CHAPTER III

THE EFFECT OF INTERMEDIARY ROLE PLAYED
BY BANKS ON THEIR VIABILITY

NATIONALISATION OF BANKS - AN EPOCH MAKING EVENT

The growth of commercial banks as primary intermediary agencies in India gained momentum since the Nationalisation of major commercial banks in July 1969, which brought over 80% of banking activities in the Country, particularly in terms of deposit mobilisation and credit dispensation, within the gamut of the public sector. This was a turning point in the history of Indian Banking. With the Nationalisation of 6 more private sector banks in 1980, 90% of the banking activities in the Country have been brought within the fold of the Public Sector. The Nationalisation of banks has been done with a view to, inter-alia:

a. meeting progressively the needs of development of the Economy in conformity with the national objectives and priorities.

b. mobilising savings and canalising them for being deployed for productive purposes in accordance with carefully drawn plans and priorities;

c. ensuring that the needs of productive sectors of the Economy, particularly farmers, small scale industrialists and self-employed professional groups are met substantially;

d. Offering liberal credit support to the neglected sectors of the Economy and to the backward areas in different parts of the Country and

e. curbing the use of bank credit for speculative and other unproductive purposes and ushering in the right atmosphere for the professionalisation of Bank Management in the Country.
In short, the core aim of Nationalisation of banks was essentially to replace class banking by mass banking.

To fulfill these objectives, banks have since taken up, additionally, several onerous social responsibilities as under:

a) extending banking facilities to unbanked and under-banked areas in the Country;

b) undertaking socio-economic surveys of backward areas in the Country with a view to preparing and implementing Credit/Action Plans for their extensive and intensive economic development;

c) extending liberal credit support to the productive efforts of the weaker sections of the society and more particularly to the weakest among the weak and the poorest among the poor such as small & marginal farmers, landless labourers, oral lessees, share croppers, small artisans, village craftsmen etc. who have no security to offer;

d) fostering the growth of new and progressive entrepreneurs and creating fresh opportunities for the neglected and backward areas in the Country;

e) curbing the use of bank credit for speculative and unproductive purposes;

f) undertaking developmental schemes such as Village Adoption Scheme etc. and

g) bringing about the right atmosphere for the development of adequate professional management in banks.

The commendable performance of banks in regard to fulfilling the objectives of Nationalisation through the several tailor-made and result-oriented socio-economic Schemes has been dealt with in the previous Chapter. It is clear that banks serve as important agents of socio-economic change in the Indian Economy and that their performance in compliance with these objectives is indeed creditable.
As pointed out earlier, opening large number of branches in rural areas, liberal extension of credit to the Priority Sectors, lending to Sick Units for rehabilitation and taking up other similar developmental activities have all led to erosion of profitability of banks. Rural branches of banks normally require long gestation periods to break-even and they are not able to earn income which would be sufficient to cover even the establishment costs incurred by them for transacting such business. Thus, every branch opened in rural areas contributes to the loss of banks.

The following Table shows the declining profitability of banks since 1970:

### TABLE 1: PROFITABILITY OF INDIAN COMMERCIAL BANKS

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Net Profit of all Scheduled Commercial Banks as ratio to their average (monthly) deposits ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>0.25</td>
</tr>
<tr>
<td>1971</td>
<td>0.22</td>
</tr>
<tr>
<td>1972</td>
<td>0.16</td>
</tr>
<tr>
<td>1973</td>
<td>0.23</td>
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<tr>
<td>1974</td>
<td>0.28</td>
</tr>
<tr>
<td>1975</td>
<td>0.29</td>
</tr>
<tr>
<td>1976</td>
<td>0.21</td>
</tr>
<tr>
<td>1977</td>
<td>0.20</td>
</tr>
<tr>
<td>1978</td>
<td>0.16</td>
</tr>
<tr>
<td>1979</td>
<td>0.16</td>
</tr>
<tr>
<td>1980</td>
<td>0.16</td>
</tr>
</tbody>
</table>

Source: Statistical Tables relating to Banks in India published by the Reserve Bank of India 1969 to 1981.
While data relating to average (monthly average) domestic deposits of banks in India are available in the Statistical Tables relating to Banks in India, published every year by the Reserve Bank of India, data relating to their average global deposits and data relating to their Income, Expenditure and Profit in respect of their Indian and overseas branches are not available/published separately at all. Individual banks also are reticent to supply such data as they treat them as strictly confidential. Due to non-availability of such data, we have related in the above Table, declared global profits of banks in India to their average domestic deposits and it has been done so, uniformly for all the years that it shows broadly the correct trend. In fact, if the overseas profit of banks is eliminated and their total net domestic profit alone is related to their average domestic deposits/business, then their profitability would show a more adverse/further declining trend.

The profitability of the Indian Scheduled Commercial Banks, which shows a continuous decline since 1975, as reflected in the ratio of their net profit to their average deposits is shown in the following graphical representation:
GRAPH: 1

PROFITABILITY OF ALL SCHEDULED COMMERCIAL BANKS IN INDIA

Scale:
X axis 1 cm = 1 Year
Y axis 1 cm = 0.1%

NET PROFIT OF ALL SCHEDULED COMMERCIAL BANKS AS RATIO TO THEIR AVERAGE DEPOSITS

YEAR
Apart from the declining trend in banks' profitability (particularly profit as proportion to average deposits), another significant feature of the banking scenario in the Country is the continuous decline in the ratio of Capital and Reserves to deposits, advances etc., as set out in the Table given hereunder. There are three main criteria for assessing the adequacy of Capital funds of banks. The more common method is to relate them (paid-up Capital and Reserves) to deposits. The second method is to relate them to the risk assets. Capital and Reserves may also be studied as a ratio to advances.

**TABLE 2: RATIO OF OWNED FUNDS (CAPITAL & RESERVES) OF INDIAN BANKS TO THE AVERAGE DEPOSITS AND ADVANCES**

(Amounts in crores of Rs.)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>4720.85</td>
<td>3467.69</td>
<td>111.33</td>
<td>2.36</td>
<td>3.21</td>
</tr>
<tr>
<td>1970</td>
<td>5437.53</td>
<td>4160.39</td>
<td>114.60</td>
<td>2.11</td>
<td>2.75</td>
</tr>
<tr>
<td>1971</td>
<td>6439.25</td>
<td>4798.41</td>
<td>121.93</td>
<td>1.90</td>
<td>2.34</td>
</tr>
<tr>
<td>1972</td>
<td>7770.10</td>
<td>5299.63</td>
<td>128.60</td>
<td>1.66</td>
<td>2.42</td>
</tr>
<tr>
<td>1973</td>
<td>9433.04</td>
<td>6271.15</td>
<td>135.61</td>
<td>1.44</td>
<td>2.16</td>
</tr>
<tr>
<td>1974</td>
<td>10998.97</td>
<td>7629.53</td>
<td>166.62</td>
<td>1.54</td>
<td>2.21</td>
</tr>
<tr>
<td>1975</td>
<td>12852.14</td>
<td>8907.66</td>
<td>210.46</td>
<td>1.64</td>
<td>2.36</td>
</tr>
<tr>
<td>1976</td>
<td>15822.20</td>
<td>11665.48</td>
<td>271.52</td>
<td>1.72</td>
<td>2.32</td>
</tr>
<tr>
<td>1977</td>
<td>19458.91</td>
<td>13585.13</td>
<td>308.40</td>
<td>1.59</td>
<td>2.28</td>
</tr>
<tr>
<td>1978</td>
<td>23736.67</td>
<td>15481.49</td>
<td>372.50</td>
<td>1.56</td>
<td>2.41</td>
</tr>
<tr>
<td>1979</td>
<td>29028.70</td>
<td>18994.49</td>
<td>437.49</td>
<td>1.51</td>
<td>2.30</td>
</tr>
<tr>
<td>1980</td>
<td>34219.71</td>
<td>22134.87</td>
<td>533.52</td>
<td>1.56</td>
<td>2.41</td>
</tr>
<tr>
<td>1981</td>
<td>41559.51</td>
<td>26687.74</td>
<td>626.03</td>
<td>1.51</td>
<td>2.35</td>
</tr>
</tbody>
</table>

**SOURCE:** Computed from data published by the Reserve Bank of India in Statistical Tables relating to Banks in India 1969 to 1981
It may be seen from the above Table that the owned funds of banks vis. Paid-up Capital and Reserves as proportion to average deposits declined sharply over the years from 2.36% in 1969 to 1.51% in 1981. Similarly, the proportion of owned funds to average advances also declined to 2.35% in 1981 from 3.21% in 1969. This decline is also depicted clearly in the following graphical representation:
GRAPH: 2
OWNED FUNDS OF ALL SCHEDULED COMMERCIAL BANKS

Scale:
X axis 1 Cm = 1 Year
Y axis 1 Cm = 1X

- - - - Ratio of paid up capital & reserves to average deposits
- - - - Ratio of paid up capital & reserves to average advances

YEAR
1960 70 71 72 73 74 75 76 77 78 79 80 81 82
The decline in the ratio of owned funds of banks in India has also been highlighted by the James Raj Committee on Functioning of Public Sector Banks appointed by the Reserve Bank of India in 1978. The Committee reported "that the rise in profitability of the banks had not been commensurate with the increase in their working funds since Nationalisation. The Committee examined the ratio of balance of profit before taxes as a proportion to total working funds since Nationalisation. This ratio is substantially lower than in the preceding decade; in any case, we consider this ratio to be unduly low compared to that of banks in developed Countries". It is true that compared to international standards this proportion is very low as may be seen from the Table appended below:

**TABLE 3: CAPITAL-DEPOSIT RATIO RELATING TO SOME BANKS IN FOREIGN COUNTRIES AS AT THE END OF 1983**

(In millions of $)

<table>
<thead>
<tr>
<th>Name of the Bank</th>
<th>Deposits</th>
<th>Capital + Res.</th>
<th>Capital + Res. as proportion to deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citi Corpn.</td>
<td>79794</td>
<td>5771</td>
<td>7.23</td>
</tr>
<tr>
<td>Chase Manhattan</td>
<td>56300</td>
<td>3576</td>
<td>6.35</td>
</tr>
<tr>
<td>Bank of America</td>
<td>95751</td>
<td>5136</td>
<td>5.36</td>
</tr>
<tr>
<td>Barclays</td>
<td>82723</td>
<td>4292</td>
<td>5.18</td>
</tr>
<tr>
<td>Lloyds</td>
<td>51527</td>
<td>3181</td>
<td>6.17</td>
</tr>
<tr>
<td>Mitsubishi Bank</td>
<td>77665</td>
<td>2773</td>
<td>3.58</td>
</tr>
<tr>
<td>Hong Kong &amp; Shanghai</td>
<td>52728</td>
<td>2551</td>
<td>4.84</td>
</tr>
<tr>
<td>Indian Comm. Bks.</td>
<td>41559</td>
<td>626</td>
<td>1.50</td>
</tr>
</tbody>
</table>

Source: The Banker (London) May, 1984
Amongst Indian banks, the ratio of State Bank of India is comparatively higher but even that, at a little more than 2%, is very low compared to international standards.

This poor ratio in the case of Indian banks is essentially due to their declining profitability. Further, the chances for their improving significantly their capital base in the near future also do not seem to be bright. As James Raj Committee put it, "Looking to the future, we believe that profitability is likely to be eroded by such factors as the increasing costs of staff salaries and other emoluments, as the impact of normal increments begins to be felt and the likelihood that working funds may not increase as fast as they have done in the past and that more and more retail banking would tend to add to the unit cost of banking operations".

Because of this poor capital base, Indian banks lack credibility in the overseas markets and as such are not able to get their due share in foreign loan syndications etc.

Data relating to profitability of banks as set out above do not take into consideration the undisclosed/secret reserves of banks. The present low level of the ratio of capital funds to deposits can be raised, only if the core recommendation of the James Raj Committee on Public Sector Banks is implemented. The recommendation is that commercial banks should be required to transfer 40% of their disclosed profits to published reserves, free of tax, as against the existing
provision in the Banking Regulation Act, for a compulsory transfer of only 20% (of the disclosed profit). However, even the implementation of this recommendation may not help step up the ratio significantly as the profitability of economic operations of banks in India is very low and is in fact declining. The difference/margin between cost of and return on funds (taking into consideration servicing costs) is called 'spread' and it determines the profit of banks. Lower the spread lesser the profitability and poorer the capital base. Thus, profit management exercise in banks boils down to the management of spread. 'Spread Management' is an effective tool for improving profit margins in banks. The importance of 'Spread Management' in banks is well recognised and demonstrated in American banks and it has also been stressed, in one of the studies made by V.Dha Varde and Sampath Singh of National Institute of Bank Management, Bombay, as vital for stepping up profitability.

A detailed study of the cost of and return on funds in the case of Indian banks would bring out clearly the adverse trends in their movements and their consequent detrimental impact on the profitability of banks.

SOURCES AND USES/INFLOW AND OUTFLOW OF FUNDS IN THE CASE OF BANKS IN INDIA

An analysis of the composition of the funds portfolio of banks in India would show that, over a period of time, their low cost funds and high yielding assets have been replaced by high cost funds and low yielding assets. The working funds of commercial banks are made up of deposits, borrowings, transit/float funds etc., besides their capital, reserves and generated profit. While deposits, borrowings and reserves of
banks can be quantified precisely, transit funds that accrue to them cannot be quantified. This can be done only by working out the net difference between the inflow and outflow of funds. Normally, paid-up capital is not taken as a regular part of sources, as it is only a one-time source of funds of banks, while reserves go on accumulating each year.

Similarly, funds mobilised by banks are deployed in the form of (a) Cash Reserves/balances with the Reserve Bank of India towards the maintenance of the Cash Reserve Ratio (CRR), (b) investments in Govt. Securities, other approved Securities etc. towards the maintenance of the Statutory Liquidity Ratio (SLR) and (o) advances.

