CHAPTER VIII

ANALYSIS OF MANAGEMENT COST AND PROFITABILITY OF DCCBs

The analysis attempted in the preceding chapters aim at evaluating the efficiency of DCCBs by selecting only one facet of bank management as the focal point of analysis. This single aspect performance evaluation may not throw any light on overall performance or efficiency of the bank management. The overall profitability, in the case of DCCBs, is the product of two variables, viz., Credit Turnover and Investment (Working Capital) Turnover. The favourable effect of credit turnover may be overshadowed, and even nullified by the unfavourable effect of capital turnover. Therefore, appraisal of overall efficiency of bank management assumes greater significance. Against this background, the present chapter aims at appraisal of management cost and profitability of the DCCBs.

Profitability - An Index of Overall Operational Efficiency:

Profitability reflects the overall efficiency of the management of a co-operative bank in loaning, recovery, investment and resource mobilisation operations.\(^1\) The

strength of a bank and its ability to meet its short and long-term obligations would depend, to a large extent, upon management efficiency, productivity, safety and profitability.²

Now-a-days, the concept of 'management of profitability' seems to have been changed from the traditional outlook of mere arriving at profit appropriation and dividend pay-out decisions to the present attitude of viewing profitability as the result rather than as the cause. There is a change in the outlook mainly because of the fact that since nationalisation of 14 commercial banks in 1969 and amendment in policy regulations by the RBI, the banks have been assigned social responsibility towards the upliftment of the weaker sections of the society. Therefore, the profit objective is not a dominant factor as it is found in other business enterprises. This changed outlook is particularly appropriate for an important service industry such as banking. At the same time, however, a predominant goal of banking is the attainment of long-term success through the earning of a reasonable rate of return for the investors along with satisfactory performance in certain "Key result areas".³

³ Ibid., p.157.
Profitability - An Important Criterion of Long-term Success of a Bank:

Profitability is an important criterion of long-term efficiency and success of any banking institution. The present outlook of viewing profitability as the result rather than as the cause, as pointed out earlier, does not and should not undermine the importance of profitability because banking industry differs from other industries in that it is a very sensitive on which is built up the trust and confidence of its customers and the community.4

Profitability improves financial soundness of a bank in the long run. It augments bank's financial resources which would be a potential source of further investment in lending business which, in turn, with efficient credit management, go a long way in improving profitability once again. Therefore, if the present profitability is the result of current credit management, at times it becomes a cause for increase in prospective lending business. The same view holds good even in case of deposit mobilisation process. If the present deposit-mix determines the magnitude of profitability, the present profitability imparts strength to the bank in mobilising potential deposits.

4. Ibid., p.162.
Case for Reasonable Return on Investment in DCCBs:

No doubt, the co-operatives are built upon the basic philosophy of "one for all, all for one". The basic objective is not of profit-making, but providing services to the members or promoting thrift. However, one should not forget that co-operative organisation "is an enterprise and not a charitable association". Therefore, every co-operative bank should aim at achieving a fair rate of return on its investment. The following factors support this view:

(i) raising of further share capital, with a view to extending its internal equity base, depends upon present rate of return on investment;

(ii) capital-mix and deposit-mix (Chapters V and VI respectively) of the DCCBs in Karnataka are characterised by the preponderance of borrowed funds and fixed deposits respectively. This implies a high degree of financial risk. High degree of financial risk coupled with poor profitability will result in possible deterioration in financial health; and

(iii) a reasonable rate of return on investment will act as a stimulating factor in mobilising potential deposits from the prospective investors.

Determinants of Profitability of DCCBs:

The profitability of the DCCBs will depend upon the following factors:

(a) nature of capital-mix,
(b) nature of deposit-mix,
(c) magnitude of management or operational cost,
(d) diversification of loan portfolios,
(e) recovery performance,
(f) overdue position,
(g) investment policies,
(h) credit and deposit potentialities,
(i) efficiency of bank management, i.e., professional outlook of bank management, etc.

Measures of (Ratio Bank for) Management and Profitability Analysis:

The following indicators were selected for appraising the cost and profitability of DCCBs:

(i) Cost of Management as a percentage to Gross Income,
(ii) Salaries as a percentage to Cost of Management,

(iii) Other Expenses as a percentage to cost of Management,

(iv) Cost of Management as a percentage to Working Capital,

(v) Net profit as a percentage to Working Capital, and

(vi) Rate of Return on Internal Equities.

