SUMMARY

ASPECTS OF PORTFOLIO BEHAVIOUR OF INDIAN COMMERCIAL BANKS

INTRODUCTION

Commercial banks are lifeline for the Indian economy. They are such compelling institutions that their role in financial intermediation can significantly influence the pace and direction of economic development. Unlike in developed countries, where they pursue the goal of profit maximization freely, the commercial banks in India have also to play a crucial role in contributing to social and economic welfare assuring equitable distribution of income and social justice. Thus, more often than not, they ride over the dilemma between twin objectives of social welfare and profit maximization. The present day commercial banking is therefore full of stress and strains and this is clearly visible from their deteriorating asset quality seriously threatening their financial health. Time is therefore ripe to attempt a systematic study of commercial banks portfolio behavior so as to find out what actually might have gone wrong with them causing so much of stress in their operation. The present study therefore is a modest attempt to investigate various aspects of their behavior related to asset and liability portfolio so as to come out with a diagnosis worthy of suitable prescriptions.

The portfolio behavior of individuals and those of banks are different. For example, in case of an individual the portfolio would consist net positive wealth whereas, in case of banks there are liabilities pitted against the asset portfolio and therefore the net value of the portfolio (after taking consideration) of liabilities may be positive, zero or even negative. Thus, unlike individuals who are influenced by their net positive wealth, relative yields, expected future prices of assets and the degree of uncertainty, the banks are concerned about their assets which are counter balanced by liabilities (mainly deposit and borrowed funds) payable as per demand or maturity (Black, J and A. R. Jasay, 1957). Additionally, unlike individual’s portfolio behavior, the banks have to maintain liquidity and follow a host of regulation as provided by appropriate authorities, usually the central bank. These regulations may relate to both acceptance of deposits (liabilities) and provisions of advances (assets). Finally unlike individual behavior the banks face
serious risk of default and capital depreciation in case of advances and investments respectively; and unfortunately there are no escape routes. Therefore, it is said that ‘advances are capital safe but not shiftable while investment are shiftable but not capital safe’. Banks, unlike individuals, would have to operate with a larger framework of constraints both in terms of variation of assets mix and its protection.

Bankers and economists have immense responsibility to find out the structural changes of portfolio and its impact on the banks in particular and the banking and financial system in general. In the present study, we have introduced portfolio structure as they appear in the balance sheet of banks. We have also noted the changing trends in the components of the balance sheet. We have sincerely attempted to encompass wide range of aspects relating to each of the components of banks portfolio.

It should be noted here that assets and liabilities are inter-dependent. Banks convert their liabilities into assets by way of advances and investments of the funds they receive in the form of deposits and borrowings. Of course, they also earn non-interest income by way of fees and charges which are directly included in the banks’ earnings. A close examination of the selected items of assets and liabilities may further unfold the nuances of portfolio structure of banks.

**IMPORTANCE OF THE STUDY**

Portfolio structure in general has been discussed by various economists and researchers from time to time. Particularly in the context of banks in European countries, there are systematic studies on assets and liabilities portfolio of banks. However a comprehensive study on various aspects of bank portfolio in the Indian context has been lacking. We have made a modest attempt to fulfill this gap by incorporating various aspects of portfolio behavior of Indian commercial banks.

The study is important as it is believed that banks with good portfolio management can maximize their earnings and also satisfy their social objectives as required by the Government and the Reserve Bank of India. At present, when most of the public sector banks are reeling
under the pressure of growing NPA, focus on aspects of portfolio management can help the banks to cut down their risk exposure as well as unnecessary spending so as to strengthen their balance sheet.

In the post reform period, banks have been given relatively more freedom to make adjustments in their deposits and advances. On the one hand this has led to healthier competition among the banks in the matter of resource mobilization; on the other, it has helped the system to create a level playing field in which those, who can really manage their portfolio better, outshine others in the areas of prioritization and resource allocation.

THE CHAPTER SCHEME

The present study is divided into seven chapters. We have planned the chapters in such a manner that it should look after three main areas of the study. This are related to designing, management and monitoring aspects.