Two important aspects of the analysis/study made herein are that it is based on average of each component of sources and uses of funds and that it takes into consideration servicing costs (which are added to cost of funds and are deducted from gross return on funds). Normally, research Studies in this area are made only on the basis of outstandings of the relevant assets and liabilities of banks and not on their averages. Thus, this computation of cost of and return on funds is somewhat uniquely more precise in its findings.

The following two Tables set out the composition of the sources/inflow and deployment/outflow of funds of all Scheduled Commercial Banks since 1969 (the year of Nationalisation) and until 1981.
TABLE NO. 14 - SOURCES (INFLOW) OF FUNDS (AVERAGE)
OF ALL SCHEDULED COMMERCIAL BANKS IN INDIA

(Amounts in crores of Rs.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Deposits</th>
<th>Borrowings</th>
<th>Other DTL</th>
<th>Total Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>4720.85</td>
<td>194.95</td>
<td>145.35</td>
<td>5061.15</td>
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<tr>
<td>1970</td>
<td>5437.53</td>
<td>314.38</td>
<td>175.44</td>
<td>5927.35</td>
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<td>1971</td>
<td>6439.25</td>
<td>298.49</td>
<td>211.43</td>
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<td>7770.10</td>
<td>194.71</td>
<td>259.63</td>
<td>8224.44</td>
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<td>1973</td>
<td>9433.04</td>
<td>268.51</td>
<td>363.49</td>
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<td>1974</td>
<td>10998.97</td>
<td>540.45</td>
<td>507.23</td>
<td>12046.65</td>
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<td>1975</td>
<td>12852.14</td>
<td>478.83</td>
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<td>1977</td>
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<td>1978</td>
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<td>1981</td>
<td>41539.51</td>
<td>1063.43</td>
<td>2007.75</td>
<td>44630.69</td>
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</table>

SOURCE: Compiled from data furnished in the Statistical Tables relating to Banks in India 1969 to 1981 published by the Reserve Bank of India.
<table>
<thead>
<tr>
<th>Year</th>
<th>Cash on hand (Rs. cr.)</th>
<th>Bal. with RBI (Rs. cr.)</th>
<th>Bal. with other banks (Rs. cr.)</th>
<th>Investments (Rs. cr.)</th>
<th>Money at call (Rs. cr.)</th>
<th>Bank Credit (Rs. cr.)</th>
<th>Total (Rs. cr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>123.67</td>
<td>164.77</td>
<td>48.27</td>
<td>139.69</td>
<td>70.93</td>
<td>3467.69</td>
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<td>4160.39</td>
<td>6169.29</td>
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<td>1971</td>
<td>171.18</td>
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<td>13585.13</td>
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<td>337.53</td>
<td>14364.64</td>
<td>313.42</td>
<td>26687.74</td>
<td>46920.38</td>
</tr>
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</table>

The structural changes in the composition of funds mobilised by banks and in the deployment of the same since 1969 are set out in the following Table:
TABLE 6 - PROPORTION OF THE DIFFERENT COMPONENTS OF SOURCES AND USES IN BANKS (%)

(Based on monthly average data for each year)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
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<td>1. Deposits</td>
<td>93.3</td>
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<td>92.7</td>
<td>94.5</td>
<td>93.7</td>
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<td>92.4</td>
<td>94.5</td>
<td>92.3</td>
<td>93.1</td>
<td>93.2</td>
</tr>
<tr>
<td>2. Borrowings</td>
<td>3.9</td>
<td>5.3</td>
<td>4.3</td>
<td>2.4</td>
<td>2.7</td>
<td>4.5</td>
<td>3.5</td>
<td>6.3</td>
<td>4.0</td>
<td>2.1</td>
<td>2.8</td>
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<td>2.4</td>
</tr>
<tr>
<td>3. Other DTL</td>
<td>2.8</td>
<td>3.0</td>
<td>3.0</td>
<td>3.1</td>
<td>3.6</td>
<td>4.2</td>
<td>3.8</td>
<td>2.9</td>
<td>3.6</td>
<td>3.4</td>
<td>4.1</td>
<td>4.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Total SLR</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
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<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Uses of Funds:

1. CRR - Balance with the RBI
   - 3.1
2. SLR:
   - 2.4
     a) Cash on hand
     - 0.9
     b) Balance with other banks
     - 26.5
   - 28.8
3. Money at Call
   - 1.3
4. Credit
   - 65.8

All Data furnished above are only percentages.

SOURCE: Computed from data furnished in Statistical Tables relating to Banks in India 1969-1981 - Published by the Reserve Bank of India.
It may be seen from the above Table that there has not been any considerable change in the composition of funds of banks. Accordingly, deposits continue to account for more than 90 per cent of the total sources of banks, and their 'Other Sources' including borrowings, other DTL etc. continue to constitute the remaining less than 10 per cent.

However, there has been a structural change in the deployment of funds by banks. The share of 'cash on hand' in the total funds deployed has been declining sizeably. This has been due to the opening of a large number of Currency Chests by Public Sector Banks since Nationalisation, whereby they are able to remit to them, in time, a substantial portion of their excess cash balances.

There is no change in the share of balances held with other banks for clearing purposes. As regards investments, quite in tune with the hike in SLR from 26% in 1969 to 35% in 1981, the share of investments (average) in total funds has increased from only 26.6% in 1969 to 30.6% in 1981; Similarly, balance maintained with the Reserve Bank of India (average) also moved up from only 3.1% in 1969 to 9.4% in 1979. Consequently, the share of credit (average) in the total of funds deployed declined from 65.8% in 1969 to 56.8% in 1981.

This structural change in the composition of funds, particularly the significant shift from high yielding advances to low yielding securities and balances with the Reserve Bank of India is represented in the following graphical representation:
GRAPH: 3
COMPOSITION OF DEPLOYMENT OF FUNDS OF ALL SCHEDULED COMMERCIAL BANKS (Average data)

Scale:
X axis 1 cm = 1 Year
Y axis 1 cm = 1%

YEAR

PROPORTION OF ADVANCES TO TOTAL FUNDS

PROPORTION OF SLR TO TOTAL FUNDS

PROPORTION OF RBI BALANCES TO TOTAL FUNDS

YEAR

1969 70 71 72 73 74 75 76 77 78 79 80 81 82
The cost of funds that flow into banks from various sources has two elements viz. the actual cost of funds and the servicing cost of mobilising these funds. Currently, there is no system/procedure, in banks, to bifurcate precisely and separately the costs incurred by them for raising funds and deploying them. As mentioned earlier, the major sources of funds for banks are deposits, borrowings, other DTL, and other transit/float funds etc. The cost of deposits and borrowings is mainly interest paid on them. Further, a portion of the establishment and other related expenses incurred by the Bank should be apportioned/added as servicing costs relating to mobilisation of deposits and other funds. Banks do not incur any cost on 'Other DTL' and other transit/float funds. However, banks incur expenses on servicing remittances etc. Hence, a portion of the total servicing costs should be apportioned for servicing remittances etc. Similarly, the return on funds deployed is essentially in the form of interest received. But establishment and other relevant costs incurred by banks for servicing credit accounts etc. are to be deducted from such interest income to compute the net return on funds deployed.

**Servicing Costs:**

Servicing costs of banks are those costs which are incurred by them for mobilising funds and deploying them. Thus, servicing costs of banks include payment of wages to their members of staff, cost of stationery and printing, postage, rent paid etc. Hence, actual cost of funds will be interest cost of funds plus servicing cost of mobilisation and similarly return on funds deployed will be interest etc. received on funds deployed in various forms less servicing.
cost incurred for such deployment. Servicing costs of banks should be apportioned properly, each year, between various services rendered by banks to their customers to assess the actual cost of funds.

A reference to the Cost Evaluation Study made in 1976 by a Sub-Committee constituted by the PEP Committee would be quite relevant and useful here. The Sub-Committee selected a sample of several branches classified into few groups providing for a representative mix of branches in different population groups such as rural, semi-urban, urban and Metropolitan and conducted a Study on the actual time spent by/at those select branches on each transaction conducted by them and computed, on this basis, the average cost, for each group of banks per Rs.100 of each type of transaction such as the issue of a DD, TT, MT etc. and the share of the cost of each of the major types of business transactions of banks in the overall cost incurred by them. The findings of the Sub-Committee in this regard are currently the only source of data available for most of the banks in regard to the costs incurred by them in rendering various types of services to their customers. According to the Report of the Sub Committee, the proportion of costs incurred by banks in rendering various types of services to their customers to their total servicing costs was as under:

<table>
<thead>
<tr>
<th>Services</th>
<th>Proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) On deposits</td>
<td>10.6%</td>
</tr>
<tr>
<td>b) Advances</td>
<td>24.4%</td>
</tr>
<tr>
<td>c) Remittances</td>
<td>10.3%</td>
</tr>
<tr>
<td>d) Foreign Exchange</td>
<td>3.7%</td>
</tr>
<tr>
<td>e) Bills</td>
<td>10.7%</td>
</tr>
<tr>
<td>f) Other Activities</td>
<td>10.3%</td>
</tr>
</tbody>
</table>

**Total Servicing Cost** 100.0%
Servicing Costs of banks may be apportioned between sources and uses of funds as under:

<table>
<thead>
<tr>
<th>SOURCES OF FUNDS</th>
<th>USES OF FUNDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits</td>
<td>Advances</td>
</tr>
<tr>
<td>Other Activities</td>
<td>Foreign Exch.</td>
</tr>
<tr>
<td></td>
<td>Remittances</td>
</tr>
<tr>
<td></td>
<td>Bills</td>
</tr>
<tr>
<td>40.6%</td>
<td>24.4%</td>
</tr>
<tr>
<td>10.3%</td>
<td>3.7%</td>
</tr>
<tr>
<td></td>
<td>10.3%</td>
</tr>
<tr>
<td></td>
<td>10.7%</td>
</tr>
<tr>
<td>50.9%</td>
<td>49.1%</td>
</tr>
</tbody>
</table>

Servicing costs incurred by all Scheduled Commercial Banks every year since 1969 and up till 1981 may be apportioned, on this basis, as under, for the purpose of finding out the actual cost of and return on funds and assess the spread between them.
## TABLE 7 - APPORTIONING OF SERVICING COSTS IN BANKS

(Amounts in crores of Rupees)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Deposits</th>
<th>Other activities</th>
<th>Total</th>
<th>Advances</th>
<th>Foreign Exch.</th>
<th>Remittances</th>
<th>Bills</th>
<th>Total</th>
<th>A + B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>73.10</td>
<td>18.55</td>
<td>91.65</td>
<td>43.94</td>
<td>6.66</td>
<td>18.55</td>
<td>19.27</td>
<td>88.42</td>
<td>180.07</td>
</tr>
<tr>
<td>1970</td>
<td>92.08</td>
<td>23.36</td>
<td>115.44</td>
<td>55.33</td>
<td>8.39</td>
<td>23.36</td>
<td>24.27</td>
<td>111.35</td>
<td>226.79</td>
</tr>
<tr>
<td>1971</td>
<td>111.60</td>
<td>28.31</td>
<td>162.80</td>
<td>67.07</td>
<td>10.17</td>
<td>28.31</td>
<td>29.41</td>
<td>134.96</td>
<td>274.87</td>
</tr>
<tr>
<td>1972</td>
<td>129.86</td>
<td>32.94</td>
<td>162.80</td>
<td>78.04</td>
<td>11.83</td>
<td>32.94</td>
<td>34.24</td>
<td>157.05</td>
<td>319.85</td>
</tr>
<tr>
<td>1973</td>
<td>159.16</td>
<td>40.38</td>
<td>199.54</td>
<td>95.65</td>
<td>14.50</td>
<td>40.38</td>
<td>41.94</td>
<td>192.47</td>
<td>392.01</td>
</tr>
<tr>
<td>1974</td>
<td>203.76</td>
<td>51.69</td>
<td>255.45</td>
<td>122.45</td>
<td>18.57</td>
<td>51.69</td>
<td>53.70</td>
<td>246.41</td>
<td>501.86</td>
</tr>
<tr>
<td>1975</td>
<td>249.50</td>
<td>63.30</td>
<td>312.80</td>
<td>149.94</td>
<td>22.74</td>
<td>63.30</td>
<td>65.74</td>
<td>301.72</td>
<td>614.52</td>
</tr>
<tr>
<td>1976</td>
<td>262.32</td>
<td>66.55</td>
<td>328.87</td>
<td>157.65</td>
<td>23.91</td>
<td>66.55</td>
<td>69.13</td>
<td>317.74</td>
<td>646.11</td>
</tr>
<tr>
<td>1977</td>
<td>302.48</td>
<td>76.74</td>
<td>379.22</td>
<td>181.79</td>
<td>27.57</td>
<td>76.44</td>
<td>79.71</td>
<td>395.81</td>
<td>745.03</td>
</tr>
<tr>
<td>1978</td>
<td>360.19</td>
<td>91.38</td>
<td>451.52</td>
<td>216.47</td>
<td>32.82</td>
<td>91.38</td>
<td>94.92</td>
<td>435.59</td>
<td>887.16</td>
</tr>
<tr>
<td>1979</td>
<td>443.59</td>
<td>112.53</td>
<td>556.12</td>
<td>266.59</td>
<td>40.43</td>
<td>112.53</td>
<td>116.91</td>
<td>536.46</td>
<td>1092.58</td>
</tr>
<tr>
<td>1980</td>
<td>543.76</td>
<td>137.79</td>
<td>681.55</td>
<td>326.76</td>
<td>49.55</td>
<td>137.79</td>
<td>143.40</td>
<td>657.72</td>
<td>1339.27</td>
</tr>
<tr>
<td>1981</td>
<td>649.44</td>
<td>164.75</td>
<td>814.19</td>
<td>390.30</td>
<td>59.18</td>
<td>164.75</td>
<td>171.15</td>
<td>785.38</td>
<td>1599.57</td>
</tr>
</tbody>
</table>

SOURCE: Computed from data compiled from Statistical Tables relating to Banks in India 1969 to 1981 published by the Reserve Bank of India
COST OF FUNDS:

