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. Deposits constitute 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. 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.

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.\(^3\) 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.\(^4\)

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 Demand Deposits are those deposits, which may be withdrawn by the depositors or transferred to someone else at any time without previous notice to the bank.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 pace.

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

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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

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CAGR 118.2% 112.8% 107.9% 107.8% 107.5%

(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**

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<td>2012-13</td>
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<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>
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Source: Reserve Bank of India, CSO

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

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

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.

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<tr>
<td>Amount (in crore)</td>
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<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>
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(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.
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.

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<td>Amount</td>
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(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 3.3**

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<td>Amount (in crore)</td>
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(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.\(^7\) 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.\(^8\) 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

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saving. In under developed countries, savings is very low. However, potential saving is also unrealized due to under development 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

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 view point of borrower, it is ‘borrowing’ and from the view point 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

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 14th 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

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11. 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>
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</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</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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<tr>
<td>(in crore)</td>
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(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 (in crore)</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>
</tr>
</tbody>
</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.\footnote{Malhotra R. N. (1990) “Banking in 1990s Pigmy Economic Review, Vol. 35 No. 7, Feb. 1990, p. 2}

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. 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.

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.