- **Involvement of Management** Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling & managing NPA would have diverted to some fruitful activities, which would have given good returns. Now days, bank have special employees to deal and handle NPAs, which is additional cost to the bank.
Credit Loss If a bank is facing problem of NPA, then it adversely affects the value of bank in terms of market for credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting in their money in the bank.

Table 5.1
Gross NPA & Net NPA of SBI

<table>
<thead>
<tr>
<th>YEAR</th>
<th>GROSS NPA (₹ in crore)</th>
<th>NET NPA (₹ in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>12667.21</td>
<td>5441.73</td>
</tr>
<tr>
<td>2004-05</td>
<td>12455.73</td>
<td>5348.89</td>
</tr>
<tr>
<td>2005-06</td>
<td>9628.14</td>
<td>4911.41</td>
</tr>
<tr>
<td>2006-07</td>
<td>9998.22</td>
<td>5257.72</td>
</tr>
<tr>
<td>2007-08</td>
<td>12837.36</td>
<td>7424.33</td>
</tr>
<tr>
<td>2008-09</td>
<td>15588.66</td>
<td>9552.02</td>
</tr>
<tr>
<td>2009-10</td>
<td>19534.89</td>
<td>10870.17</td>
</tr>
<tr>
<td>2010-11</td>
<td>25326.29</td>
<td>12346.9</td>
</tr>
<tr>
<td>2011-12</td>
<td>39676.46</td>
<td>15818.85</td>
</tr>
<tr>
<td>2012-13</td>
<td>51189.4</td>
<td>21956.5</td>
</tr>
</tbody>
</table>

(Source: Compiled from SBI Annual Reports)

By the observation of the above table it is clear that although the Gross NPA as well as Net NPA of SBI is showing a declining trend from the base year i.e. 2003-04 to 2005-06, but after this period there is a sharp upward movement up to the end of the study period i.e. 2012-13. The NPA are rising year to year from 2006-07 to 2012-13 at an increasing rate. The Gross NPA & Net NPA of SBI shows a growth of 4.04 times and 4.03 times respectively over the base year.
Table 5.2
Gross NPA to Advances

<table>
<thead>
<tr>
<th>YEAR</th>
<th>GROSS NPA (₹ in crore)</th>
<th>ADVANCES (₹ in crore)</th>
<th>% of Gross NPA to Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>12667.21</td>
<td>157934</td>
<td>8.02</td>
</tr>
<tr>
<td>2004-05</td>
<td>12455.73</td>
<td>202374</td>
<td>6.15</td>
</tr>
<tr>
<td>2005-06</td>
<td>9628.14</td>
<td>261642</td>
<td>3.68</td>
</tr>
<tr>
<td>2006-07</td>
<td>9998.22</td>
<td>337337</td>
<td>2.96</td>
</tr>
<tr>
<td>2007-08</td>
<td>12837.36</td>
<td>416768</td>
<td>3.08</td>
</tr>
<tr>
<td>2008-09</td>
<td>15588.66</td>
<td>542503</td>
<td>2.87</td>
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<td>2009-10</td>
<td>19534.89</td>
<td>631914</td>
<td>3.09</td>
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<td>2010-11</td>
<td>25326.29</td>
<td>756719</td>
<td>3.35</td>
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<td>2011-12</td>
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<td>2012-13</td>
<td>51189.4</td>
<td>1045616</td>
<td>4.89</td>
</tr>
</tbody>
</table>

(Source: Compiled from SBI Annual Reports & % calculated by researcher)

By looking at the above table it is clear that in the base year i.e. 2003-04, there is a very high percentage of gross NPA in comparison to the advances. Although there is a fluctuating trend from 2003-04 to 2008-09 but after 2008-09 there is a sharp increment in gross NPA in comparison to advances. So this situation shows a dangerous sign for the profitability to the bank. If we analyze the Gross NPA to Advances of SBI in terms of percentage during the study period it shows a very high rate of fluctuations (2.87 to 8.02). The average % of Gross NPA to Advances was 4.27 % (SBI) which shows a higher rate of NPA in comparison to SCB (3.38 %) of India.

Table 5.3
Net NPA to Advances

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NET NPA (₹ in crore)</th>
<th>ADVANCES (₹ in crore)</th>
<th>% of Net NPA to Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>5441.73</td>
<td>157934</td>
<td>3.45</td>
</tr>
<tr>
<td>2004-05</td>
<td>5348.89</td>
<td>202374</td>
<td>2.64</td>
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<td>2005-06</td>
<td>4911.41</td>
<td>261642</td>
<td>1.88</td>
</tr>
<tr>
<td>2006-07</td>
<td>5257.72</td>
<td>337337</td>
<td>1.56</td>
</tr>
<tr>
<td>2007-08</td>
<td>7424.33</td>
<td>416768</td>
<td>1.78</td>
</tr>
<tr>
<td>2008-09</td>
<td>9552.02</td>
<td>542503</td>
<td>1.76</td>
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<td>2009-10</td>
<td>10870.17</td>
<td>631914</td>
<td>1.72</td>
</tr>
<tr>
<td>2010-11</td>
<td>12346.9</td>
<td>756719</td>
<td>1.63</td>
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<tr>
<td>2011-12</td>
<td>15818.85</td>
<td>867579</td>
<td>1.82</td>
</tr>
<tr>
<td>2012-13</td>
<td>21956.5</td>
<td>1045616</td>
<td>2.09</td>
</tr>
</tbody>
</table>

(Source: Compiled from SBI Annual Reports & % calculated by researcher)

If we talk about Net NPA to advances, there is a fluctuating trend in whole of the study period. It shows a declining trend from 2003-04 to 2005-06 in terms of Net NPA. From 2006-07 to the end of the study period i.e. 2012-13 it shows an upward movement.

Similarly % of Net NPA to advances also having fluctuating trend during the study period. It is declining from 2003-04 to 2006-07 and from 2007-08 to 2010-11 it is again showing a declining trend. But from 2011-12 to 2012-13 it shows an upward movement.

Table 5.4
Gross NPA to NET PROFIT

<table>
<thead>
<tr>
<th>YEAR</th>
<th>GROSS NPA (₹ in crore)</th>
<th>NET PROFIT (₹ in crore)</th>
<th>Ratio of Gross NPA to Net Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>12667.21</td>
<td>3681</td>
<td>3.44</td>
</tr>
<tr>
<td>2004-05</td>
<td>12455.73</td>
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</tr>
<tr>
<td>2005-06</td>
<td>9628.14</td>
<td>4407</td>
<td>2.18</td>
</tr>
</tbody>
</table>
In the above table it looks that the ratio of Gross NPA to Net Profit is declining from 2003-04 to 2008-09, but it due to the fact that Gross NPA are decreasing from the year 2003-04 to 2005-06 and on the contrary the Net Profit is showing an upward movement in whole of the study period. From 2009-10 to 2012-13 the ratio of Gross NPA to Net Profit is increasing sharply due to the fact that Gross NPA are increasing very sharply in this period.

### Table 5.5
**Net NPA to NET PROFIT**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NET NPA (₹ in crore)</th>
<th>NET PROFIT (₹ in crore)</th>
<th>Ratio of Net NPA to Net Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>5441.73</td>
<td>3681</td>
<td>1.48</td>
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<tr>
<td>2004-05</td>
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<tr>
<td>2011-12</td>
<td>15818.85</td>
<td>11707</td>
<td>1.35</td>
</tr>
<tr>
<td>2012-13</td>
<td>21956.5</td>
<td>14105</td>
<td>1.56</td>
</tr>
</tbody>
</table>

(Source: Compiled from SBI Annual Reports & ratio calculated by researcher)
It is clear from the above table that the ratio of Net NPA to Net Profit is fluctuating in whole of the study period. During first three years of the study Net NPA has declining trend and after this period it shows an upward movement up to the end of the study period. Up to the first six years the ratio was in declining mode. High Net NPA is a dangerous sign for the profitability of the bank.

Table 5.6
Gross NPA to TOTAL ASSETS

<table>
<thead>
<tr>
<th>YEAR</th>
<th>GROSS NPA (₹ in crore)</th>
<th>TOTAL ASSETS (₹ in crore)</th>
<th>% of Gross NPA to Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>12667.21</td>
<td>407815</td>
<td>3.11</td>
</tr>
<tr>
<td>2004-05</td>
<td>12455.73</td>
<td>459883</td>
<td>2.71</td>
</tr>
<tr>
<td>2005-06</td>
<td>9628.14</td>
<td>493870</td>
<td>1.95</td>
</tr>
<tr>
<td>2006-07</td>
<td>9998.22</td>
<td>566565</td>
<td>1.76</td>
</tr>
<tr>
<td>2007-08</td>
<td>12837.36</td>
<td>721526</td>
<td>1.78</td>
</tr>
<tr>
<td>2008-09</td>
<td>15588.66</td>
<td>964432</td>
<td>1.62</td>
</tr>
<tr>
<td>2009-10</td>
<td>19534.89</td>
<td>1053414</td>
<td>1.85</td>
</tr>
<tr>
<td>2010-11</td>
<td>25326.29</td>
<td>1223736</td>
<td>2.07</td>
</tr>
<tr>
<td>2011-12</td>
<td>39676.46</td>
<td>1335519</td>
<td>2.97</td>
</tr>
<tr>
<td>2012-13</td>
<td>51189.4</td>
<td>1566261</td>
<td>3.27</td>
</tr>
</tbody>
</table>

(Source: Compiled from SBI Annual Reports & % calculated by researcher)

In the above table the total assets are increasing constantly during whole of the study period. It has an upward movement. But the percentage of Gross NPA to Total Assets is showing a declining trend from 2003-04 to 2008-09 and after that it increasing rapidly and attain a peak point of 3.27 % in the last year of the study. It is due the fact that the Gross NPA of SBI have increased sharply in the last four years of the study. So it can be said that from the last three or four years the position of NPA is becoming poorer.
### Table 5.7
Net NPA to TOTAL ASSETS

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NET NPA (₹ in crore)</th>
<th>TOTAL ASSETS (₹ in crore)</th>
<th>% of Net NPA to Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>5441.73</td>
<td>407815</td>
<td>1.48</td>
</tr>
<tr>
<td>2004-05</td>
<td>5348.89</td>
<td>459883</td>
<td>1.24</td>
</tr>
<tr>
<td>2005-06</td>
<td>4911.41</td>
<td>493870</td>
<td>1.11</td>
</tr>
<tr>
<td>2006-07</td>
<td>5257.72</td>
<td>566565</td>
<td>1.16</td>
</tr>
<tr>
<td>2007-08</td>
<td>7424.33</td>
<td>721526</td>
<td>1.1</td>
</tr>
<tr>
<td>2008-09</td>
<td>9552.02</td>
<td>964432</td>
<td>1.05</td>
</tr>
<tr>
<td>2009-10</td>
<td>10870.17</td>
<td>1053414</td>
<td>1.19</td>
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<tr>
<td>2010-11</td>
<td>12346.9</td>
<td>1223736</td>
<td>1.49</td>
</tr>
<tr>
<td>2011-12</td>
<td>15818.85</td>
<td>1335519</td>
<td>1.35</td>
</tr>
<tr>
<td>2012-13</td>
<td>21956.5</td>
<td>1566261</td>
<td>1.56</td>
</tr>
</tbody>
</table>

(Source: Compiled from SBI Annual Reports & % calculated by researcher)

In the above table the percentage of Net NPA to Total Assets is showing a declining trend in the first six years of the study period, after that it has a fluctuating trend. In the year 2008-09 it was 1.05 %, in 2009-10 it was 1.19 % and finally in the year 2012-13 it went up to 1.56 %.