The cost of and return on banks' funds can be computed by providing/taking into consideration servicing costs for mobilisation and dispensation of funds on the basis of data furnished in the above Table. As break-up data relating to expenditure incurred by banks on servicing funds obtained from different sources are not available separately (for each source) and as the main purpose of this exercise is only to show broadly how the cost of funds (interest cost plus servicing cost) has been increasing for banks over the last several years, costs relating to individual sources of funds have not been worked out separately. The following Table shows as to how banks' cost of funds has been on the increase since 1969:
TABLE 8 - COST OF FUNDS OF ALL SCH. COMMERCIAL BANKS

(Amounts in crores of Rs.)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Total funds mobilised (ave.)</th>
<th>Servicing cost</th>
<th>Interest Cost</th>
<th>Total Cost</th>
<th>Average Cost per Rs. 100 of funds mobilised</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>5061.15</td>
<td>91.65</td>
<td>189.99</td>
<td>281.64</td>
<td>5.56</td>
</tr>
<tr>
<td>1970</td>
<td>5927.35</td>
<td>115.44</td>
<td>226.18</td>
<td>341.62</td>
<td>5.76</td>
</tr>
<tr>
<td>1971</td>
<td>6949.17</td>
<td>139.91</td>
<td>287.26</td>
<td>427.17</td>
<td>6.14</td>
</tr>
<tr>
<td>1972</td>
<td>8224.44</td>
<td>162.80</td>
<td>345.60</td>
<td>508.40</td>
<td>6.18</td>
</tr>
<tr>
<td>1973</td>
<td>10065.04</td>
<td>199.54</td>
<td>445.77</td>
<td>645.31</td>
<td>6.41</td>
</tr>
<tr>
<td>1974</td>
<td>12046.65</td>
<td>255.45</td>
<td>664.65</td>
<td>920.10</td>
<td>7.64</td>
</tr>
<tr>
<td>1975</td>
<td>13867.92</td>
<td>312.80</td>
<td>859.32</td>
<td>1172.12</td>
<td>8.45</td>
</tr>
<tr>
<td>1976</td>
<td>17429.98</td>
<td>328.87</td>
<td>1188.83</td>
<td>1517.70</td>
<td>8.70</td>
</tr>
<tr>
<td>1977</td>
<td>21063.61</td>
<td>379.22</td>
<td>1467.03</td>
<td>1846.25</td>
<td>8.77</td>
</tr>
<tr>
<td>1978</td>
<td>25117.13</td>
<td>451.57</td>
<td>1709.17</td>
<td>2160.74</td>
<td>8.60</td>
</tr>
<tr>
<td>1979</td>
<td>31456.46</td>
<td>556.12</td>
<td>2158.91</td>
<td>2715.03</td>
<td>8.63</td>
</tr>
<tr>
<td>1980</td>
<td>36789.13</td>
<td>681.55</td>
<td>2789.65</td>
<td>3471.20</td>
<td>9.43</td>
</tr>
<tr>
<td>1981</td>
<td>44630.69</td>
<td>814.19</td>
<td>3601.42</td>
<td>4415.61</td>
<td>9.89</td>
</tr>
</tbody>
</table>

Notes on Computation:

Total Average Funds, as set out in the Table, include Demand and Time Deposits from banks and others, borrowings from banks & others (other than from IDBI/WABARD), other Demand and Time Liabilities and borrowings from the Reserve Bank of India. Interest cost refers to interest, commission and brokerage paid on deposits, borrowings, rediscounts and other business. The calculation of servicing cost has been detailed earlier. The cost of funds is calculated by adding interest cost to servicing cost and computing their proportion to total funds.
It may be seen from the above Table that the cost of mobilisation of funds, for banks, has increased from only Rs.5.69 per Rupees hundred in 1969 to Rs.9.76 per Rupees hundred in 1981. The reasons for such increase in cost of funds is spelt out in detail in the following paragraphs:

**REASONS FOR THE INCREASING COST OF FUNDS:**

A. Interest cost of Funds:

It may be seen from the Table 8 given above that the cost of banks in regard to collection of deposits has increased substantially between 1969 and 1981. This rise was primarily due to a large increase, during this period, in the rates of interest relating to deposits, as shown below:

**TABLE 9 - RATE OF INTEREST PAID ON DEPOSITS**

<table>
<thead>
<tr>
<th>Term Deposits for periods between</th>
<th>Rate of Interest per annum paid by banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>As on Sep. 1 1969</td>
<td>As at the end of 1981</td>
</tr>
<tr>
<td>----------------</td>
<td>------------------</td>
</tr>
<tr>
<td>15 days &amp; 45 days</td>
<td>1.25</td>
</tr>
<tr>
<td>46 days &amp; 90 days</td>
<td>2.50</td>
</tr>
<tr>
<td>91 days &amp; 6 months</td>
<td>4.00</td>
</tr>
<tr>
<td>6 months &amp; 9 mths.</td>
<td>4.50</td>
</tr>
<tr>
<td>9 months &amp; 1 year</td>
<td>5.00</td>
</tr>
<tr>
<td>1 year &amp; 2 years</td>
<td>5.50</td>
</tr>
<tr>
<td>2 years &amp; 3 yrs.</td>
<td>5.75</td>
</tr>
<tr>
<td>3 years &amp; 5 yrs.</td>
<td>6.00</td>
</tr>
<tr>
<td>5 years &amp; above</td>
<td>6.50</td>
</tr>
</tbody>
</table>

**SOURCES:** Report on Currency & Finance 1969-70 to 1981-1982
The above Table clearly sets out the increase in the cost of banks, since Nationalisation, in regard to acquisition of deposits. However, the hikes in the rates of interest on deposits were effected with a view to, inter alia, compensating the fall in the real value of money on account of inflation in the Economy and thereby to boost savings. Nevertheless, the cost of funds for the Banking System has been steadily rising since Nationalisation.

Another important reason for the rise in the cost of funds has been change in the deposit mix whereby the ratio of time deposits to total deposits has been growing steadily. This ratio has improved significantly since Nationalisation from 45 : 55 as at the end of June 1969 to 20 : 80 for 1981. Thus, term deposits mobilised by banks have outgrown, in terms of quantity, demand deposits, thereby resulting in higher costs of funds for banks. Though time deposits are more stable in character and help curb, to that extent, liquidity pressure in the Economy, yet mobilisation of such funds on a large scale has hiked up banks' cost of funds.

B. SERVICING COST OF FUNDS:

Further, banks' cost of mobilisation of funds has been going up due to steady increase in their establishment expenditure as well, particularly since Nationalisation, due to, inter alia, (a) wages payable to their staff members, (b) increase in rents payable by them to their premises and (c) increase in their other overheads such as printing, stationery, postage & telephone charges etc. Branches of banks should, therefore, step
up sufficiently their business so as to meet this hike in their establishment costs. It takes a fairly long gestation period for branches of banks, particularly the newly opened rural branches, to break-even. These branches incur loss (after providing for interest payable to/receivable from the Head Office, under the Transfer Price System) and this adds to the banks' cost of funds. The banks' cost of servicing funds as ratio to average funds deployed remained stationary at 3.42% for 1969 as well as for 1981. However, the decline should have been far greater considering the economics of scale. In other words, as per the theory of economics of scale, for such a large scale expansion in business, this ratio should have fallen to far lower levels, particularly in the context of a steep increase in average deposits plus average advances per employee from Rs.2.98 lakhs in 1971 to Rs.11.0 lakhs in 1981.

It may be seen from the Table appended below that servicing costs (establishment costs) as proportion to total Current Operating Expenses have also been declining steadily over the years:

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Total Current Operative Expenses</th>
<th>Servicing Cost</th>
<th>Servicing Cost as proportion to total C.O.E.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>370.06</td>
<td>180.07</td>
<td>48.66</td>
</tr>
<tr>
<td>1974</td>
<td>1166.55</td>
<td>501.86</td>
<td>43.02</td>
</tr>
<tr>
<td>1978</td>
<td>2596.33</td>
<td>887.16</td>
<td>34.17</td>
</tr>
<tr>
<td>1980</td>
<td>4128.92</td>
<td>1339.27</td>
<td>32.44</td>
</tr>
<tr>
<td>1981</td>
<td>5200.99</td>
<td>1599.57</td>
<td>30.75</td>
</tr>
</tbody>
</table>

SOURCES: Statistical Tables relating to Banks in India 1969-1981, published by the RBI
It may be pointed out that deposits per employee in Citibank and other foreign banks are more than $1 million while in India it is very low at $0.09 million. While these two standards may not be strictly comparable, yet this reveals the reason for the very low servicing costs of overseas banks compared to those banks in India. Thus, though superficially the ratio of servicing costs to sources of funds as well as to total earnings seems to have declined, yet it has increased effectively. We may attribute this increase in servicing cost to several factors as set out hereunder:

a) The militant trade unions of bank employees always fight successfully in seeking higher wages and thus four negotiated bi-partite settlements in regard to wages of Award Staff Members of banks have been effected so far and these were followed by hikes in salaries of bank officers too. These have led to substantial hikes in salaries of bank employees;

b) Further, due to inflation in the economy, Dearness Allowance being paid to employees which is linked to the cost of living index has been constantly on the increase, particularly since 1971. Thus, the consumer price index for Industrial Workers which was only 186 in March 1971 (1960=100) spurted to 574 in June 1984. This has boosted steadily the salaries of bank employees;

c) Rural branches of banks account for nearly 40% of their total number of branches and, as mentioned earlier, their gestation period is quite long. Hence, these branches do not have adequate business to engage
all their employees fully. Thus, a sizeable number of employees of banks who work in these rural areas are grossly under-utilised. This under-utilisation of services hikes up proportionately the establishment costs of banks and

d) The costs of Stationery & Printing, rent etc., (other than interest on deposits and borrowings and salaries etc. paid to employees) which constitute a significant portion of the servicing costs of banks have increased significantly since Nationalisation. This is borne out by the fact that while these expenditure constituted only 8.11% of the total current Operating Expenses in 1969, they constituted as much as 29.62% in 1981. This means that even with increased quantity of business transacted, the ratio has gone up due to increase in such expenditure.

RETURN ON DEPLOYMENT OF FUNDS:
While cost of funds has been on the increase, during the past one and a half decades, for banks, the return on funds deployed by them has not been increasing pari passu during this period.

Return on funds may be computed on the same lines as is done for computing cost of funds. However, real/net return would be, as mentioned earlier, total income less servicing cost. It may be seen from Table 11 that the Return on Funds had increased steadily from 6.27% in 1969 to 10.22% in 1976, but declined thereafter to 9.39% in 1979 and again improved to 11.13% in 1981. The reasons for the declining return on funds are discussed in the following paragraphs:
### TABLE 11 - RETURN ON DEPLOYMENT OF FUNDS

(Amounts in crores of Rs.)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Total Funds (average)</th>
<th>Total Operating Earnings for the year</th>
<th>Total Earnings less servicing cost</th>
<th>Net Return on every sum of Rs.100 deployed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>5272.12</td>
<td>418.75</td>
<td>88.42</td>
<td>330.33</td>
</tr>
<tr>
<td>1970</td>
<td>6169.29</td>
<td>504.81</td>
<td>111.35</td>
<td>393.46</td>
</tr>
<tr>
<td>1971</td>
<td>7191.97</td>
<td>635.80</td>
<td>134.96</td>
<td>500.84</td>
</tr>
<tr>
<td>1972</td>
<td>8397.52</td>
<td>738.72</td>
<td>187.05</td>
<td>511.67</td>
</tr>
<tr>
<td>1973</td>
<td>10281.74</td>
<td>909.25</td>
<td>192.47</td>
<td>716.78</td>
</tr>
<tr>
<td>1974</td>
<td>12180.80</td>
<td>1290.08</td>
<td>246.61</td>
<td>1043.67</td>
</tr>
<tr>
<td>1975</td>
<td>14103.68</td>
<td>1712.94</td>
<td>301.72</td>
<td>1411.22</td>
</tr>
<tr>
<td>1976</td>
<td>16069.70</td>
<td>2165.35</td>
<td>317.24</td>
<td>1847.11</td>
</tr>
<tr>
<td>1977</td>
<td>21820.79</td>
<td>2574.89</td>
<td>395.61</td>
<td>2179.88</td>
</tr>
<tr>
<td>1978</td>
<td>26303.95</td>
<td>2912.12</td>
<td>435.59</td>
<td>2476.53</td>
</tr>
<tr>
<td>1979</td>
<td>32547.60</td>
<td>3591.08</td>
<td>536.46</td>
<td>3054.62</td>
</tr>
<tr>
<td>1980</td>
<td>38712.83</td>
<td>4597.89</td>
<td>657.72</td>
<td>3940.17</td>
</tr>
<tr>
<td>1981</td>
<td>46920.38</td>
<td>6010.58</td>
<td>785.38</td>
<td>4225.20</td>
</tr>
</tbody>
</table>

**SOURCE:** Statistical Tables Relating to Banks in India 1969 to 1981, published by the Reserve Bank of India.
Notes on Computation:

Data relating to Total Average Funds, as set out in this Table, include Cash in hand, Balances with other Banks, both in Current & other Accounts, balances with the Reserve Bank of India (inclusive of the excess of average balances with the Reserve Bank of India over the statutory minimum), money at call and short notice, advances to banks, other assets, investments in Govt. and other approved Securities, advances (inclusive of Loans, Cash Credits and Overdrafts, Inland Bills purchased and discounted etc.). Return on these funds refer to total Current Operating Expenses less servicing cost which include (a) interest dividend, commission and exchange earned on inland bills etc. purchased and discounted, loans and advances, investments, deposits with the Reserve Bank of India and other banks etc. (b) service charges on inland collections, inland remittances, transactions involving foreign exchange business and (c) miscellaneous business.
A) THE IMPACT OF THE MONETARY AND CREDIT POLICIES OF THE
MONETARY AUTHORITIES AND THE DECLINE IN THE HIGH YIELDING
LENDABLE RESOURCES OF BANKS;

B) FISCAL POLICY OF THE GOVERNMENT OF INDIA AND

C) BANKS TAKING TO, ON AN INCREASING SCALE, HIGH COST AND
LOW YIELDING SOCIAL LENDING AND OTHER SOCIO-ECONOMIC
ACTIVITIES.