(i) **Cost of Management as a Percentage to Gross Income:**

The cost of management of a DCCB, which comprises establishment charges and contingencies, is an important operational cost of the bank and, therefore, its relationship with the gross earnings of the bank and capital employed in business (working capital) needs to be examined in the context of study of efficiency of management.6

A rise in the percentage of cost of management to gross income may be due to increase in the volume of loan business or mobilisation of deposits or employment of additional staff or increase in other expenses due to

inefficiency of management, and vice versa. The upward movement in the cost of management not accompanied by the growth in deposits or loan business indicates inefficient role of bank management in controlling or reducing the bank's operational cost.

The trend in the percentage of cost of management to gross income is presented in Table VIII.1:

Table VIII.1: Cost of Management as a Percentage to Gross Income - Overall Analysis.

(Rs. in lakhs)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost of Management</th>
<th>Gross Income</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978-79</td>
<td>459</td>
<td>619</td>
<td>74.15</td>
</tr>
<tr>
<td>1979-80</td>
<td>572</td>
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<td>88.54</td>
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<td>1980-81</td>
<td>732</td>
<td>759</td>
<td>96.44</td>
</tr>
<tr>
<td>1981-82</td>
<td>827</td>
<td>857</td>
<td>96.50</td>
</tr>
<tr>
<td>1982-83</td>
<td>968</td>
<td>980</td>
<td>98.78</td>
</tr>
</tbody>
</table>

SOURCE: Statistical Statements Relating to Co-operative Movement in India for the related years.

It is evident from the above Table that while the cost of management has been on the rise throughout the
Diagram VIII-1

Cost of Management as a Percentage to Gross Income

Percentage (Income/Cost):

100 |
90  |
80  |
70  |
60  |
50  |
40  |
30  |
20  |
10  |
0   |


Co-operative Years

Gross Income

Cost of Management
period under study along with the rising gross income, its percentage to gross income shows an upward trend. This is because the rate of increase in the cost of management is far more than that in the gross income. It signifies poor contribution of the cost of management towards the profitability position of the DCCBs.

Districtwise analysis of the percentages of cost of management to gross income (Table VIII.2) indicates that the rate of increase in the cost of management was more than the rate of increase in the gross income, and in some cases, the former outstripped the latter. The same is crystal clear from the fact that the number of DCCBs working under losses went on increasing year after year. At the end of June, 1979, there were only 3 DCCBs working under losses but the number of loss leaders increased to 8 at the end of June 1983. It is also pathetic to note from the table that in case of certain DCCBs (e.g., Chitradurga) there was no gross income to cover any portion of cost management at the end of June 1982 and 1983.

(ii) **Salaries as a Percentage to Cost of Management**

The cost of management comprises salaries and other expenses. It is made clear from the analysis of the
Table VIII.2: Cost of Management as a Percentage to Gross Income - Districtwise Analysis.  

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>C.M.</td>
<td>G.I.</td>
<td>%</td>
<td>C.M.</td>
<td>G.I.</td>
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<tr>
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<tr>
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<td>32</td>
<td>59.38</td>
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<td>Chitradurga</td>
<td>16</td>
<td>9</td>
<td>177.78</td>
<td>20</td>
<td>11</td>
</tr>
<tr>
<td>Tumkur</td>
<td>14</td>
<td>15</td>
<td>93.33</td>
<td>20</td>
<td>21</td>
</tr>
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<td>Mysore</td>
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<td>67.74</td>
<td>28</td>
<td>42</td>
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<tr>
<td>Mandya</td>
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<td>62</td>
<td>45.16</td>
<td>39</td>
<td>60</td>
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<td>22</td>
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<td>61.11</td>
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<td>38</td>
</tr>
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<td>Kodagu</td>
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<td>47</td>
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<td>74</td>
<td>94.59</td>
<td>80</td>
<td>70</td>
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<tr>
<td>North Canara</td>
<td>26</td>
<td>41</td>
<td>63.11</td>
<td>29</td>
<td>41</td>
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<td>Gulbarga</td>
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<td>15</td>
<td>120.00</td>
<td>20</td>
<td>17</td>
</tr>
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<td>Bidar</td>
<td>20</td>
<td>35</td>
<td>57.14</td>
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<td>41</td>
</tr>
<tr>
<td>Raichur</td>
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<td>90.91</td>
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<td>11</td>
</tr>
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<td>25</td>
<td>13</td>
<td>192.31</td>
<td>27</td>
<td>28</td>
</tr>
</tbody>
</table>

**Source:** Statistical Statements Relating to Co-operative Movement in India for the related years.

**Note:**
- C.M. = Cost of Management,
- G.I. = Gross Income.
- Indicates Gross Loss.
percentage of cost of management to gross income that the cost of management increased more than the gross income. A change in the cost of management may be caused by:

a) the change in the amount of salaries, or
b) the change in other expenses, or
c) the changes in both.