- **Market Risk:**

Market risk refers to the risk of losses in the bank’s trading book due to changes in equity prices, interest rates, credit spreads, foreign-exchange rates, commodity prices and other indicators whose values are set in a public market as well as the volatilities of those prices. To manage market risk, bank deploy a number of highly sophisticated mathematical and statistical techniques. Chief among these is value-at-risk (VAR) analysis, which over the past 15 years has become established as the industry and
regulatory standard in measuring market risk. The following are the types of market risks -:

a) **Liquidity Risk:** Bank Deposits generally have a much shorter contractual maturity than loans and liquidity management needs to provide a cushion to cover anticipated deposit withdrawals. Liquidity is the ability to efficiently accommodate deposit as also reduction in liabilities and to fund the loan growth and possible funding of the off-balance sheet claims. The cash flows are placed in different time buckets based on future likely behavior of assets, liabilities and off-balance sheet items. Liquidity risk consists of Funding Risk, Time Risk & Call Risk.

b) **Interest Rate Risk:** Interest Rate Risk is the potential negative impact on the Net Interest Income and it refers to the vulnerability of an institution’s financial condition to the movement in interest rates. Changes in interest rate affect earnings, value of assets, liability, off-balance sheet items and cash flow. Earnings perspective involves analyzing the impact of changes in interest rates on accrual or reported earnings in the near term. This is measured by measuring the changes in the Net Interest Income (NII) equivalent to the difference between total interest income and total interest expense.

c) **Forex Risk:** Foreign exchange risk is the risk that a bank may suffer loss as a result of adverse exchange rate movement during a period in which it has an open position, either spot or forward or both in same foreign currency. Even in case where spot or forward positions in individual currencies are balanced the
maturity pattern of forward transactions may produce mismatches. There is also a settlement risk arising out of default of the counter party and out of time lag in settlement of one currency in one center and the settlement of another currency in another time zone. Bank is also exposed to interest rate risk, which arises from the maturity mismatch of foreign currency position.

d) Country Risk: This is the risk that arises due to cross border transactions that are growing dramatically in the recent years owing to economic liberalization and globalization. It is the possibility that a country will be unable to service or repay debts to foreign lenders in time. It comprises of Transfer Risk arising on account of possibility of losses due to restrictions on external remittances; Sovereign Risk associated with lending to government of a sovereign nation or taking government guarantees; Political Risk when political environment or legislative process of country leads to government taking over the assets of the financial entity (like nationalization, etc.) and preventing discharge of liabilities in a manner that had been agreed to earlier; Cross border risk arising on account of the borrower being a resident of a country other than the country where the cross border asset is booked; Currency Risk, a possibility that exchange rate change, will alter the expected amount of principal and return on the lending or investment.

- **Meaning of Value at Risk – ‘VAR‘:**

A statistical technique used to measure and quantify the level of financial risk within a firm or investment portfolio over a specific time frame. Value at risk is used by risk
managers in order to measure and control the level of risk which the firm undertakes. The risk manager's job is to ensure that risks are not taken beyond the level at which the firm can absorb the losses of a probable worst outcome.

- **Introduction to Value-at-Risk Models:**

A value-at-risk model measures market risk by determining how much the value of a portfolio could decline over a given period of time with a given probability as a result of changes in market prices or rates. For example, if the given period of time is one day and the given probability is 1%, the value-at-risk measure would be an estimate of the decline in the portfolio value that could occur with a 1% probability over the next trading day. In other words, if the value-at-risk measure is accurate, losses greater than the value-at-risk measure should occur less than 1% of the time.

The two most important components of value-at-risk models are the length of time over which market risk is to be measured and the confidence level at which market risk is measured. The choice of these components by risk managers greatly affects the nature of the value-at-risk model. The choice of confidence level varies among different risk managers. For example Basel Committee recommends the 99.9% confidence level for capital adequacy purposes. For internal use, lower confidence levels are often used. For example J.P. Morgan uses a 99% confidence level. Citibank uses a level of 95.4% and Goldman Sachs uses a 95% level. Another parameter that varies among risk managers is the time horizon over which VAR is estimated. The Basel Committee recommends a time horizon of ten days for most capital market transactions.  

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objective of credit risk measurement is to assess the expected loss given a default. Broadly speaking, the expected credit loss on a portfolio depends on following factors:

1. The probability of default

2. The expected value of position or exposure at the time of default, and

3. The recovery rate.

The following formula illustrates this relationship in the case of a single investment “X” –

\[ E [CL] = d \times LGD \]

\[ OR = d \times E [X] \times (1-R) \]

Where, CL = Credit Loss

\[ d = \text{probability of default} \]

\[ X = \text{the value of the position or exposure} \]

\[ R = \text{the recovery rate, that is, the proportion of the instrument value recovered after default as part of the liquidation process} \]

\[ LGD = \text{Loss Given Default.} \]

5.7 Techniques to Measure Profitability:

Measurement of profit is essential for taking various policy level decisions under different circumstances. Measurement of profitability provides overall performance of a concern. It is also useful for forecast measurement of a unit’s performance. According to Murthy V.S. “The most important measurement of profitability of a company is ratio i.e. 
profitability of assets, variously referred to as earning power of the company return on total investment or total resources committed to operation.”\textsuperscript{12}

According to Block and Hirt “The income statement is the major device for measuring the profitability of a firm over a period of time.”\textsuperscript{13} Thus, the profitability of a business unit can be evaluated or measured from number of perspectives. The following are the major techniques may be used to measure profitability:

(i) Trend Analysis

(ii) Ratio Analysis

\textbf{(i) Trend Analysis:} Trend Analysis is helpful in making comparative study of the changes in an item or groups of item over a period of time and to draw conclusion. Pat made an assessment of the RBI’s Report on “Trend and Progress of Banking’ in India, 2007-08, which reported a relatively-healthy position of the Indian banking system. He noted that the various groups of banks reported improvements in net profits, return on assets and return on equity. Two basic indicators of sound banking system, namely, capital to risk weighted assets and quality of assets, also revealed considerable improvements over the years.\textsuperscript{14}

The following steps are followed:

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\begin{enumerate}
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The following steps are followed:
1. Select a base year.

2. Assign a weight of 100 percent to the base year for the related item.

3. Compute index number for other years under study based on base year for the related item.

To chalk out the trends in the profits and profitability of the bank under study, the following indicators have been selected:

(i) Income
(ii) Expenditure
(iii) Spread
(iv) Burden
(v) Net profit
(vi) Profitability

a) Trends of Income: Table 5.8 and chart 5.8 presents the trends of income and % increase over previous year of SBI from 2003-04 to 2012-13.

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>38073</td>
<td>39548</td>
<td>43184</td>
<td>44008</td>
<td>57645</td>
<td>76479</td>
<td>85962</td>
<td>97219</td>
<td>120873</td>
<td>135692</td>
</tr>
<tr>
<td>% Change</td>
<td>3.87</td>
<td>9.19</td>
<td>1.91</td>
<td>30.99</td>
<td>32.67</td>
<td>12.4</td>
<td>13.09</td>
<td>24.33</td>
<td>12.26</td>
<td></td>
</tr>
</tbody>
</table>
Income of SBI was ₹ 38073 crore at the end of the base year 2003-04, which showed an upward trend during the study period and reached to ₹ 135692 crore at the end of the study period 2012-13. Index on the base year revealed the fact that the income of the bank was about 3.56 times at the end of the study period. It showed favorable position of the bank. It revealed the fact that the bank might have expanded network, launched new service products, which attracted clients. In short, overall income performance improved during the study period.

Percentage increase over previous year showed fluctuating trend during the study period. It ranged between 3.87 % in 2003-04 to 32.67 % in 2008-09. It was 1.91 % in 2006-07 and hiked to 30.99 % in the next year only but then onward in the subsequent years of the study period, it slowed down the growth of income.

**b) Trends of Interest Earned:** Table 5.9 and chart 5.9 present the data related to trends of interest earned, its index on the base year, percentage increase over previous year and interest earned as percentage of total income of
SBI for the period from 2003-04 to 2012-13. Interest earned is the part of the total income earned. Any increase in interest earned indicates increase in lending, increase in rate of interest on lending, launching of new lending products, etc.

**Table 5.9**

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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>30460</td>
<td>32428</td>
<td>35795</td>
<td>37242</td>
<td>48950</td>
<td>63788</td>
<td>70994</td>
<td>81394</td>
<td>106521</td>
<td>119655</td>
</tr>
<tr>
<td>% Change</td>
<td>6.46</td>
<td>10.38</td>
<td>4.04</td>
<td>31.44</td>
<td>30.31</td>
<td>11.29</td>
<td>14.65</td>
<td>30.87</td>
<td>12.33</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)

Interest earned of SBI was ₹ 30460 crore in the base year 2003-04, which rose to ₹ 119655 crore at the end of the study period, 2012-13, which was 3.93 fold over the base year. Percentage increase over previous year remarked fluctuating trend during the study period. It ranged between 4.04 % in 2006-07 to 31.44 % in 2007-08. Interest earned as percentage of total income also showed fluctuating trend during the study
period. It ranged between 80.01% in 2003-04 to 88.18% in 2012-13. It indicated aggregate 84% of the total income earned, was out of interest earned.

c) **Trends of Non-Interest income:** Table and chart 5.10 presents the data of the trends of Non-interest income, of SBI for the period from 2003-04 to 2012-13. Non-interest income is the part of the total income earned. Non-interest income is also known as ‘other income’. There are two components of other income or non-interest income: fee and treasury income. Usually, around 70% of the total is fee income. Any increase in non-interest income indicates decrease in lending, decrease in rate of interest on lending, decrease in interest earned, etc. and vice-versa.

**Table 5.10**

<table>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>7612</td>
<td>7120</td>
<td>7389</td>
<td>6765</td>
<td>8695</td>
<td>12691</td>
<td>14968</td>
<td>15825</td>
<td>14351</td>
<td>16037</td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
Non-interest income of SBI was ₹ 7612 crore in 2003-04, which rose to ₹ 16037 crore at the end of 2012-13. It decreased to ₹ 6765 crore in 2006-07, but it increased to ₹ 12691 crore in 2008-09. Overall it has a growth of 2.11 times over the base year.

**d) Trends of Total Expenditure:** The term ‘Total Expenditure’ refers the renouncing aspect of the revenue transaction. It is the part of revenue application of fund or the out flow of goods and services, which are matched with revenue to determine profit or loss. Most of the expenses of banking industry are pre-estimated expenditure. They are fixed for the short time duration. The main bank expenditure is grouped under the following main heads:

(i) Interest expended

(ii) Operating expenses (salaries, allowances, provident fund, bonus, etc.

(iii) Other expenses

Generally, State Bank incurs the expenditure for payment of interest on deposits and borrowings. RBI decides the rate of interest on deposits and borrowings. So, the bank has very little control over it, but bank can control operating expenses incurred for human resource (personnel, managers, clerks). State Bank can also reduce the expenditure and loss by implementing cost reduction techniques, controlling non-performing assets, improving organizational structure and by using information technology. Reduction in expenditure will result into increase in profitability of bank. Table and chart 5.11 present the trends of total expenditure and percentage change over the previous year of SBI for the period from 2003-04 to 2012-13.
Table 5.11
Trends of Total Expenditure

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Amount</td>
<td>34392</td>
<td>35243</td>
<td>38777</td>
<td>39466</td>
<td>50916</td>
<td>67358</td>
<td>76796</td>
<td>88954</td>
<td>109166</td>
<td>121587</td>
</tr>
<tr>
<td>(in crore)</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Change</td>
<td>2.47</td>
<td>10.03</td>
<td>1.78</td>
<td>29.01</td>
<td>32.29</td>
<td>14.01</td>
<td>15.83</td>
<td>22.72</td>
<td>11.38</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)

The Total Expenditure of State Bank of India was ₹34392 crore for the base year. It remarked an upward movement during whole of the study period and came to ₹121587 crore at the end of the study period 2012-13. It had compounded its total expenditure by about 3.54 times over the base year. In 2004-05, it increased by 7.56 % compared to the previous year, 2003-04. It increased in 2007-08, by 29.01 %, in 2008-09 by 32.29 %. In 2009-10 it comes down to 14.01 %, again in 2010-11 it increases to 15.83 % and in 2011-12 by 22.72 % as compared to their respective previous years. Percentage increase over previous year slowed down in the subsequent years, it increased by 3.28 % in 2008-09, by 6.89 % in 2011-12. It reflects that total overall the expenditure of SBI
increased but there was a high fluctuation in total expenditure incurred by SBI during the study period.

e) Trends of Interest Expended: Bank expends interest on deposits and RBI determines the rate of interest for deposits. So, bank has very little control over it. More deposits results into the more amount of interest expended. Hence, increase in amount of interest expended will be either due to increase in rate of interest on deposits or increase in amount of deposits or vice versa. Table and chart 5.12 represents the trends in interest expended, percent increase over previous year of SBI for the period from 2003-04 to 2012-13.

Table 5.12
Trends of Interest Expended

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Amount (in crore)</td>
<td>19274</td>
<td>18483</td>
<td>20159</td>
<td>22184</td>
<td>31929</td>
<td>42915</td>
<td>47322</td>
<td>48868</td>
<td>63230</td>
<td>75325</td>
</tr>
<tr>
<td>% Change</td>
<td>(4.10)</td>
<td>9.07</td>
<td>10.04</td>
<td>43.93</td>
<td>34.41</td>
<td>10.27</td>
<td>3.27</td>
<td>29.39</td>
<td>19.13</td>
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</tbody>
</table>

(Source: Annual Reports of SBI)
Interest expended of SBI was ₹ 19274 crore in the year 2003-04. It perceived mixed trend during the study period and reached to ₹ 31929 crore in 2007-08. It decreased to ₹ 18483 crore in 2004-05 but it increased to ₹ 20159 crore in 2005-06. Its index on the base year registered 3.91 folds effect over its base year in 2003-04 but 1.09 folds increase in 2005-06. It increased by 13.17 percent in 2005-06 compared to the previous year, 2004-05. In the subsequent years, it rose by 0.97 percent, 33.89 percent in 2006-07 and 2007-08 respectively compared to their respective previous years.