A. IMPACT OF THE MONETARY POLICY OF THE RESERVE BANK OF INDIA
AND THE FALL IN LENDABLE RESOURCES:

The impact of the Monetary Policy of the Reserve Bank of
India on banks in India has been/is very significant. As
seen earlier, rates of interest payable by banks on deposits
were stepped up since 1969. Thus, the main feature of the
monetary policy of the Reserve Bank of India since Nationali-
sation, and more particularly since 1974, has been to res-
trict the lendable resources of banks with a view to contai-
ning inflation and this is reflected candidly in the drop,
since then, in the ratio of credit extended by banks to their
working funds, as shown below:

..78.
### TABLE 12 - CREDIT-WORKING FUNDS RATIO OF ALL SCHEDULED COMMERCIAL BANKS

(Amounts in crore of Rs.)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Average working funds* of all Sch. Com. Banks</th>
<th>Average credit of all Sch. Com. Exa.</th>
<th>Credit-Working Fund Ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>5027.42</td>
<td>3435.26</td>
<td>64.35</td>
</tr>
<tr>
<td>1970</td>
<td>5836.59</td>
<td>6148.41</td>
<td>69.20</td>
</tr>
<tr>
<td>1971</td>
<td>6089.62</td>
<td>8789.31</td>
<td>75.38</td>
</tr>
<tr>
<td>1972</td>
<td>8099.41</td>
<td>9255.60</td>
<td>87.21</td>
</tr>
<tr>
<td>1973</td>
<td>8827.71</td>
<td>4234.15</td>
<td>47.37</td>
</tr>
<tr>
<td>1974</td>
<td>11658.94</td>
<td>7297.23</td>
<td>62.40</td>
</tr>
<tr>
<td>1975</td>
<td>13540.93</td>
<td>8870.33</td>
<td>65.21</td>
</tr>
<tr>
<td>1976</td>
<td>17194.73</td>
<td>11603.90</td>
<td>67.49</td>
</tr>
<tr>
<td>1977</td>
<td>20681.78</td>
<td>13545.24</td>
<td>65.75</td>
</tr>
<tr>
<td>1978</td>
<td>24540.32</td>
<td>15413.25</td>
<td>62.25</td>
</tr>
<tr>
<td>1979</td>
<td>30337.60</td>
<td>18896.62</td>
<td>62.29</td>
</tr>
<tr>
<td>1980</td>
<td>35595.17</td>
<td>22330.59</td>
<td>61.92</td>
</tr>
<tr>
<td>1981</td>
<td>43248.96</td>
<td>26027.75</td>
<td>61.70</td>
</tr>
</tbody>
</table>

* Deposits plus paid-up capital and reserves plus borrowings.

Source: Statistical Tables Relating to Banks in India, 1969-81

Thus, the credit-working funds ratio of banks declined from 86.3% in 1970 to 81.7% in 1981. This means that banks diverted, to that extent, their flow of funds from credit to other types of financial assets such as investments, balance with the Reserve Bank of India etc. This is to be looked at from the yield angle.
The average yield on CRR has been low at 9% p.a. While the average yield on advances is substantially high and leaves a fairly good margin of profit for banks, the yield on statutory balances kept by them, particularly their investments in Govt. and approved Securities, under the SLR has been low at an average rate of 7.5% p.a. and as such these do not match even the cost of mobilising funds. Hence, the progressive diversion of funds by banks from the relatively higher income fetching advances portfolio to low yielding assets portfolio such as cash balances under the CRR and investments etc. under the SLR, resulting in a declining credit-deposit ratio, has affected their profitability quite adversely. This decline in the credit-deposit ratio of banks has been due to several restrictive measures introduced by the Reserve Bank of India from time to time, as under:

a) frequent hikes in CRR & SLR;
b) introduction of the incremental CRR, resulting in impounding (by the Reserve Bank of India) of a fixed proportion of incremental deposits of banks by way of additional reserves;
c) revisions in the formulae/raising the cut-off point relating to eligibility of banks for Refinance (from the Reserve Bank of India) against Food & Export Credit;
d) increase in margins under Selective Credit Controls;
e) reduction in the rates of interest leviable by banks on advances and

f) imposition of quantitative and qualitative restrictions on lendings - [for instance, banks were required by the Reserve Bank of India in 1980 to ensure containing their expansion in credit during the year to 80% of their deposit growth or in accordance with the quantum of increase (in credit) recorded by them during the preceding year whichever was the highest].
a. Cash Reserve Ratio (CRR):

As per the Reserve Bank of India Act 1934, banks are required to maintain, with the Reserve Bank of India, 3% of their DTL as interest free basic Cash Reserves (basic CRR), in order to ensure liquidity, particularly in regard to their day to day operations. Further, this is also used as a tool to control inflationary trends in the Economy. Any variation in the Cash Reserve Ratio (CRR) effected by the Reserve Bank of India would reduce or augment, as the case may be, the lendable resources of banks and to that extent monetary expansion can be contained or improved. However, CRR is used increasingly as an effective tool for containing monetary expansion only since 1973. Accordingly, the Reserve Bank of India took a major step, in 1977, of impounding, as additional CRR, 10% of the incremental demand and time liabilities of banks since January 14, 1977 and up till October 31, 1980.

However, one-fifth of this impounded sum was released to banks, in two equated instalments, in the middle of 1984. Nevertheless, this measure of impounding 10% of incremental liabilities of banks was re-introduced since November 1983 and it continues to be in vogue ever since. This measure curtails significantly the lendable resources of banks.

The following Table shows the variations made by the Reserve Bank of India in the CRR since 1973:

...81...
Thus, it may be seen that the Reserve Bank of India had impounded effectively, in a phased manner, between 1977 and 1981, nearly 12.5% of the DTL of banks. This was so because, apart from the CRR of 7% (of DTL), the 10% of the incremental DTL impounded since Jan. 14, 1977 was not allowed to be withdrawn since then.

Thus, the total funds impounded by the Reserve Bank of India under the CRR increased from only Rs.185 crores, as on the last Friday of 1969 to Rs.4,380 crores as on the last Friday of 1981, accounting for 11.3% of the increase in deposits of all Scheduled Commercial Banks during that period.
Apart from the statutory requirement of banks to maintain a stipulated proportion of their DTL as Cash Reserves with the Reserve Bank of India (under the CRR), as set out earlier, they are also required to maintain another stipulated portion of their DTL as investments in Government (Central & State) Securities. This is called the Statutory Liquidity Ratio (the SLR). Statutory Liquidity Ratio was introduced originally under the Banking Regulation Act 1949, in order to ensure (a) financial discipline in banks and (b) the safety of the funds of depositors. Subsequently, certain modifications were made in the definition of SLR to supplement and strengthen the effectiveness of CRR as a vital tool of monetary policy. However, with the passage of time, it has come to be used by the Reserve Bank of India as a source to raise funds for the Government. Hence, the Reserve Bank of India has been increasing the SLR from time to time. Loans floated by the Government are, therefore, subscribed, to a very great extent, by banks and this they do not because of their willingness to do so but because, as mentioned earlier, they are statutorily required to do so. In fact, the Reserve Bank of India varies SLR in accordance with the borrowing programmes of the Government. SLR, therefore, is currently more a source of funds for the Government than a source of deployment/investment of funds by banks.

Banks are required to maintain SLR in the form of (a) investments in eligible securities of the Union and State Governments and State associated bodies and in other approved Securities; (b) cash on hand and (c) net balances with other banks (inter-bank credit and balances with other banks being taken as net of each other). Of these three components, cash on hand fetches no return at all and net balances with other banks fetch nominal or no return as they are maintained only for meeting clearing requirements of banks. Hence, within the stipulated level of SLR, banks try to keep the proportion of the last two components (viz. cash on hand and net balances...
with banks) to the total of funds maintained under the SLR at the lowest level possible and invest, to the maximum extent possible, in Securities as they fetch income to them. The composition of SLR as maintained by all Scheduled Commercial Banks, as on the last Friday of 1981, was as under:

**TABLE 14 - MAINTENANCE OF SLR BY ALL SCHEDULED COMMERCIAL BANKS**

(Amounts in crores of Rs.)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>Proportion to total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SLR maintained (Average)</td>
<td>18,376</td>
<td>100.00</td>
</tr>
<tr>
<td>a) Cash on hand</td>
<td>910</td>
<td>4.95</td>
</tr>
<tr>
<td>b) Balance with other banks</td>
<td>703</td>
<td>3.93</td>
</tr>
<tr>
<td>c) Investments</td>
<td>16,763</td>
<td>91.22</td>
</tr>
</tbody>
</table>

**SOURCE:** Compiled from data furnished in the Statistical Tables Relating to Banks in India-1981 published by the Reserve Bank of India.

It may be seen from the above Table that more than 91% of the SLR maintained by banks was in the form of subscriptions made to Central & State Government Securities, other approved Securities etc.

There was no classification as CRR and SLR prior to 1962, for the purpose of maintenance of liquidity by individual banks. But by an amendment to the Banking Regulation Act 1949, the Reserve Bank of India was empowered to raise SLR upto 25%. By another amendment in 1984, the ceiling limit has been raised further to 40%. With a view to containing
liquidity pressure in the Economy caused by inflation and mobilising funds for the Central and State Governments through market borrowings, as mentioned earlier, especially in the light of the need for the Government to finance, of late, huge Plan outlays, SLR has been raised, by the Reserve Bank of India, from time to time, as shown hereunder:

<table>
<thead>
<tr>
<th>Date</th>
<th>SLR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uptill Feb. 1970</td>
<td>25%</td>
</tr>
<tr>
<td>Since Feb. 1970</td>
<td></td>
</tr>
<tr>
<td>April 1970</td>
<td>26%</td>
</tr>
<tr>
<td>Aug. 1970</td>
<td>27%</td>
</tr>
<tr>
<td>Aug. 1972</td>
<td>28%</td>
</tr>
<tr>
<td>Nov. 1972</td>
<td>29%</td>
</tr>
<tr>
<td>Dec. 1978</td>
<td>30%</td>
</tr>
<tr>
<td>June/July '74</td>
<td>32%</td>
</tr>
<tr>
<td>Dec. 1978</td>
<td>34%</td>
</tr>
<tr>
<td>Sep. 25, 1981</td>
<td>33%</td>
</tr>
<tr>
<td>Oct. 30, 1981</td>
<td>34%</td>
</tr>
<tr>
<td>July 28, 1984</td>
<td>36%</td>
</tr>
<tr>
<td>Sep. 1, 1984</td>
<td>37%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>38%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>39%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>40%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>41%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>42%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>43%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>44%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>45%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>46%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>47%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>48%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>49%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>50%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>51%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>52%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>53%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>54%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>55%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>56%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>57%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>58%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>59%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>60%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>61%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>62%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>63%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>64%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>65%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>66%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>67%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>68%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>69%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>70%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>71%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>72%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>73%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>74%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>75%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>76%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>77%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>78%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>79%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>80%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>81%</td>
</tr>
<tr>
<td>Sep. 1, 1985</td>
<td>82%</td>
</tr>
<tr>
<td>July 6, 1985</td>
<td>83%</td>
</tr>
<tr>
<td>Oct. 30, 1985</td>
<td>84%</td>
</tr>
<tr>
<td>July 28, 1985</td>
<td>85%</td>
</tr>
</tbody>
</table>

Thus, there had been a spurt in the SLR since 1970. Consequently, a sizeable quantum of deposits mobilised by banks is being taken away from banks, under the SLR, apart from the CRR, particularly since 1970. The composition of funds maintained by banks, under the SLR, as on the last Fridays of 1969 & 1981, was as under:
TABLE 15 - SPURT IN SLR BETWEEN 1969 AND 1981

(Amounts in crores of Rs.)

<table>
<thead>
<tr>
<th>Components As on the last <em>Fridays of</em></th>
<th>1969</th>
<th>1981</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Cash on hand</td>
<td>143</td>
<td>856</td>
<td>713</td>
</tr>
<tr>
<td>b) Bal. with other banks</td>
<td>174</td>
<td>346</td>
<td>172</td>
</tr>
<tr>
<td>c) Investments in Sec.</td>
<td>1224</td>
<td>14365</td>
<td>13141</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1541</td>
<td>15567</td>
<td>14026</td>
</tr>
</tbody>
</table>

** SOURCE: ** Computed from data furnished in Statistical Tables Relating to Banks in India 1969 to 1981, published by the Reserve Bank of India.

Thus, Scheduled Commercial Banks in India had set apart, towards SLR, as much as Rs. 14,026 crores or 38.0% of their net average increase in deposits of Rs. 37,000 crores between the last Fridays of 1969 and 1981.

Bank’s investments in the low yielding Govt. Securities, which also suffer from a fairly huge depreciation over a period of time, is quite heavy. Hence, though the Govt. utilise these funds for the promotion of public good, yet this affects adversely the profitability of banks.

Both CRR and SLR, which are primarily monetary measures to contain expansion in money supply, constituted, together, 49.3% of the incremental deposits of all Scheduled Commercial Banks between the end of June 1969 and the end of 1981.
c. Lendings of the Reserve Bank of India:

The Reserve Bank of India as the Bankers’ Bank and as the Lender of the Last resort plays a vital role in promoting the health of the Banking System in the Country. It lends to commercial banks (a) on occasions when, due to the emergence of liquidity bind, they suffer from temporary mismatches between their sources and uses/inflow and outflow of funds; (b) to enable banks to achieve desired directional changes in their lendings and (c) to help implement more effectively the policies of the Govt. of India. Sec. 17 of the Banking Regulation Act 1949 deals with these aspects.

