FOR RESTRICTED CIRCULATION

REPORT OF THE PEP COMMITTEE ON BANKING

RESERVE BANK OF INDIA

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CHAIRMAN

Shri J.C. Luther

MEMBERS

Shri V.V. Divatia

Shri A. Raman

Shri P.N. Khanna

Shri S.R. Avadhani

Shri O.T.M. Nambiar

Dr. Meenakshi Tyagarajan

MEMBER-SECRETARY

Shri C.S. Ramachandran

LETTER OF TRANSMITTAL

J.C. LUTHER
CHAIRMAN
PEP COMMITTEE ON BANKING

October 7, 1977

My dear Shri Narasimham,

I have great pleasure in submitting the report of the Working Group on Productivity, Efficiency and Profitability in banks (PEP Committee on Banking) set up by the Reserve Bank in April 1976.

2. In India, the growth and orientation of banking in recent years have been so dynamic and innovative that the seventies can well be termed as the decade of banking revolution. As a part of declared policy, the net-work of the branches of banks has penetrated far and wide into remote and rural areas opening up untapped sources for mobilisation of savings as well as hopeful opportunities for financing pioneering programmes for development of backward areas and sectors of the economy. No longer are the banks merely passive and neutral intermediaries between the lenders and the borrowers; they have now emerged into a new role as prime movers for economic growth. These unprecedented developments have thrown up multiple challenges calling for a wide-ranging reappraisal of traditional policies and procedures. It is in this context, and to some extent at my instance, that the PEP Committee was constituted in April 1976 in the wake of the momentous decision to enforce a ceiling of lending rates of interest with the twin objective of making credit cheaper for the borrower and focussing attention on the crucial importance of operational efficiency for the banks.

3. The terms of reference of the Committee covered a number of aspects in which voluminous information had to be collected from the Banks and subjected to a rigorous and meaningful analysis. The comprehensive questionnaire issued for this purpose was divided into 10 Sections comprising as many as 170 specific items. The response from the Banks was, by and large, excellent and their comments have been a source of enlightenment on a number of complex and important issues. The wealth of data and ideas that have thus become available to the Reserve Bank can serve as a useful background and reference material for future studies of related subjects.

4. One of the specific areas for the Committee's examination related to the pattern of cost structure for the various banking services. For this purpose an elaborate and comprehensive programme for obtaining and analysing data was designed and implemented by the Committee. Even though the scope of the study was confined, for practical reasons, only to 21 selected banks and period of reference only to one month, the workload involved in this exercise was truly tremendous; over one lakh returns had to be processed and analysed involving time-consuming, painstaking and sophisticated exercises including statistical estimation of the costs of various services. The results of these studies had to be fitted in an appropriate framework for evolving a rational structure of the service charges. In this regard, detailed discussions were also held with the banks at various levels to appreciate the practical implications of the schedule of prices envisaged by the Committee.

5. The suggestions and recommendations in this Report cover rather a wide area including various aspects of both macro and micro-level credit planning, comparative evaluation of the Banks' performance and their internal systems and methods of work. Of particular significance is the Committee's recommendation for initiating a process, in close coordination with the Planning Commission and the Central Government, for shaping and implementing a comprehensive Annual Plan of monetary and credit measures for the banking industry in consonance with the envisaged pattern of developmental programmes. Other important recommendations include a new pattern of criteria for the evaluation of the operational performance of Banks with due regard to the achievement of socio-economic objectives, an improved form and pattern for Annual Accounts, suggestions for cost reduction and pricing policies with an eye on improving efficiency and profitability. The general approach of the Committee has been not only to seek solutions for immediate problems but also to outline a long-term programme of action for future.

6. I would like to record, here, my deep appreciation of the constructive, co-operative and unsparing contributions made by all the members of the Committee and Shri C.S. Ramachandran, the Member-Secretary, in particular, in organising and conducting various studies and participating actively in the preparation of the Report. At various times, they have

gladly borne a heavy burden of demanding tasks in addition to their normal work. It is with a heavy heart that I have to make a reference, here, to influential role played by Shri A. Raman whose untimely and sad demise on the eve of the completion of the Committee's work has been, indeed, a grievous loss to banking.

7. It goes without saying that the pivotal point for initiating and supervising the implementation of the various recommendations of the Committee will have, necessarily, to be located in the Reserve Bank. The members of the Committee are generally of the view that there is an immediate need for strengthening and, to some extent, recasting the organisational set-up within the Reserve Bank for more effective and co-ordinated action amongst various wings and divisions such as the Credit Planning and Credit Authorisation Cells. Of special urgency in this connection is the task of ensuring the expeditious installation of a management information system within the Banks as a pre-requisite for a meaningful planning and control of operations with special reference to the monitoring of industrial units which have been newly established and those which are in various stages of "sickness". It will also be necessary to make regular and systematic arrangements for undertaking studies on the cost structure of Banks and other related areas on a continuing basis.

8. For me, working on this Committee has been a matter of honour and privilege. I am deeply appreciative of the confidence reposed in me by the Reserve Bank for this interesting assignment. I am personally grateful to the Reserve Bank for this rare opportunity of getting better-acquainted with the banking industry and also for the kind indulgence in extending the duration of the Committee due to unforeseen circumstances.

With warm regards,

Yours sincerely,

Sd/-

(J.C. LUTHER)

Shri M. Narasimham,
Governor,
Reserve Bank of India,
Central Office,
Bombay.

AP/

C O N T E N T S

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CHAPTER I

THE NEW BANKING SCENE : TASKS AND CHALLENGES

1.1 The Social Control Scheme and the subsequent nationalisation of 14 major commercial banks brought about a turning point in the history of Indian banking. The purpose of the new policy was to enable the banking system to serve better the needs of society on the basis of clearly defined socio-economic objectives, the important of which was a wider diffusion of economic power. Realisation of these objectives required a widening and deepening of the banking infrastructure in the country. In particular, banks were called upon to cater to the needs of the vast multitude of borrowers in the hitherto unbanked or neglected sectors such as agriculture, small industry, professionals and self employed persons and other small productive endeavours. The assumption of such additional socio-economic tasks was, however, required to be met without in any way diluting their responsibilities to other productive sectors. The challenge posed to the banking system was to ensure that they meet these new responsibilities without sacrificing the traditional ones. It was apparent that this could be possible only if banks functioned without discarding the canons of efficiency and profitability.

<u>New Setting</u>

1.2 Historically, commercial banking in India developed as an urban entity, catering to the banking and credit needs of the medium and large industry and wholesale trade in the metropolitan and port towns. Towards the close of the sixties, the expectations of the community from the banking system increased substantially. It was increasingly emphasised that banking is a kind of public service and the banker is a public servant.

1.3 The record of banks' performance in compliance with those objectives is indeed creditable. There has been a sea-change in the banking landscape, both geographically and functionally. The massive branch expansion programme with a major thrust into the rural hinterland, the changing pattern of credit flow encompassing a large number of small borrowers, attempts at attuning procedures and practices to serve better the fast changing aspirations of the community, large scale recruitment, training and orientation programmes, are all developments which indicate that the banking system has undergone a major transformation from 'wholesale' to 'retail' banking.

<u>Creditable Performance</u>

1.4 Deposit resources of the banking system have increased over fourfold during less than a decade from Rs 3962 crores at the end of December 1967 to Rs 17,557 crores at the end of March 1977. Deposits as a percentage of national income (at current prices) form nearly 23 per cent at present compared to 14 per cent in 1967. Credit extended by banks has likewise increased almost fivefold from Rs 2747 crores at the end of December 1967 to Rs 13145 crores in March 1977. These two important parameters of banking are symbolic indicators of the rapid growth in banking since the implementation of the Social Control Scheme in December 1967.

1.5 For catering to the banking needs of the community in different parts of the country the basic requirement of banks was to have a broad operational base. Banks, therefore, launched a massive branch expansion programme, unparalled in the history of world banking. During the nine year period between 1967 and 1976, banks opened 16655 new offices, of which nearly seven out of every ten were in rural and semi urban areas. With more than 24000 offices at present, the average population covered per branch improved from 73000 in December 1967 to less than 23000. The branch expansion programmes of banks had a distinct bias towards providing banking facilities in rural areas. As a result of the massive thrust into the rural hinterland, the number of commercial bank branches at rural centres increased from about 1500 in December 1967 to 8820 in December 1976 and the share of rural branches in the total increased from 22 per cent to 37.3 per cent. The Lead Bank Scheme introduced in December 1969 helped considerably in extending banking facilities in a planned manner to unbanked centres in rural areas and backward regions, particularly in the initial stage of its operation. The setting up of bank offices in remote rural centres has helped to dispel the feeling that banking is a privilege of the few well placed urbanites and has thus played a vital role in educating the villagers that a bank office is an important engine of growth in the rural areas too.

1.6 Alongside this geographical expansion, functional diversification also took place. Banks formulated special credit schemes to cater to the diverse credit needs of agriculture, small industry and other small borrowers. Some of the banks adopted villages with a view to meeting the total credit needs of their inhabitants in an integrated manner. The Lead Bank Scheme helped to concentrate development efforts in specific areas. Delegation of authority and decentralisation of sanctioning powers were ensured to dispose of expeditiously loan applications in remote parts. Banks started recruiting agricultural and technical officers to help process properly loan applications of the priority sector applicants and supervise the end-use of credit. Special training and orientation programmes were arranged for the benefit of the staff required to attend to rural banking. Forms were printed in regional languages and procedures and practices were streamlined. Simultaneously, under the direction of monetary authorities banks began to impart a greater degree of credit discipline among big borrowers to ensure that their drawals were minimum and essentially need-based.

1.7 As a result of these various measures, the sectoral distribution of credit has undergone a marked change in favour of small borrowers. The share of large and medium industry and wholesale trade in total credit has gone down from about 80 per cent in 1968 to about 60 per cent at present. Correspondingly, the share of priority sectors (agriculture, small-scale industry and other small borrowers) has increased from 13 per cent to 30 per cent of total non-food credit (excluding advances given for food procurement). The exports sector now receives about 11 per cent of the total credit as against 6 per cent in 1966. The credit requirements of the public sector undertakings are attended to on a priority basis. The banking system was called upon to finance massive food procurements. At the end of March 1977, the outstanding amount was about Rs 2,300 crores or 16.6 per cent of the total advances.

1.8 Finance provided to the agricultural sector has increased from about Rs 67 crores in March 1968 to Rs 1280 crores in March 1977, accounting for about 10 per cent of the total credit as against barely 2 per cent in March 1968. The number of borrowal accounts increased from a few thousands in March 1968 ~~are~~ to around four million in March 1972. It should be noted that the credit given by banks to agriculture ~~is~~ will soon reach ~~almost o~~f the same magnitude as that of the co-operative movement which has been in force for over seven decades. The case studies undertaken in banks on the impact of bank finance to agriculture have revealed that such assistance has helped considerably in generating production and employment opportunities. Equally significant is the dispersal of bank credit among a large number of other small borrowers, such as retail traders, transport operators, small businessmen, etc. In March 1968 such borrowal accounts with banks were less than 50,000 but to-day they are in the neighbourhood of about 1.3 million. Bank lending has now been attuned to ensure that any viable productive endeavour which can generate employment and income would not suffer from want of credit, regardless of its size.

1.9 The total number of borrowal accounts which was around 1 million in 1968, has spurt to over 7 million at present. The average size of the loan has gone down from Rs 27, 194 per account in March 1968 to Rs 13,936 in December 1976. Excluding advances to industry, the average size of a loan works out much smaller viz. Rs 5,798 as against Rs 9,495 in 1968.

1.10 The large network of bank branches has provided institutional savings media to the rural community. Banks have framed attractive deposit schemes tailored to suit the rural needs and have succeeded in mopping up substantial rural savings. Deposits mobilised by new rural offices amounted to Rs 665.61 crores at the end of December 19 which would have been largely frittered away in the absence of a proper institutional saving facility. Deposit accounts in rural areas have increased from 46.70 lakhs in December 1972 to 99.69 lakhs at the end of 1975. Total deposit accounts with the banking system have more than doubled from 349 lakhs in December 1972 to 703 lakhs in December 1975.

1.11 During the period between 1967 and 1977, Indian Banks added 58 overseas branches, taking the total to 94. In addition to many known advantages, these branches helped to improve profits of their banks.

1.12 Considerable organisational efforts and planning became necessary to cope with the large scale expansion of branch offices. The entry into new fields of activities which in the initial years are likely to be low or non-profit yielding for obvious reasons had to be ensured without impinging on the needs of the other sectors and also without affecting the confidence of depositors. It is an acknowledged fact that banks have acquitted themselves creditably in this task.