Interest paid as percentage of total expenditure worked out 56.04 percent for 2003-04, 52.44 percent for 2004-05, 51.99 percent for 2005-06, 56.21 percent for 2006-07, 62.71 percent for 2007-08, 63.71 percent for 2008-09, 61.62 percent for 2009-10, 54.90 percent for 2010-11, 57.92 percent for 2011-12 and 61.95 percent for 2012-13. It registered fluctuating trend during the study period. It indicates aggregate 60 percent of the total expenditure was incurred for the interest payment on deposits and borrowings.

f) Trends of Operating Expenses: Table & chart 5.13 show the trends of operating expenses of SBI from 2003-04 to 2012-13. Operating expenses of bank include salaries, allowances, provident fund, bonus, etc. Increase in operating expenses indicates increase in burden and decrease in profitability.

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in crore)</td>
<td>9245</td>
<td>10074</td>
<td>11725</td>
<td>11824</td>
<td>12609</td>
<td>15649</td>
<td>20319</td>
<td>23015</td>
<td>26069</td>
<td>29284</td>
</tr>
<tr>
<td>% Change</td>
<td>8.97</td>
<td>16.39</td>
<td>0.84</td>
<td>6.64</td>
<td>24.11</td>
<td>29.84</td>
<td>13.27</td>
<td>13.27</td>
<td>12.33</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
Operating expenses of SBI was ₹ 9245 crore for the base year, 2003-04. It stated upward movement during the study period and reached to ₹29284 crore at the end of the study period 2012-13. Its percentage increase over previous year was 8.97 percent, 16.39 percent, 0.84 percent, 6.64 percent, 24.11 percent, 29.84 percent, 13.27 percent, 13.27 percent and 12.33 percent for 2003-04, 2004-05, 2005-06, 2006-07, 2007-08, 2008-09, 2009-10, 2010-11,2011-12 and for 2012-13 respectively. Operating expenses as percentage of total expenditure remained at 26.88 percent in 2003-04, 28.58 percent in 2004-05, 30.24 percent in 2005-06, 29.96 percent in 2006-07, 24.76 percent in 2007-08, 23.23 percent in 2008-09, 26.46 percent in 2009-10, 25.90 percent in 2010-11, 23.88 percent in 2011-12 and 24.08 percent in 2012-13. It registered fluctuating trend during the study period. It indicates aggregate 22 percent of the total expenditure was incurred for operating expenses.
g) **Trends of Other Expenses:** Table 5.14 and chart 5.14 reveal the trend of other expenses, of SBI for the period from 2003-04 to 2012-13. Other expenses of bank have been calculated applying the following formula.

**Formula:**

Other expenses = Total expenditure – Total interest expended – Operating expenses

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<tbody>
<tr>
<td>Amount (in crore)</td>
<td>5872</td>
<td>6686</td>
<td>6893</td>
<td>5459</td>
<td>6378</td>
<td>8794</td>
<td>9155</td>
<td>17071</td>
<td>19866</td>
<td>16977</td>
</tr>
<tr>
<td>% Change</td>
<td>13.86</td>
<td>3.10</td>
<td>(20.80)</td>
<td>16.83</td>
<td>37.88</td>
<td>4.11</td>
<td>86.47</td>
<td>16.37</td>
<td>(14.54)</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
Other expenses of SBI were ₹ 5872 crore in 2003-04. It registered fluctuating trend during the study period. Percentage increase over previous year remarked highly fluctuating trend during the study period. It decreased by (15.71) % in 2006-07, it increased by 16.83 % in 2007-08, 37.88 % in 2008-09 afterwards, in 2009-10, it decreased by 4.11 % but, in the subsequent years in 2010-11 it remarked upward movement by 86.47 % respectively. It decreased to (14.54) % in 2012-13. Other expenses as percentage of total expenditure remarked fluctuating trend during the study period. It was 17.08 % in 2003-04, 18.97 % in 2004-05, 17.77 % in 2005-06, 13.83 % in 2006-07, 12.53 % in 2007-08, 13.06 % in 2008-09, 11.92 % in 2009-10, 19.20 % in 2010-11, 18.20 % in 2011-12 and 13.96 % in 2012-13. It indicates aggregate 18 % of the total expenditure was incurred for other expenses.

**h) Trends of Spread:** Financial performance of bank is based on the concept ‘spread’. Spread is nothing but surplus of interest income over interest expenses. This ratio is also known as "Interest expenditure to interest income ratio". In other words “spread” is the difference between the interest earned and interest paid by the bank. It is the difference between the income earned by deployment of funds and the cost of funds\(^{15}\). Another author defines spread as “the difference between the average gross interest received on average earning assets and the average gross interest paid on average liabilities\(^{16}\). This ratio is reflective of efficiency in the use of funds.

\(^{15}\) M.M. Thakar, profit planning in banks, IBA Bulletin, Feb,1991, p.21

\(^{16}\) Verghese S.K. profits and profitability of Indian Commercial Banks in the seventies, National Institute of Bank Management, Bombay 1983 p.19
The spread of a bank improves or increases if there is an increase in interest income or a decrease in interest expenses or more than proportionate increase in interest income than proportionate increase in interest expenditure and vice-versa. If interest expenditure is more than interest income, shows danger signal for a bank, as it means interest margins getting squeezed.

Table and chart 5.15 provide the data relating to trends of spread, of SBI for the period from 2003-04 to 2012-13.

**Table 5.15**

**Trends of Spread**

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<tbody>
<tr>
<td>Amount (in crore)</td>
<td>11186</td>
<td>13945</td>
<td>15636</td>
<td>15058</td>
<td>17021</td>
<td>20873</td>
<td>23672</td>
<td>32526</td>
<td>43291</td>
<td>44330</td>
</tr>
<tr>
<td>% Change</td>
<td>24.66</td>
<td>12.13</td>
<td>(3.70)</td>
<td>13.04</td>
<td>22.63</td>
<td>13.41</td>
<td>37.40</td>
<td>33.10</td>
<td>2.40</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)
Spread of SBI was ₹ 11186 crore in 2003-04. It showed upward movement during the study period and reached to ₹ 44330 crore at the end of the study period, 2012-13. It increased by 24.66 percent in 2004-05 compared to its previous year 2003-04. It increased by 12.13 percent, in 2005-06 by 13.04 percent in 2007-08, by 22.63 percent in 2008-09, by 13.41 percent in 2009-10, by 37.40 percent in 2010-11, by 33.10 percent in 2011-12 and by 2.40 percent in 2012-13 as compared to their respective previous years.

i) Trends of Burden: Excess of non-interest expenditure over non-interest income of a bank is known as burden. In other words, burden means difference between non-interest expenditure (consisting establishment expenditure and other expenditure) and non-interest income (comprising of commission, brokerage and other miscellaneous receipts) of bank. Profits may be defined as the difference between spread and burden. Burden is in the nature of operating cost. It represents non-interest expenses that are not covered by non-interest income. The magnitude of the burden of bank, is affected by the following factors:

1. Efficiency of manpower management.
2. Efficiency of general bank management.
3. Efficiency of ancillary business.

Bank always try to maintain burden at the minimum so as to get higher profit. Burden is calculated applying the following formula:

Burden = Non-interest expenditure – Non-interest income

Where: Non-interest expenditure = Total expenditure – Interest expended
Table and chart 5.16 represents the data for burden of SBI for the period from 2003-04 to 2012-13.

Table 5.16
Trends of Burden

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<tbody>
<tr>
<td>Amount</td>
<td>7506</td>
<td>9640</td>
<td>11229</td>
<td>10517</td>
<td>11752</td>
<td>14506</td>
<td>24261</td>
<td>31585</td>
<td>30225</td>
<td></td>
</tr>
<tr>
<td>(in crore)</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Change</td>
<td>28.43</td>
<td>16.48</td>
<td>(6.34)</td>
<td>(2.14)</td>
<td>14.19</td>
<td>23.43</td>
<td>67.25</td>
<td>30.19</td>
<td>(4.31)</td>
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</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)

Burden of SBI was ₹ 7506 crore in the year 203-04, which increased in the subsequent years and reached to ₹ 30225 crore at the end of the study period. It increased by 28.43 % in 2004-05, by 16.48 % in 2005-06, by (6.34) % in 2006-07, by (2.14) % in 2007-08, by 14.19 % in 2008-09, by 23.43 % in 2009-10, by 67.25 % in 2010-11, by 30.19 % in 2011-12 and by (4.31) % in 2012-13 in comparison to their respective previous years. In the year 2006-07, 2007-08 and in 2012-13 it show downward trend. It decreased by (2.14) % in 2007-08 as compared to its previous year 2006-07.
j) **Trends of Net Profit:** Profit is the prime indicator for performance. Profit is an event of the business unit, which indicates revenue is in excess of its expenditure or cost. Revenue is derived from service provided by it and cost is the total expenditure incurred while rendering service. The higher the profit, the better the financial performance of the business.

Table and chart 5.17 reveals the data related to net profit of SBI for the period from 2003-04 to 2012-13.

**Table 5.17**

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<tbody>
<tr>
<td>Amount (in crore)</td>
<td>3681</td>
<td>4305</td>
<td>4407</td>
<td>4541</td>
<td>6729</td>
<td>9121</td>
<td>9166</td>
<td>8265</td>
<td>11707</td>
<td>14105</td>
</tr>
<tr>
<td>% Change</td>
<td>16.95</td>
<td>2.37</td>
<td>3.04</td>
<td>48.18</td>
<td>35.55</td>
<td>0.49</td>
<td>(9.83)</td>
<td>41.65</td>
<td>20.48</td>
<td></td>
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</tbody>
</table>

(Source: Annual Reports of SBI)

Net profit of SBI was ₹ 3681 crore in the base year 2003-04, it show an upward movement during whole of the study period from 2003-04 to 2010-11 and from 2011-12
to the end of the study period. Its net profit increased by 16.95 percent, by 2.37 percent by, 3.04 percent, by 48.18 percent, by 35.55 percent, by 0.49 percent by, 41.65 percent and by 20.48 percent in 2004-05, in 2005-06, in 2006-07, in 2007-08, in 2008-09, in 2009-10, in 2011-12 and in 2012-13 respectively in comparison to their respective previous years. While it decreased by 9.83 percent in 2010-11 compared to their respective previous years.

**k) Trends of Profitability:** The term ‘profitability’ is consisting two words ‘profit’ and ‘ability’. Thus, profitability means ‘profit earning capacity’ of a business unit. Profitability is the ability of firms to generate earnings. 17 It is the indicator of efficiency with which the operations of the organization are carried on. The performance of a bank is evaluated with the help of the profitability criteria. It indicates net profit as percentage of working fund. Table and chart 5.18 present the data for profitability index of SBI for the period from 2003-04 to 2012-13.

**Table 5.18**

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</thead>
<tbody>
<tr>
<td>Amount</td>
<td>2.50</td>
<td>2.61</td>
<td>2.27</td>
<td>0.72</td>
<td>1.01</td>
<td>1.04</td>
<td>0.88</td>
<td>0.71</td>
<td>0.88</td>
<td>0.91</td>
</tr>
</tbody>
</table>

(Source: Annual Reports of SBI)

Table 5.18 shows that profitability of SBI was 2.50 percent in the base year 2003-04 which registered highly fluctuating trend during the study period. It reached to the peak point of 2.61 percent in 2004-05 during the study period. It came to 2.27 percent at the end of the study period, 2005-06.

(ii) **Ratio Analysis:** Ratio analysis is a powerful tool of financial analysis. The growth, development and the present position of a unit in term of profit can be analyzed through the calculation of various ratios. A ratio is defined as “the indicated quotient of two mathematical expression”.\(^{18}\) It is also defined as “an arithmetical relationship between two variables or figures” It establishes reasoned relationship between two variables. Ratio analysis is also defined as "the process of determining and interpreting numerical relationship based on financial statements". A ratio is a statistical yardstick that provides a measure of the relationship between variables or figures.\(^{19}\)


A ratio is known as a symptom, like the blood pressure, the pulse rate or the temperature of an individual. Ratio analysis is used as a device to diagnose the financial condition. It tells whether the financial condition is very strong, good, partly good, questionable or poor. A ratio is customarily expressed in three ways: times, proportion and percentage. It may also be depicted in the form of diagram & chart.

1. Interest Earned as % to Total Income: It is income out of main activities of the banking business. The components of interest earned are interest and discount received on advances and income from various investments. Interest earned as % to total income represents the amount earned as interest out of total income. Table & chart 5.19 shows the data of interest earned as % to total income of SBI from 2003-04 to 2012-13.