The Reserve Bank of India's credit assistance to banks is of two types viz. re-discounting and refinancing. The Re-discounting Scheme, with its nomenclature as the ‘New Bill Market Scheme’ was introduced in November 1970. Under the Scheme, the Reserve Bank of India rediscounts, at the Bank Rate, on presentation to them, by commercial banks, eligible Bills of Exchange of customers discounted by them. Refinancing is of two types viz. discretionary refinancing and entitlement refinancing. As mentioned earlier, the former is granted by the Reserve Bank of India in its capacity as the lender of the last resort for banks, to help them tide over temporary illiquidity arising out of certain unexpected big withdrawals or clearing shortages etc.; whereas the latter is granted as an entitlement to banks for extending credit support to certain specific schemes of the Government involving public interest; for instance, banks are entitled for refinancing against credit extended by them to the Food Corporation of India for its food procurement operations. The Reserve Bank of India provides refinancing to banks against advances made by them (a) to the Food Corpora-
tion of India for its food procurement operations, (b) for the purpose of exports, (c) for import of Capital goods, (d) to small farmers etc.

Such borrowings by banks from the Reserve Bank of India provide additional source of funds for them. Hence, given the CRR and SLR, the credit-deposit ratio of banks would vary depending upon the variations made by the Reserve Bank of India (as also other financial institutions) in regard to provision of refinance and rediscounting facilities to them. In other words, more the refinance and rediscounts available to banks, higher would be their credit-deposit ratio. Thus, provision of Refinance and Rediscount to banks is yet another effective tool in the hands of the Reserve Bank of India to regulate the flow of credit from banks.

The eligibility of banks for such Refinance & Rediscount facilities from/with the Reserve Bank of India is decided on the basis of the relevant formulae laid down by the Reserve Bank of India from time to time in terms of its Credit Policy, particularly for every Slack & Busy Seasons.

The Policy of the Reserve Bank of India, during the past few years, has been to peg down the eligibility of commercial banks for Refinance and Rediscount to the lowest extent possible. In fact, the Reserve Bank of India has totally dispensed with the rediscounting facility since 1980. Further, banks are also not encouraged to resort frequently and as a matter of routine, to the refinance facility even against their eligibility/entitlement.

The following Table furnishes the ratio of borrowings (monthly average) of commercial banks from the Reserve Bank of India to their working funds (monthly average) during the past one and a half decades...
### TABLE 16 - BORROWINGS OF ALL SCHEDULED COMMERCIAL BANKS FROM THE RESERVE BANK OF INDIA

(Amounts in crores of Rs.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Average borrowings of Sch. Com. Ers. from the Reserve Bank of India</th>
<th>Average deposits plus paid-up capital &amp; Reserves plus borrowings</th>
<th>Ratio of borrowings to working funds (Ratio of Col. 1 to 2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>86.90</td>
<td>5087.42</td>
<td>1.73</td>
</tr>
<tr>
<td>1970</td>
<td>213.25</td>
<td>5914.50</td>
<td>3.64</td>
</tr>
<tr>
<td>1971</td>
<td>187.66</td>
<td>6859.63</td>
<td>2.74</td>
</tr>
<tr>
<td>1972</td>
<td>56.52</td>
<td>8095.41</td>
<td>0.71</td>
</tr>
<tr>
<td>1973</td>
<td>69.17</td>
<td>9837.16</td>
<td>0.70</td>
</tr>
<tr>
<td>1974</td>
<td>243.20</td>
<td>11608.04</td>
<td>2.10</td>
</tr>
<tr>
<td>1975</td>
<td>218.18</td>
<td>13540.93</td>
<td>1.61</td>
</tr>
<tr>
<td>1976</td>
<td>931.13</td>
<td>17194.73</td>
<td>4.83</td>
</tr>
<tr>
<td>1977</td>
<td>566.15</td>
<td>20601.78</td>
<td>2.75</td>
</tr>
<tr>
<td>1978</td>
<td>266.11</td>
<td>24640.32</td>
<td>1.08</td>
</tr>
<tr>
<td>1979</td>
<td>613.54</td>
<td>30337.80</td>
<td>2.02</td>
</tr>
<tr>
<td>1980</td>
<td>545.25</td>
<td>35592.17</td>
<td>1.53</td>
</tr>
<tr>
<td>1981</td>
<td>567.35</td>
<td>43248.96</td>
<td>1.31</td>
</tr>
</tbody>
</table>

**SOURCE:** Computed from data furnished in the Statistical Tables Relating to Banks in India, 1969 to 1981 published by the Reserve Bank of India

Although no firm trend can be seen from the above Table, yet it is quite clear that the Reserve Bank of India has used this as a tool for promoting effective monetary management and to contain expansion in credit with the result that no lendings could be planned or made on the basis of availability of refinance and/or rediscounts from the Reserve Bank of India.
If the policy of the Reserve Bank of India since Nationalisation is any index, it can be taken that availability of refinance from the Reserve Bank of India would, in future, be very nominal and insignificant and that rediscount facility with the Reserve Bank of India would be totally non-available for banks.

d) Restrictions, by the Reserve Bank of India, on lendings by commercial banks

The Reserve Bank of India has powers, as the monetary authority of the Country, to control expansion in credit by commercial banks. This control is exercised by it in two ways viz. Qualitative and Quantitative credit controls. While qualitative credit control restricts flow of bank funds to certain essential and vulnerable sectors or against stocks of selected securities or sensitive commodities such as food grains, sugar, cotton etc., quantitative credit control restricts, in general, the quantum of lendings of commercial banks. Qualitative selective credit control measures, which are in the nature of imposition of changes in margins and interest rates, moral suasion etc., are applied to curb flow of credit to certain sensitive sectors, as mentioned earlier. However, this measure is more operational in nature and as such does not have any far reaching impact on the working of banks. In other words, the selective credit control measures of the Reserve Bank of India affect only a small portion of bank credit. For instance, as on the last Friday of March 1984, only 3.1% (or Rs. 1,271 crores) of the total 'Net Bank Credit' extended by all Scheduled Commercial Banks were within the scope of selective credit control measures of the Reserve Bank of India. Further, if advances to the Cotton Corporation of India for import of cotton etc., which account for a big chunk of these advances, are excluded, the proportion of total advances extended by banks against the sensitive commodities would constitute a still lower proportion to the total net bank credit extended by them.
Quantitative Credit Control by the Reserve Bank of India was not very significant prior to 1977. The quantum of lending by commercial banks depended, in those days, on the capacity and willingness of borrowers to borrow and the capacity of banks to lend. The willingness of borrowers to borrow was conditioned mainly by rates of interest levied by banks on borrowings and capacity of banks to lend depended upon the levels of CAR and SLR required to be maintained by them, their eligibility to borrow from the Reserve Bank of India etc. However, the Reserve Bank of India has started imposing significant quantitative restrictions on lendings by banks since 1977, as set out hereunder:

a) In November 1978, banks were advised to plan their non-food credit expansion in such a manner as to ensure that their incremental gross non-food credit-deposit ratio for the period between Dec. 1, 1978 and end March 1979 was contained positively at a level of not more than 40%.

b) In August 1979, banks were advised that the expansion, in absolute terms, in their non-food credit portfolio, during the Financial Year 1979-80, should be significantly less than that recorded by them during the preceding year. Further, banks were advised to cut down, till the end of 1979, the effective drawing power of all big borrowers (i.e. those who were enjoying aggregate fund based credit limits of Rs.25 lakhs or over each), under the Cash Credit facility, to 80% of the limits and this cut was later extended uptill June 1980;
c) In March 1980, banks were advised to ensure that expansion, in absolute terms, in non-food credit, during the 15 month period ended last Friday of June 1980 was not higher than that recorded during the corresponding period of the preceding financial year;

d) In June 1980, banks were advised that they were at liberty to step up the level of their non-food credit, during that Slack Season, strictly within their own resources;

e) In May 1981, banks were advised to ensure that expansion in non-food bank credit in the Slack Season of 1981 was at least marginally lower than that recorded in the Slack Season of the preceding year and

f) In July 1982, banks were advised that their non-food credit expansion during the Financial Year 1982-83 should not exceed, in terms of percentage, the rate of expansion recorded in 1981-82 (viz. 16.87%).

Thus, the guidelines laid down by the Reserve Bank of India restricting, in quantitative terms, expansion in credit since 1978 led, on the one hand, to a fall in the rate of expansion in advances and a decline in their credit-deposit ratio on the other. Thus, though banks had funds for lending even after maintaining CRR and SLR at the required levels, yet they did not expand their credit portfolio as they were not permitted to do so.

**IMPACT ON THE ECONOMY**:

Any hike in CRR and/or SLR by the Reserve Bank of India affect adversely the lendable resources of all Scheduled Commercial Banks. This is more particularly so in the present context when banks are required to (a) extend
huge credit to the Food Corporation of India for its food procurement operations and fertiliser transaction and to the Cotton Corporation of India for import of cotton etc. and (b) extend up to 40% of their total outstanding Net Bank Credit (i.e. gross credit less bills re-discounted) to the Priority Sectors and within the advances to the Priority Sectors a fixed proportion - say 25% thereof - to the 'Weaker Sections'. Any hike in SLR & CAR only helps to reduce the flow of credit to the non-food conventional sectors consisting of Large & Medium Scale Industries, Wholesale Trade etc. Of course, this would lead to a cut in credit facilities, particularly working capital facilities, to the Conventional Sectors and this would, in turn, lead to a decline in production etc. This is evident from the following Table which shows the decline, during the last few years, in the share of advances to medium and large scale industries and wholesale trade in the total bank advances:

**TABLE 17 - ADVANCES OF ALL SCHEDULED COMMERCIAL BANKS TO MEDIUM & LARGE SCALE INDUSTRIES**

<table>
<thead>
<tr>
<th>As on the last Friday of</th>
<th>Share of Medium &amp; Large Scale Industries in the total Net Bank Credit extended by banks (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 1968</td>
<td>60.6</td>
</tr>
<tr>
<td>June 1976</td>
<td>36.1</td>
</tr>
<tr>
<td>June 1979</td>
<td>34.9</td>
</tr>
<tr>
<td>June 1980</td>
<td>36.1</td>
</tr>
<tr>
<td>June 1981</td>
<td>38.5</td>
</tr>
<tr>
<td>March 1984</td>
<td>38.3</td>
</tr>
</tbody>
</table>

**SOURCE:** Report on Currency & Finance 1968 to 1981 published by the R.B.I.
As shown in the above Table, the share of Medium and Large Scale Industries in the total advances had fallen from nearly 61% in March 1966 to just 38% as of end March 1984.

B. FISCAL POLICIES OF THE GOVT. OF INDIA

The fiscal policy of the Govt. of India also has a vital impact on the working of Scheduled Commercial banks. Normally, the fiscal policy of the Government and the monetary policy of the Reserve Bank of India are mutually complementary and supplementary. Thus, any contemplation of higher market borrowings by the Govt. would be reflected in enhancement of SLR by the Reserve Bank of India so as to ensure the required subscription to the loans floated by the Govt. of India.

As mentioned earlier, Interest Tax was introduced, for the first time, in the Union Budget 1974-75 whereby banks were required to pay to the Union Government as tax a sum equivalent to 7% of interest income earned by banks. However, interest earned by banks on these investments in Government securities and securities and debentures of companies and statutory corporations and interest earned on transactions between Scheduled Banks were exempted from this tax. The levy was withdrawn with effect from March 1978. Nevertheless, it was re-introduced, after an interval of two years, in the Union Budget relating to the Financial Year 1980-81 and was made payable with effect from July 1, 1980. However, this time there was a change in the procedure to be adopted. While the earlier tax was payable out of the interest collected from borrowers, the new tax (burden) was allowed to be passed on to borrowers on a pro-rata basis. This tax, therefore, did not affect the profitability of banks directly as it was shifted/passed on to borrowers. The Reserve Bank of India laid down the minimum rate of interest for lending and the maximum rates in regard to advances made to certain special categories of borrowers.
therefore, did not affect the profitability of banks directly as it was shifted/passed on to borrowers. The Reserve Bank of India laid down the minimum interest rate for lending and the maximum rates in regard to advances made to certain special categories of borrowers.

Data relating to amounts paid by banks as Interest Tax since 1975 are set out in the following Table:

**TABLE 18 - INTEREST TAX PAID BY BANKS**

(Amounts in crores of Rs.)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Interest tax paid by all H.A.</th>
<th>Declared profit H.A.</th>
<th>Ratio of Interest Tax paid to declared profit (Ratio of 1 to 2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974#</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>1975</td>
<td>86.74</td>
<td>175.57</td>
<td>49.41</td>
</tr>
<tr>
<td>1976</td>
<td>101.02</td>
<td>265.34</td>
<td>38.07</td>
</tr>
<tr>
<td>1977</td>
<td>115.24</td>
<td>272.04</td>
<td>42.36</td>
</tr>
<tr>
<td>1978#</td>
<td>18.27</td>
<td>328.63</td>
<td>5.56</td>
</tr>
<tr>
<td>1980</td>
<td>80.00</td>
<td>422.31</td>
<td>18.95</td>
</tr>
<tr>
<td>1981</td>
<td>190.42</td>
<td>683.79</td>
<td>27.85</td>
</tr>
</tbody>
</table>

* Data not separately available for 1974

# Only for three months of the year

**SOURCE:** Computed from data furnished in Statistical Tables Relating to Banks in India 1974 to 1981, published by the R.B.I.
As shown in the above Table, amounts paid by all Scheduled Commercial Banks as Interest Tax accounted for, almost every year, a substantial portion of their declared profits; in other words, their declared profits had been reduced to nearly one half of what they would have been otherwise.