The magnitudes of both the salaries and cost of management are reflected in Table VIII.3:

Table VIII.3: Salaries as a Percentage to Cost of Management - Overall Analysis.

(Rs. in lakhs)

<table>
<thead>
<tr>
<th>Year</th>
<th>Salaries</th>
<th>Cost of Management</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978-79</td>
<td>322</td>
<td>459</td>
<td>70.15</td>
</tr>
<tr>
<td>1979-80</td>
<td>410</td>
<td>572</td>
<td>71.68</td>
</tr>
<tr>
<td>1980-81</td>
<td>471</td>
<td>732</td>
<td>64.34</td>
</tr>
<tr>
<td>1981-82</td>
<td>558</td>
<td>827</td>
<td>67.47</td>
</tr>
<tr>
<td>1982-83</td>
<td>630</td>
<td>968</td>
<td>65.08</td>
</tr>
</tbody>
</table>

SOURCE: Statistical Statements Relating to Co-operative Movement in India for the related years.
STRUCTURE OF COST OF MANAGEMENT OF THE DCCBs.

Diagram VIII-2

Relative Shares of Each Cost Component:

- 1978-79: 70.15%
- 1979-80: 71.66%
- 1980-81: 64.34%
- 1981-82: 67.47%
- 1982-83: 65.06%

Co-operative Years:
- 1978-79
- 1979-80
- 1980-81
- 1981-82
- 1982-83

Salaries and Other Expenses.
It can be observed from the above table that while the salaries have been on the rise throughout the period of study with the rising cost of management, its percentage to cost of management shows an erratic trend. This is mainly due to variations in other expenses. This signifies lack of cost control measures or inefficiency of bank management.

Districtwise analysis (Table VIII.4) reveals that the salaries, in absolute terms, of the DCCBs increased all through the period under analysis. However, its proportion to cost of management shows an erratic trend. Anyhow major portion of the cost of management is represented by the amount of staff expenditure. It indicates an urgency of evaluating the contribution of the existing staff towards the growth in loan business or deposits, etc. with the help of labour productivity evaluation techniques.

(iii) Other Expenses as a Percentage to Cost of Management:

The category of 'other expenses' comprises office rent and rates, depreciation, printing and stationery, provisions for contingencies, etc. An increase in other expenses without corresponding positive growth in the banking business indicates an inefficiency of top management
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
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<tr>
<td>1</td>
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<td>16</td>
<td>15</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td>2</td>
<td>Mysore</td>
<td>15</td>
<td>12</td>
<td>11</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>3</td>
<td>Chittapur</td>
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<td>13</td>
<td>11</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>4</td>
<td>Mysore</td>
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<td>10</td>
<td>10</td>
</tr>
<tr>
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<td>10</td>
<td>10</td>
</tr>
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<td>6</td>
<td>Mysore</td>
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<td>10</td>
<td>10</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>7</td>
<td>Chittapur</td>
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<td>8</td>
<td>Mysore</td>
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<td>6</td>
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<td>11</td>
<td>Chittapur</td>
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<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>12</td>
<td>Mysore</td>
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<td>4</td>
<td>4</td>
<td>4</td>
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</tr>
<tr>
<td>13</td>
<td>Chittapur</td>
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<tr>
<td>14</td>
<td>Mysore</td>
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<td>2</td>
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<tr>
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<td>Chittapur</td>
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<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

**Table VIII A: Salaries as a Percentage to Cost of Management - District-wise Analysis.** (Rs. in lakhs)

**SOURCE:** Statistical Statements Relating to Co-operative Movement in India for the Related Years.

**NOTES:** S = Salaries paid to employees of the DCCBs. C.M = Cost of Management.
or lack of proper cost control measures and vice versa.

The Table VIII.5 shows the relationship between other expenses and cost of management:

Table VIII.5: Other Expenses as a Percentage to Cost of Management - Overall Analysis.