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<tbody>
<tr>
<td>Amount</td>
<td>80.01</td>
<td>82.00</td>
<td>82.89</td>
<td>84.63</td>
<td>84.92</td>
<td>83.41</td>
<td>82.59</td>
<td>83.72</td>
<td>88.13</td>
<td>88.18</td>
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<tr>
<td>(in %)</td>
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(Source: Performance Highlights of SBI, percent calculated by researcher from table 5.8 & 5.9)
Interest earned as % to total income of SBI was 80.01 percent in 2003-04, which show an upward movement for the whole study period from 2003-04 to 2012-13. It registered upward movement from 2003-04 to 2012-13 and reached to 88.18 percent in 2012-13. It improved to 82.00 percent in 2004-05 and a little bit more improved to 82.89 percent in 2005-06. It varied from 80.01 percent to 88.18 percent during the study period. Average of interest earned as % to total income was 84.04 percent.

2. Non-Interest Income as % to Total Income: The sources of Non-interest income for the bank are brokerage, commission; profit on exchange, charges, interest and dividend earned and other miscellaneous incomes. Generally non-interest income is utilized to meet non-interest expenditure. Thus, non-interest income affects the burden. The higher the non-interest income, the lower the burden. If burden can be reduced, profitability of the bank can be increased. Table and chart 5.20 reveals the data of non-interest income as % to total income of SBI for the period from 2003-04 to 2012-13.

Table 5.20
Non-Interest Income as % to Total Income

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</thead>
<tbody>
<tr>
<td>Amount</td>
<td>19.99</td>
<td>18.00</td>
<td>17.11</td>
<td>15.37</td>
<td>15.08</td>
<td>16.59</td>
<td>17.41</td>
<td>16.28</td>
<td>11.87</td>
<td>11.82</td>
</tr>
</tbody>
</table>

(Source: Performance Highlights of SBI, percent calculated by researcher from table 5.8 & 5.10)
Non-interest income as % to total income of SBI was 19.99 percent in 2003-04, which in the subsequent years up to 2007-08, it registered downward trend, which was 18.00 percent in 2004-05, 17.11 percent in 2005-06, 15.37 percent in 2006-07 and 15.08 percent in 2007-08. It moved up to 16.59 percent in 2008-09 and to 17.41 percent in 2009-10. It reached to 16.28 percent in 2010-11, 11.87 percent in 2011-12 and to 11.82 percent in 2012-13. This ratio indicates 15.95 percent of the total income was earned out of non-interest income.

3. Interest Expended as % to Total Expenditure: Interest is expended on deposits and borrowings, which are collected by the bank as main source of income. The ratio of interest expended as % to total expenditure indicates the rate at which the bank pays interest on the deposits and borrowings. Table 5.21 and chart 5.21 shows the data of interest expended as % to total expenditure of SBI for the period from 2003-04 to 2012-13.
Table 5.21
Interest Expended as % to Total Expenditure

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</thead>
<tbody>
<tr>
<td>Amount (in %)</td>
<td>56.04</td>
<td>52.44</td>
<td>51.99</td>
<td>56.21</td>
<td>62.71</td>
<td>63.71</td>
<td>61.62</td>
<td>54.90</td>
<td>57.92</td>
<td>61.95</td>
</tr>
</tbody>
</table>

(Source: Performance Highlights of SBI, % calculated by researcher from table 5.11 & 5.12)

Interest expended, as % to total expenditure was 56.04 percent in 2003-04 which showed much ups and down during the study period. It went up to 62.71 percent in 2007-08 but it came down in 2005-06 to 51.99 percent. It reached to 63.71 percent in 2008-09. It reached to the highest point of the study period to 63.71 percent in 2008-09 but in the immediate year, 2009-10, it moved down to 61.62 percent. It moved down to 56.04 percent to 52.44 percent and to 51.99 percent in 2003-04, in 2004-05 and in 2005-06 respectively. This indicates that SBI expended aggregate 57.95 percent of the total expenditure for interest payment.
4. Spread as % to Working Fund: The term spread refers to the surplus of interest income over interest expenses of bank for a particular financial year. Profitability of the bank can be measured applying the ratio “spread as % to working fund.”

Table 5.22 and chart 5.22 provides the data related to spread as % to working fund during the study period i.e. from 2003-04 to 2012-13 for the bank under study.

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<tbody>
<tr>
<td>Amount (in %)</td>
<td>2.74</td>
<td>3.03</td>
<td>3.17</td>
<td>2.38</td>
<td>2.54</td>
<td>2.39</td>
<td>2.27</td>
<td>2.78</td>
<td>3.26</td>
<td>2.87</td>
</tr>
</tbody>
</table>

(Source: Performance Highlights of SBI, percent calculated by researcher himself)

Spread as % to working fund of SBI was worked out to 2.74 percent for the base year 2003-04, which increased to 3.03 percent in 2004-05, to 3.17 percent in 2005-06.
After this, it shows a fluctuating trend during rest of the study period. It was 2.38 percent in 2006-07, 2.54 percent in 2007-08 but it went up to 3.26 percent in 2011-12. It went down to 2.87 percent in 2012-13.

**5. Net Profit as % to Working Fund:** “Net profit as % to working fund” is one of the indicators of profitability. It is an important measurement for the efficiency. Here, net profit means the balance of profit as per profit and loss account and working fund means total of balance sheet less contra items.

Table 5.23 and chart 5.23 shows the data related to net profit as % to working fund for the study period 2003-04 to 2012-13 for the bank.

### Table 5.23
**Net Profit as % to Working Fund**

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</tr>
</thead>
<tbody>
<tr>
<td>Amount (in %)</td>
<td>0.90</td>
<td>0.94</td>
<td>0.89</td>
<td>0.72</td>
<td>1.01</td>
<td>1.04</td>
<td>0.88</td>
<td>0.71</td>
<td>0.88</td>
<td>0.91</td>
</tr>
</tbody>
</table>

(Source: Performance Highlights of SBI, % calculated by researcher from table 1.5 & from assets & liabilities)
Net profit as % working fund of SBI worked out to 0.90 percent for the base year which increased to 0.94 percent in 2004-05 but in the immediate year 2005-06 it moved down to 0.89 percent and again went down to 0.72 percent in 2006-07. It improved to 1.01 percent in 2007-08, 1.04in 2008-09. Once more, it went down to 0.88 percent in 2009-10. Then, it improved and reached to 0.91 percent at the end of the study period. The study indicates that net profit to working fund position of the bank showed highly impressive performance in the year 2007-08 while it was the worst in the year 2010-11.

Sampath examined the factors influencing profitability of commercial banks. According to him, profit means the excess of total revenue over total expenses, whereas profitability means the rate of return on working funds. Further he emphasized that profitability depends on certain factors like interest income, interest expenses and manpower expenses, other expenses and non-interest income.\(^\text{20}\)

**Conclusion:**

Bank is a commercial venture. The main objective of any commercial venture is to earn profit and to enlarge profit by making the most efficient use of the resources available to them. Measurement of profit is essential for taking various policy level decisions under different circumstances. The profit of a business may be measured by studying the profitability of investment in it. Profitability is the result of financial as well as operational efficiency.

Profitability of the bank is by and large affected by the Non-Performing Assets. So Non-Performing Assets in banking industry has become a subject of intense importance and

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discussion. It has become a barometer of the health of bank and discussion on any bank is incomplete without the mention of NPA. Our country also now having a large portion of bank credit locked in NPA’s and hence NPA is receiving a greater importance. Thus NPA has the potential to directly affect the economy of the country.

To chalk out the trends in the profits and profitability of the bank under study, some of the indicators like Income, Expenditure, Spread, Burden, Net profit and Profitability have been selected. Their conclusion at a glance is as under –

1. Income Index on the base year revealed the fact that the income of the bank was about 3.56 times at the end of the study period. It showed favorable position of the bank. It revealed the fact that the bank might have expanded network, launched new service products, which attracted clients. In short, overall income performance improved during the study period.

2. The Total Expenditure of State Bank of India was ₹ 34392 crore for the base year. It remarked an upward movement during whole of the study period and came to ₹ 121587 crore at the end of the study period 2012-13. It had compounded its total expenditure by about 3.54 times over the base year.

3. Spread is nothing but surplus of interest income over interest expenses. Spread of SBI was ₹ 11186 crore in 2003-04. It showed upward movement during the study period.

4. Excess of non-interest expenditure over non-interest income of a bank is known as burden. Burden of SBI was ₹7506 crore in the year 203-04, which increased in the subsequent years and reached to ₹30225 crore at the end of the study period.
5. Net profit of SBI shows an upward movement during whole of the study period from 2003-04 to 2010-11 and from 2011-12 to the end of the study period.

6. Profitability of State Bank of India shows fluctuating trend during whole of the study period.

7. The average % of Gross NPA to Advances was 4.27 % which shows a higher rate of NPA (3.38 %) in comparison to SCBs of India.

8. The Gross NPA & Net NPA of SBI shows a growth of 4.04 times and 4.03 times respectively over the base year.

In this chapter the researcher has discussed about the profit earning ability of the bank. As we all know that ‘more risk more profit’ and risk is all pervasive and is prevalent in every activity, be it a manufacturing or trading or service related. Banking Industry, primarily dealing with financial services can be no exception and thus encounters with many related Risks. In this context, credit risk in bank represents the most important type of risk. As stated by Reserve Bank of India (RBI, 2005), Credit Risk is the major component of Risk Management system and this should receive special attention of the Top Management of a Bank. Credit Risk is considered as the major risk inherent in a Bank’s banking activities. Any mismanaging of this risk may lead a Bank into great trouble or even Bankruptcy. Credit risk is defined as the risk that a firm’s customer and the parties to which it has lent money will fail to make promised payments. There are basically two major types of risks that bank is exposed to in the course of its financial operations, viz. credit risk & market risk, so it is imperative that bank have to identify and measure various types of risks faced by them and initiate suitable remedial measures to mitigate them.
CHAPTER 6

CHALLENGES AND ISSUES AHEAD

The banking industry in India has a huge canvas of history, which covers the traditional banking practices from the time of Britishers to the reforms period, nationalization to privatization of banks and now increasing numbers of foreign banks in India. Therefore, Banking in India has been through a long journey. Banking industry in India has also achieved a new height with the changing times. The use of technology has brought a revolution in the working style of the bank. Nevertheless, the fundamental aspects of banking i.e. trust and the confidence of the people on the institution remain the same. The majority of the banks are still successful in keeping with the confidence of the shareholders as well as other stakeholders. However, with the changing dynamics of banking business brings new kind of risk exposure.

6.1 INTRODUCTION:

In recent time, we have witnessed that the World Economy is passing through some intricate circumstances as bankruptcy of banking & financial institutions, debt crisis in major economies of the world and euro zone crisis. The scenario has become very uncertain causing recession in major economies like US and Europe. This poses some serious questions about the survival, growth and maintaining the sustainable development.

However, amidst all this turmoil India’s Banking Industry has been amongst the few to maintain resilience. The tempo of development for the Indian banking industry has been
remarkable over the past decade. It is evident from the higher pace of credit expansion; expanding profitability and productivity similar to bank in developed markets, lower incidence of non-performing assets and focus on financial inclusion have contributed to making Indian banking vibrant and strong. Bank has begun to revise their growth approach and re-evaluate the prospects on hand to keep the economy rolling.

6.2 INDIAN BANKING – THE FUTURE AHEAD:

India is well positioned to become the fourth-largest economy in the world by 2025 with a GDP growth rate of 7 - 8 % a year\(^1\). This robust economic growth would be possible if the banking sector is able to adequately and efficiently meet the needs of a growing economy. Moreover, the Indian Economic Environment has witnessed path breaking reform measures initiated by the Government since early 1990s. As the socio economic development of a country depends on how strong the banking sector is and vice versa, reforms measures were also targeted towards the financial sector. In fact, the banking sector – the dominating segment of any Financial System – affects the economic performance of a country and there exist a causal link between the banking sector and the real sector. The causal link is, however, quite significant. Thus, the Indian banking system too, has been acting as an important agent of economic growth and intermingles with different segment of the financial sector. Therefore, it can be anticipated that in the light of the present economic situation and its increased industrial financing requirements, the Indian banking system will further grow in size and complexity while acting as a change agent. However, as State Bank of India grows in size and

complexity, it now has to function increasingly under competitive pressures.

Moreover, increasing emphasis on globalization of the Indian economy has opened up new avenues and challenges for the SBI but at the same time profit margin is reduced. In view of these developments, bank is subjected to tremendous pressures for enhancing profitability to sustain competition in the market. Thus, all these factors are mounting pressures on the performance of SBI and in its quest to remain competitive, bank is now more concerned for enhanced profitability and it has become even more accountable to its stakeholders.