1.13 These admittedly far reaching reforms unparallelled in the history of world banking were, however, achieved at a price. The large scale branch expansion programme exerted severe pressure on manpower resources of banks. Trained personnel to man the increasing number of branches was lacking. Although training and orientation programmes were stepped up, they fell short of requirements. The absence of properly organised management information system (MIS) and the lack of timely feed-back widened the communication gap between the head office and branches. Added to these constraints were decentralisation of powers and delegation of authority which were not accompanied with a proper system of the head office control on branches in remote areas. This had its inevitable impact on productivity and efficiency at the branch level.

1.14 While the operational costs of the banking system have increased steadily partly owing to factors beyond the control of the bank management, no systematic attempt has been made so far to adopt scientific methods to improve productivity and efficiency in the banking system. Individual efforts made in this direction are scattered and their impact is marginal. Banking has to emerge as a 'viable' and not 'subsidised' means of achieving the national policy objective. The banking system has to take immediate steps for improving efficiency and profitability. To the extent that banks are able to improve profitability, their capacity to undertake promotional responsibilities would be greater. Further, lending for new activities should be taken as a search for new markets rather than a mere social obligation. Banks are set to make increasing use of the marketing techniques which have become accepted management tools for the banking industry in developed countries.

1.15 Banks have to conduct their operations within the framework of sound banking canons. Granting that promotional activities may in the initial stage cause the rate of return to go down somewhat, in course of time, social investments should become economic investments and start paying returns. In this context, it is worthwhile to recall what the National Credit Council's Study Group on 'Organisational Framework for Implementation of Social Objectives' headed by Prof.D.R. Gadgil had to say : "The Group was of the view that an element of subsidy should not be mixed up with banking business. Apart from such promotional expenditure as a credit institution can and should undertake, the subsidisation, though desirable because of national policy in favour of any category, should come from the State or any other proper authority giving the subsidy, either directly or through the banking system, by making it possible for the banks to lower their normal charges".

1.16 Banks also did not take adequate cognisance of their reduced choice in deployment of funds in planning their business. Under the anti-inflationary monetary policy pursued since 1973, the pre-emptive uses to which bank funds have to be put have increased. The statutory liquidity ratio was raised in stages between 1972 and 1976 from 28 per cent to 33 per cent and the reserve ratio from 3 to 7 per cent in 1973 and is currently prescribed at 6 per cent*. These are low yielding assets and therefore affect banks' earnings. In addition, there are priority and preferred sector advances including advances for food procurement, public sector undertakings, export credit and the Differential Interest Rate Scheme - on all of which the yield is low. What is more, the servicing charges of small accounts are high, thus adding further to the banking costs.

* This does not include 10 per cent of the incremental liabilities impounded since January 15, 1977.

1.17 The statutory pre-emptions currently add up to 39 per cent of banks' resources. Of the remaining 61 per cent deposit resources, over 48 per cent are to be deployed under policy direction in the priority and preferred sectors on which the return is low. It is thus obvious that the choice of banks in levying interest charges (subject to the maximum of 16.5 per cent) to cover up costs is limited only to about 13 per cent of their deposit resources. The following table illustrates how a bank deploys its deposits of Rs 100.

	Outstand-ings	Percent to aggregate deposits
	(As on March 25, 1977) (Rs in Crores)	
I. Aggregate Deposits	17557	100.0
1. Cash on hand	358	2.0
2. Balances with RBI	1146	6.5
3. Investments in Govt. and other approved securities	5539	31.5
4. Credit for food procurement operations	2190	12.5
5. Credit for public sector undertakings	1438	8.2
6. Credit for priority sectors in the private sector	3475	19.8
7. Credit for Exports +	1171	6.7
II. Total of 1 to 7	15317	87.2
III. Balance (I - II)	2240@	12.8@

\+ There may be a small element of double counting as between items 5, 6 & 7 but this will not materially affect the dimensions indicated.

@ The balance will be somewhat higher if account is taken of the rediscounting and refinancing facilities.

1.18 The deposit mix in recent years has changed more in favour of term deposits with longer maturities which carry higher costs. Thus, while the cost of resources has constantly gone up, the choice for earnings has been reduced with the increasing proportion of low yielding assets. This is a real dilemma before the banking system.

1.19 The manner in which trade union relations were handled in the banking industry often led to undermining the management control. In the absence of sufficient business at rural branches - at any rate in the initial stage - a number of offices could not be made viable. In the process the customer service has suffered. The Interim Report on the Customer Service observed, "There is a general feeling to-day both amongst bankers themselves and in the public at large, that customer service rendered by banks leaves much to be desired, and in certain respects has indeed reached a very low level"*.

1.20 The increase in capital funds could not keep pace with the phenomenal growth of business. The owned funds of banks (capital + reserves) as a proportion of their total deposit liabilities formed only 1.5 per cent in December 1976 as against 2.3 per cent in December 1969 and 3.4 per cent in 1961. Considering the acceptable norms in international banking, the capital base of Indian banks appears meagre. As a result Indian banks are put in an inconvenient or disadvantageous position when it comes to important dealings in the field of international banking.

1.21 The charges levied by banks to their customers on various services such as drafts, T.Ts., remittances, collection of bills, etc. do not have any scientific basis nor are related to actual costs. There has been a lot of adhocism in these and there is no uniformity.

1.22 At present there is no way of knowing how one bank compares with others in performance or even within a bank, how a branch X compares with a branch Y or Z. The need for evolving a measuring rod with agreed common norms of efficiency and performance has been felt for a long time but nothing much has been done to devise criteria for measuring relative performance ~~efficiency~~. Similarly, a great deal of work needs to be done to rationalise systems and procedures both for the industry as a whole and within a bank.

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* Working Group on Customer Services-Interim Report.

1.23 A review of the work relating to efficiency, productivity and profitability done since the publication of the Saraiya Commission Report suggests that except for individual efforts in some banks nothing much has been done. For the industry as a whole the Interim Report of the Study Group on Customer Service deserves special mention as Customer satisfaction depends upon the efficient service rendered at a reasonable cost. Following the recommendations of the Study Group to frame 'Guidelines for Follow-up of Bank Credit' banks have been endeavouring to bring about a measure of financial discipline among big borrowers. Banks are also improving their planning and information system which would enable them to put their scarce resources to the optimum use. Under the auspices of the Indian Banks' Association, banks have made some joint efforts to solve specific problems such as prescribing the ceiling on inter-bank call money rates, penal rates and service charges and inter-bank remittances. Given a proper framework, it becomes easier to resolve the problems affecting banks' productivity, efficiency and profitability.

1.24 It was, therefore, felt that the banks should make every effort on a continuing basis to bring down costs and improve operational efficiency which alone would form an enduring basis for sustained profitability in the long run. Banks should seek to adjust their lending rates in a rational and viable manner so that such adjustments do not become a mere profit-making proposition, resulting in indifference to the building up of greater efficiency. What is really needed is that the interest adjustments should reflect the basic policy objectives; at the same time there should be a systematic and continuous search for innovations to bring about cost reduction and better operational efficiency.

1.25 Against this background Reserve Bank constituted a working group to examine the question of cost control, operational efficiency and bank profitability. Accordingly, the Working Group on Banking Costs, Operational Efficiency and Profitability of Banks (known as PRODUCTIVITY, EFFICIENCY AND PROFITABILITY (PEP) COMMITTEE ON BANKING) was constituted on April 12, 1976 with the following :

(1) Shri J.C. Luther, (2) Shri V.V. Divatia, (3) Shri A. Raman, (4) Shri P.N. Khanna, (5) Shri S.R.Avadhani, (6), Shri O.T.M. Nambiar, (7) Dr (Kum.) Meenakshi Tyagarajan and (8) Shri C.S. Ramachandran.

The terms of reference of the Committee were as under :

(i) to suggest practical and realistic criteria for the evaluation of the performance of individual banks with reference, inter alia, to the fulfilment of socio-economic objectives of national importance;

(ii) to determine the basis for assessment of cost of various banking services;

(iii) to plan and organise a systematic survey to provide estimates of average cost and income in respect of the different functions undertaken, taking into account the special features of each of the large and medium sized banks, groups of small banks, and select types of branches;

(iv) to provide guidelines on the pricing policy of banks in relation to the services rendered to the constituents;

(v) to suggest internal systems and procedures to control banking costs, improve operational efficiency, productivity and profitability of banks; and

(vi) to advise on the nature of cost studies which may be undertaken by individual banks for evolving standards for cost control, rationalisation of service charges and evolving suitable methods for profitability analysis of branches.

1.26 The Group was authorised to take such assistance of specialists from other institutions including banks, Indian Banks' Association and the National Institute of Bank Management as might be considered necessary. The Committee was expected to take into account the recommendations on banking costs, operational efficiency and profitability of the Banking Commission.

<u>Approach to work</u>

1.27 A detailed questionnaire covering all aspects of commercial bank operations was issued to the scheduled commercial banks. The questionnaire was also sent for comments to the Principals of Staff Training Colleges of banks and some important institutions and individuals. Some members of the Committee had discussions on issues arising from the questionnaire with the executives of public sector banks and some of the larger private sector banks. The questionnaire met with good response and the material received was sifted, collated and analysed by the Secretariat of the Committee.

1.28 The Committee undertook certain studies having a bearing on the terms of reference. A technical sub-committee headed by Shri V.V. Divatia was constituted for this purpose.

A banking costs study was organised, covering about 1000 branches of 21 selected banks. The objective of the study was to estimate the cost of servicing various activities of banks. The study involved the collection of relevant information through suitably designed schedules on cost and output data from the selected branches and the time spent on various activities by staff members in each of the selected branches. The technical sub-committee had meetings with representatives of the banks selected for study and the Managers of the more important branches included in the sample, to explain the scope of the study and type of reporting required from staff members. The Secretariat of the Committee followed this up with personal visits to some of the selected branches. Over one lakh returns were received from the selected branches; these were processed on the computer and the results tabulated and analysed by the Secretariat.

The Committee also undertook a study on loss incurring branches of banks, in collaboration with 5 nationalised banks. The other studies undertaken by the Committee included (i) the scope for mechanisation and computerisation of banks and (ii) an exhaustive analysis of the earnings and expenses of banks.

1.29 The time schedule originally prescribed that the report should be submitted by the end of September 1976. As a result, with the limited staff and time at the disposal of the Committee only a few studies could be undertaken with the help of exports in the respective fields. Particular mention should be made of the reports prepared by Shri Rameshwar Thakur, Chartered Accountant, on annual accounts of banks, statutory audit and tax laws and Prof. Bhattacharya of Indian Institute of Management Ahmedabad on market segmentation.

1.30 The Report of the Committee is divided into 12 Chapters. Chatper I traces the background against which the Committee has reviewed the problems arising in the fields of costs, productivity, efficiency and profitability. Chapter II deals with planning, budgeting and marketing In Chapter III, the problems regarding the Bank Management Information System are discussed and a scheme is drawn up for the purpose. Chapter IV outlines the issue arising out of evolving criteria for measurement of performance of banks and a model is suggested. Chapter V is devoted to accounts, audit and taxation. Chapter VI reviews the trends in earnings and expenses of commercial banks.

<u>Chapter Design</u>

Chapter VII deals with the Survey on Banking Costs conducted by the Committee and analyses the results of the said study.

Chapter VIII incorporates suggestions for changes in systems and procedures for improving efficiency and reducing costs.

Chapter IX deals with the operational and procedural aspects covering simplification of the cash remittance system, arrangements for speedy destruction of soiled notes, setting up of more currency chests, etc.

Chapter X is concerned with problems of bank and branch profitability. It also incorporates some recommendations regarding transfer pricing based on the study on 'loss incurring branches'.

Chapter XI covers various aspects of pricing of services with special reference to costs and return.

Chapter XII gives a resume of the Report with important recommendations.

Among the important considerations the Committee had kept in view, special mention should be made of three. One, the scheme of recommendations is such that it could be implemented irrespective of monetary policy changes. Two, the accent of the Report is on the future. The aim is to ensure the healthy growth of the banking industry such that in the coming five to ten years' period, it can meet effectively the emerging challenges. Three, although in western countries, accounting procedures of banks are more or less fully automated, the Committee has not gone into this area in view of the fact that our economy, having surplus manpower labour intensive methods are generally preferable. All the same it has expressed views on some of the aspects of banks' work which need to be oriented to computerisation and mechanisation, with the ultimate object of making banking management system as prompt and effective as possible.

