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

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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 along 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 IMPORTANCE 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 shows 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 low 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>High</th>
<th>Low</th>
<th>Close</th>
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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.

Table J
CRR changed by RBI

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<tr>
<td>CRR</td>
<td>Min 4.50 Max 4.50</td>
<td>Min 4.75 Max 5.00</td>
<td>Min Unch. Max 5.00</td>
<td>Max 5.25 Min 5.50 Max 7.50</td>
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<td>Min 5.00 Max 5.75</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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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 road block 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 on hand. The bank has got to earn income. Hence, 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 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
Credit-Deposit Ratio and Investment-Deposit Ratio OF SCB & SBI

<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

<table>
<thead>
<tr>
<th>Year</th>
<th>SCB</th>
<th>SBI</th>
<th>SCB</th>
<th>SBI</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>73.5</td>
<td>77.45</td>
<td>35.3</td>
<td>34.24</td>
</tr>
<tr>
<td>2007-08</td>
<td>74.6</td>
<td>77.55</td>
<td>35.5</td>
<td>35.26</td>
</tr>
<tr>
<td>2008-09</td>
<td>73.9</td>
<td>73.11</td>
<td>35.7</td>
<td>37.18</td>
</tr>
<tr>
<td>2009-10</td>
<td>76.4</td>
<td>78.58</td>
<td>36.1</td>
<td>35.54</td>
</tr>
<tr>
<td>2010-11</td>
<td>77.2</td>
<td>81.02</td>
<td>36.9</td>
<td>31.65</td>
</tr>
<tr>
<td>2011-12</td>
<td>79.97</td>
<td>83.13</td>
<td>34.6</td>
<td>29.91</td>
</tr>
<tr>
<td>2012-13</td>
<td>81.48</td>
<td>86.94</td>
<td>36.4</td>
<td>29.17</td>
</tr>
</tbody>
</table>

(Source: Database from Reserve Bank of India & SBI % calculated by researcher)
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.