6.3 Satisfaction level of the stakeholders of SBI:

With reference to the above lines, in the present study the satisfaction level of the customers of SBI is analyzed according to the data received in the area survey. For this purpose the information received through questionnaire was assembled in a table on the basis of predetermined number as 1 to 5. For the purpose to analyze the data, for every level of satisfaction a fixed value (X) was assigned as positive or negative. In short, the value assigned for various levels of satisfaction and for their evaluation the format of a table is given below-

<table>
<thead>
<tr>
<th>Level of satisfaction</th>
<th>Value assigned for various levels (X)</th>
<th>Frequency of Respondents (f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highly Satisfied</td>
<td>2</td>
<td>***</td>
</tr>
<tr>
<td>Satisfied</td>
<td>1</td>
<td>***</td>
</tr>
<tr>
<td>Not clear/ Neutral</td>
<td>0</td>
<td>***</td>
</tr>
<tr>
<td>Dissatisfied</td>
<td>-1</td>
<td>***</td>
</tr>
<tr>
<td>Highly Dissatisfied</td>
<td>-2</td>
<td>***</td>
</tr>
</tbody>
</table>
So, on the basis of value assigned for level of satisfaction and related frequency, the mean is calculated of the response provided by the respondents of every question. On the basis of the analysis & tables made with the help of primary data, the particulars of customers satisfaction level is as under-

**PART A (Position & Available Amenities)**

To know the customer satisfaction level in SBI, first of all the position & available amenities in the branches of the bank were analyzed. For this purpose the answers were collected by the customers on different aspects of the position & available amenities in the bank which is presented with the help of Table L. On the basis of the data collected, the question wise as well as collective analysis is as follows-

**Question No. 1: Availability of the Means of Transportation**

By analyzing the answers given by the customers regarding this question it is clear that 78 % of the customers are satisfied with the means available to reach the bank. In this 53 % customers are fully satisfied and 25 % are satisfied. The mean of these data is 1.16 which shows the satisfactory level of the customers.

![Chart 6.1](image-url)
Question No. 2: Parking Facility

It is clear from the table that only 27% customers are fully satisfied with the parking facility provided by the bank. 21% of the customers are neutral where as 21% customers are not satisfied with the parking facility of the bank. The mean is also less than 1 which shows that an improvement is required in this area.

Chart 6.2

Question No. 3: General Facilities

The answers given by the customers reveals that only 31% customers are fully satisfied with the general facilities provided by the bank, 26% are satisfied, 20% was not clear and 23% of the customers seems not to be satisfied with this facility. Here the mean is 0.58 which is low and require an improvement.

Chart 6.3
Question No. 4: Cleanliness

Here we can say that only 27 % of the customers are fully satisfied with this aspect, 34 % are satisfied, 21 % have no answer where as 18 % of the customers are not satisfied, out of it 15 % are dissatisfied & 03 % are highly dissatisfied with the cleanliness of the bank. So this aspect is also required an improvement in this area.

Chart 6.4

Question No. 5: Safety provisions

It is clear from the table that only 37 % customers are fully satisfied with the safety provisions of the bank, 21 % are satisfied, 23 % are not clear, 14 % are dissatisfied and 05 % of the customers are fully dissatisfied with the safety provisions provided by the bank. The mean in this regard is although is 0.71 which is not bad but it is due to the fact that approximately one fourth of the customers are not clear about it. So it is required a great improvement in this regard to make trust in the bank.
Question No. 6: Decoration
The answers given by the customer shows that they are not satisfied with the decoration quality of the bank. Only 21% of the customers fully satisfied, 28% are satisfied, 24% are neutral 11% are dissatisfied and 16% of the customers are fully dissatisfied with the decoration quality of the bank. So it can be improved.

Conclusion: If we see the overall answers of the customers regarding the position and amenities, than it is clear that on an average the customers of the bank are not satisfied. The table shows that only 32.67% of the customers show their satisfaction in different questions asked to them. The overall mean which is 0.66 is also not
satisfactory. It is concluded that they are not getting proper amenities in the bank. Therefore bank is required to take a good care in this direction, so that the satisfaction level of the customers may improve.

Table L
Available Amenities

<table>
<thead>
<tr>
<th>Q. No.</th>
<th>Level of Satisfaction</th>
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<th>Neutral/Not clear</th>
<th>Dissatisfied</th>
<th>Highly Dissatisfied</th>
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<th>Average</th>
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PART B (Banking Product & Services)

To know the satisfaction level of banking products & services provided by the SBI; the range of products, process time, fees & charges etc. are analyzed. On the basis of the data collected, the question wise as well as collective analysis is presented in Table M.

Question No. 1: Range of Banking Product & Services

It is clear from the answers given in reference to the different product and services provided by the bank that only 23 % of the customers are fully satisfied with it, 43 % are satisfied, 21 % are neutral and 13 % of the customers are not satisfied with the product and services provided by the bank. The mean value is also less than one.

![Pie Chart](chart6.7)

Question No. 2: Process Time in the Service

By analyzing the answers obtained in this regard, it can be said that only 16 % of the customers seems to be fully satisfied with the process time in obtaining the service which reflects the unwillingness of the employees in performing their duty at right time. 24 % customers are satisfied, 30 % are neutral, 20 % are dissatisfied and 10 % of the customers are highly dissatisfied in this reference. The mean which is 0.16 is also very low.
Question No. 3: Fee & Charges on the Banking Services

The answers given by the customers reveal that only 9% of the customers are fully satisfied with it, 34% are satisfied, 28% are neutral while 29% of the customers are not satisfied with the fees and charges levied by the bank on their banking services. The mean value is 0.19 which shows the negative aspect of the customers of the bank in this regard.

Question No. 4: Availability of Published or Unpublished Data Regarding Banking Services and Product

With reference to this question the researcher got mixed answers as only 26% of the customers are highly satisfied with the availability of published or unpublished data
regarding banking product and services. 36 % of the customers are satisfied, 18 % are unable to show their views and 20 % are unsatisfied with it. Although the mean was 0.60 which represent that some steps must be taken by the bank in this regard.

**Chart 6.10**

**Question No. 5: Level of Services Provided**

It is clear from the table that the level of services provided by state bank of India is not up to the mark. Only 18 % of the customers are highly satisfied with the level of services provided by the bank, 35 % are satisfied, 21 % have no answer while 18 % are dissatisfied and 8 % of the customers are highly dissatisfied with the level of services. Here the mean is 0.37 only. So the level of services provided by the bank can be improved, so that the no. of customers may increase by taking this step.

**Chart 6.11**
Question No. 6: Level of satisfaction with banking product & services

The answers provided by the customers of the bank reveals that only 22 % of the customers are highly satisfied with banking product and services. This shows that either bank has no interest in improving the level of satisfaction with their product and services provided by it or bank is unaware in this regard. 35 % of the customers are satisfied, 21% are neutral, 18 % are dissatisfied and 4 % are highly dissatisfied in this regard.

Chart 6.12

Conclusion: By observing the answers of the customers, it can be said that in all only 19 % of the customers are highly satisfied with the product and services provided by State Bank. The overall mean which is only 0.43 also not presenting a good picture of the services provided by the bank. In all 34.5 % of the customers are satisfied, 23.17 % customers are seems to be neutral, 17 % are dissatisfied and 6.33 % are highly dissatisfied with it.
### Table M

#### Banking Product & Services

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<th>Q. No.</th>
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<th>Neutral/Not clear</th>
<th>Dissatisfied</th>
<th>Highly Dissatisfied</th>
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<td>% of Frequency</td>
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<td>25</td>
<td>4</td>
<td>100</td>
<td></td>
</tr>
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<td>4</td>
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### PART C (Banking Methods & Process)

To study this part different aspect of banking like services, working hours of the bank, paper work, pass book entries etc. are analyzed. The data collected in this regard are tabulated in Table N.

#### Question No. 1: Working Hours of the Bank

With reference to this question table shows that 26 % of the customers are highly satisfied with working hours of the bank, 35 % are satisfied, 25 % customers have no
answer while 8 % are dissatisfied and 6 % of the customers are highly dissatisfied with the working hours. The mean is 0.67 which is not bad and clearly shows that the working hours of the bank are in satisfactory position.

Chart 6.13

**Question No. 2: Paper Work**

Here it can be said that customers are satisfied as well as dissatisfied too with the paper work process in the bank. 19 % of the customers are highly satisfied, 34 % are satisfied, one fourth of the customers are neutral in this case where as 17 % customers are dissatisfied and only 5 % are highly dissatisfied. So it can be suggested that bank should minimize & simplify the paper work.

Chart 6.14
Question No. 3: Removal of Complaints / Queries

In this area the bank seems to be helpless or is unable to clear its position. 61% of the customers show their negative response in this reference out of which 26% of the customers gave no response, 23% are dissatisfied and 12% customers are highly dissatisfied in this regard. Only 9% of the customers are highly satisfied and 30% are satisfied with it. The mean was 0.01 which indicate that the bank is unable to remove the queries of their customers.

Chart 6.15

Question No. 4: Communicating Means to the Customers

Here also the customers have different opinions about communication of necessary information. 22% customers are highly satisfied, 37% are satisfied where as 20% are unable to express their views, 15% are dissatisfied and 6% of the customers are highly dissatisfied. So there is a lack of proper communication channel which in today’s scenario is very essential. Similarly the mean which is 0.54 does not represent a good picture of it.
Question No. 5: Bank Statement & Pass-Book Entries

Here the customer seems to be satisfied with the bank statement provided by the bank and with the entries in the pass-book. The mean which is 0.75 shows a good picture of it. The table shows that 29.5% of the customers are highly satisfied and 37% are satisfied in this regard. Only 3% of the customers are highly dissatisfied and 14% are dissatisfied with this service. 17% customers are neutral.
Question No. 6: Banking Services According to Customers Need

The responses collected from the customers shows that 49 % of the customers are getting services according to their need, out of it 21 % of the customers are highly satisfied and 28 % of the customers are satisfied. 24 % customers are not sure about it, while 11 % of the customers are dissatisfied and 16 % customers are highly dissatisfied. The mean is 0.43 which shows that services can be improved.

Chart 6.18

Conclusion: By observing the different answers given by the customers, it can be said that overall the position is moderate. In all 55.33 % customers are satisfied out of which 20.5 % are highly satisfied & 34.83 % are satisfied with the methods and process adopted by State Bank. 23 % was not sure. 15 % customers are dissatisfied and 6.67 % are highly dissatisfied in this regard. The overall mean is 0.475 which shows the moderate position of the bank.
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PART D (Human Resource Management)

In any of the service sector there is a direct relation of customer satisfaction with the human resources. The behavior and view of the employees of the organization towards their customers is the base of sound relations between them. To keep this view in mind, to know the satisfaction level of the customers of SBI, the Human Resource Management is analyzed. Different aspects regarding this are presented in Table O.

Question No. 1: Number of Employees & their Sufficiency

According to the table the position seems to be sound enough. According to 64% customers the number of employees was sufficient. 20% customers were silent. 7% were dissatisfied and 9% customers were highly dissatisfied. The mean is 0.67 which represents a good position of number of employees in the bank.

Chart 6.19

Question No. 2: Employee’s Willingness to Work

Here the customers gave mixed responses. 19% of the customers are highly satisfied and 41% of the customers are satisfied with the bank employee’s willingness to work. 25% customers are neutral in this regard 11% are dissatisfied and 4% customers are highly dissatisfied due to willingness to work of the employees.
Question No. 3: View of the Employees towards Customers

It is clear from the responses given by the respondents that only 20% of the customers are fully satisfied with the helping view of the bank’s employee, 37% are satisfied, 22% were unable to say anything while 15% of the customers are dissatisfied and 6% are fully dissatisfied with it. The mean which is 0.5 also represents the mixed responses of the customers. Bank’s employees are required to give proper information to their customers & always ready to help them.

Chart 6.20

Chart 6.21
Question No. 4: Behavior of the Employees towards Customers

With reference to this question the respondents are seems to be satisfied with the behavior of the bank’s employees. 18 % of the customers are seems to be fully satisfied whereas 46 % are satisfied with the behavior of the employees. 11 % are neutral, 17 % are dissatisfied and 8 % are fully dissatisfied with it.

Chart 6.22

Question No. 5: Knowledge of the Banking Products to the Employees

In this question the customers provide mix responses. 21 % of the customers are fully satisfied about the awareness of the banking products to the employees, 34 % are satisfied, one fourth of the customers are not clear about it whereas 15 % of the customers are dissatisfied and 5 % are fully dissatisfied with it. So it is required that bank staff must have proper knowledge about their products.