C. SOCIAL BANKING:

Though banks are essentially commercial organisations, yet they are playing, since Nationalisation, a vital role in the field of social banking, thereby helping the socio-economic
uplift of the people, particularly the weakest among the weaker sections of society, in accordance with the basic objectives of planning in the Country. The following are the major areas in which social banking is carried on by banks which affect the return on their funds and step up their cost of administration:

A. EXTENSION OF CREDIT ON A LARGE AND INCREASING SCALE TO THE PRIORITY SECTORS AND UNDER SPECIAL SCHEMES SUCH AS 20 POINT ECONOMIC PROGRAMME, PARTICULARLY THE D.R.I. SCHEME;
B. NURSING SICK UNITS;
C. IMPROVING CONSIDERABLY THEIR BRANCH NET-WORK IN RURAL AREAS, PARTICULARLY IN UNBANKED CENTRES;
D. LEAD BANK SCHEME;
E. VILLAGE ADOPTION SCHEME and
F. SPONSORING REGIONAL RURAL BANKS.

a) Extension of credit to the Priority Sectors
   and under the 20 Point Programme

At the second meeting of the National Credit Council held at New Delhi on July 24, 1969, it was emphasised that commercial banks should step up their involvement in financing Priority Sectors. With the Nationalisation of major banks in 1969, they were again advised to lend substantially to the Priority Sectors. The Reserve Bank of India and the Government of India monitor closely the performance of banks in this regard. The composition of Priority Sectors was finalised in 1972 on the basis of a Report submitted by the Informal Study Group on Statistics relating to Advances to the Priority Sectors constituted by the Reserve Bank of India in May 1971.
Borrowers covered by the Priority Sectors enjoy certain concessions. They get preference over others in regard to credit allocations; further, they are also entitled for several concessions in regard to terms and conditions including rates of interest, margin etc. The Reserve Bank of India has prescribed ceilings on rates of interest chargeable by banks on advances to borrowers covered by the Priority Sectors which are normally far lower than the rates prescribed for borrowers covered by the Conventional/Non-Priority Sectors.

In pursuance of a commitment made to the Estimates Committee of the Lok Sabha, Public Sector banks were advised, in November 1974, to enlarge the flow of credit to the Priority Sectors so as to raise their share in the aggregate credit extended by them to a level of 33-1/3% by/before the last Friday of March 1977. In March 1979, the total advances extended by all Public Sector banks, put together, to these Sectors accounted for 33% of their total credit. However, this achievement was somewhat lopsided in that while some banks did reach this target as per schedule, several banks did not. Hence, when the Union Finance Minister met the Chief Executives of major commercial banks in the Country in January 1979, he indicated that the shortfall recorded by individual banks in reaching the targeted level (of 33-1/3% of total credit) should be made good by them as early as possible and in any case not later than September 1979. Accordingly, several banks reached this target by this date line.
Further, at a meeting that the Union Finance Minister had with the Chief Executives of Public Sector Banks on March 6, 1980, it was agreed (a) that all banks should aim at raising the proportion of their aggregate Priority Sector Credit to their total 'Net Bank Credit' to 40% by or before the end of March 1985 and (b) that within this overall target of 40%, a significant proportion should be deployed to beneficiaries under the 20 Point Programme. A Working Group was constituted under the Chairmanship of Dr K S Krishnaswamy, the then Deputy Governor of the Reserve Bank of India, to consider the modalities to be adopted for effectively implementing these decisions.

The Group suggested certain sub-targets as well to be reached by banks, within the overall target of 40%, in regard to extension of credit to certain sub-categories (of Priority Sectors) and also revised/expanded the scope of the Priority Sectors by including therein a few more categories of borrowers. The major recommendations of the Working Group which were approved by the Reserve Bank of India were:

A. **Main Target:**

Banks should step up their advances to the Priority Sectors to a level that would constitute, by end March 1985, atleast 40% of their total 'Net Bank Credit'.

B. **Sub-Targets:**

1. Direct advances to agriculture (including allied activities such as dairy farming etc.) should be stepped up, before end March 1985, so as to constitute a level of 40% of the aggregate Priority Sector Credit; in other words, direct advances to agriculture should reach by/before end March 1985, a level of 12% of the 'Net Bank Credit' extended by banks.
2. Direct advances to 'Weaker Sections' in agriculture (inclusive of Weaker Sections in allied activities) such as Small & Marginal farmers etc., should constitute, by March 1983, 50% of direct agricultural credit and

3. Advances to Weaker Sections in the SSI should constitute, by March 1983, 12.5% of the aggregate credit extended by them to Small Scale Industries.

Weaker Sections for the purpose of reaching this target comprised of (a) Small & Marginal farmers with land holdings of five acres or less each and landless labourers and persons engaged in allied activities with borrowal limits (for such activities) not exceeding Rs.10,000 each; (b) borrowers in the Small Scale Industrial Sector with aggregate credit limits of Rs.25,000 or less each; (c) borrowers covered by the other Priority Sectors with limits of less than Rs.25,000 each and (d) single vehicle transport operators. Within the Priority Sectors, borrowers covered by 'Weaker Sections' listed above were required to be given preferential treatment.

C. The scope of the Priority Sectors should be/were widened by including therein Housing and Consumption Loans extended to the poor and Loans to State sponsored organisations assisting the Weaker Sections within the Priority Sectors.

20 POINT PROGRAMME:

The 20 Point Economic Programme was introduced by the Govt. of India during the period of the Emergency and banks were advised to lend, in a big way, to borrowers covered by the Programme. However, during the
Janata rule, the Government did not evince keen interest in the implementation of the Programme and hence the Reserve Bank of India and the Govt. of India gave up monitoring the implementation of the Programme by banks. With the return of Congress (I) to power in March 1980, the 20 Point Programme was revised and is implemented ever since with greater force. Hence, the Reserve Bank of India too has again started monitoring the performance of banks in this regard. Krishnaswamy Working Group were also required under their terms and reference to find out the modalities for the effective implementation of the 20 Point Programme by banks. Of the 20 Points, 11 Points, listed below, are of immediate and direct relevance to banks:

1. Continued adoption of measures to (a) bring down prices of essential commodities, (b) streamline production and distribution of essential commodities and (c) ensure strict economy in Government expenditure:

Banks are, therefore, required to ensure extension of liberal credit to fair price shops, Consumer Co-operative Super Bazars etc. and to retail traders in essential commodities;

2. Implementation of agricultural land ceilings and speedier distribution of surplus land and compilation of land records:

Banks are required to extend liberal credit to landless agricultural labourers, allottees of surplus lands etc.;

3. Stepping up provision of house sites for landless and weaker sections:

Banks have been called upon to extend liberal credit support to agricultural labourers, landless agricultural labourers and allottees of house sites, for taking up productive activities;
4. Bonded labour, wherever it exists, will be declared illegal.
Banks may extend adequate credit to released bonded labourers for rehabilitating them socially and economically;

5. Plan for liquidation of rural indebtedness, Legislation for moratorium on recovery of debt from landless labourers, small farmers & artisans; This means that banks should grant liberal credit for clearing rural indebtedness and financing farmers and artisans for pursuing productive activities;

6. Five million more hectares to be brought under irrigation. National Programme to be evolved for use of ground water; This calls upon banks to finance liberally minor irrigation;

7. New development plan to be evolved and implemented for development of handloom sector; Banks are expected to finance, in a big way, handloom weavers;

8. Improvement in quality and supply of people's cloth to be ensured; Banks may extend credit for supply of standard cloth to distributors;

9. National Permit Scheme to be introduced for road transport; Banks should, therefore, extend liberal credit to transport operators under the National Permit Scheme;

10. Essential commodities to be provided to people at controlled prices; Banks should extend credit support to borrowers for supply of essential commodities and
11. Books and stationery to be provided to students at controlled prices:

Accordingly, banks have to assist, through credit, supply of Books and Stationery to students at controlled prices.

The decision to step up the level of Priority Sector credit of all Scheduled Commercial Banks from 33-1/3% to 40% of 'net bank credit' was taken in the context of a felt need for increased flow of credit to borrowers covered by the 20 Point Economic Programme of the Prime Minister; hence, banks were advised that within the overall target of 40% in regard to advances to the Priority Sectors, a significant portion thereof should be allocated to the beneficiaries of the 20 Point Programme.

Accordingly, advances extended by banks, under the Programme, reached a level of Rs.3,968 crores, as at the end of 1983. Banks stepped up their advances to the Priority Sectors from only Rs.441 crores (or 1% of their total credit) to 2.60 lakh borrowers in June 1969 to as much as Rs.11678 crores or 38.5% of their net credit to 1.67 crore borrowers in Dec. 1982 (a 26 fold expansion) as set out below:
### Table 19 - Performance of Scheduled Commercial Banks in Regard to Extension of Credit to The Priority Sectors

(No. of A/cs. in thousands & Amounts in crores of Rs.)

<table>
<thead>
<tr>
<th>Categories of Priority Sectors</th>
<th>June 1969</th>
<th>December 1982</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of A/cs.</td>
<td>Balance</td>
</tr>
<tr>
<td>1. Agriculture</td>
<td>165</td>
<td>162</td>
</tr>
<tr>
<td>2. S &amp; T</td>
<td>51</td>
<td>251</td>
</tr>
<tr>
<td>3. Road &amp; Water</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport Operators</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>4. Setting up of</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Indl. Estates</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>5. Retail Trade &amp; Small Business</td>
<td>33</td>
<td>19</td>
</tr>
<tr>
<td>6. Professionals &amp; SelfEmployed</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>7. Education</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>8. Others</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>260</td>
<td>441</td>
</tr>
</tbody>
</table>

**Source:** Report on Currency & Finance 1969 to 1982 published by the Reserve Bank of India

This expansion in Priority Sector credit was achieved by banks in a phased manner by deploying, every year, on an average, more than 40% of their incremental credit to the Priority Sectors. The pie diagram given below depicts clearly the Sector-wise break-up of credit extended by banks in the Country.
SECTORWISE DEPLOYMENT OF CREDIT OF
ALL SCHEDULED COMMERCIAL BANKS

JUNE-1969

JUNE-1984
IMPACT OF SOCIAL LENDING ON BANKS:

After complying with the CRR and SLR requirements, banks are left with only very limited funds at their disposal. Currently (i.e. in August 1985), banks are required to set apart 50% of their incremental liabilities towards CRR & SLR. Further, the Reserve Bank of India is yet to release to banks their funds amounting to Rs.1500 crores (which is equal to 2% of their liabilities), being four-fifths of the sum impounded by them earlier under the 10% incremental CRR for the period from Jan. 14, 1977 to Sep. 31, 1980. Besides, 10% of the incremental liabilities of banks since November 12, 1983 are being impounded by the Reserve Bank of India towards incremental CRR; a total sum of Rs.1,800 crores or 2.25% of their liabilities stands impounded, till date, this way. Thus, the lendable resources of banks stand restricted to only over 50% of their outstanding DTL or 44% of their incremental DTL plus their borrowings from the Reserve Bank of India and other financial institutions and the Call Money Market. As seen earlier, the return on funds deployed by banks as CRR & SLR is far lower than the cost incurred by them in mobilising those funds and this loss is more than offset by them by lending the remaining portion of their DTL. But even within these lendable resources, banks are required to deploy funds equivalent to 40% of their total 'Net Bank Credit' to the low yielding Priority Sectors. Though
such a diversion of the flow of bank finance from the traditional Sectors to the Priority Sectors is a welcome feature in that it has helped substantially generation of employment opportunities, increased production of goods, commodities and services, growth of various sectors in the Economy, modernisation of agriculture, reduction of rural indebtedness etc., yet it has led to considerable erosion of the profitability of banks.

Banks have been able to step up, substantially, their lendings, particularly to the Priority Sectors, since Nationalisation mainly by opening a large number of branches in the rural and semi-urban areas which due to, inter-alia, their long gestation period are highly unprofitable and uneconomical, as seen earlier. The establishment expenditure of these branches is quite heavy. Thus, though by strengthening their branch network, banks have been able to lend, in a very big way, to the Priority Sectors, yet they have been able to do so only at the risk of erosion of their profitability.

Another significant aspect of social lending by banks is the higher Costs incurred by them for servicing these accounts. According to a Study made by the Sub-Committee to the PEP Committee, the Banking Industry in the Country
spends, on an average, Rs.4.41 and Rs.3.42 on servicing every sum of Rs.100 lent by them to the agricultural & SSI Sectors respectively. Thus, the net return from lendings to agriculture and SSI should be computed by deducting from the interest earned from them 4.41% and 3.42% respectively towards servicing costs incurred by banks in this regard. Lendings to borrowers covered by the Priority Sectors are normally made without security, with low margins and at lower rates of interest. Normally, the recovery performance of banks in regard to these lendings is quite disappointing and hence overdue advances and those which are doubtful of recovery mount up for banks and they constitute a huge chunk of the outstanding credit of banks. This is yet another problem faced by banks in the field of social banking. However, no published data are available in regard to the recovery performance of the Banking System in the Country. The only data that are available in this regard are on the recovery of direct advances to agriculture. The percentage of recovery to demand in respect of direct agricultural advances granted by the public sector banks was 52.25% in June 1982. In other words, recycling of funds to the extent of 47.8% of those advances has not been/is not done. Similarly, in the case of Small Scale Industry Sector, several thousands of industrial units have become sick and huge additional credit is required to be deployed to rehabilitate them and incidentally, this alone would enable them to recover, in full, the loans given to them. As at the end of June 1982, there were 27,406 sick industrial undertakings in the Country enjoying bank loans to an extent of Rs.2,356.47 crores, of which 76.91% or 21,080 units have been classified (by banks) as non-viable units. Thus, banks have to necessarily nurse sick units, help stabilise them and also thereby help themselves recover their dues in full.
The next relevant issue is that of advances becoming 'bad and doubtful' due to poor recovery. Of course, Deposit Insurance & Credit Guarantee Corporation provides insurance to banks in respect of loans sanctioned by them to agriculture & ARI Sectors and for other small loans. However, banks have to bear 25% of the loss arising out of advances becoming bad. As in the case of overdue accounts, no statistical data are available in this regard. However, it may be pointed out that provision for bad & doubtful debts takes away a sizeable portion of the gross profit of banks every year and the proportion of such provisions to gross income is also on the increase, every year, for banks.