1.31 The Committee received considerable assistance and co-operation from a number of institutions and individuals. The Committee would like to thank them all. In particular, the Committee wishes to thank the Chairman of the State Bank of India for the active help and co-operation extended by the Bank for the Committee's work. Besides providing space for accommodating the cost unit of the Committee's Secretariat in the State Bank of India premises, the Bank spared the services of Shri A.V. Ramanathan, a Senior Official from the State Bank of India to assist the Committee exclusively in its work. The Bank also gave necessary programming and computer support for processing of the cost data. But for this generous help, it would not have been possible for the Committee to complete the work within the limited time available.

Acknowledgements

1.32 The Committee also wishes to thank the Chairman and senior executives of all the banks for the valuable suggestions given by them in their replies to the questionnaire issued by the Committee. The Committee also had thebenefit of discussions with them from time to time on the various issues covered by the terms of reference.

1.33 The Committee wishes to place on record its deep appreciation of the contribution made by Shri A.V. Ramanathan (State Bank of India). He assisted the Committee in planning and organising the Cost Study and in evolving the structure of service charges and the pricing formula recommended by the Committee. He was also associated with the drafting of the Report. For all practical purposes, he functioned as a member of the Committee.

1.34 In the formulation of ideas and in the drafting of the Report, valuable assistance was given by Dr. A.C. Shah (Bank of Baroda), Smt. R. Ramani and Shri P.N. Joshi (Bank of India) and Shri R. Narayanan (Indian Overseas Bank).

1.35 Shri P.L. Tandon, DirectorGeneral of NCAER, Shri S.G. Shah (Indian Banks' Association), Shri S.N.S. Raghavan (Grindlays Bank) and the Faculty members of the National

Institute of Bank Management offered constructive suggestions relevant to the work of the Committee. The Committee wishes to place on record their grateful thanks to them.

1.36 Some institutions and individuals prepared papers on specific projects for the use of the Committee. The Committee wishes to thank them all and in particular Shri Rameshwar Thakur of Messrs Thakur Vaidyanatha Iyer & Co. and Profs. S.K. Bhattacharya and A.H. Kalro of the Indian Institute of Management, Ahmedabad.

1.37 Some of the Committee members had informal discussions with Shri P.G. Damle, Director General, Overseas Communications Service on the feasibility of improved communication in banking. He offered constructive ideas in this direction and outlined a scheme for the same. The Committee wishes to place on record their grateful thanks to him.

1.38 The Committee is also grateful to Shri V. Subrahmanyan, Principal, Reserve Bank Staff College, Madras for the facilities extended for the meetings of the Secretariat of the Committee.

1.39 The Committee places on record the valuable work done by the Secretariat (list appended) in the Credit Planning Cell. The Committee also places on record its deep appreciation of the excellent work done by the Member-Secretary Shri C.S. Ramachandran in organising the work of the Committee, collecting and analysing the material required for the preparation of the Report and in co-ordinating the work of the Group through its various stages of deliberations.

1.40 The Committee records with profound regret and deep sense of loss the sudden demise of Shri A. Raman, a member of the Committee. The Secretariat of the Committee functioned from the Credit Planning Cell of which he was in charge. The Committee had the benefit of his expertise and valuable guidance in the planning, co-ordination and organisation of several aspects connected with the Report.

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CHAPTER II

PLANNING, BUDGETING AND MARKETING

2.1 The operational efficiency of banks can be enhanced significantly if they make effective use of planning and marketing techniques. Although most of the banks are undertaking the planning exercise, in terms of coverage, reliability and methodology, there are wide variations.

2.2 To start with, a business plan or performance budget requires that the progress for the coming year should be

The need for a business plan

planned sufficiently in advance in respect of major activities such as deposits, advances, investments, branches, staff, capital expenditure, earnings, expenses and profit. The rationale behind the exercise is that banking operations should be reoriented to provide better service and to obtain the maximum business growth by adopting a market approach. The performance budget helps the management to proceed along the projected goals and the performance evaluation at monthly or quarterly intervals indicates the deviations and corrective action that should be initiated. The budgetary method also helps to keep control on cost factors, promotes a feeling of cost consciousness and enables a judicious use of scarce resources. Further, it helps in promoting healthy competition between branches and evaluating the adequacy or otherwise of the existing policy and procedures.

2.3 Granting that the planning system may differ from bank to bank as regards priorities, techniques, sequence

Basic steps required

of events and the like, there are certain basic steps which will have to be taken if planning in a bank is to become meaningful:

(1) The exercise of planning should begin fairly in advance before the year starts - say in September-October. By this time the economic scene becomes clear with the completion of the monsoon. It is necessary to prepare an economic outlook for the coming year, analyse its implications for the banking industry in terms of the likely monetary policy, credit demand by borrowers and deposit growth and then study the bearing of the likely developments in the economy as well as the banking industry on the unit for which the plan is being prepared. Further, there are certain general guidelines which are available from the Reserve Bank's credit policy as well as credit budget discussions. Here it is not so much the various estimates which are important as the critical understanding of them. Once this task is completed, based on it, the Chairman should issue policy guidelines for business growth in the coming year. The statement should give a brief review of performance during the current year, compare them with goals and targets laid down earlier and draw appropriate lessons. It should then mention clearly the new shifts in policy and introduction of new programmes. At the same time it is useful to give some broad ideas of the likely behaviour of main indicators. This is a starting point for the operating heads to begin their exercises. They know the thinking of the top management, the framework within which individual operating head will have to prepare their own budgets and the special factors which they will have to bear in mind. The policy statement is designed to promote discussions at different levels. It is not rigid or irrevocable.

....3.

(2) It is advisable to provide a uniform format with the help of which branches could collect essential data. The format should be so designed that in addition to data, qualitative information in regard to important problems could also be collected. The branch Agent/Manager should discuse with his own staff, estimates of business growth, problems and their solutions. This should be followed by a well-planned and purposeful dialogue between the regional authorities on the one hand and the branch manager on the other. There should be a two way traffic. The greater the participation of the branch manager and his team in the preparation of the plan, the better would be the quality of a plan and its implementation. This process is sometimes called settlement of budgets - at the branch level, the regional level and the head office level. This process should generally be over by February when all estimates for the previous year are also made available for incorporation.

(3) The performance of the plan should be reviewed at least every quarter and its report should be available to the regional heads for their action. However, the mid_year review should be more comprehensive, when the opportunity should be taken to introduce necessary changes in the light of the performance during the first half year.

(4) There should be an agency at the head office which co-ordinates the work in regard to different aspects of planning, prepares outlook reports, collects the required information from the regional heads, gives shape to the final plan and draws up the review reports from time to time, suggests necessary changes to be made in the course of implementation and above all provides continuous direction and guidance to the operating heads.

The regional offices should also have Planning Cells which could help them in building up the information systems and preparing plans on the basis of budgets of individual branches.

It would be advisable to entrust the plan work to the Economic and Statistics Department. Where the planning work-load may be very heavy, a separate Planning Department may be established but even here too this Department may be closely associated with the Economic and Statistics Department. The Planning Department would have continuous liasion with operational departments without which it would be difficult for it to function. The heads of planning departments should have informal but regular exchange of ideas and information with the Credit Planning Cell of the Reserve Bank of India. This will go a long way in building up the informed opinion and improving the quality of planning at the bank level.

(5) The annual budgeting or planning system will have to be started in two ways, one, activities like branch expansion, recruitment and training, new schemes and programmes spill over a longer period than one year. - As a result, a perspective plan (also referred to as long range or strategic planning) will have to be prepared. The time perspective for such a plan may initially be a three or five year period, with details worked out for the first year and broad magnitudes indicated for the subsequent years. The emphasis here will be on direction rather than quantification. Two, there are certain functional, critical or geographical areas which require medium term plans of action, such as the work in the field of agriculture, small borrowers, rural branches and lead districts. Special studies will have to be conducted to evaluate the experience and formulate appropriate development strategies.

...5.

2.4 In recent years, banks the world over are making an increasing use of marketing approach. It is recognised that market segmentation leads to better planning of resources and operations, more meaningful control, development of specialised schemes and consequent provision of better quality customer services, clearer focus towards market penetration, direction and thrust. In our own country, the tremendous expansion in branch network, the introduction of great diversity of banking services arising out of national policy of providing funds to priority and neglected sectors, rationalisation and controlling credit allocation to large industrial houses were somehow bringing about new understanding and insight amongst bankers relating to different market segments. If the diversity of the markets is ignored it is possible that market opportunities represented by unfulfilled customer needs might be ignored and lost.

<u>Market Segmentation</u>

2.5 Segmentation, therefore, is basically an attempt towards a more precise definition of the nature of the markets served and for improving the understanding of the nature of the customer needs. Segmentation can be meshed with performance budgeting and information system for developing targets of desired performance in each market segment consistent with the potential, and also for providing information, comparing actual performance with targets. In the process, segmentation leads to more efficient allocation of resources and better management planning and control for taking remedial action where actual performance is out of line with the desired level of performance. Such a market segmentation-oriented planning and information system will lead to better analysis and appraisal of performance and add considerably to the management's ability to respond decisively and quickly to changing market segments. Realising the importance of this approach, the Committee requested Prof.S.K. Bhattacharyya of the Indian Institute of Management, Ahmedabad to prepare a special study on the subject. The Committee is broadly in agreement with the recommendations made by him. In particular, it would like to draw attention to the scheme of market segmentation suggested by him for Indian Banks. According to him, the most appropriate market segments in respect of operations of most large commercial banks in India would be:

(a) <u>Commercial and Institutional (C&I)</u>

The segment will essentially be composed of medium and large size industries and institutional customers like Municipal, Government and some autonomous bodies, societies, trusts, clubs, etc. There are several reasons why C&I banking operations can be deemed to be reasonably similar in terms of following attributes:

- impersonality of ownership
- nature of the banking operations (though it is slanted in favour of credit in commercial sub-segment and deposits in the case of institutional sub-segment)
- manner and mode of operation of accounts
- volume of transactions
- skills required for analysing, processing and meeting the demands for credit

(b) <u>Personal Banking</u>

This segment is relatively easy to identify in the sense that it represents individuals who wish to have deposit facilities from which they can periodically withdraw money and use banking facilities for meeting their personal needs of making payments, remitting money or transferring funds from one place to another. Some of the distinctive attributes of the segments are:

- Personal or individual operations of the account
- The size and nature of operations of the account
- The kind of services required
- The promotional requirements

(c) <u>Agricultural Banking</u>

In this segment, the customers are essentially concerned either for obtaining funds for carrying out agricultural operations or depositing funds arising out of such operations. The relative attributes of the sector are:

- The operations arising out of agricultural or related activities
- The nature, timing and the size of operations
- The skills required for analysing, processing and meeting the demands of credit

(d) <u>Small Industries and Small Business (SISB)</u>

The customers in this market segment are essentially individuals or from small firms which carry individualised business operations or entrepreneurs who earn their livelihood from carrying out personalised occupations like taxi drivers, shop keepers, etc. The attributes in relation to particular segments are:

- The ownership pattern of business operations
- The size of demand for funds
- The nature of customer operations
- Skills required for analysing, processing and meeting the demands for credit

Depending upon the workload, small industries and small borrowers could be divided into two separate segments.

(e) Export and International Banking

The customers in this group are either export houses who organise export activities on behalf of companies in the group to which they belong or outside companies which account for substantial exports or are concerned with supplying services which are critical in terms of exports e.g. shipping, etc. The relative attributes of this market segment are:

- The speed with which demands for funds have to be processed
- The close interlinkage of business operations with regulatory provisions relating to exports, etc.
- The nature, size and timing of funds required
- Skills required for analysing processing and meeting the demand for credit
- The inter-relationship with operations in the home market in respect of goods and services also produced and sold within the country.

(f) Banking Services

The customers in this segment - individuals, companies and institutions - are those who wish to avail of the specialised banking services relating to collections, remittances, transmission, foreign exchange facilities etc. The distinctive attributes of this segment are:

- The sporadic nature of payment
- The specialised skills required for meeting the needs of customers' services
- The substantive requirements of knowledge of procedures and systems as distinct from appraisal skills

2.6 The Committee recognises that the above market segments are not immutable for all times. In fact, segmentation must be a continuous process ensuring that changes

The views of the Committee

are made in the constitution of segments as and when the market composition, the nature of banking services demanded and the external environment which influences customer behaviour change. It would not be advisable to constitute market segments in a bank where the relative skills, personnel, etc. are scarce or available on such a limited scale so as to create problems of inadequacies of service if the constitution of market segmentation leads to greater customer demand. As regards the question whether segmentation can be introduced uniformly in all units beginning from very small branches to the head office, it is necessary that the criteria of size and future potential have to be applied with imagination. It would be obviously inappropriate to constitute market segments in small branches. On the other hand, segmentation would clearly be desirable and necessary in respect of very large branches. In the remaining category of medium branches dealing with several market segments it would be desirable to create segments only in respect of those market segments which are substantially large, for example, small industries in the industrial estate branch. The corollary of this would be to lump together other segments in such branches as generalised banking services.