Chart 6.23
Question No. 6: Efficiency and Devotion of work of the Employees

It is clear from the table that bank’s employees are efficient and devoted to their work. 23 % of the customers are fully satisfied and 48 % of the customers are satisfied with it. 12 % are neutral in this regard, 12 % are dissatisfied and only 05 % of the customers are fully dissatisfied with it. It is a good practice adopted by the bank’s employees. The mean which is 0.72 also represent the same.

Conclusion: If we talk about the Human Resource Management of the bank, than it can be concluded that overall condition is neither good nor bad, but moderate and can be improved. Overall 21.5 % of the customers are fully satisfied, 40.33 % are satisfied whereas 19.17 % customers are unable to say anything about the HRM policy of the bank. 12.83 % of the customers are dissatisfied and 6.17 % customers are fully dissatisfied with it. The mean which is 0.58 also does not reflect a sound position of HRM policy adopted by the bank.
Table O
Human Resource Management

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6.4 THE EMERGING CHALLENGES BEFORE STATE BANK OF INDIA AND THE FOCUS AREAS:

Financial sector reforms and liberalization of prudential regulations have thrown in a lot of opportunities for Indian bank to grow and diversify their areas of business operations. There is no doubt that deregulation has opened up new vistas for bank to augment revenues but it has entailed greater competition and consequently greater risks and a chain of challenges.

These challenges emerged as a result of emergence of new banks, new financial institutions, new instruments and new opportunities in the environment. With globalization, newer technologies and techniques in areas like fund management and security creation has been introduced. Also innovative products which are tailor-made to meet the varied requirements of customers are introduced in the market to cater the needs of the customers in a better way. Thus, today, bank is subjected to cut-throat competition and in order to survive, bank need to be proactive in meeting these emerging challenges. Moreover, competition has resulted in extending the frontiers of banking activities, which calls for understanding and up gradation of skills in various areas and more importantly in the area of risk management. Although the SBI is one of the best public sector banks in Asia in terms of efficiency, the bank has to go a long to compete with other banks. Therefore, the following are the areas (challenges) on which State Bank of India need to focus for their sustenance –
6.4.1 Challenge Regarding Deposit Mobilization:
The success of the banking greatly lies on the deposit mobilization performance of the bank as the deposits are normally considered as a cost effective source of working fund. Bank is facing a great trouble in accepting the deposits. For example as inflation accelerates, deposits become less attractive, depending on the interest rate. Another problem is risk-reward profile of investment alternatives. Here the assumption would be that the relative attractiveness of deposits falls if investment alternatives offer more favorable risk-reward profiles. Strong competition in the banking sector could necessitate higher interest rates being offered to attract deposits. From the banks’ point of view, this could reduce the attractiveness of deposits as a funding instrument. At the same time, depositors would find them more attractive.

6.4.2 Product Innovation:
Interestingly the bank is seeing discontinuous growth driven by new products and services that include opportunities in credit cards, consumer finance and wealth management on the retail side, and in fee-based income and investment banking on the wholesale banking side. And as customers are now insisting on products which suit their individual requirements, bank is forced to opt for product innovation in order to hang on to their precious customers. Moreover, given the demographic shifts resulting from changes in age profile and household income, Indian consumers will increasingly demand enhanced institutional capabilities and service level from bank. Thus, the challenge for bank is on how to assess the needs of their clientele and offer customized products to meet their satisfaction.
There are many advantages of providing and developing existing ancillary services and introducing new services by bank like generation of additional income, more staff-customer contact which would help in further product innovation, and creation of a new differentiated market positions through developing new business opportunities and by providing a unique set of customer packages.

Thus, product innovation is of utmost importance as competition has increased tremendously and product boundaries have blurred. Moreover, the distinction between various players in the financial segment is also getting blurred and bank is facing competition from foreign banks, financial institutions, mutual funds, NBFCs, provident funds and pension funds etc. Therefore, to stay ahead in the race, bank will have to leverage technology for innovative product development including developing sophisticated financial products.

### 6.4.3 Challenge regarding CRR:

The main reason to maintain the CRR is to keep a bank liquid at any point of time. For CRR the bank have to hold a specific part of their deposits in the form of cash balances with the RBI. Generally CRR is maintained by RBI to control the liquidity in the market and to control the inflation. If there is any increase is CRR it slows down the growth of the economy. While maintaining the CRR, bank has to face many problems. For example if there is any hike in the CRR the bank must deposit more amounts of cash with RBI and hence it cannot lend more money to the market. Similarly firms operating in the economy needs money for expansion and for various purposes. If interest rates are high due to increase in CRR, the firms may not get money from the bank. Due to this, growth of the economy slows down.
Public might take loan for availing some services. Due to high interest rates public may consume less. If CRR is increased the public will consume less and will have direct impact on GDP.

### 6.4.4 Challenges Regarding Profitability Aspects:

Profitability has been considered as one of the important objective / motto of any commercial activity. Profit is a signal for the allocation of resources and a yardstick for judging managerial efficiency. Bank plays a vital role in the economic resource allocation of country. Good financial performance rewards the shareholders for their investment. This, in turn, encourages additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative impact on the economic growth.

In a country where the financial sector is dominated by bank, any failure in the sector has an immense implication on the economic growth of the country. This is due to the fact that any bankruptcy that could happen in the sector has a contagion effect that can lead to bank ruins, crises and bring overall financial crisis and economic tribulations.

More often, loan is the major asset of bank from which they generate income. The quality of loan portfolio determines the profitability of bank. The loan portfolio quality has a direct bearing on bank profitability. Liquidity is another factor that determines the level of bank performance. Liquidity refers to the ability of the bank to fulfill its obligations, mainly of depositors.

The macroeconomic policy stability, Gross Domestic Product, Inflation, Interest Rate and Political instability are also other variables that affect the performances of bank. For instance, the trend of GDP affects the demand for bank’s asset. During the declining
GDP growth the demand for credit falls which in turn negatively affect the profitability of bank. On the contrary, in a growing economy as expressed by positive GDP growth, the demand for credit is high. So the bank is required to keep eagle watch on the above areas to maintain its profitability. Profitability of State Bank of India shows fluctuating trend during whole of the study period. In the base year it was 2.50 %, in 2006-07 it comes down to 0.72 %, in next year it was 1.01 % and in 2012-13 it was 0.88 %

6.4.5 Use of Information Technology in Service Delivery Process:

The decade of 90s has witnessed a sea change in the way banking is done in India and technology has brought in this change in the functioning of the bank. Till 1980s, bank had only one delivery channel which is the branch presence. However, technology has opened up options for various delivery channels. Technology aided products like ATMs, Point of Sale devices, Anywhere Banking, Smart cards, Internet Banking etc., have given the customer to choose his channel of getting catered to his requirements. The profitability of bank increases when services are provided through e-channels like ATMs. However, the implementation and functioning of e-channels in the bank seem to be relatively smooth in the developed economies but in developing or transition economies, it may not be so. Thus, the challenge before the bank is how to go for ‘convergence’ of all the delivery channels so as to provide anything, anywhere and through any mode.

The private sector banks as well as foreign banks have embraced technology right from the inception of their operations and therefore, they have adapted themselves to the changes in the technology easily. On the other hand, the staff of state bank has vast
and rich experience but they may not have sufficient knowledge in the area of IT or may not be familiar with technological tools that can be used in the service delivery process. As technology has become indispensable in banking operations, the challenge for the bank is on how effectively they are able to use technology in the banking operations. In other words, as technology ingrains itself in all aspects of a bank’s functioning, the challenge before bank at present is on how to exploit the potential for profiting from investments made in technology.

6.4.6 Risk Management:

Bank is exposed to severe competition and hence is compelled to encounter various types of financial and non-financial risks. Risks and uncertainties form an integral part of banking which by nature entails taking risks. Bank are now required to clearly discriminate avoidable and unavoidable risks and are required to focus on the extent to which such risks can be taken by the Bank. It is imperative that Bank have to identify and measure various Risks faced by them and initiate suitable remedial measures to mitigate them.

Banking risk results into Expected and Unexpected losses. Bank relies on their capital as a buffer to absorb such losses. According to experts State Bank need to maintain enough capital for prudential corrective action to prevent any risk. The efficiency of capital plays a major role in this exercise and bank is advised to adopt risk management practices. Credit risk in bank represents the most important type of risk. Managing Credit Risk in Bank is a herculean task as robust Risk Management strategies and practices are needed for identifying, measuring, controlling and minimizing the impact of Credit Risk.
In emerging markets, risk management, has become a greater concern with the modernization of banking sector and financial markets. This is due to the new risks that Bank face with greater exposure to the global banking sector as well as under the new payments systems which demand greater efficiency with quicker transactions, lower levels of fraud and transaction errors. Thus, Risk management has become an important area of focus for the Bank.

Under BASEL I, bank was focused on credit risk and market risk and their risk management strategies were focused on managing these risks individually in isolation. However, BASEL II has brought into focus a large number of risks which bank needs to tackle. In fact, BASEL II has highlighted the inter-linkages of a large number of risks like credit risk, liquidity risk, market risk, operational risk etc., with a view to achieve a more comprehensive risk management framework. Therefore, implementation of BASEL II is being increasingly seen as a medium through which bank constantly endeavor to upgrade the risk management systems to address the changing environment.

6.4.7 Problem of NPA on the Operations of Bank:

Non-Performing Assets in banking industry has become a subject of intense importance and discussion. It has assumed greater significance in the world of banking & bank. NPA does not affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity. Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for shortest period of time. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.
Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling & managing NPA would have diverted to some fruitful activities, which would have given good returns. Now days, bank have special employees to deal and handle NPAs, which is additional cost to the bank. If a bank is facing problem of NPA, then it adversely affects the value of bank in terms of market for credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting in their money in the bank.

The Gross NPA & Net NPA of SBI shows a growth of 4.04 times and 4.03 times respectively over the base year. The average % of Gross NPA to Advances was 4.27 % which shows a higher rate of NPA.

6.4.8 Development of Knowledge and Skills of its Human Resources:

For any service organization, Human Resource Development is the most important need and bank is no exception. To meet the challenges of a fast growing knowledge economy, the trust needs to be on Human Resource Development for which the existing training systems of bank need to be revamped. This is felt necessary in order to keep pace with the fast-changing banking environment at home and abroad.

It is commonly observed that in bank there are certain rigidities. In matters of recruitment, it has been seen that initially the bank were able to attract the educated manpower but not the specialists. Thus, the focus must shift from generalist orientation of the staff to specialist orientation i.e., recruiting those who have the ability to imbibe and absorb technology. In the light of this requirements there need to be thorough improvements in the existing practices of recruitment, training and redeployment.
Therefore, large investments will have to be made both in Information Technology and Human Resource Development for imparting knowledge and skill which in turn would reduce response time and accelerate credit delivery and decision making as well as to expand ancillary business.

Gelade and Ivery examined the relationships between human resource management (HRM), work climate, and organizational performance in the branch network of a retail bank. Significant correlations were found between work climate, human resource practices, and business performance. The results showed that the correlations between climate and performance cannot be explained by their common dependence on Human Resource Management factors, and that the data are consistent with a mediation model in which the effects of HRM practices on business performance are partially mediated by work climate.²

6.4.9 Customer Relationship Management:

Customer Relationship Marketing (CRM) is the latest buzzword and bank are using this tool to acquire new customers, to retain the old customers and to service the existing and new customers. Customer loyalty seems to be a thing of the past and bank is offering many incentives to enhance customer loyalty. As such this is one of the challenging areas that bank need to focus. Therefore, in view of the present situation, bank need to analyze behavioral patterns of the customers, their needs and accordingly develop products to suit their requirements.

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In this context, data mining has become an important tool for decision making by the bank management. Through data mining, the Executive Information System (EIS), Decision Support System (DSS) have become faster and more accurate. Thus, bank need to be customer-centric in order to acquire and retain customers. And for this, a bank need to appoint Customer Relationship Managers, field-level sales force, help desk, call centers, interactive voice response systems, kiosks, interactive television and e-mail.

6.4.10 Need for Branch Rationalization:
Bank, in order to reduce its administrative costs, need to rationalize the branch networking by consolidating the number of branches within a local area into a single profit center without affecting customer service. Moreover, at the industry level, strategic alliances and mergers of even healthy bank would also become necessary.

6.4.11 Need for Greater Prudence:
Future banking has to be based on prudence. New blood with new skills is to be inducted to face the coming challenges. Business will have to be organized on more commercial lines with focus on income and profit centers and on Information Technology. Prudent policies for provisioning have to be adopted apart from norms laid down by the RBI for investments and credit.