All these factors affect the profitability of banks adversely.

DRI SCHEME
(Differential Rate of Interest Scheme)

Under the DRI Scheme, which has been designed to provide credit assistance at nominal rate of interest to the poorest of the poor in the society, public sector banks extend loans to eligible borrowers at a rate of interest of 4% per annum. This Scheme was introduced in 1972 and was extended to cover the entire country in May 1977. Normally, loans under the Scheme do not exceed Rs.1500 per party by way of Working Capital and Rs.5000 per party by way of Term Loan.

The Government of India has stipulated that lendings of public sector banks under this Scheme, at any point of time, should be equivalent to at least 1% of the net credit extended by them as on the last Friday of the preceding year; further, of the total advances made under the Scheme, advances to persons belonging to Scheduled Castes/Scheduled Tribes should constitute a minimum
of 40%; similarly, two-thirds of the aggregate lending under the Scheme should be routed through rural and semi-urban branches.

As against these targets, public sector banks had, under the Scheme, lent, as at the end of 1982, a total sum of Rs.311.50 crores covering 33.44 lakh persons, which accounted for 1.17% of the total 'net bank credit' extended by them as on the last Friday of the preceding year. The Table given below furnishes details relating to the advances made by public sector banks, under the Scheme, since 1972:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of borrowal accounts</th>
<th>Amount outstanding (Rs. in crores)</th>
<th>Proportion of DRI Adv. to total adv. that were outstanding as on the last Friday of preceding year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1972</td>
<td>26</td>
<td>0.87</td>
<td>0.02</td>
</tr>
<tr>
<td>1973</td>
<td>230</td>
<td>10.06</td>
<td>0.22</td>
</tr>
<tr>
<td>1974</td>
<td>313</td>
<td>13.35</td>
<td>0.23</td>
</tr>
<tr>
<td>1975</td>
<td>465</td>
<td>20.99</td>
<td>0.31</td>
</tr>
<tr>
<td>1976</td>
<td>1005</td>
<td>47.24</td>
<td>0.56</td>
</tr>
<tr>
<td>1977</td>
<td>1392</td>
<td>67.99</td>
<td>0.61</td>
</tr>
<tr>
<td>1978</td>
<td>1620</td>
<td>90.00</td>
<td>0.74</td>
</tr>
<tr>
<td>1979</td>
<td>2076</td>
<td>139.80</td>
<td>0.98</td>
</tr>
<tr>
<td>1980</td>
<td>2510</td>
<td>193.56</td>
<td>1.04</td>
</tr>
<tr>
<td>1981</td>
<td>2925</td>
<td>257.50</td>
<td>1.17</td>
</tr>
<tr>
<td>1982</td>
<td>3344</td>
<td>311.50</td>
<td>1.17</td>
</tr>
</tbody>
</table>

*Source: Report on Currency & Finance 1972 to 1982 published by the Reserve Bank of India*
It may be mentioned that although the amount lent under the Scheme accounted for, as on the last Friday of 1982, less than 1.17% of the net credit outstanding as at the end of the preceding year, yet even for that amount, banks lost, on an average, 7.25% [if we take cost of funds inclusive of Servicing Cost at 9.75% and return on DRI advances at 2.5% (net of Servicing Cost at 1.5%)]. If the cost of servicing these lendings also is taken into account, the return on these funds would be still lower.

It is estimated that overdues in respect of DRI lendings account for nearly three-fourths of the total credit outstanding under the Scheme. This adds to the loss that accrues to banks in respect of lendings under this Scheme. Nevertheless, lendings under the Scheme enable poor people in the community to set themselves up in gainful self-employment. In fact, as mentioned earlier, in view of the need to uplift the poorest among the poor, all beneficiaries/borrowers covered under the Scheme have been brought within the ambit of the Priority Sectors with effect from 1982 on the lines of the recommendations made by the Working Group on Priority Sector lendings, appointed by the Reserve Bank of India. Beneficiaries under the Scheme constitute one of the five components of the Weaker Sections, total advances to which are required to constitute, as mentioned earlier, at least 25% of the aggregate Priority Sector credit or 10% of the total net bank credit extended by banks.

**NURSING SICK UNITS**

The next important aspect of social banking relates to nursing of sick units. As mentioned earlier, several
Large, Medium & Small Scale Industrial units have become sick due to a host of factors, the most important among them being inefficient management and banks nurse several of these units which are viable so that they may be rehabilitated and restored to normal health.

A Unit is considered sick if it (a) incurs cash loss, for one year and, in the judgement of its bank, is likely to continue to incur cash loss for the following year as well, (b) has an imbalance in its financial structure, such as a Current Ratio (ratio of Current Assets to Current Liabilities) of less than 1 : 1 and (c) has a worsening debt-equity ratio. However, a sick unit may be considered viable if it is in a position to repay its debt in about eight to ten years. These sick units are provided with bank finance for rehabilitation at concessional rates of interest, which, of course, cannot be lower than the minimum lending rate prescribed by the Reserve Bank of India. The rates of interest on fresh term loans and fresh working capital finance and interest on existing working capital finance are treated on the same footing and are given priority for repayment over the interest accrued on current term loans and the funded portion of existing working capital finance. Advances granted, as of end June 1983, to sick units enjoying credit limits (from the Banking System) of Rs.1 crore or over each amounted to Rs.1,913.10 crores covering 463 units, of which Small Scale Industrial Units were 64368 and they accounted for Rs.626.52 crores or as much as 32.75% of the said sum of Rs.1,913.10 crores.

Banks provide the following facilities/concessions to sick units:

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a. Waiver of interest accrued/payable by the units;
b. Simple rate of interest on rehabilitation finance offered/extended to them;
c. Funding of interest and conversion of it into Loans repayable over a period of time;
d. (Prescription of) lower margins;
e. (Charging) lower rates of interest and
f. (Prevision of) larger holiday periods.

Concessions like waiver of interest, charging simple/ lower rates of interest etc. affect adversely the income of banks and hence their profitability as well. Other concessions such as funding of interest payable, grant of long holiday periods etc. result in locking up of huge amounts of banks with these few units which, in turn, affects, to a great extent, recycling of funds by banks.

Thus, a sizeable portion of the gross credit extended by banks has been locked up in the form of rehabilitation finance extended to sick industrial units. Further, the return from these advances is also quite poor - it is just equal to their (banks') cost of funds. Further, if costs incurred by banks on servicing the lending accounts of sick SSI Units which are under rehabilitation are deducted from the interest income that accrues to banks from these Units, then banks would only incur loss.

BRANCH EXPANSION PROGRAMME:
As mentioned earlier, one of the major objectives of Nationalisation of major commercial banks in 1969 was to spread the banking habit amongst the people.
in the Country. Accordingly, the Reserve Bank of India evolved its policy of Bank Branch Expansion which necessitated banks to open a large number of branches in the rural and semi-urban areas of the Country.

The branch expansion policy as enunciated by the National Credit Council in March 1968 envisaged banks opening branches which would be more than at least one-third of the number of branches opened by them during the preceding two years; within this overall target, at least 50% of the branches were required to be opened in unbanked centres; similarly, at least 50% of the branches were required to be opened in the rural and semi-urban centres of the Country.

The Branch Expansion Policy as revised by the Reserve Bank of India in March 1970 required those banks which had more than 60% of their offices in rural and semi-urban centres in the Country as on December 31, 1969 to open one office at an urban centre for every two offices opened by them, after December 1969, in rural and semi-urban centres; as regards other banks, the ratio was one branch to be opened in an urban centre for every three offices opened by them in rural and semi-urban centres. Banks were required to evolve/draw up three year Rolling Plans for opening branches. Banks were given a target of 5000 new branches to be opened by them during the three year period from 1975 to 1977. Further, they were required to ensure that while reaching these targets, a large number of offices were opened by them in unbanked/under-banked centres in rural and semi-urban areas, unbanked block/taluk headquarters and under-banked districts/States so as to eliminate regional economic imbalances.
However, the Branch Expansion Policy announced by the Reserve Bank of India in January 1978 sought to contain undue expansion of bank branches with a view to ensuring consolidation (of the already opened/functioning branches). Further, banks were advised to select unbanked centres in deficit districts (i.e. districts where average population per bank office was higher than the national average), giving priority to such districts in States where the average population covered per bank office for the State as a whole also was higher than the national average. The allotment of urban and Metropolitan centres to banks for opening branches was restricted to the discretion of the Reserve Bank of India.

In September 1978, a new Branch Licensing Policy for the three year period 1979-81 was announced by the Reserve Bank of India. While the basic objective of the policy continued to be expansion of banking facilities in deficit areas and reduction of inter-district and inter-State disparities, the policy also placed emphasis on rural development, in accordance with the recommendations of the Dantwala Committee (constituted by the Reserve Bank of India in 1977) on the working of Regional Rural Banks in the Country and the Ramath Working Group (Working Group to Study the Problems Arising out of the Adoption of Multi-Agency Approach in Agricultural Financing, 1976). This policy was based on the multi-agency approach with emphasis on ensuring co-ordination between various financial institutions such as commercial and co-operative banks, Regional Rural Banks etc. to avoid wasteful competition between them and duplication of efforts. The Policy accorded top priority to opening of bank branches in all Community Development Block Head Quarters in the Country. To reduce imbalance, within various districts, in the Country, between rural and
semi-urban areas, additional licences for opening branches in rural and semi-urban areas were proposed to be given under this Policy. Further, expansion in Urban/Metropolitan centres was proposed to be allowed only on a highly selective basis. It was also laid down that wherever Regional Rural Banks functioned, the concerned Lead Banks would get priority for opening branches. Further, Lead Banks were asked to open more branches in their Lead Districts. Banks which had a regional character were not to be asked, generally, to open branches in far-flung areas but were advised to concentrate on their own areas of operation or expand in the adjoining deficit areas on a selective basis.

The Reserve Bank of India announced, in the beginning of 1982, their revised Branch Expansion Policy for banks for the three-year period 1983-85. The main thrust of the Policy was continued emphasis on banks improving their branch network in rural areas by opening more branches. The aim was to achieve, by March 1985, a banking coverage of one office for an average of 17000 persons in the Country, based on 1981 Census. Lead Banks were required to identify, in consultation with the concerned State Governments, unbanked rural centres in their respective Lead Districts and thereby prepare a map showing information about the location of existing bank offices as well as unbanked centres in their Lead Districts. The identified centres were required to be placed subsequently before the District Credit Council. The State Governments were then required to forward to the Reserve Bank of India a consolidated list of identified centres in their respective States in order of preference and also indicate therein the type of bank offices required at each place. Priority
was to be given to opening branches at centres in deficit districts while expansion in surplus districts was sought to be phased out from 1984-85 unless there was an immediate need for establishing a bank office at a particular centre. The first preference for opening branches in these centres was given to the Regional Rural Banks. In case there were no Regional Rural Banks in the area, priority was to be given to banks having a fairly good network of branches in the Region as also those having an essentially regional character. Establishment of offices in semi-urban centres was sought to be considered only if there was an immediate need for banking facilities in such centres. The restrictive policy in regard to permitting expansion in urban and Metropolitan centres in the Country was sought to be followed by allowing banks to open branches in the Urban & Metropolitan centres only on a highly selective basis as it was done earlier and proposal for expansion in such centres was to be considered only on an annual basis.

Thus, the policy of the Reserve Bank of India since 1969 has been one of expansion of branch network in rural and semi-urban areas and Block Headquarters in the Country and elimination of inter-State and inter-district disparity in regard to branch network.

The following Table sets out the proportion of rural branches to the total number of new branches opened by banks in India during every year since 1970:
TABLE 21 - PROPORTION OF RURAL BRANCHES OPENED TO ALL BRANCHES OPENED BY ALL SCHEDULED COMMERCIAL BANKS

<table>
<thead>
<tr>
<th>YEAR (July to June)</th>
<th>Total no. of new brs. opened by bks.</th>
<th>Of which no. of brs. opened in rural centres</th>
<th>Proportion of new rural brs. opened to total no. of new branches opened (Col.3 as % of Col.2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-70</td>
<td>1869</td>
<td>1230</td>
<td>65.8</td>
</tr>
<tr>
<td>1970-71</td>
<td>1862</td>
<td>1217</td>
<td>64.7</td>
</tr>
<tr>
<td>1971-72</td>
<td>1609</td>
<td>537</td>
<td>33.4</td>
</tr>
<tr>
<td>1972-73</td>
<td>1740</td>
<td>744</td>
<td>42.8</td>
</tr>
<tr>
<td>1973-74</td>
<td>1574</td>
<td>695</td>
<td>38.4</td>
</tr>
<tr>
<td>1974-75</td>
<td>1794</td>
<td>641</td>
<td>35.7</td>
</tr>
<tr>
<td>1975-76</td>
<td>2490</td>
<td>881</td>
<td>35.4</td>
</tr>
<tr>
<td>1976-77</td>
<td>3582</td>
<td>1846</td>
<td>51.5</td>
</tr>
<tr>
<td>1977-78</td>
<td>3214</td>
<td>2269</td>
<td>70.6</td>
</tr>
<tr>
<td>1978-79</td>
<td>2186</td>
<td>1531</td>
<td>70.0</td>
</tr>
<tr>
<td>1979-80</td>
<td>2217</td>
<td>1768</td>
<td>79.7</td>
</tr>
<tr>
<td>1980-81</td>
<td>3267</td>
<td>2550</td>
<td>77.6</td>
</tr>
<tr>
<td>1981-82</td>
<td>3470</td>
<td>2744</td>
<td>79.1</td>
</tr>
<tr>
<td>1982-83</td>
<td>2902</td>
<td>2284</td>
<td>78.7</td>
</tr>
<tr>
<td>1983-84</td>
<td>3253</td>
<td>2694</td>
<td>82.8</td>
</tr>
<tr>
<td>TOTAL</td>
<td>37069</td>
<td>23541</td>
<td>63.5</td>
</tr>
</tbody>
</table>


The population group-wise composition of bank branches as at the time of Nationalisation and as on June 30, 1984 was as under:

...118...
### TABLE 21 - POPULATION GROUP-WISE CLASSIFICATION OF BRANCHES

<table>
<thead>
<tr>
<th>Population group</th>
<th>July 19, 1969</th>
<th>June 30, 1984</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td>1860</td>
<td>25372</td>
</tr>
<tr>
<td></td>
<td>(22.3)</td>
<td>(56.0)</td>
</tr>
<tr>
<td>Semi-urban</td>
<td>3344</td>
<td>9262</td>
</tr>
<tr>
<td></td>
<td>(40.2)</td>
<td>(20.4)</td>
</tr>
<tr>
<td>Urban</td>
<td>1456</td>
<td>5759</td>
</tr>
<tr>
<td></td>
<td>(17.5)</td>
<td>(12.7)</td>
</tr>
<tr>
<td>Metropolitan/Fort Town</td>
<td>1661</td>
<td>4929</td>
</tr>
<tr>
<td></td>
<td>(20.0)</td>
<td>(10.9)</td>
</tr>
<tr>
<td>Total</td>
<td>5321</td>
<td>45332</td>
</tr>
<tr>
<td></td>
<td>(100.0)</td>
<td>(100.0)</td>
</tr>
</tbody>
</table>

**NOTE:** Figures in brackets indicate the proportion of each category of branches to the total number of branches in the Country.