2.7 It should be emphasised that segmentation will provide to Indian banks many new benefits by way of development of specialised skills, systematic and methodical exhibition of potential for growth and development, formulation of segmental policies leading to better customer service and satisfaction, cost efficiency, organisational effectiveness and purposive and meanigful management planning and information. The fact that segmentation would also necessitate changes in accounting systems would have to be recognised and appropriate action taken in this regard even prior to the introduction of segmentation.

2.8 Banks are required to prepare credit budgets as per the guidelines issued by the Credit Planning Cell of the Reserve Bank. The credit budgets focus attention on resources and their deployment in a given period.

<u>Credit Budgeting</u>

Sectoral deployment of credit is projected in detail, giving sector-wise and industry-wise allocations. Banks are expected to have detailed dialogues with their major industrial and trading borrowers to get an inkling of their business intentions and credit requirements. They arealso expected to sutdy in detail developments in industries where their advances are substantial, in particular the sick units, if any.

2.9 The Reserve Bank holds discussions with major industries and business organisations and thereafter discussions are held every quarter with individual banks on their own credit budgets to bring about proper integration between credit requirements of industry and business organisations on the one hand and banks' credit budgets on the other. The Reserve Bank then frames an overall credit plan for the country as a whole, taking into account the bank's individual credit budgets, likely increase in agricultural and industrial output and such other economic indicators as the tolerable limit of money supply, the price situation, national policy objectives, priorities etc.,

2.10 This exercise is being carried out during the last three or four years. Year after year necessary changes are being made. Recently, as a further refinement of the credit budget exercise, banks have been asked to prepare quarterly credit budgets and as a further dimension to the BSR system of reporting introduced in December 1972, a monthly and even weekly Monitoring Returns have been introduced. It would be pertinent here to mention that although the BSR system has met with some success, the statistical base both at the individual bank's and in the Reserve Bank is still very weak and substantial improvement in this field is called for so that data could be available on time and in better quality to be helpful for evolving a more realistic credit plan.

2.11 Speaking on the occasion of the Annual General Meeting of the Indian Banks' Association on May 28, 1977, the Reserve Bank Governor, Shri M. Narasimham summed up the situation as follows:

"For some years past, the Reserve Bank has been trying to inculcate in banks the need for a proper budgeting of their credit in the light of resource availability. Credit planning as a national exercise itself has not ... taken deep or firm enough roots. The Reserve Bank itself is concerned with this. So is the Government. I suggest bankers also should apply their minds to this problem and work out in consultation with the Reserve Bank the manner in which, what one might call, the macro-decisions on credit planning can be meshed with micro-decisions on credit disbursement at the individual bank or branch level. It is only in this way that the decisions regarding sectoral deployment or regional allocation of credit can make their effective impact at the field level. If banking is to become what we all wish it to be, a viable and potent instrument of economic transformation, the role of banks in distributing our scarce credit resources against the many competing demands on them, in accordance with the national and rational priorities, becomes important".

2.12 The Committee is constrained to observe that the work of business planning and credit budgeting is done in most of the banks in a haphazard and disjointed manner. There is no proper appreciation at the top management level in banks of the precise purpose and significance of planning. The plan is often taken as a once for all exercise. No effort seems to have been made towards preparing a Credit budget which reflects the Consensus of the various departments of a bank, the credit budget has still not emerged as a document prepared after fullest internal discussions and accepted by all concerned in the Bank. The credit budget does not represent a continuous process of thinking and evaluation of policies to observe the accepted targets in the Plan.

2.13 The Credit budget has to be an integral part of the performance budget/business plan. The two refer to different time periods - the credit budget relating to the financial year and the performance budget to the banks accounting (Calendar) year. There is also some difference in focus; while the credit budget is concerned mainly with the regulation of credit flows in line with the policy objectives of the Reserve Bank, the performance budget has some wider implications, including those of corrections of regional imbalances, consideration of profitability, man-power planning etc. However, since the basic objective of budgeting - whether for "credit" or for "performance" - is for a planned approach to a bank's operations, there has to be a high degree of consistency between the two. For instance, the performance or business plan has to fit into the framework of the credit policy, taking account of all constraints on resource deployment. Often the business plan of the bank and the credit budget submitted to the Reserve Bank are unrelated and contain inconsistencies. The Committee emphasises that the banks must realise that their credit budgets at the bank level is a part of the overall credit plan and for this purpose, it is obligatory on their part to visualise macro requirements and national objectives and prepare their plans in a meaningful manner.

2.14 It is incumbent on banks to strengthen their organisational set up for planning not only at the head office level but also at the regional level. Banks' staff even at the grass root level should be properly motivated so that credit planning becomes a permanent way of life with banks. Organisational weakness are mainly due to inadequate appreciation by the top management in banks to accept planning as an operational requirement.

2.15 The planning competence should include not only proficiency in planning techniques per se but also the ability to adopt these techniques to suit the conditions of the industry as well as the unit, the capacity to co-ordinate at different levels within the organisation and a wider vision and understanding of the forces that are at work in the economy and the industry. It is essential to impart intensive training in planning methodology to those who are charged with that responsibility in banks. Concerted efforts will have to be made to cultivate the climate of acceptance of the plan at all levels and its effective implementation. This can be ensured by the top management through a series of dialogues with the staff at all levels as also by building up the two way channels of communication so that new ideas and programmes are not merely passed on to the staff down below but problems and improvements are constantly pushed upward in the system.

2.16 The Committee strongly feels that attitudinal change in the top management level of banks should be brought about to ensure wholehearted commitment of the top echelons to the planned approach to banking operations. Once the top management takes personal interest in the credit budget exercise, motivating the staff down the line becomes easy. Special training programmes, seminars and workshops explaining the significance, method and manner of credit budget at branch and regional levels need to be organised both at individual banks and at the national level training institutions. Motivating personnel would be possible only through intensive training and dialogues with bankstaff. Also, the syllabus for the CAIIB examination may include courses on credit planning and performance budgeting.

2.17 While these measures at the bank level would improve the planning machinery in individual banks, at the macro level both for providing guidance and for making the overall credit plan more realistic, it is necessary to initiate certain measures. Intensive efforts have to be made to study in depth the credit requirements of different industries to provide positive leadership to individual bank's credit planning efforts. Also, a better industry level, bank level and unit level coordination is called for. In order to make credit planning more effective, a long term perspective of banking parameters is essential. For this purpose, the Reserve Bank should undertake detailed perspective studies on important aspects of banking depicting likely trends over a period of the next ten to fifteen years.

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CHAPTER III

BANK MANAGEMENT INFORMATION SYSTEM

3.1 Any corrective or advance action in regard to productivity, efficiency or profitability presupposes knowledge on the nature and dimension of their problems. This is possible provided the concerned bank has a systematic and regular flow of information and its analysis. With the growing geographical and functional expansion of the banking system, the flow of information its timing and reliability - has become a real problem. It is with this aspect in view that the question of introducing Bank Management Information System (BMIS) has been discussed in this Chapter. So far no systematic attempts have been made to introduce it in most banks, despite the recommendations made earlier by the Banking Commission. The Committee is of the view that the BMIS should be accepted by all banks as an important management tool. The system and the manner of its introduction as well as co-ordination between the concerned bank and the Reserve Bank are discussed in the subsequent sections.

Background

3.2 It is necessary to trace the background of the problem of the BMIS so as to develop a clearer perspective for future action. The first attempt in this direction was made in 1957 when an inter-departmental sub-committee was appointed by the Reserve Bank of India to examine the various returns. However, the comparability of data collected in various returns still continued to be somewhat vitiated ~~visited~~ owing to differences in definitions of some items like capital, reserve, deposits, borrowings, etc. The result was the appointment of another committee in February 1966 under the Chairmanship of the Economic Adviser of the Reserve Bank. This Committee was asked to examine the returns submitted by banks to the Reserve Bank with special reference to the statutory requirements and with a view to securing consistency and uniformity in concept of various terms used in different returns and to reduce work-load on banks. Timely and correct reporting was al stressed. The Committee made a number of useful recomme tions taking into account the developments which had tak place in banking since 1957. Again, in 1968, the working group on banking statistics suggested the introduction of the return known as Uniform Balance Book (UBB) in respect of advances. The experience with UBB however turned out to be far from happy. The Banking Commission in its report made a detailed review of the present position of information flow in the banking system in relation to the information needs of the banking industry and made a numb of suggestions and recommendations for the introduction o Management Information System in banks. The observations made by the Banking Commission were based on the Report o the Study Group on 'Information System in the Banking Industry and Data Processing' of the National Institute of Bank Management and the Study Group on 'Banking Costs' set up by the Commission itself. Meanwhile, the Reserve Bank had set up another Committee on Banking Statistics to rationalise the process of reporting banking data (excluding data reported on statutory returns) to the Economic Department of the Reserve Bank. The outcome was the Basic Statistical Returns (BSR). The BSR system has considerably simplified statistical reporting, reduced the frequency of reporting and strengthened the data base in banks.

3.3 In the light of the experience gained so far, certain general observations can be offered on the statistical reporting of banks. In the matter of information systems, a kind of barrier has been in existence between the banks and the Reserve Bank, making for duplication, delays and even neglect or indifference in supplying the figures to the Reserve Bank. The reason ~~is~~ was that the banks themselves ~~have~~ had not felt involved or enthused to take special interest in the task of data collection and processing. The figures ~~are~~ were meant for the Reserve Bank, and therefore, they had to be supplied and that is all. Special efforts, regular machinery for collection of data, training in this field, attention to details have been lacking in a large measure, or in some cases even totally neglected.

3.4 Further, various departments of a bank called for the same or similar statistical information from branches, thus, increasing the work-load at the branch level. The situation continues uncorrected even now. The non-response or delays from branches are generally due to this fact. Certain forms introduced for specific purposes continue to be collected even when they have outlived their utility. What is more, particularly in respect of priority and neglected areas, returns have continuously increased without any attempt to rationalise or integrate them. With little statistical expertise, particularly at the branch level, comparability of data often suffers. When adjustments become necessary, say, for non-response of some branches, they are done on an arbitrary basis.

3.5 With the increasing developmental responsibilities, banks are frequently called upon to supply various types of information. The returns prescribed earlier for statutory and control purposes within a bank are no longer considered sufficient. The Reserve Bank, the Ministry of Finance and also the State Governments call for *ad hoc* information from time to time. In addition, the number of internal control or information returns has increased considerably in response to the rapidly changing banking scene.

3.6 These various aspects emphasise the need for an articulated system of data collection, wherein banks can also use the data at branch, district, region, state and Bank levels and the Reserve Bank as well as the Central and State Governments can also secure the data that they need. This gave rise to the idea of setting up of an integrated information system in banking. It is suggested that whatever data are collected by the Reserve Bank should not suffer any alienation but should form part of the bank's internal information needs. Appropriate feedback at various levels is also envisaged.

3.7 The Report of the Banking Commission made a major attempt to give a concrete shape to the Management Information System (MIS) in banks. It outlined the objectives of the MIS, the items to which it should relate, and the mechanism through which such a system could be effectively implemented and suggested a framework within which the returns, their periodicity, the sampling procedures to be adopted, reference dates or periods to which the returns related. This was the first time that the information needs for the banking industry was viewed as a whole. The framework set out still holds good although the BSR set of returns have replaced the UBB and other returns prescribed earlier.

3.8 As a follow-up, a National Level Steering Committee for MIB has been constituted in the Reserve Bank to oversee and guide the work of the information system in the banking industry. The Committee of Direction on Banking Statistics set up in the Reserve Bank of India after the introduction of the BSR is enlarged by the inclusion of banker members to give effect to the introduction of the MIS. The Committee finds that while some progress has been made in providing the feed-back, a proper integration between individual bank's requirements and the macro feedback has not yet materialised. With this in view it is envisaged to set up an Implementation Committee. It would work through Task Forces, one in each bank, which will go into the information system for individual banks. In a Seminar held on July 7, 1973, it was stressed that the statistical reporting system introduced by the Reserve Bank should form part of a much wider information system in banks and should be considered as an integral part of bank's operations. It must be added, however, that subsequent action on the part of the Reserve Bank and the banks has been slow.