6.4.12 Asset Liability Management:
Bank should give utmost importance to Asset Liability Management from the view point of liquidity as well as interest rate sensitivity. In fact, an effective Asset Liability Management technique aims to manage the volume, mix, maturity, rate sensitivity,
quality and liquidity of assets and liabilities as a whole so as to attain a predetermined acceptable risk/reward ratio. Thus, the purpose of ALM is to enhance the asset quality; quantify risks associated with the assets and liabilities and further manage them. Asset Liability Management is deemed necessary because asset-liability mismatches expose the bank to various types of risks i.e., risks of illiquidity and insolvency; risks arising from globalization and deregulation.

6.4.13 Brand Building and Management:
As bank offer a variety of services under an umbrella brand, building a brand and managing it has become a challenge. Bank should focus on building a powerful brand that has high brand equity. This is because a brand with high brand equity implies that they have higher brand loyalty, name awareness, perceived quality and strong brand associations. Therefore, huge investment of resources – both monetary and time – is required to build a brand and for its management.

6.4.14 Synergy out of Mergers and Acquisitions:
It has been seen that bank have inherent disadvantages like limited IT infrastructure, excess manpower, huge brick and mortar branch network etc. with these disadvantages they need to compete with new generation private sector banks as well as foreign banks. As a result of their inherent disadvantages, they suffer from competitive disadvantage and unless they gear themselves to cope up with this challenges and competition, they may have to lose large share of their remaining clientele. Therefore, bank, need to opt for mergers and acquisitions with compatible entities to acquire synergy. This is deemed necessary because technology adoption, offering innovated
and customized products at the doorsteps of the customers are the need of the hour. Moreover, it is significant to note that mergers and acquisitions will result in creation of large balance sheets and broadening of the customer base and thereby lending those banks a stamp of universality. Therefore, in the present day context, small is no more necessarily considered to be beautiful?

6.4.15 Enhancing Shareholders’ Value:

In a knowledge economy, shareholders of bank are increasingly taking interest in the affairs of the bank. The Committee on Banking Sector Reforms (BSR), chaired by M. Narasimham, recommended that the minimum shareholding by Government/ RBI in the equity of State Bank of India be brought down from 51 per cent to 33 per cent. Therefore, the participation of shareholders of bank which was limited till the other day will not remain so anymore. The shareholders expect to earn higher dividend or optimize appreciation of the scrip at the stock market. Therefore, one of the challenges bank face is how to meet the expectations of the shareholders and enhance the value of the bank. Therefore, bank has to devise ways and means as to how to optimize the shareholders’ value in each and every business activity they undertake.

6.4.16 Financial Inclusion:

Bank nationalization in India marked a paradigm shift in the focus of banking as Government, through nationalization, intended to shift the focus of bank from class banking to mass banking. Therefore, in the light of Government policies, one of the challenges before bank is to redesign their business strategies so as to incorporate specific plans to promote financial inclusion of low income group by treating it as a
business opportunity as well as a corporate social responsibility. In January 2006, bank was permitted to utilize the services of non-governmental organizations (NGOs/SHGs), micro-finance institutions and other civil society organizations as intermediaries in providing financial and banking services through the use of business facilitator and business correspondent (BC) models. The BC model allows bank to do ‘cash in - cash out’ transactions at the location of the BC and allows branchless banking. At present, it may appear that taking banking to the unprivileged and unbanked sections may not be profitable but gradually it can emerge as commercial profitable business.

Dev stated that financial inclusion is significant from the point of view of living conditions of poor people, farmers, rural non-farm enterprises and other vulnerable groups. Apart from formal banking institutions, which should look at inclusion both as a business opportunity and social responsibility, the author conclude that role of the self-help group movement and microfinance institutions is important to improve financial inclusion.  

6.4.17 Anti-Money Laundering:

As a result of increased integration in the global financial industry, the misuse of banking industry has been observed in recent years. These include the use of banking services for activities like, terrorist financing, drug trafficking and money laundering. In few countries although there is a comprehensive legislative systems and well defined enforcement mechanism; but there are a number of countries where the entire regulatory framework is at initial stage. In such countries, banking institutions are exposed to adverse consequences of these activities in the form of reputational,

operational, legal and concentration risks. For instance, the institutions have to pay the investigations or the penalty charges, decline in the stock value, assets seizures, temporary termination of correspondent banking facilities, etc. the tackling of this issue requires a coordinated effort of the banking institutions, regulators, law enforcement agencies, etc. In this regard, SBP has already taken some viable steps to prevent the use of banking institutions for illegal activities.

6.4.18 E-Banking:
Another area where still a lot of progress should be made is the E-banking. Although bank is now offering on-line services to their customers, bank is required to move more expeditiously so as to optimally utilize the E-banking network. This will not only lower the transaction costs but will also help in improving the customer services. The ATM penetration ratio is still quite low and the efforts are needed to not only further expand the ATM network more aggressively but also to improve upon the security standards.

New Challenges: The financial sector reforms have laid the base for a sound and viable banking system even though we have to travel still same distance. The following are the new challenges for future banking:

1. Greater specialization by bank in different niches of the market such as retail, agriculture, export, small-scale and corporate sector.

2. Greater reliance on non-fund business such as advisory and consultancy services, guarantee and custody services.

3. Greater overlap in product coverage between commercial banks and non-bank financial intermediaries.
4. Greater financial dis-intermediation with large companies accessing securities
debt domestically and from financial markets abroad.
All of these will require the bank to prepare a corporate plan over the next five years
taking into account its own strengths and the markets in which it is looking to operate.
Bank should not expect customers to walk in. They should seek customers. That will be
the important change in new scenario.4

CONCLUSION:
Over the years, it has been observed that clouds of trepidation and drops of growth are
two important phenomena of market, which frequently changes in different sets of
conditions. The pre and post liberalization era has witnessed various environmental
changes which directly affects the aforesaid phenomena. It is evident that post
liberalization era has spread new colors of growth in India, but simultaneously it has
also posed some challenges.
Thus, SBI in the days to come will be a challenging one, which will be marked by high
expectations of customers, who are well informed and possess the technical knowledge
to conduct banking transaction from home or office or while on move. Although IT plays
an important role in banking business, yet personalized service will continue to have
relevance in SBI – where a large proportion of the country’s population is still illiterate.
To sum up, it can be said that with increased competition, bank face the challenge of
sustenance and for these SBI need to develop proactive strategies with focus on
product innovation, off-balance sheet activities to increase their income from non-core
activity, efficiency in service delivery process, effective risk management etc. and more

4. Edited by Raj kapila& Uma Kapila "Banking & Financial Sector Reforms in India" * a paper
importantly on customer satisfaction through tailor-made product packages. Moreover, competition should not necessarily be viewed with trepidation, in fact it should be seen by the State bank as an opportunity to enter global financial intermediation and provision of financial services. As the economic importance of services (financial) increases in terms of value added (global), international banking operations should be viewed as a lucrative profit opportunity by bank. The competition from global bank and technological innovation has compelled the bank to rethink their policies and strategies.
CHAPTER 7

FINDINGS AND SUGGESTIONS

Indian banking sector has a long journey of growth since 1955, started with the nationalization of the State Bank of India. The first nationalization phase was in 1969, and the second phase in 1980, it lead to rapid expansion of bank branches all over India. Deposit mobilization and priority sector lending in highly protected environment with extremely regulated framework adversely affected the financial resource mobilization and allocation by the bank. The reforms again needed in this industry. In 1991, The Narsimham Committee report gave a new dimension to Indian Banking sector. The private banks and foreign banks have entered in the market. So, now, there is a global competition in the banking industry in India.

As an effect of liberalization, privatization and globalization policy, there have not only been rapid expansion in the number of banking institutions in the country, but the banking horizon of the country has also changed significantly. The foreign banks, which accounted for only 32% of the total number of banks in the country in 1991, grew up to 42% by 2001. In view of the fact that the bank that have been operating in an extremely protected economic environment and may lost out in the wave of competition from the private and foreign banks, the schemes of financial assistance for capital restructuring for the economically weak bank were also introduced during last decade. Besides to that, the bank were also given time to meet the prudential and capital adequacy norms as well as norms to manage Non-Performing Assets. So, the bank is now working on the concept of universal banking and service oriented banking. The whole process of reforms has intensified competition leading to overall improvement in financial
performance. Despite recapitalization by the government the overall performance of nationalized banks continued to lag behind private sector banks.

**SUMMARY:**

Banking system was in existence in the crudest form during Vedic period in India. Though banking industry has its roots ever since 1688, in India it is only after 1939 that the industry has achieved subsistence after initial setbacks and failures. Later, the State Bank of India (Subsidiary Banks) Act was passed in 1959, enabling the State Bank of India to take over eight former state-associated banks as its subsidiaries.

The Government of India introduced the State Bank of India bill in the Lok Sabha on 16th April 1955 and it was passed by the parliament and got the President’s assent on 8th May 1955. The act came into force on 1st July 1955 and from this date the whole of the undertaking of the Imperial Bank of India within the country was transferred to the State Bank. Thus, the erstwhile Imperial Bank of India was nationalized from July 1, 1955 and rechristened as “State Bank of India”.

The Economy of India is the seventh-largest in the world by nominal GDP and the third largest by purchasing power parity (PPP). India is one of the fastest growing service sectors in the world with annual growth rate of above 9% since 2001.

State Bank of India has achieved the growth in various fields like Capital fund, Deposits, Advances, Investments, Fixed assets, Profits, No. of Branches, No. of Employees etc.

In the present study there is neither a single comprehensive study nor any attempt has been made to analyze the contents of financial aspects of State Bank of India. Hence the present study is a humble effort to bridge the gap in the existing literature. There are
few of the researchers who take only one or two aspects of financial nature with reference to SBI. That is why this researcher takes the topic as “Financial Appraisal of State Bank of India “because there is hardly any study on this topic.

An academic study on the financial performance of the nationalized banking sector in India is very important and pertinent in the context of its structural existence. Before taking up such an exercise, an attempt is made in this section to present a review of the available studies in the relevant area. Organized or formal research in banking and related areas is of recent origin in India. The research studies conducted in this field relate mostly to institutional, functional and developmental activities of bank.

**FINDINGS:**

The major findings are as under.

- One big problem is that more than 60% of the population lives in the rural areas in isolated villages. It therefore become cost ineffective to have bank branches there.
- Customers require literacy to utilize banking services which majority of the population especially the rural inhabitants do not have.
- The SBI has not fully regained the confidence that many customers lost; thus making deposit attraction difficult. This could be due to partly the attitude of bank staff towards customers.
- Problem against deposit mobilization is the unfavorable macro-economic environment with high inflation and reserve requirement and their associated low returns on deposits.
• The next aspect was taken by the researcher was Net NPA to Net advances, which was a solid problem for the bank. NPA of SBI is quite high, however, showed decreasing trend during the period of study.

• CRR is another big problem for the bank. The firms operating in the economy needs money for expansion and for various purposes. If interest rates are high due to increase in CRR, the firms may not get money from the bank. Due to this, growth of the economy slows down.

• The Gross NPA & Net NPA of SBI shows a growth of 4.04 times and 4.03 times respectively over the base year.

• The average % of Gross NPA to Advances was 4.27 % (SBI) which shows a higher rate of NPA in comparison to SCB (3.38 %) of India.

• On the basis of the running average of last nine years, credit deployed by the SCB & SBI shows that the State Bank of India has deployed much credit in comparison to Scheduled Commercial Bank (23.49 % > 21.81 %) on the other hand investment made by the SCB & SBI shows that the SBI has less investment in comparison to Scheduled Commercial Bank (17.68 % < 8.67 %).

• State Bank is likely to benefit most due to high interest rates. The Net Interest Margins (It is the difference between the interest they earn on the money they lend and the interest they pay to the depositors) for bank is likely to increase leading to growth in profits & the stock prices.

• The operational efficiency was significantly differing in this analysis; basic three ratios i.e. spread as % to Working Fund, Net Profit as % to Working Fund have been calculated. Net income as % to Average Working Funds in SBI is
fluctuating. The ratio indicates the weak performance of State Bank of India. In the base year it was 0.90 %, in 2006-07 it comes down to 0.72 %, in next year it was 1.01 %, in 2011-12 it was 0.71 % and in the last year it was 0.91 %.

- The productivity & efficiency of SBI had been reduced due to hike in wages and increasing operational cost in bank. Interest spread of bank was also under pressure due to administered rates imposed on the banking system.

- The bank operated within the administered interest rate structure and lacked flexibility. There was no element of competition within the bank. This had a deleterious impact on bank’s management capabilities and innovativeness, both in areas of deposits and advances. The rigidity of banking system paved the way for a gradual uprising of external competition from other agencies like post office, UTI, LIC, chit funds, equity market, real estate market and new instruments like CDs, CPs, etc.

- Income Index on the base year revealed the fact that the income of the bank was about 3.56 times at the end of the study period. It showed favorable position of the bank, but he internal strength of SBI with regard to efficiency, productivity, NPA and profitability has decline resulted in deteriorating the financial health of the bank.