**SOURCE:** Computed from Report on Currency & Finance — 1983-84, published by the R.B.I.

Thus, the share of rural branches in the total number of branches in the Country has improved markedly from 22.3% to 56.0%. This means that nearly 64% of the branches opened since Nationalisation have been opened in rural centres.
Consequent upon this massive branch expansion programme initiated by the Reserve Bank of India, there has been a large scale mobilisation of rural savings by banks. Thus, the proportion of deposits mobilised by banks through their rural branches in the total deposits of all Scheduled Commercial Banks rose to 14.1% as of end June 1983 from 3.1% as of end June 1969, resulting for the first time, in large scale conversion of physical savings into financial savings in the rural areas of the Country.

Further, this branch expansion programme enabled banks to extend credit assistance, in a large measure, to the agricultural sector which contributes nearly 60% of our National Income. This helps ensure availability of credit, in rural areas, at low and reasonable rates of interest, which, in turn, helps elimination of rural indebtedness. The share of advances granted by Scheduled Commercial Banks through their rural branches in their total advances rose to 12.4% as of end June 1983 from only 1.5% as of end June 1969; this has helped spread of banking habits in the rural parts of the Country.

However, this massive rural branch expansion programme of banks has affected, adversely, their profitability as banks incur huge costs and realise poor return from these branches. Some of the major factors responsible for the poor performance of rural branches are set out below:

(a) The longer gestation period required by rural branches of banks is a major factor. Given the costs of overheads, a minimum level of business in terms of deposits and advances is required for a branch to utilise the overhead costs and thereby be viable. Rural branches normally require a gestation period of about five years. Hence, due to increased overheads and non-utilisation of full capacity, particularly during the gestation period, the rural branches incur huge losses.
(b) The next factor is the composition of the deposits at rural branches. Practically almost all deposits collected by rural branches are those mobilised from small individual savers and as such deposits maintained by traders, industrialists and big institutions are highly negligible. Consequently, the ratio of savings and time deposits to total deposits of these branches is very high. Hence, rural branches pay more interest on term and savings deposits maintained by them. The ratio of current deposits to total deposits of rural branches of banks was only 7.60% as against 20.20% for metropolitan branches as at the end of 1981. The cost of acquiring funds is thus substantially higher for rural branches.

Further, as per a study made by the PEP Committee, the servicing cost of Rs.100 of deposits was higher for rural branches at Rs.1.68 compared with only Rs.1.54 for metropolitan and Urban branches. This renders the cost of acquisition of deposits still higher for rural branches.

(c) Yet another factor is the poor return on funds deployed by rural branches. This is essentially due to unfavourable composition of their credit portfolio. The advances portfolio of most of the rural branches is essentially comprised of credit extended to the Priority Sectors which fetch only low return, as seen earlier. In other words, the share of high yielding advances at rural branches is very low. Consequently, the income earned by rural branches from high yielding advances is not sufficient for them to compensate the loss of income suffered by them due to extension, on a large scale, of low yielding advances, while it is contrary in the case of Metropolitan branches.
Further, as in the case of deposits, the cost of servicing these advances is also higher for rural branches at Rs.3.24 for every sum of Rs.100 (advanced by the rural branches) compared to only Rs.1.17 in the case of Metropolitan branches as computed by the Sub-Committee to the PBP Committee. This affects adversely the income of rural branches. Thus, with higher servicing costs and low return on advances, rural branches incur sizeable less.

(d) Banks earn non-interest income as well in the form of commission (on DDs, TTs, MTs issued etc.), discount (on Bills), Exchange, brokerage etc. This income has been on the increase. The ratio of this income of banks to their total income moved up sharply from 13.29% in 1972 to around 18% in 1981. This is more particularly so in the case of Metropolitan branches. Hence, even though overhead costs are quite heavy even for Metropolitan branches, yet their income is quite high due to their non-interest income. In fact, if banks have been earning profit in the Country during the past few years, despite the increasing cost of and declining return on their funds, it has been so mainly because of their increasing non-interest income.

But branches in rural areas have lesser opportunities for such income, as rural areas are more agriculture oriented and lack potential for these types of business, which include issuing DDs, TTs, MTs etc., under-writing shares, issuing LCs and Guarantees, remittances, collection of Bills, foreign exchange transactions etc.

Thus, opening large number of branches in rural and semi-urban areas (as part of social banking and with a view to mobilising savings and spreading banking habits in these areas and ensuring their rapid economic development) has affected considerably the viability of banks.

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The Lead Bank Scheme was introduced by the Reserve Bank of India in December 1969 and this was a major step taken towards the implementation of the twin objectives of mobilisation of deposits on a massive scale throughout the Country and accelerating the flow of credit to the Weaker Sections of the society. The Study Group which was constituted in October 1968, with the approval of the National Credit Council, under the Chairmanship of Prof. D R Gadhgil, pointed out the urgent need for commercial banks in the Country to adopt an Area Approach to study local problems and identify credit gaps in the Economy and thereby formulate suitable integrated Credit Plans to bridge those credit gaps and ensure rapid economic growth in different parts of the Country. It also suggested that District should be treated as the operative unit for the purpose of planning. In August 1969, the Governor of the Reserve Bank of India appointed a Committee of Bankers with Shri F K F Nariman as Chairman to evolve a co-ordinated programme for improving banking facilities/strengthening bank branch network in the under-banked districts of the Country. As recommended by the Committee, the Reserve Bank of India evolved the Lead Bank Scheme, under which all the Districts in the Country with the exception of Greater Bombay, Calcutta and Madras and the Union Territories of Delhi, Chandigarh and Goa have been placed under the State Bank of India and its Group, the 14 Nationalised Banks and two private sector banks so that they may play a 'Lead Role' in those Districts in accelerating the tempo of their economic growth.

The first task assigned to Lead Banks, under the Scheme, was to undertake an intensive survey of their respective Lead Districts and identify potential centres, particularly in rural and semi-urban areas, for opening new branches.
They were also required to convene meetings of the District Level Co-ordination Committees for discussion in regard to opening branches, evolution and evaluation of Schemes for extension of credit assistance etc. These forums, in fact, acted as connecting links between the Administrative Machinery at the Districts and banks therein and all issues relating to the development of the Districts were discussed in these meetings. Later, in 1973, banks were asked to prepare Credit Plans for these Districts. However, the exercise relating to the drawing up of the Credit Plans was far from satisfactory. Hence, in 1978, the Credit Plans relating to these Lead Districts were duly revised by the Lead Banks. In 1979, the exercise relating to the preparation of Credit Plans was further improved and the Lead Banks were asked to prepare Credit Plans for their Lead Districts, for the three year period 1980-82, in the light of the potential available in those Districts and on the basis of the relevant guidelines issued by the Reserve Bank of India.

While the impressionistic surveys undertaken by banks resulted in identification of potential centres for opening of branches by banks, the Credit Plans prepared by them helped to a considerable extent in the growth of the various sectors of the District economy and greater flow of funds to various sectors.

**Village Adoption Scheme:**

Similarly, under the Scheme of Village Adoption by banks, they were able to lend, on a comprehensive basis, to all sectors of the Economy in the Adopted Villages. Earlier, there was an impression amongst banks that once a village was 'Adopted' by a bank, other banks would be prohibited to lend there; but, in 1980, the Reserve Bank of India clarified that the adoption of a village
by a bank would only mean that it had declared its intention to do intensive lending in that village and that it would not preclude other banks from financing in that area; thus, the Reserve Bank of India has confirmed the multi-agency approach to banking in the Country, which is also reflected clearly in its Branch Licensing Policy. However, the cost of implementation of both the Lead Bank and Village Adoption Schemes has been quite minimal. It is estimated that each Lead District costs the Banks an expenditure of around Rs.2.00 lakhs per year.

REGIONAL RURAL BANKS (RRBs):

Several Regional Rural Banks have been sponsored by commercial banks in different parts of the Country to ensure accelerated flow of credit to the rural sector, particularly agriculture and to mobilise more effectively rural savings. Each Regional Rural Bank is sponsored by a public sector bank which provides the necessary assistance to the RRB through subscription to its share capital, provision of managerial and financial assistance etc.

The Reserve Bank of India undertook a Study, in 1981, on the working of the RRBs on the basis of viability criterion as suggested by the Dantwala Committee set up by them earlier. The Study revealed that nearly 50% of the working funds are mobilised by the RRBs through borrowings from the Reserve Bank of India or the sponsoring banks of which nearly 70% are made good by the sponsoring banks. The total advances extended by the RRBs amounted to, as at the end of March 1984, Rs.809 crores, of which more than Rs.100 crores were borrowed from the sponsoring banks at concessional rates of interest. Normally, sponsoring banks would not get
any profit on the funds lent to the RRBs, as they lend
to RRBs more or less at a rate which is just equal to
their cost of funds. Besides, sponsoring banks render
several other valuable services to their RRBs, for which
they incur substantial cost. Further, RRBs require a
gestation period of at least four to five years and a
minimum level of business of about Rs.3 crores as indica-
ted by the Dantwala Committee. Thus, while, on the one
hand, sponsoring banks get no return on their contribu-
tions to the capital of the RRBs, on the other they are
to necessarily own the loss made by the RRBs during their
gestation period.

Thus, sponsoring of RRBs by Public Sector Banks, which
they are obliged to do, boosts up the expenditure of
banks and contributes to their declining profitability.

In sum, the contribution of banks for the socio-economic
uplift of the people has resulted in their declining
profitability.

SUM UP:

Thus, as discussed earlier, while the return for banks
on their funds rose up till 1976 and began to decline
thereafter, their cost of funds has been on the rise
steadily ever since 1969. Hence, the spread between
the return on and cost of funds, which reflects the profi-
tability of banks, began to narrow down since 1977.

The following Table sets out the trends in regard to
the movement of the 'spread' between the cost of and
return on bank funds since 1969:
<table>
<thead>
<tr>
<th>YEAR</th>
<th>Return per Rs.100 of funds deployed</th>
<th>Cost per Rs.100 of funds mobilised</th>
<th>Spread (Difference between Return &amp; Cost)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>6.27</td>
<td>5.56</td>
<td>0.71</td>
</tr>
<tr>
<td>1970</td>
<td>6.38</td>
<td>5.76</td>
<td>0.62</td>
</tr>
<tr>
<td>1971</td>
<td>6.96</td>
<td>6.14</td>
<td>0.82</td>
</tr>
<tr>
<td>1972</td>
<td>6.93</td>
<td>6.18</td>
<td>0.75</td>
</tr>
<tr>
<td>1973</td>
<td>6.97</td>
<td>6.41</td>
<td>0.56</td>
</tr>
<tr>
<td>1974</td>
<td>8.57</td>
<td>7.64</td>
<td>0.93</td>
</tr>
<tr>
<td>1975</td>
<td>8.91</td>
<td>8.45</td>
<td>1.56</td>
</tr>
<tr>
<td>1976</td>
<td>9.09</td>
<td>8.70</td>
<td>1.52</td>
</tr>
<tr>
<td>1977</td>
<td>9.13</td>
<td>8.77</td>
<td>1.22</td>
</tr>
<tr>
<td>1978</td>
<td>8.96</td>
<td>8.60</td>
<td>0.32</td>
</tr>
<tr>
<td>1979</td>
<td>8.98</td>
<td>8.63</td>
<td>0.76</td>
</tr>
<tr>
<td>1980</td>
<td>9.81</td>
<td>9.43</td>
<td>0.75</td>
</tr>
<tr>
<td>1981</td>
<td>10.26</td>
<td>9.09</td>
<td>1.24</td>
</tr>
</tbody>
</table>

**SOURCE:** Statistical Tables Relating to Banks in India—1969 to 1981, published by the R.B.I.

Even though there was a marginal improvement in the 'spread' in 1981, yet it was perhaps due to temporary variations in the return on/cost of funds. However, due to a host of developments that took place later in the Banking scenario such as a hike in wages to bank employees, expansion in the aggregate advances extended to the Priority Sectors and the consequent increase in their share in total 'net bank credit', a massive increase in Food Credit, a hike in the CRR and SLR levels led to a steady decline in the 'spread' in the later years.

The trend in the movement of 'spread', as set out in the above Table has been depicted in the following graphical representation:
Thus, the intermediary role played by banks in India which are directly/closely monitored by the monetary authorities/Govt. of India has affected adversely their very profitability. If they had been given a free hand to perform, of course within certain given broad framework, they would have, in no uncertain terms, generated better profit and would have strengthened their own funds. However, as they are, inter-alia, subject to several controls imposed by the monetary authorities and they are to play the role of catalysts of socio-economic change in the Country, their profitability is at a low ebb.
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4. —— : I.5.


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