BSR System

3.9 Following the Report of the Committee on Banking Statistics which examined in depth the problems of the statistical returns including the UBB, the BSR set of returns was introduced in December 1972. These returns relate to the non-statutory type and replace the earlier similar returns called for by the Reserve Bank in the Economic Department. The format of the BSR 1 Part A is on the style of the UBB. These forms have now been in vogue for over four years, and have achieved considerable success in terms of a high rate of response, although delays still abound. The machinery set up in the Reserve Bank and in the banks to expedite submission of returns by branches, the arrangement for feedback in a broad form at present and in some considerable details later on, the reduction in the frequency of submission of BSR 1 Parts A and B, as well as other returns and perhaps also the growing realisation on the part of banks' top management about the real need for statistical information -

all these factors have contributed to a fair measure of success of the new system. Attempts are being made by the Reserve Bank to provide the feedback in respect of the BSR1 right upto the district level. Similar feedback in respect of deposits (BSR2) can also be organised. A branch manager should be in a position to compare his performance in respect of deposit mobilisation and advances - particularly advances to priority sectors - by comparing his own figures (rates, ratios, levels, etc.) with a similar set of branches (similar in terms of the age of a branch and the population group to which it belongs) of his own bank and of all banks in his own district. Similar comparisons can also be made at higher levels and provision has been made for this purpose in the scheme of computer output.

Information System on Follow-up of Bank Credit

3.10 Another important development was the setting up by the Reserve Bank in July 1974 of a Study Group to Frame Guidelines for Follow-up of Bank Credit (or what is popularly known as the Tandon Committee). The Study Group's work is closely linked with the information system useful both to the banks and the Reserve Bank. The terms of reference gave a pointed direction to the Committee to suggest the type of operational data and other information that could be obtained by banks periodically from borrowers and by the Reserve Bank from the lending banks; to make recommendations for obtaining forecasts from borrowers of their (a) business production plans and (b) credit needs; and to make suggestions for prescribing norms for different industries and to indicate the broad criteria for deviating from these norms. It was also observed in the inaugural meeting of the Committee that the information system which provided the basis of communication between the borrower, the operating agency of the banks, the bank's head office and the Reserve Bank, "Should be so devised that it took care of the objective of credit supervision and also improved the responsiveness of the banking system to policy changes introduced from time to time".

3.11 The Study Group confined its attention to working capital finance as distinct from project finance and its recommendations on the subject of information system were necessarily related to the proper end-use of funds. For the first time, information system and operational aspects of credit management have been brought together. Another point of interest is that the recommended information system is in the nature of a 'monitoring' system rather than a set of statistical returns. It is intended to give more frequent (quarterly) data on a uniform basis for assessing certain aspects of credit operations of the borrowers in relation to their sales, costs, inventory norms, funds flow position, etc. Compilation of these data is not specifically suggested but it has been left to the Reserve Bank to consider what data it should call for to see that the information system works. Compilation of this information, now likely to become available on a <u>uniform basis</u> in all banks, would yield a rich store of meaningful data which can be analysed industry-wise, and to the extent possible region-wise. Recommendations to this effect are, therefore, made in the proposals set out in this report.

3.12 The basis of the information system recommended by the Committee rests on (1) a Quarterly Operating Statement (QOS) Forms I & II, (2) annual plan and (3) half-yearly proforma balance sheet and profit and loss account. The system is proposed for all borrowers with an aggregate limit of Rs.1 crore and above. The QOS asks for data on sales, cost of sales, profits, current assets and current liabilities in Form I, and on sources and uses of funds in Form II. The figures to be reported are in terms of the previous quarter's estimates and actuals, and the current quarter's estimates. The two forms taken together are expected to yield certain operational and financial ratios which can be judged against norms thereof. The deviations of estimates from actuals can be studied and reasons for wide divergence analysed. The annual plan statement is expected to give information for not only the past year but also the projected balance sheet, funds flow and the operational plan for the next year. This has to be submitted with the application for fresh limits or renewal. Against this plan, quarterly performance and budgeting have to be assessed.

3.13 The Reserve Bank has already taken action on these recommendations and has asked the banks to institute a system of recommended QOS forms as well as annual plan forms. Units with a total limit of Rs.1 crore and above are being covered. This work is being handled in the Department of Banking Operations and Development of the Reserve Bank and a Committee of Direction has been set up in this Department to oversee the working of this information system. However, the system is yet to take firm roots to become a tool of credit planning.

CAS Reporting System

3.14 So far as the operational aspects are concerned, the Reserve Bank relies mainly on the Credit Authorisation Scheme (CAS), for which information has to be supplied by the lending bank to the Reserve Bank in a prescribed set of forms for larger borrowers. Once the limits are authorised, no further information at regular intervals is being called for by the Reserve Bank except when the borrower seeks enhancement. Also, though ~~the~~ QOS information system is operative within the lending banks, and at the operational level in the case of large accounts, no regular periodic information on sales, costs, funds flow etc. is obtained and analysed by the Reserve Bank to build up the industry level credit planning. Regular submission of information in the CAS forms on an annual basis, the six-monthly Credit Information System return and collection of data submitted under the QOS forms would go a long way to stabilise the information system in the Reserve Bank and enrich the data base for analytical and policy formulation and review purposes. It would be possible to generate industry-wise compilations based on these QOS and annual data and compare the performance of any individual large borrower against the total industry-wise data-sets. Norms of inventory and receivables as well as other important aspects relating to individual borrowers could be compared. The idea should be not only to analyse the past but also to predict the future.

Monitoring Priority Sectors

3.15 The National Credit Council - an important outcome of the scheme of social control over banks - defined the priority sector for the first time for development of agriculture, small scale industries and other 'hitherto neglected sectors'. For monitoring the performance of banks in the fulfilment of socio-economic objectives, the Reserve Bank through the Department of Banking Operations and Development (DBOD), began to call periodical reports from banks, giving their advances position, as regards the stipulated categories of borrowers. In course of time, with the inclusion of data on the Village Adoption Scheme, Farmers Service Cooperative Societies, the Half-a-million Job Programme, the DIR Scheme etc., information requirements further increased. The introduction of the Lead Bank Scheme added a new dimension. Following the recommendations of the Reserve Bank Study groups on the working of the Lead Bank Scheme, a half-yearly statement is required to be submitted by banks to the Reserve Bank, giving districtwise details as regards the implementation of the Scheme. The proformae prepared by the Ministry of Finance also strive to attain the same purpose with the objective of keeping the district and state authorities informed about the progress in implementation of the Lead Bank Scheme, districtwise.

Signals for Sick Units

3.16 Of late, considerable stress is laid on evolving a system of 'signals' which would give advance indication of a unit turning sick. In respect of an already sick unit or irregular accounts, information should be such as to ascertain at frequent intervals whether the unit is benefiting from special limits sanctioned or special treatment given to it with a view to nursing it so that it reaches viability in as short a time as possible. The QOS system for monitoring data and a more careful scrutiny of the monthly stocks statements should provide with sufficient frequency, information to the banks for large sick units. No doubt, some qualitative data regarding the quality of management, the state of machinery, absolescence ~~absolence~~ content, market sentiments, etc. have to be separately obtained. An analysis of QOS data should also throw light on the question whether a particular large unit is likely to turn sick. In view of this, it is of utmost importance that apart from individual banks keeping track of sick or potentially sick units, the Reserve Bank itself should build up sufficient data files on individual large units - and particularly the sick or the likely sick ones - by collecting information through QOS forms and the CAS forms annually as also from term lending institutions. Handling of large sick units on a continuous basis cannot be left to lending banks alone. It requires an inter-institutional coordination system.

Specific suggestions

3.17 Having brought up-to-date the various stages of data development, it is possible to go on to the task of prescribing what the BMIS should be and how it should be operated. The information needs of the banking industry have to be studied against three relevant characteristics: (1) volume of data, (2) timing, and (3) reliability. The first factor becomes important so that banks are not burdened with the collection and processing of an unduly large volume of data. Specific suggestions in this regard can be made as follows:

(1) The National Level Steering Committee for MIS constituted in the Reserve Bank should be activised. The Committee of Direction on Banking Statistics set up for the purpose of implementation should also be activised. We understand that the Committee has taken up the work of organising Task Forces, one in each bank, which should go into the information system for individual banks. This work too should be speeded up.

(2) As a first step, the Task Force in the bank should organise a workshop to rationalise and streamline the internal reporting system. Participants in the workshop should be drawn from the cross section of the staff - Agents/Managers from smaller and bigger branches, Regional Managers, concerned functional heads from the Central Office as also invitees from the Implementation Committee. The workshop should be ~~preceeded~~ preceded by a thorough homework, which among other things, should systemactically list down all internal returns, the authorities which are calling them, their frequency, the purposes for which they are called for, as also the scope for dropping, modifying or changing such returns, reading of selected literature, etc. The Committee understands that similar work done in a few banks has resulted in curtailing the work load on branches to a significant extent. For this, training programmes organised in banks will have to be revamped.

(3) It is a common experience that priority sector returns have grown both in number and complexity. Further, many of the ad hoc returns called for at the Central Office also relate to these sectors. It is advisable to introduce a Master Statement in respect of each of the activities such as agriculture, small-scale industry, and other small borrowers. The data contained

in this Master Statement could be ~~shifted~~ sifted from different angles at the Central Office and the required statements to be submitted to the Reserve Bank or the Ministry of Finance without calling for fresh returns. It is better to resort to computer for processing data for different purposes. Simultaneously, the accounting system at the branch level in respect of such advances should be so organised that the required data should just flow as by-products.

(4) Different authorities ask for different types of data. There is hardly any co-ordination or cross checking. It is essential to centralise the data base in the Economic and Statistics Department of a bank. Except with regard to specialised types of information, it is this Department which should ask for, collect and compile all the information in the bank. It should be ensured that in banks where such departments are not well organised, the task should be taken up on a priority basis The specialised departments, having made use of the data they have collected directly, should pass on the information to the central pool. A similar arrangement should also be made at the regional level and the Statistics Department at the region should obtain a clearance from the central Economi and Statistics Department before introducing new returns. It is necessary to bring about a fair measure of uniformity in the returns called for by the regional offices within a bank.

(5) A wide variety of machines for data processing is being manufactured in the country. Every bank should draw a programme of mechanisation for a period of about three years. However, while resorting to mechanisation, they have to ensure the immediate absorption of the displaced labour and also provide the technical training facilities to the staff capable of taking advantage of such new developments.

(6) The Economic and Statistics Departments should not be satisfied with the mere calling of the information, compiling it and submitting to either the Reserve Bank or the Ministry of Finance. It should analyse the data either processed by the department or made available to it as a feedback by the Reserve Bank of India from the policy angle and forward important findings to the concerned operating heads in each functional area for necessary follow-up action. In many of the banks, the information flow at present is a one-way traffic. This must change. Depending upon the interest at the branch and the regional office, the information processed or analysed at the Central Office should be passed on down the line.

(7) If data are to have any meaning, they should be made available in time for any worthwhile use. It is important to distinguish data for monitoring which are needed for immediate purposes and data required for long-term planning and development purposes. The periodicities of submission of returns should be so arranged that the more important data particularly those needed for monitoring, are available at more frequent and timely intervals. Often a great deal of energy and money are spent and considerable time is wasted in getting accurate figures on 100 per cent basis where all this accuracy may not be necessary. Depending on the data needed and ti and resources available, sampling methods can be used, so that a known margin of errors can be stated.

<u>Objectives of BMIS</u>

3.18 Keeping the above considerations in mind, one may mention the following broad objectives on the lines of the Banking Commission Report which the BMIS is intended to serve :

For the Banking Sect

i) To ensure from time to time that requirements prescribed by the law relating to banking are satisfied;

ii) to ensure satisfactory implementation of the monetary and credit policy;

iii) to ensure a high level of operational efficiency; and

iv) to provide information to the general public regarding the working of the banking sector.

For the Reserve Bank of India

i) Management, regulation, effective control and supervision over the monetary and credit system, including debt management;

ii) management of the foreign exchange resources;

iii) meeting the special needs in respect of analytical, policy-oriented studies;

iv) informing the interested public about the progress of the banking industry; and

v) in the context of an integrated data structure, evolving a feedback system of the processed information in the form of meaningful tables to the banks and their branches.