(Rs. in lakhs)

<table>
<thead>
<tr>
<th>Year</th>
<th>Other Expenses</th>
<th>Cost of Management</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978-79</td>
<td>137</td>
<td>459</td>
<td>29.85</td>
</tr>
<tr>
<td>1979-80</td>
<td>162</td>
<td>572</td>
<td>28.32</td>
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<tr>
<td>1980-81</td>
<td>261</td>
<td>732</td>
<td>35.66</td>
</tr>
<tr>
<td>1981-82</td>
<td>269</td>
<td>827</td>
<td>32.53</td>
</tr>
<tr>
<td>1982-83</td>
<td>338</td>
<td>968</td>
<td>34.92</td>
</tr>
</tbody>
</table>

**SOURCE:** Statistical Statements Relating to Co-operative Movement in India for the related years.

It can be seen in the above table that other expenses, in absolute terms, moved up significantly from Rs.137 lakhs at the end of June 1979 to Rs.338 lakhs at the end of June 1983; forming approximately two fold increase over that of 1979. However, in relation to cost of management, it showed ups and downs mainly because of corresponding changes in other component of cost of management (Table VIII.3).
Districtwise analysis (Table VIII.6) reveals that there is an upward movement, in absolute terms, in the amount of other expenses incurred by the DCCBs in Karnataka. But the proportion of other expenses to cost of management reflects zigzag movement. Moreover, there is a phenomenal increase in the percentage of certain DCCBs. For example, the percentage of other expenses to cost of management in the case of Gulbarga D.C.C. Bank shot up from 33 per cent at the end of June 1979 to 60.42 per cent at the end of June 1983. This indicates negligence on the part of the bank management to arrest abnormal increase in other expenses or lack of cost consciousness on the part of management.

(iv) Cost of Management as a Percentage to Working Capital

The RBI suggested that the percentage of cost of management to working capital should be two. However, the prudent financial management should see that the cost of management, which can also be termed as inevitable or unavoidable cost or cost incidental to carry on investment activity or the cost which ought to be incurred in order to pay the cost of investment, does not exceed the rate of gross return on working capital.

7. Ibid., p.181.
### Table VIII.6: Other Expenses as a Percentage to Cost of Management - Districtwise Analysis.

(All in lakhs)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>O.E.</td>
<td>C.M.</td>
<td>%</td>
<td>O.E.</td>
<td>C.M.</td>
</tr>
<tr>
<td>Bangalore</td>
<td>5</td>
<td>18</td>
<td>27.78</td>
<td>7</td>
<td>22</td>
</tr>
<tr>
<td>Kolar</td>
<td>4</td>
<td>13</td>
<td>30.77</td>
<td>4</td>
<td>17</td>
</tr>
<tr>
<td>Shimoga</td>
<td>8</td>
<td>19</td>
<td>42.11</td>
<td>9</td>
<td>21</td>
</tr>
<tr>
<td>Chitradurga</td>
<td>5</td>
<td>16</td>
<td>31.25</td>
<td>9</td>
<td>20</td>
</tr>
<tr>
<td>Tumkur</td>
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<td>35.71</td>
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</tr>
<tr>
<td>Mysore</td>
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<td>Mandya</td>
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<td>33.33</td>
<td>6</td>
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<td>Dharwad</td>
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<td>36.00</td>
<td>10</td>
<td>27</td>
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</tbody>
</table>

**Source:** Statistical Statements Relating to Co-operative Movement in India for the related years.

**Note:** O.E. = Other Expenses.  
           C.M. = Cost of Management.
The percentage of cost of management to working capital of the DCCBs in Karnataka is shown in Table VIII.7:

Table VIII.7: Cost of Management as a Percentage to Working Capital - Overall Analysis. (Rs. in lakhs)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost of Management</th>
<th>Working Capital</th>
<th>Percentage</th>
</tr>
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<tr>
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<tr>
<td>1979-80</td>
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<td>1982-83</td>
<td>968</td>
<td>33,923</td>
<td>2.85</td>
</tr>
</tbody>
</table>

SOURCE: Statistical statements relating to Co-operative Movement in India for the related years.

It can be observed from the above that both of them have been regularly rising with the exception that there was a set back in the growth of working capital in 1980. Though there are fluctuations in the percentage, yet the percentage of cost of management to working capital in respect of all the years is much more than the norm of 2 per cent as suggested by the RBI. It signifies inefficiency of bank management.
Districtwise analysis of the percentage of the cost of management to working capital (Table VIII.8) indicates that except Shimoga and Bidar DCCBs in 1979, Kodagu D.C.C.B. in 1981 and Chitradurga D.C.C.B. in 1983, the percentage of all other D.C.C.Bs was not equal to or less than the norm of 2 per cent of working capital. The fact that the percentage jumped up from 4,30 per cent at the end of 1979 to 8.25 per cent at the end of 1983 (Gulbarga D.C.C.B.) speaks of the gross inefficiency of bank management.