The detailed chapter scheme is as under.
1. Introduction
2. Literature Review, Objectives, and Research Methodology
3. Deposit Behavior of Commercial Banks.
4. Implications of Capital Adequacy
5. Lending and Investment Behavior of Commercial Banks.
7. Conclusions

The first chapter introduces the concept of banks portfolio and reveals its perspective. It further elaborates the design and structure of banks portfolio both on assets and liability sides, as they conventionally appear in the bank’s balance sheet. The share of various items of assets and liability portfolio are depicted to gauge their relative importance. It can be observed that there are significant changes in the share of individual components of both assets and liabilities under the period of study 1992-2012. The second chapter details the extensive review of literature on the
topic of study and builds the background for the analytical work carried out in the subsequent chapters. The study also brings forth the existing gap which the present study seeks to fill up. The second chapter also lists out objectives of the study. In the same chapter, we intend to present research methodology and hypotheses as undertaken in the study.

The successive four chapters deal with some vital aspects of banks’ portfolio. Chapter three provides a detailed review of growth of bank deposits and throws light on structural changes that took place during the period 1992-2012. In the same chapter we have reviewed cost of deposits of various bank groups and also maturity pattern of term deposits. In the chapter cash deposit ratio, credit deposit ratio and investment deposit ratio are also analyzed for their pervasive influence on the banking system.

The fourth chapter first introduces the concept of bank capital and then analyses ratio of capital and net worth to total liabilities separately. The chapter is of immense importance as it goes on discussing about the Basel accord and changing capital to risk weighted ratio (CRAR). In this chapter we have also attempted to study capital compliance of commercial banks in India. It has been observed that there is likelihood of huge capital requirement to satisfy the latest Basel III accord, lest the banks would be thrown to imperiling circumstances.

Lending and investment behavior of commercial banks are depicted under chapter five of present study. The ensuing chapter studies the growth of bank advances and investments separately for each of the bank groups selected for the purpose of study. From the balance sheet point of view the structure of advances are classified as type wise, security wise and sector wise. The study of each category has a different purpose, for example, under type wise advances we study the nature and types of items such as bills purchase and discounted, cash credits and term loans. Similarly the security wise classifications are to understand secured and unsecured nature of advances. Sector wise analysis of bank advances relates to priority sector and non-priority sectors. In the analysis of investments it has been observed that the banks are largely exposed to government and other approved securities and their investment in long term capital market instruments is almost negligible. The chapter concludes with the study of advance and investments of scheduled commercial banks in India in relation to gross domestic product.
The sixth chapter devotees completely to asset quality of banks where we concentrate on the issues related to non-performing assets and various measures taken for improvement in the quality of banks assets. The mainstay of the chapter is the behavior of the advances and NPAs for each of the bank groups. The quality of the assets are analyzed in terms of gross NPAs to gross advances, net NPAs to net advances and net NPAs to total assets. We have also analyzed changing structure of NPAs for various bank groups. One of the interesting aspect of NPAs relate to increasing provisions for all bank groups over the period. One can understand the logic of priority sector NPAs from the nature of credit allocation itself. However significant portion of non-priority sector NPAs is a matter of great concern as banks do not expect to spawn so much of non-performing assets from the commercial sectors. We have also presented quantitative models describing the impact of NPA on Return on Assets. We have also build separate bank group wise models to explain the impact of term loans, priority sector lending and lending rates on non-performing assets of various bank groups.

The concluding chapter seven summarizes the major findings of the present study. The chapter also seeks to list out the policy issues and suggests areas for further study

**OBJECTIVES OF THE STUDY**

A glimpse of literature survey suggests that diversified aspects of banks portfolio are studied in isolation. The survey also suggests that there are three important aspects of portfolio behavior of commercial banks. These are issues related to deposits mobilization, capital adequacy and quality of loans and investments including those concerns originating from poor quality of assets particularly NPAs. A comprehensive analysis considering these aspects of banks behavior in a single study is still lacking. The focus of the present study is to bring forth few critical aspects of portfolio behavior of commercial banks for the purpose of both academic discussion and policy implications. Following are the major objectives of the study:-