Data Base in a Bank

3.19 The Committee has gone in detail into the various forms of information being collected by the Reserve Bank at present from banks and recommends the building up of a Bank Management Information System (BMIS) with the following data base :

- The statutory returns submitted by banks to the Reserve Bank
- The BSR set of returns

- The return prescribed for credit information scheme (six-monthly)
- Weekly return on the sectoral deployment of credit prescribed for monitoring the Credit Budgets of banks.
- The monthly return on advance prescribed recently for large accounts and a monthly return on deposits and credit.
- The QOS and annual statements to follow-up the end use ~~of~~ credit
- The set of return prescribed for the CAS (to be made a regular annual set of returns)
- The set of financial and other ratios, their frequency distribution, means, medians and 1st and 3rd quartiles compiled on the basis of the selected sample of public limited and private limited companies
- Company profiles for large borrowers on the basis of each company's balance sheet and annual accounts, the current statements and QOS and the CAS returns. This will serve as data bank in respect of large borrowers
- Other necessary environmental data for BMIS

3.20 The objective of quick monitoring can be met through the Weekly return on credit, the monthly returns on deposits and credit as well as the processed data relating to large borrowal accounts. The Reserve Bank should get copies of the quarterly QOS data through the banks and the processed data may be used for monitoring.

3.21 The data can also provide advance signals in respect of developing sickness in large individual units and help keep constant watch over units already gone sick. QOS and annual statements will enable the banks to compute ratios of inventories and receivables which can be compared with the norms set in respect thereof - industry by industry. The QOS will throw considerable light on the seasonality of the various ratios and estimates.

3.22 The above information system should provide tabulations at branch, district, State and all-India levels in respect of deposits, advances, remittances and other services. Information with regard to items on which special emphasis is being laid now, should also be derivable from the above set of returns and whatever changes in coding system (as suggested later) or minor changes in the formats of the BSR are necessary to obtain such information, should be made after a detailed examination. Opportunity should also be taken to streamline the flow of data in respect of advances as reflected in the BSR-1 Parts A & B, the Credit Information Scheme return, the weekly and monthly returns now prescribed by the Credit Planning Cell, data collected by the Credit Guarantee Organisation, the Credit Guarantee Corporation, etc., so that duplication, if any, may be eliminated. Apart from this, the information collected at different geographical and sectoral levels will also be provided.

3.23 As regards operational efficiency, the BMIS should first provide a feedback right upto the branch level so that each branch has a comparative picture of its own operations vis-a-vis operational magnitudes and rates and ratios at district, State, all-India levels for other similar branches of its own bank and all such branches of all banks. For weak branches, such comparisons should prove to be a spur to better progress.

Measures for the Reserve Bank

3.24 The Steering Committee on MIS should attempt to bring about uniformity in various terms and concepts as also methods of classification used by various departments/organisation of the Reserve Bank. Further, the reference dates for calling the information should also be uniform. The Committee of Direction should be entrusted with the job.

3.25 There should be better co-ordination in the Reserve Bank to back up the BMIS. To this end, inter-departmental arrangements will have to be streamlined. Whatever organisational strengthening is necessary in the Reserve Bank and in the head offices and regional offices of the commercial banks for the effective implementation of the BMIS should be done without any loss of time.

3.26 Now that the credit budget is done on a quarterly basis and banks have acquired some experience in handling the BSR, it may be possible for individual banks, if they deem it necessary to change the frequency from half-yearly to quarterly. However, for the system as a whole, such a change may take some time. The BSR throws up important data which could be put to various uses for control, planning and information.

3.27 Under Section 42 of the Reserve Bank of India Act, banks are required to submit every Friday a statement indicating important items of assets and liabilities. It is learnt that the cost of collecting these data by means of telegram/telex from a large number of branches spread far and wide in the country is quite heavy. Further, many number of the branches are not able to submit this statement within the prescribed period. As a result, in such cases, figures are to be repeated in view of the statutory obligation to file the return within five days. The Committee is of the view that this statement, instead of being called on every Friday, should be called on the second and last Fridays of every month. This would reduce the workload as well as the cost of branches, improve the timely submission and also ensure accuracy of data. In making this recommendation the Committee is also aware of the fact that money supply and other statements in the Reserve Bank's Weekly commercial report may have to be made fortnightly, instead of weekly as at present. However, the Committee feels that more accurate and reliable data are better than the data whose base is weak.

3.28 In order that identification of parties and processing of data are facilitated, it is imperative that banks should begin to appreciate the need for giving <u>Code Numbers</u> at least to large borrowers, to different types of sectors or segments to which credit flows or from which deposits are received. Banks have already exporter/importer Code Numbers, which system has facilitated the processing of foreign exchange receipts and payments data and carrying out matching exercises between regions and duplicate and triplicate CR forms. The Reserve Bank has also evolved uniform branch codes which have been instituted successfully and which can be further used on cheques and other documents as well. The Income-tax department has also codes of their assessees (although these are not being used for processing or crosslinkage purposes). Time has now come to make a beginning with the uniform code numbers for large borrowers which are mainly private corporations or public sector undertakings. Since large borrowers are only about five thousand in number, the task should not be difficult. Also, since they have accounts in a number of banks, it is necessary to have information on tap about the total outstanding bank credit according to types of facilities sanctioned. The uniform code of large borrowers would facilitate monitoring and compilation of data in the Reserve Bank through QOS and annual statements. Since large accounts are generally confined to larger branches, the latter should not find it difficult to adopt coding for large borrowers.

3.29 The large borrowers may be suitably defined and a beginning may perhaps be made with those having total working capital (including demand loans) limits of Rs.1 crore or more or with total term loans of Rs. 25 lakhs or more. Later on, these limits could be lowered to bring in more number of borrowers in the net of coding system.

3.30 So far as small borrowers are concerned, it needs to be examined whether those with limits of Rs. 10,000 or less can be correctly identified with a detailed classification of priority sectors. It also appears that the data regarding advances made to weaker sections of society cannot be aggregated even in BSR 1 Part B. The subject devised under the general classification of weaker sections will also have to be accommodated in the coding or classificatory system.

3.31 If the measures recommended above are implemented the BMIS would be given a good start and a sound foundation would have been laid on which future developments in the information system can take place.

CHAPTER IV

CRITERIA FOR EVALUATION OF PERFORMANCE

4.1 Banks are no longer guided by a mere profit consideration as was the case prior to nationalisation or even under the social control scheme. They are increasingly called upon to shoulder developmental and social responsibilities which inevitably lead to somewhat lower rates of return in the initial stage. In other words, profit has to be tempered with social purpose. How to bring about a healthy balance between the two is a question engaging the attention of the Reserve Bank, the Government and the bankers.

4.2 The discussion on the subject has thrown up certain basic considerations. It is agreed on all hands that banks should make enough profit to cover their costs, promotional expenses, build up a sound capital base and pay a reasonable dividend to the exchequer on the share capital held by the Government. Banks being business organisations, profit should continue to remain the basic consideration. At no time their operations should result in a loss and act as a drag on the Government revenue. The promotional activities which they are being called upon to undertake should not partake the nature of subsidy or grants which are the privileges of the Government only. The social investments which they make today in the rural branch expansion, in the diversification of credit in favour of small borrowers and in the development of backward areas should turn into economic investments tomorrow or day after and start paying reasonable returns. It would not be in the interest of either the banking industry or the economy to allow social investments to degenerate into economic losses. The essence of credit is that it is used productively. Thus, in the process, like the

Basic Considerations

quality of mercy, credit helps both, the borrowers and the lender. The credit once taken has to be repaid but in doing so the borrower has been able to generate some surplus with him. It needs to be emphasised here that the instrument of credit in our context has to be wielded positively and not passively. The past experience has shown that credit followed development. There are enough experiments in world of banking to suggest that credit should lead development. This is the essence of change in the role of credit in recent years. To perform this role, the banks should be strong and healthy. To the extent they are able to maintain sound health, their ability to undertake promotional responsibilities would be all the greater.

4.3 Any attempt to evolve appropriate criteria for the assessment of performance of banks will have to take the above considerations in view while striking a balance between economic viability and social benefit.

<u>Composite Index - Problems</u>

4.4 The concept of a composite index of operational efficiency and profitability has been developed in this chapter based on certain indicators which will represent the various aspects of performance of banks. Such an index does not have the felicity and smoothness of index numbers of prices and production. The difficulty starts with the meaning attached to the term 'Operational efficiency'. This difficulty can be compared to that which one encounters in defining the term capacity of an industrial unit when one attempts to construct the index of capacity utilisation. Added to this is the problem of choosing appropriate indicators of operational efficiency. These indicators must be relevant and quantifiable. It is no use having ethereal indicators for which it may not be possible to collect data. Also, the choice of indicators is usually a highly subjective one and the expert knowledge of the subject is necessary. Inasmuch as experts also differ among themselves, any chosen set of indicators is bound to evoke criticism of one sort or another.

4.5 The set of indicators chosen for the present study is given in Annexure A. It may be seen from there that the indicators have been broadly grouped under three heads (A)- Operational efficiency - Productivity, (B) - Operational efficiency with regard to the social objectives stipulated from time to time and (C) Profitability. The main considerations governing the choice of indicators under Group A are that banking being a highly labour intensive industry, the general performance of banks will be to a large extent reflected in the efficiency with which cash and man-power are managed. Labour productivity has been depicted in terms of both physical and monetary measures. The ratio of deposits to cash balances is taken as a broad indicator of the efficiency in cash management. Besides, mention may also be made of an index of the size of overheads in relation to working funds which has been included under Group A.

4.6 Coming to social objectives, the performance of banks into two distinct directions has been taken note of. In the first place, the penetration of banks into rural and semi-urban centres is represented in terms of four indicators designed for this purpose. The other set of five indicators pertains to the sectoral (or functional) aspect of credit deployment to different priority sectors such as agriculture, small scale industries and others. Here, emphasis is laid on credit to small borrowers in the agricultural sector involving amounts less than Rs.10,000/-. All the indicators appearing under group C are by and large conventional measures of costs or profitability.

4.7 Admittedly, operational efficiency is a very wide term and more groups could perhaps be thought of. For instance, customer service is one group which could be considered for inclusion in the index. The problem is about data. Some proxy indicators (or surrogates) which in turn can be expressed in quantitative terms can be considered for inclusion.

4.8 An important point about the choice of indicators needs to be noted. The set of indicators listed in Annexure 'A' does not represent either the first or the last choice. In a way they are the final outcome of a series of experimental runs with many more indicators each of which satisfies the broad analytical considerations referred to earlier and hence becomes eligible for inclusion. However, their collective performance is yet another important aspect and viewed thus, some indicators had to be dropped or replaced while a few others were combined or modified otherwise. It may be useful to briefly state some of the significant changes effected in this context. Deposits and advances per employee were considered as two separate indicators to start with but clubbed together into a single index largely based on performance. A physical measure of productivity, namely, number of deposit accounts per employee was not considered in the initial stages but was included later in the group. Another indicator measuring the spread between interest earned and interest paid to working funds was also tried but it failed to sufficiently discriminate between banks. Though the ratio of export credit to total advances was once taken as a separate indicator, subsequently it was found to be redundant in the presence of indicators relating to total priority sector advances as well as such advances to agriculture, small scale industries and others. The ratio of bad debts written off to net earnings was also thought of as a worthwhile addition to the list but in view of the small and erratic nature of the magnitudes reported it was not feasible to include the same in the finally chosen set. An indicator which may be considered appropriate today may cease to be so in future. For instance, if places become saturated with branches, the ratio relating to the increase in branches in rural and semi-urban areas to the increase in total number of branches becomes irrelevant in measuring the progress of operational efficiency. When the variation in an indicator is likely to come to an end for one reason or another, that indicator becomes obsolete and the search for other appropriate indicators has to begin. Also, a new indicator which becomes relevant on grounds of policy or other considerations has to be inserted provided data also become available for that indicator. Thus, the set of indicators once fixed does not become sacrosanct for all time, It is suggested that an appropriate set of indicators may be considered keeping in view the various points outlined above.

4.9 Data for the chosen set of indicators are taken from official sources such as Basic Statistical Returns, Statistical Tables Relating to Banks in India and related publications. An exhaustive list of the sources of data used and the concepts and definitions of various items taken are given in Annexure 'B'. It may be seen therefrom that the data pertain generally to the period 1969 to 1975. In the case of indicators under group 'B', however, information is available only from 1973 and these have been made use of.