(v) Net Profit as a Percentage to Working Capital:

This is a measure of profitability of investment. An increase in the percentage contributes positively towards the growth of internal equity, potential deposit growth and credit expansion and vice versa.

The trend of profitability is indicated in Table VIII.9;
Table VIII.8: Cost of Management as a Percentage to Working Capital - Districtwise Analysis.

(m. in lakhs)

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**Source:** Statistical Statements Relating to Co-operative Movement in India for the related years.

**Note:** C.M. = Cost of Management. W.C. = Working Capital.
Table VIII.9: Percentage of Net Profit to Working Capital - Overall Analysis.

(Rs. • in lakhs)

<table>
<thead>
<tr>
<th>Year</th>
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<th>Working Capital</th>
<th>Percentage</th>
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<tr>
<td>1981-82</td>
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<td>0.10</td>
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<tr>
<td>1982-83</td>
<td>12</td>
<td>33,923</td>
<td>0.04</td>
</tr>
</tbody>
</table>

SOURCE: Statistical Statements Relating to Co-operative Movement in India for the related years.

It is evident from the above table that there is a gradual decrease in the amount of net profit from year to year and that there is phenomenal growth in working capital. The net effect of these factors is that the percentage of net profit to working capital went down steeply from year to year. Besides, it can also be inferred that the rate of return on gross investment is far from satisfactory in any of the years. It signifies absence of financial prudence on the part of bank management.

Districtwise analysis of the percentage of net profit to working capital (Table VIII.10) indicates that
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<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
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<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
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<tr>
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**Net Profit as a Percentage to Working Capital - District-wise Analysis**

**Table VIII.10:**

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<tr>
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<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
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<td>0.80</td>
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<td>7268</td>
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<td>4521</td>
<td>1.51</td>
<td>12</td>
<td>1791</td>
</tr>
<tr>
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<td>2224</td>
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</tbody>
</table>

**NOTE:**

- Denotes Net Loss (-)
- Denotes Net Profit (+)

**SOURCE:**

- Statistical Statements Relating to Co-operative Movement in India for the related years.
there is a declining trend in the profitability of the DCCBs in Karnataka. This is evident from the fact that the number of DCCBs contributing negatively towards the improvement in financial health increased from 3 at the end of 1979, to 5 at the end of 1980, to 7 at the end of 1981, and dropped down to 6 at the end of 1982 and again went up to 8 at the end of 1983. This phenomenon may be due to heavy borrowings at higher cost, inefficiency of credit management or inefficiency of investment management by the DCCBs.

(vi) **Rate of Return on Internal Equities:**

This indicator measures the rate of return from the point of view of existing shareholders or prospective investors. The upward movement is desirable, because it augments resource position of the DCCBs and acts as stimulating factor while raising further share capital.

The percentage of return on internal equities is shown in Table VIII.11:

(vide next page)
Table VIII.11: Rate of Return on Internal Equities – Overall Analysis.

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Profit</th>
<th>Internal Equities</th>
<th>Rate of Return (%)</th>
</tr>
</thead>
<tbody>
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<tr>
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SOURCE: Statistical Statements Relating to Co-operative Movement in India for the related years.

It is evident from the above table that the net profit both in absolute and relative terms jumped down significantly from year to year. It signifies poor potential ability of the DCCBs in raising further resources.

Districtwise analysis of the rate of return on internal equities of the DCCBs (Table VIII.12) depicts that certain DCCBs like Bangalore, Tumkur, Mysore, Mandya, Kodagu, Belgaum, Bijapur, North Canara and Bidar have been
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<td>ROR(%)</td>
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<td>I.E.</td>
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</table>

**SOURCE:** Statistical Statements Relating to Co-operative Movement in India for the related years.

**NOTE:**
- **N.P.** = Net Profit.
- **I.E.** = Internal Equities.
- **ROR(%)** = Rate of Return in Percentage.
- **(-) Denotes net loss.**
providing at least something, if not in a reasonable measure, throughout the period under analysis. It indicates the inefficiency of other DCCBs in earning a reasonable rate of return on their equities. The number of DCCBs which did not provide any return on internal equities increased from 3 at the end of 1979, to 5 at the end of 1980, to 7 at the end of 1981, dropped down to 6 at the end of 1982 and again went up to 8 at the end of 1983. This indicates the phenomenon of overcapitalisation in the majority of the DCCBs in Karnataka.