1. To undertake a comprehensive review of growth and structure of bank deposits in India.
2. To study changes in bank deposits mix with respect to rate of interest changes, and other factors and discuss issues originating therein.
3. To study relationship between deposit with advances and investments.
4. To study composition and structure of capital held by the commercial banks in India.
5. To study the issues of capital adequacy and its impact on commercial banks of different bank groups.
6. To study the sector-wise growth of bank advances and identify the constraints.
7. To study the issues related to recovery of loans of commercial banks.
8. To make a comprehensive study of investments of banks and implications thereof.
9. To study and analyze the issues related to non-performing assets and their implications on commercial banks.
10. To understand and analyze the determinants which are crucial for an optimal portfolio mix of commercial banks.
11. To suggest recommendations on the basis of study so undertaken.

**HYPOTHESES OF THE STUDY**

The hypotheses of the present study are as follows:

1. The structure of bank deposits varies over time due to variation in structure of interest rates.
2. Capital adequacy has serious implications on banking business.
3. The banks’ capitals are sufficiently enhanced to meet adequacy norms over the period under study.
4. The commercial banks suffer from financial repression in the matter of choice of lending to different sectors of the economy.
5. There is substantial preemption of banks resources in the name of statutory requirements.
6. The banks suffered from poor recovery of loans during the period under study.
7. There is not enough freedom of choice in the context of bank investments.
8. Non-performing assets of banks have increased during the period under study.
9. The quality of banks assets and earnings are positively related.
10. The choice of optimum asset portfolio has been less pronounced.
METHODOLOGY OF STUDY

We have divided the commercial banks in four different groups: SBI and its associates, twenty nationalized banks, private sector banks and foreign banks. Wherever needed, individual bank’s performance is highlighted as example for substantiation, but the study does not attempt individual or bank-wise analysis. While for policy purposes, group-wise bank analysis are crucial, generality of arguments would require further study of variables at both bank and branch levels.

The study is based mainly on secondary data available for a period of twenty years, that is, 1992-2012. Wherever needed for substantiation of arguments, previous years’ data are analysed. The period of study would highlight the portfolio behavior of banks in the last two decades after the economic reforms and liberalization measures were ushered in.

A vast source of data available from RBI, commercial banks and financial institutions are collected and analyzed. Some data are also taken from annual reports of banks, economic survey and other relevant government publications. Various other reports and balance sheets of commercial banks are used in the study. Data and studies on Indian banks at international level, wherever found suitable, are also incorporated in the study for the purpose of analysis.

The present study starts with the introduction to the concept of portfolio and its importance for commercial banks. After the review of literature, the study attempts to understand the behavior of commercial banks with respect to deposits, capital, advances and investments. For the purpose of study we have used simple statistical calculations and ratios to both understand and compare relative significance of items of banks’ assets and liabilities. Growth rates, both simple and compound, are used to show the trends of variables during the period under study. Simple statistical tools such as correlation coefficient are also used to study the interrelationships between the variables, wherever needed.

The graphs and charts are adequately used to enhance the understanding of comparative trends originating from the data. Growth rates, both simple and compound, are used to show the trends of variables during the period under study. Simple statistical tools such as correlation coefficient are also used to study the interrelationships between the variables, wherever needed. We have
also attempted group wise regression analysis in Chapter 3 and Chapter 6 to substantiate our arguments.

CONCLUSION

The heterogeneity of behavior of commercial banks emerges as a strong point in the study of various bank groups. There are important issues related to deposits, advances and investments, where the group of private banks and foreign banks have performed significantly well. There are also perceptible differences between various bank groups in their functioning and management of capital adequacy and non-performing assets.

The study has attempted to explore some selected issues of portfolio behaviour of various banks groups. Due to enormity of the theme, we had to undertake group wise study than an elaborated study of all individual banks. Admittedly, details of individual bank’s behaviour are not within the scope of our study. It is left to the intriguing researchers to further unfold the dimensions of asset quality and its impact on individual banks. Our study would remain prospective in nature and indicative in prescription.

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