- The Total Expenditure of State Bank of India was ₹ 34392 crore for the base year. It remarked an upward movement during whole of the study period and came to ₹ 121587 crore at the end of the study period 2012-13. It had compounded its total expenditure by about 3.54 times over the base year. It is an alarm to the financial health of the bank.
- Spread is nothing but surplus of interest income over interest expenses. Spread of SBI was ₹ 11186 crore in 2003-04. It showed upward movement during the study period.

- Excess of non-interest expenditure over non-interest income of a bank is known as burden. Burden of SBI was ₹ 7506 crore in the year 203-04, which increased in the subsequent years 4.02 times and reached to ₹ 30225 crore at the end of the study period.

- Profitability of State Bank of India shows fluctuating trend during whole of the study period. In the base year it was 2.50 %, in 2006-07 it comes down to 0.72 %, in next year it was 1.01 % and in 2012-13 it was 0.88 %

- While there has been explosion in the number of transactions, the work technology in bank has not changed. Whereas aspirations and expectations of the people from the banking system have increased, customer service has been affected adversely.

- The rapid expansion of bank branches and spectacular increase in banking operations unaccompanied by proper training of staff and adoption of modern techniques of banking resulted in deteriorating customer services.

- The expansion of staff and accelerated promotions had diluted the quality of man power.

- Only 32.67 % of the customers show their satisfaction with regard to the position and amenities of the State Bank.

- Only 19 % of the customers are highly satisfied with the product and services provided by the bank.
• With reference to the methods and process adopted by the bank in all 55.33% customers are satisfied out of which 20.5% are highly satisfied & 34.83% are satisfied.

• If we talk about the Human Resource Management of the bank, than it can be concluded that overall condition is neither good nor bad, but moderate and can be improved. Overall 21.5% of the customers are fully satisfied.

• While playing the crucial developmental role for the economy, the SBI did not pay enough attention to its own development in terms of new management practices, new systems and procedures induction of modern technology and human resource development.

• The quality of credit portfolio of SBI has suffered due to deficiencies in identification of borrowers, very low alternation given to market prospects and capacity of borrowers. It has adversely affected the viability of the bank.

• The competitive efficiency of bank deteriorated with wider coverage lines of supervision and control lengthened.

• There was lax attitude of bank towards profitability under the presumptions that any problem with the banks’ bottom line would be automatically taken care of by the Government of India.

SUGGESTIONS:

By referring the above findings, there are some suggestions by the researcher for better performance of the bank. These suggestions are as under:
1. TACKLING NON PERFORMING ASSETS (NPAs): NPAs are a severe drain on the profitability of SBI. On the one hand, no income on such accounts can be recognized and on the other hand, certain amount of provision has to be made from the profits, depending on the asset classification and availability of security. This has a double-impact on profitability - No interest on such dead asset and Need to maintain capital on the Risk Weighted Asset.

The problem of tackling NPAs has two aspects - one of recovery of NPAs and the other of avoidance of slippage. While recovery of NPAs can be tackled to some extent through compromise settlements, filing of cases in DRTs, conduct of Recovery Camps etc., slippage can be avoided through proper training to staff members in credit skills and through proper monitoring and collection processes.

Once this improved level of knowledge is achieved, credit as a product can be more proactively sold, rather than reactively granted as in the past. Some of the steps to tackle the problem of NPAs are:

- Building an effective credit appraisal system within the Bank and bringing professionalism in appraisal.
- Monitoring of assets on an ongoing basis with intelligence on the industry to which the borrower belongs and initiating the trouble shooting exercise at the beginning itself.
- Building a sound and reliable information base through networking.
- Establishing a tested credit-risk evaluation model with features for risk management in dynamic market conditions.
- Evolving policies with focus and thrust on sound risk management systems.
• Putting in place proper control mechanism for feedback and analysis for corrective action.

• Eliminating the fear psychosis and creating a climate of confidence among the Bank personnel through proper motivation and creating a healthy environment based on trust and confidence.

• Setting NPA management as the organizational goal and ensuring that the spirit pervades all through the organization.

• Motivating employees and giving adequate training in tenancies of recovery mechanism.

• Ensuring changes in the mindset to cope with the market realities in Credit Risk and NPA management.

2. DEPOSIT MOBILIZATION: The following method may be used to improve the deposit mobilization by the state Bank –

• There should be freedom to State bank to decide the interest rates on deposits at different centers/locations to take liberalization firm roots in the banking system.

• Reduce the minimum balance requirement

• Regular deposits and higher daily balance encouraged by increasing interest rates

• Awarding those with higher balances (i.e. raffle promotion)

• High quality client service

• Reduce administrative cost through ‘saving boxes’

• Integrated advice for investments and deposits
3. IMPROVEMENT IN LENDING: The following are some of the measures-

(a) Cutting Interest Rates - This should increase the demand for bank lending as firms and consumers are more willing to borrow rather than save. In normal circumstances, a cut in interest rates probably would increase State Bank lending.

(b) Quantitative Easing - Quantitative easing is a general policy to increase the money supply and indirectly increase bank lending.

(c) Funding for Lending Scheme (FLS) - The funding for lending scheme encourage bank to lend directly to the real economy (household consumers and firms). Unlike quantitative easing, FLS is directly tied to bank lending.

(d) National Loan Guarantee Scheme - The government announced a national loan guarantee scheme. In theory, this should make it easier for small firms to borrow money because the government is willing to underwrite the loans. This should make bank more willing to lend because they have less risk of losing the money.

(e) Forward Guidance - A commitment by Central Bank to keep base rates low for considerable time. The hope is that if bank expect short term rates to remain low for considerable time, this will help reduce long term lending rates.

4. INNOVATION: Innovation with technology can add to a Bank's competitive edge in rendering services to its clients. If it is not possible to be the first in the
market, the next best is to become a fast follower i.e. to quickly adapt to the new idea and operationalize it at the earliest. It is necessary to stay ahead, constantly upgrade the products and create new markets. If the bank develops innovative methods to reduce cost and provide cheaper and quality products and services at reasonable prices, than it will survive.

5. IMPART BANK AUTONOMY: SBI management should be given autonomy and flexibility, subject only to broad guidelines regarding all these matters. Bank should not be under any informal or formal requirements of prior permission from any one before opening or closing a branch, even closing a branch in rural areas. Even, internally, less hesitant attitude towards free competition would be welcome. Bank should be responsible for its own recruitment including clerical recruitment and for all its policies, whether credit or personnel or any other. Once carefully selected and found successful than bank chairman and senior staff should be continued in their job in the same bank as long as possible without being worried about silly retirement rules. Performance bonuses to senior management and indeed to all staff should be given as decided by individual. Boards of directors, once selected, board members should also have long tenure with changes made by the chief executives in consultation with other directors as and when necessary and not at behest of the Government. As long as State Bank is owned substantially by the Government, all talk of autonomy will be an element of wishful thinking. More autonomy should certainly be given to manager of the bank.
6. PROFIT MAXIMIZATION: Profitability can be increased to a greater extent by improvement in utilization of manpower and increase in ancillary earning than due to increase in net interest earnings from the fund operations. Bank's profitability largely depends on efforts made by management to minimize establishment / overhead costs, enhance operational efficiency through cost effective operations and to systematically cost and appropriately price their services, an exercise which should be done as a continuous and ongoing process. SBI will have to develop special skills, knowledge and management capabilities in their staff for under taking non-fund business. There is an urgent need for popularizing concept of profit planning at all levels especially, in branches creating an awareness that profitability should be the hallmark of each banking operation at all levels, would go a long way in improving profitability of bank.

7. TECHNOLOGY UPGRADEATION: In the deregulated environment, technology will be the key to reducing transaction costs, offering customized products and managing risks. The world is being swept by technological changes, and technology related products are having shorter life cycles and, therefore, SBI executives must start formally planning as to how their branches would survive and thrive in the new banking environment. It will, of course, be a very big challenge but in meeting this challenge lies its future. It needs to be understood that every future business is an information business. However, in adopting technology, there will be challenges in managing personal, in training the workforce, in educating customers, in infrastructure support that is not evenly
available across their large networks—all have to be addressed. The high investment has to be justified with increased business volumes. Relocating the back-office functions in every branch to a centralized location can, to some extent, do this. It is important to remember that technology is only an enabler. Success lies in aligning technology with the business strategy and redefining processes to get maximum advantage. There is a need for improving and upgrading work technology to cope up with the growing volume of business transactions.

8. TACKLING THE RISKS: To manage market risk, SBI should deploy a number of highly sophisticated mathematical and statistical techniques. Chief among these is value-at-risk (VAR) analysis, which over the past 15 years has become established as the industry and regulatory standard in measuring market risk.

9. IMPROVING THE SPREAD: It is necessary to reduce cost to the maximum extent possible to ensure that the SBI is able to maintain a decent spread. Improving the deposit mix with higher proportion of low cost deposits is the best way to contain the interest cost. Further, non-salary non-interest expenditure should be contained to the nearest minimum. Wherever possible, branches may be considered for rationalization, as a means to cut costs. Unutilized/under-utilized premises and other assets should be sold or rented out to augment income. Loss making Subsidiaries/branches should be considered for hiving off.
10. **RETAILING CUSTOMER LOYALTY:** Retaining customer loyalty is one of the important ingredients in the restructuring process. In fact, it is cheaper to retain an existing customer than to get a new one. Similarly a dissatisfied customer can spread a bad image about the Bank, which would be detrimental to the turnaround process. No organization on the turnaround path can afford adverse publicity. A satisfied customer, on the other hand, will be a good Ambassador to the bank and facilitate growth and new business. Customer service has turned a full circle and has become a fulcrum of all the activities of the bank. Further, gone are the days when customers of bank had to stand in queues to verify their balance, deposit and withdraw cash. In other words, the services sector is a standing testimony to the adage "Customer is the King".

State Bank need to focus more on quality of services in tune with the expectations of the public at large. Now customers are highly discerning and have a very low tolerance for poor service. They have a greater propensity to switch service providers. Hence, State Bank should identify and anticipate customer requirements and develop the capability of servicing those needs. Relationship management is the name of the game in the banking industry today and customers never had it so good before. In a savings-driven economy like ours, bank have finally come of age and the emphasis is now on making the customer feel that he is the master. In an ever changing environment where loyalties are fickle and competition is fierce, bank should woo customers with a plethora of value added services, as now the race is to be better than the best.
11. **REORGANIZATION OF BANKING STRUCTURE:** There is a need for structural change in the organizational system of State Bank with a view to make it more efficient and less wasteful. There is a need for the splitting up of the State Bank of India into smaller bank on the principle of geographical contiguity. Each circle of State Bank may become an independent bank in itself.

12. **INFRASTRUCTURE:** Nearly 60 percent of the banking infrastructure, particularly in the form of branch network is located in the rural and semi urban areas. Hence, it is imperative that for any reform to succeed, it is fundamental that utilization of this infrastructure is strengthened and so also the man power deployed in it. The developmental role of bank is constrained by the availability of infrastructure and activities of state agencies in the area. Therefore, merely pumping in of more credit by bank will not automatically lead to development. However, if the state and other agencies evolve suitable schemes to enable people to involve them in productive activities, then the bank can step in and provide the credit that will be needed.

13. **ENCOURAGING COMPETITION:** In an increasing competitive environment, bank cannot continue to operate as monolith. In fact, a break-up of this monolith is not only inevitable but highly desirable. The bank can no longer use uniform norms for personnel policies, including recruitment and wages policies, up gradation of technology, risk management and branch network. To increase competition, foreign banks and new private sector domestic banks should be actively encouraged. There is a need for increasing competition in the
bank given that the limited entry of small banks allowed so far is unlikely to introduce such competition on an adequate scale. One option is to allow a large scale entry of private banks. Allowing the large scale entry of private banks to provide more meaningful competition could help to improve the performance of State Bank, but it has the risk of forcing closure of Bank’s weak branches. The more viable option would therefore be to privatize at least some of the Bank’s branches. The new bank should be allowed to expand rapidly to increase competition for existing banks. The government must allow more competition between banks and the cartel type activities of IBA should be ended.

13. PRIVATIZING BANKS: In India, the empirical case for privatization is especially strong as it is clear that public ownership has virtually paralyzed the management efficiency of State Bank due to political and administrative interference in the allocation of credit. Only those that appear to have problem over a period of time should be privatized not partially but completely through take overs. Considering pros and cons of privatization, the case for privatizing the bank seems to be strong. Privatization is theoretically a desired policy option. In reality, privatization of bank has proven to be difficult, making the end point unclear. The problem of political opposition of privatization has no short cut solution in a democracy and can only be solved over time through consensus building. If the bank is viewed as dole giving agencies without having any sow in their own affairs the situation can only get worse. There is much sense in letting bank do their own business with least interference for best results.