4.10 Given the basic data needed, there are at least two methods of measuring the indicators for each of the public sector banks included in the study. As per the first method, the measurement is by way of marginal or incremental ratios worked out for the period chosen. For the other method, the average ratios computed for the terminal year of the study period, say 1975, constitute the matrix of observations.

4.11 The two methods of measurement suggested above have their own merits and limitations. Whereas the average ratios represent the levels attained, indicator-wise, the incremental ratios reflect the directions and related magnitudes of change in each of the selected indicators during a given period. For this reason the former may be said to be comparatively static and the latter is termed dynamic. From the point of view of stability, the average ratio is at times preferred particularly when either the data used represent flows such as profits, net earnings, etc., which are more volatile or where time intervals involved are relatively short. However, in the present case incremental ratios are particularly relevant since they indicate the specific achievement during a period subsequent to nationalisation and hence they also show the degree of attainment of the objectives for which nationalisation was brought about. To the extent that the incremental data are not available for the entire period 1969-75 but only for the more recent period 1972 or 1973 to 1975, banks which had brought about greater degree of achievement in the earlier years of nationalisation of 14 banks and then slowed down would be unduly under-ranked. This cannot be helped since data on changes for the earlier period are not available. In the present study both the methods have been made use of.

4.12 Even when indicators are chosen and the appropriate method of measurement is decided, the problem of adding them up through weighting diagram remains. The appropriate procedure is to determine weights of individual indicators according to their individual contribution to operational efficiency. This is one of the most difficult parts of the whole exercise. In the case of a consumer price index, one knows or atleast determines the weights which logically should be in proportion to the household expenditure on items which generally go into the basket of consumption. In the industrial production index the weights are proportional to the value added by the industrial items. Such an obvious choice of weights is not possible in the case of the operational efficiency index.

4.13 Under the above circumstances, there are only two possible approaches for ascertaining the performance of individual banks.. They are (a) simplistic method of ranking and (b) ranking based on factor scores obtained by the factor analysis technique. In the first approach, equal weights are attached to indicators so that the composite index will be based on total scores obtained for each of the banks by adding their indicator-wise ranks (see statements 1 and 2 for indicator-wise ranks). The second or the more sophisticated method makes use of the technique of Factor Analysis. Essentially the technique implies resolving the original set of nineteen selected indicators into a much smaller set of factors (generally one or two) which explain a substantial part of the total variance (say 70 to 80 per cent) exhibited by all the indicators.

4.14 The crucial steps involved in adopting this technique are briefly as follows: To begin with the chosen indicators based on the observations in respect of the 15 public sector banks are standardised and the variance-covariance matrix of the standardised variates is obtained. The significant characterstic roots (or Eigen values) and their associated vectors representing the factor loadings are then derived. Factor scores assigned to each bank is calculated from the loadings in respect of the r significant characterstic root. The banks are finally ranked on the basis of factor scores worked out.

4.15 In the context of our present study, one more point requires mention and that is about the application of the factor analysis technique to each of the sub-sets of indicators (such as X, Y1, Y2 and Z) rather than to the whole set of nineteen indicators. The rationale in so doing is two-fold. Firstly, among the banks under study, there exists an inverse relationship between operational efficieny with respect to productivity and their grading with regard to social objectives. Thus, banks scoring higher ranks according to the forme are found in the lower rung in terms of the latter. A similar situation is also encountered even within the set of indicators for social objectives so that it would be more appropriate to sort them into two distinct sub-sets, namely, one depicting the penetration of banks into rural and semi-urban areas (i.e. geographical penetration) and another to take note of the deployment of credit to priority sectors (sectoral penetration). Under the circumstances, the pooling of all indicators may conceal the substantial degree of divergence that seems to exist among the four groups, X, Y1, Y2 and Z. Applying the factor analysis to these groups to get a composite index also does not seem feasible. A second and perhaps more important consideration is the problem of interpretation of the factors in terms of operational characterstics of banks. Incidentally, the splitting into sub-sets also enables one to have sufficient number of observations in relation to the number of variables (or indicators). From a technical angle therefore, it seems more appropriate to consider these four groups of efficiency indicators separately rather than talking in terms of a composite index. However, if one does need ranking based on the efficiency ranking of each of these four groups, one possible course of action may be to combine these group rankings by giving equal weightage. So long as conventional measures of operational efficiency and those based on social objectives do not move in harmony, such a crude method may have to be used. This has also been attempted and the results are presented later in Table 3.

4.16 In short, the foregoing could be summarised thus. There is no such thing as a single operational efficiency of banks. It has many facets which are complementary as well as substitutive. The emphasis laid on each will also keep on changing with reference to time. To attempt reducing them into one dimension will be devoid of content and may, at times, be misleading too. As such, a discussion on the four aspects (X,Y1,Y2 and Z) is preferred to the interpretation in terms of the composite index although for the sake of this exercise a composite index has been constructed by totalling the rankings.

4.17 The results obtained from the simplistic approach and through the factor analysis technique are summarised separately for average and marginal ratios in Tables 1 and 2 respectively. For a proper appreciation of the bank's performance, it is necessary to pay equal attention to not only the levels attained but also about the degree of attainment of growth as referred to earlier. This integrated picture of performance based on average and marginal ratios is brought out in the enclosed graphs drawn separately for groups X, Y1, Y2 and Z as well as for the composite set.

4.18 The graphs indicate that there is a close association between the ranks given to banks based on average ratios and those obtained on the marginal basis of measurement. This is clearly shown by the cluster of points (banks) around the line of equality of ranks assigned to each of the banks using both the methods of measurement. The farther is a point (bank) from the origin, farther the bank goes down the scale of efficiency. Similarly if a point departs significantly from the line, it points out to the degree of discordance between the ranks obtained by both the methods. Points above the line indicate comparatively better performance in terms of average ratios whereas those below the line have relatively done well in marginal terms. It will be useful to bear the foregoing remarks in mind while reading the graphs attached.

4.19 To see the effect of aggregation over the groups in the process of arriving at the composits index, it would be necessary to classify the banks into a smaller number of groups (say three) namely, above average (Group I), average (Group II) and below average (Group III). The broad picture arising therefrom is presented below: The banks are indicated by numericals 1 to 15.

Efficiency Index

	Productivity	Profitability	Spatial	Sectoral	Composite
Group I - above average	1	9	14	9	9
	2	4	1	12	13
	3	6	5	13	2
	4	13	15	10	14
	5	2	13	3	1
Group II - average	6	3	9	14	4
	7	14	7	6	3
	8	12	11	2	6
	9	11	10	15	10
	10	10	2	4	5
Group III - below average	11	1	3	11	11
	12	7	4	1	7
	13	8	8	7	8
	14	15	12	5	12
	15	5	6	8	15

4.20 The inferences/recommendations based on the study may be now summarised as follows:

(i) An assessment of operational efficiency at a more disaggregated and homogeneous level of groups seems more realistic and meaningful than evolving an efficiency measure at the overall level which is highly amorphous.

(ii) The approach adopted has shown its usefulness in measuring the relative success achieved by banks generally during 1969-75 in regard to the diverse aspects in which the term operational efficiency is defined or viewed in the exercise.

(iii) Banks could periodically assess their own performance vis-a-vis other main competing banks using this approach. No definite periodicity could be prescribed since the timing of and the period for such appraisal will be to a large extent dictated by the phenomena measured and the time required for the policies initiated to have its full impact felt at the operational level.

(iv) The study attempted here is to be understood as experimental in nature and therefore the results are provisional. However, considerable scope exists for enlarging its content through the identification of additional indicators that are crucial to the operations of banks and the generation of reliable data for their measurement. The degree of success attained in so doing evidently rests on the initiative and drive of individual banks.

AP/

ANNEXURE 'A'

Selected Indicators of Operational Efficiency and Profitability of Banks

X. Operational efficiency (general)

1. (Advances + Deposits) per employee
2. Number of deposit accounts per employee
3. Total income per employee
4. Net income per employee
5. Ratio of working funds to establishment expenses
6. Ratio of deposits to cash balance

Y_1. Operational efficiency with respect to social objectives - spatial

1. Proportion of rural and semi-urban branches to the total branches
2. Ratio of rural and semi-urban branch deposits to total deposits
3. Ratio of saving and term deposits in rural and semi-urban areas to total saving and term deposits
4. Ratio of Number of accounts of saving and term deposits in rural and semi-urban areas to total number of accounts of saving and term deposits

Y_2. Operational efficiency with respect to social objectives - sectoral

5. Ratio of advances to priority sectors to total advances
6. Ratio of agricultural advances (direct) to total advances
7. Ratio of advances to small scale industries to total advances
8. Ratio of advances to other priority sectors to total advances
9. Ratio of agricultural advances (direct less than Rs 10000/- to total agricultural advances

Z. Profitability

1. Ratio of investment income to Net Income
2. Ratio of net profits to Net Income
3. Ratio of Net Income to working funds
4. Ratio of Net Income to establishment expenses

Note: Wherever possible the indicators are based on the data for the period 1969-75; however the indicators in respect of social objectives (sectoral) pertain to 1973-75 since the requisite data are available only for this period.

ANNEXURE 'B'

Basic concepts and sources of data used

1. Aggregate Deposits (Total Deposits)	:	These data have been taken from B.S.R. output. The amount is in rupees thousands. Total Deposits cover both demand and time deposits. Data are taken for June 1969 and June 1974.
2. Total Number of Employees	:	The data pertain to the years ended December 1969 and December 1974. It is taken from A_2 Return, and relate to all staff employed for the bank as a whole including foreign offices.
3. Total Income	:	Total income is taken from A_2 Return. The figures pertain to the years ended December 1969 and 1974. Total income represents earnings of the bank by way of interest, discount, dividend, commission and exchange, on loans and advances, bills purchased and discounted, investments, plus recoveries on assets previously written down and gains from other revaluation of or sales of assets; plus other sources (Commission of L/Cs, Bills for collection, T.Ts. and D.Ds. sold, other service charges and other income).
4. Net Income	:	This is taken from A_2 Return. This represents total income minus interest paid on deposits and borrowings for the years ended December 1969 and December 1974. The amount is in Rupees thousands.
5. Working Funds	:	It represents paid-up capital, reserves and deposits. The figures are taken from balance sheets of the Banks for the years ended December 1969 and December 1974. The amount is in Rupees thousands.
6. Establishment Expenses	:	These figures are taken from A_2 Return for the period December 1969 and December 1974 and cover expenditure incurred by the bank on salaries and allowances (including overtime allowances), contribution to provident/pension fund, medical and leave fare concessions Special payments such as bonus or ex-gratia payments and travelling allowances are not included.

7. Cash Balance : Cash Balance include cash in hand with bank, and cash balances kept with the RBI, SBI and others. These outstanding figures are taken as on June 1969 and June 1974. The cash balance ratio is the ratio of cash balances to aggregate deposits and are in Rupees thousands.

8. Total number of branches : It includes, rural, semi-urban, urban and metropolitan branches. Data are taken from the records in Branch Licensing Section of the DBOD and are as on 30th June 1969 and 30th June 1975.

9. Rural and Semi-Urban Branch Deposits : Deposits mobilised in Rural and Semi-urban areas are collected as on June 30, 1969 and June 30, 1975. The data are taken from BSR output.

10. Total advances : Total advances include (i) total of loans, cash credits and overdrafts in India (ii) foreign bills purchased and discounted in India (iii) inland bills purchased and discounted in India. Dues from the Banks are excluded. Data are collected from BSR output and from DBOD weekly registers for the period June 1969 and June 1974 and are in Rupees thousands.

11. Agricultural advances (direct) : It is the total amount outstanding as on 30.6.1972 and 30.6.1975. The data are collected from B.P.Section of DBOD. The data for 1969 are not available either Bank-wise or classified into direct and indirect finance.

12. Other priority sectors advances : The amount outstanding as on the last Friday of June 1972 and 1975 are taken. It is in Rupees thousands. The data are collected from B.P.Section of DBOD. The data for 1969 are not available Bank-wise. Advances to other priority sectors include advances made to retail traders, small business-men, professional and self employed persons, and advances to educational bodies.

13.	Agricultural advances (direct in the category of less than Rs 10,000/-) :	These data on both the number of accounts and total amount are collected from BSR and Credit Planning Cell. The amount is in Rupees thousands. Total agricultural advance is taken for June 1973 and December 1975.
14.	Advances to small scale industries :	These data are for the years June 1973 and December 1975, and are collected from IFD. They are in Rupees thousands.
15.	Savings and term deposits in rural and semi-urban areas :	For savings deposits and for term deposits in the data relating to rural and semi-urban are combined together for the years December 1973 and June 1975 respectively. Similarly for calculating ratio total savings and total term deposits for the years December 1973 and June 1975 are taken. The amount is in Rupees thousands. BSR is the source.
16.	Net profit :	Net profit is taken from A_2 Return. It is for the period December 1969, and December 1974. It is the differences between the total income and total expenses. Total expenses include interest paid, commission, brokerage paid, establishment expenses, other working expenses, dues on land, building, municipal taxes etc. It excludes taxes on profits. Depreciation written off and loss incurred on sale of assets, and bad debts written off are included.
17.	Investment income :	This refers to income received by the Commercial Banks on their investments in different securities. Data are taken from the Special Returns called for from Banks. It refers to the years ended December 1969 and December 1974.
18.	No.of deposit accounts :	This refers to the total number of deposits accounts maintained with the Banks as at the end of March 1970 and December 1974 and data are taken from BSR.

ANNEXURE 'C'

A NOTE ON FACTOR ANALYSIS

The main object of factor analysis is to represent the given set of observations in terms of a smaller number of underlying orthogonal factors or hypothetical variables, which convey all the essential information of the original set of variables.

The simplest model that can be formulated is the linear model. Suppose n tests are performed on N individuals. Then the model will be :-

$$Z_{ji} \neq a_{ji} F_{1i} + a_{j2} F_{2i} + \text{-------} + a_{jn} F_{ni}$$

$i - 1,2$ --------, N and $j - 1,2$ --------, n.

There Z_{ji} - Statistical score of the i^{th} individual for the j^{th} test.

F_{pi} - Value of the p^{th} factor for the i^{th} individual

a_{ji} - Factor loadings.

Dropping the subscript i, the model becomes

$$Z_j = a_{ji} F_1 + a_{j2} F_2 + \text{------} + a_{jn} F_n \quad j = 1,2, \text{---} n$$

Or in matrix notation

$$Z = AF \text{ where } Z = \begin{Vmatrix} Z_1 \\ A_2 \\ Z_n \end{Vmatrix} \quad A = \begin{Vmatrix} a_{11} & \text{---} & a_{1n} \\ a_{21} & \text{---} & a_{2n} \\ a_{n1} & \text{---} & a_{nn} \end{Vmatrix} \quad F = \begin{Vmatrix} F_1 \\ F_2 \\ F_n \end{Vmatrix}$$

The aim is to estimate the factor loadings as well as the factors.

Mainly there are two methods to find out the factor loadings. They are (i) Principal Component Method and (ii) Varimax Method and since the former is used, the rationale behind this method is explained below.

Let V_p be the contribution of variance due to the p^{th} factor F_p

Now $Z_{ji} = a_{j1} F_{1i} + a_{j2} F_{2i} + \text{--------} + a_{jn} F_{ni}$

$$\therefore \frac{\sum Z_{ji}^2}{N} = a_{ji}^2 \frac{\sum F_{1i}^2}{N} + a_{j2}^2 \frac{\sum F_{2i}^2}{N} + \text{--} + a_{jn}^2 \frac{\sum F_{ni}^2}{N}$$

$$+ 2 \left[a_{ji} a_{j2} \sum F_{1i} F_{2i} + \text{---} + a_{ji} a_{j3} \sum F_{1i} F_{3i} + \text{------} \right]$$

But F_{ji} is S.N. (0, 1)

and Z_{ji} is S.N. (0, 1)

$\therefore 1 = a_{ji}^2 + a_{j2}^2 + \text{--------} + a_{jn}^2$

The terms on the right hand side represent the portions of the unit variance of Z_j ascribable to the respective factors e.g. a_{jp}^2 is the contribution of the factor F_p to the variance of Z_j. The total contribution of F_p to the variance of all the variables is given by

$$a_{1p}^2 + a_{2p}^2 + \text{-------} + a_{np}^2$$

Further if r_{jk} is the correlation between Z_j an Z_k then

$$r_{jk} = \sum_{p-1}^{n} a_{jp} \quad a_{kp}$$

$\therefore$ Here the problem is to maximise

$$V_1 = a_{11}^2 + a_{21}^2 + \text{-------} + a_{n1}^2$$

Subject to the above condition $r_{jk} = \sum_{p-1}^{n} a_{jp} \quad a_{kp}$

consider the function

$$T = V_1 + \sum_{j-1}^{n} \sum_{k-1}^{n} \lambda_{jk} \left[\sum_{p-1}^{n} a_{jp} \quad a_{kp} - r_{jk} \right]$$

Where $\mu_{jk}\,(j, k = 1, 2 \ldots\ldots\ldots n)$ are Lagrange Multipliers. Differentiating T with respect to a_{jp} and setting the derivative equal to zero and then simplifying we get,

$$\delta_{1p}\ a_{ji} + \sum_{k=1}^{n} \mu_{jk}\ a_{kp} = 0$$

where $\delta_{1p} = 1$ when $p = 1$

$\qquad\quad = 0$ when $p \neq 1$

Multiplying this equation by a_{ji} and summing over j we get

$$\delta_{1p} \sum_{j=1}^{n} a_{ji}^2 + \sum_{j=1}^{n} \sum_{k=1}^{n} \mu_{jk}\ a_{ji}\ a_{kp} = 0$$

But $\delta_{1p}\, a_{ji} + \sum_{k=1}^{n} \mu_{jk}\ a_{kp} = 0 \Rightarrow \sum_{j=1}^{n} \mu_{jk}\ a_{ji} = -\,a_{k1}$

and let $\sum_{j=1}^{n} a_{j1}^2 = \lambda$

$$\therefore\ \delta_{1p}\lambda - \sum_{k=1}^{n} a_{k1}\ a_{kp} = 0$$

Again multiplying this equation by a_{jp} and summing over p,

$$a_{ji}\lambda - \sum_{k=1}^{n} a_{k1}\ r_{jk} = 0$$

This equation is true for each value of $j = 1, 2 \ldots\ldots\ldots n$

$$\therefore\ (1-\lambda)\ a_{11} + r_{12}\, a_{21} + r_{13}\, a_{31} + \ldots.\ r_{1n}\, a_{n1} = 0$$

$$r_{21}\, a_{11} + (1-\lambda)\ a_{21} + r_{23}\, a_{31} + \ldots\ldots + r_{2n}\, a_{n1} = 0$$

$$\cdot$$
$$\cdot$$
$$\cdot$$
$$\cdot$$
$$\cdot$$

$$r_{n1}\, a_{11} + r_{n2}\, a_{21} + r_{n3}\, a_{31} + \ldots\ldots + (1-\lambda)\ a_{n1} = 0$$

The necessary and sufficient condition for this system to have a non-trivial solution is :-

$$\begin{vmatrix} (1-\lambda) & r_{12} & \cdots & r_{1n} \\ r_{21} & (1-\lambda) & \cdots & r_{2n} \\ \cdot & & & \\ \cdot & & & \\ \cdot & & & \\ \cdot & & & \\ \cdot & & & \\ r_{n1} & r_{n2} & \cdots & (1-\lambda) \end{vmatrix} = 0$$

or $(R - \lambda I) = 0$

This is a characteristic equation of degree n.

let $\lambda 1$, $\lambda 2$, ... n be its characteristic roots with corresponding characteristics vectars

$$q_1, q_2, \text{----------} q_n$$

Let $\lambda 1$ be the largest root and

$q_1 = (\alpha_{11}, \alpha_{21} \ldots\ldots \alpha_{n1})$ be the corresponding characteristic vector. Then the estimates of a_{ji} (j=1, 2 ......) can be given as

$$a_{ji} = \frac{\alpha_{ji}\sqrt{\lambda_1}}{\left(\alpha_{11}^2 + \alpha_{21}^2 + \ldots\ldots\ldots + \alpha_{n1}^2 \right)^{1/2}}$$

Thus factor loadings of F_1 can be determined. Similarly factor loadings of F_2, which will account for a maximum of the residual variance, can be found out. In mathematical terms we have to maximise

$$V_2 = a_{12}^2 + a_{22}^2 + \ldots\ldots\ldots + a_{n2}^2$$

subject to $r_{jk}(1) = r_{jk} - a_{j1} \quad a_{k1}$

$$= a_{j2} \quad a_{k2} + \ldots\ldots\ldots a_{jn} \quad a_{kn}$$

Proceeding exactly in the same way as before we can estimate the second factor loadings.

In the same way, all factor loadings can be estimated from the original correlation matrix R.

Out of n factors we choose those factors which are significant in explaining the total variance. A factor P is called significant if corresponding characteristic root.

$$\lambda P \geqslant 1$$

Statement - 1: Ranking of Public Sector Banks with respect to Profitability and Operational Efficiency

Average Ratio 1975

Bank	Operational Efficiency (Productivity)						Operational Efficiency - (Spatial)				Social Objectives (Sectoral					Profitability (Average)			
	X						Y_1				Y_2					Z			
	1.	2.	3.	4.	5.	6.	1.	2.	3.	4.	1.	2.	3.	4.	5.	1.	2.	3.	4.
1	1	6	3	3	2	2	2	1	1	4	14	12	11	15	15	14	8	1	3
2	3	8	2	1	14	15	12	8	7	12	9	8	8	12	13	7	3	11	7
3	7	4	7	6	6	6	11	1	13	6	5	2	6	7	3	9	5	10	6
4	8	7	5	4	4	10	14	7	14	13	6	7	10	3	2	3	2	14	2
5	4	5	8	13	3	5	6	4	3	5	13	15	14	8	1	15	12	3	12
6	2	13	1	2	1	7	13	15	15	15	8	10	9	10	11	8	1	9	1
7	6	11	4	10	7	12	8	6	6	8	11	11	13	9	14	12	13	6	13
8	5	10	10	12	11	4	15	14	12	14	15	14	15	11	12	13	14	4	14
9	12	14	11	5	12	11	7	12	9	7	1	1	2	4	8	1	4	13	4
10	11	2	6	7	10	9	9	11	11	3	4	3	4	6	4	5	9	8	11
11	10	12	9	9	13	1	5	9	8	10	12	6	12	13	5	4	11	7	8
12	9	3	12	14	5	3	10	10	10	11	3	5	1	2	9	11	10	5	9
13	14	1	13	11	9	14	3	3	4	2	2	4	5	1	7	2	6	15	10
14	15	15	14	8	8	13	1	2	2	1	10	9	7	14	10	6	7	12	5
15	13	9	15	15	15	8	4	5	5	9	7	13	3	5	6	10	15	2	15

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STATEMENT-2 RANKING OF PUBLIC SECTOR BANKS WITH RESPECT TO PROFITABILITY AND OPERATIONAL EFFICIENCY
(Marginal Ratio)

Bank	Operational Efficiency (Productivity)						Operational Efficiency (Spatial)				Social Objectives (Sectoral)					Profitability (Marginal)			
	X						Y_1				Y_2					Z			
	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.	14.	15.	16.	17.	18.	19.
1	1	1	1	1	1	4	3	1	2	12	11	9	8	12	13	13	9	1	4
2	3	8	2	2	6	15	9	9	11	15	10	12	3	8	10	5	5	14	7
3	8	4	10	9	2	5	12	14	14	5	8	2	10	7	1	11	3	7	5
4	6	11	6	5	4	10	11	6	13	13	13	11	15	5	3	7	1	12	2
5	2	3	9	13	3	2	6	2	4	6	14	13	13	13	4	15	12	2	12
6	7	15	5	7	5	7	7	13	15	14	6	8	6	4	8	6	2	9	3
7	4	9	3	6	12	12	2	3	9	9	9	10	11	9	11	14	14	5	14
8	5	6	7	10	13	6	10	10	7	8	15	15	14	14	15	12	13	3	13
9	10	13	8	4	8	11	5	15	3	2	1	1	1	3	12	1	4	13	1
10	11	5	12	11	11	8	13	12	8	3	2	3	4	6	2	8	10	8	11
11	9	10	4	3	14	1	4	7	10	10	12	6	12	11	6	2	11	6	8
12	14	7	14	14	10	3	15	11	12	11	3	5	9	1	9	3	6	10	10
13	15	2	15	12	9	14	14	5	5	4	4	7	7	2	5	4	7	15	9
14	12	14	11	8	7	13	8	4	1	1	5	4	5	10	7	9	8	11	6
15	13	12	13	15	15	9	1	8	6	7	7	14	2	15	14	10	15	4	15

TABLE

RANKING OF PUBLIC SECTOR BANKS WITH RESPECT TO PROFITABILITY AND OPERATIONAL EFFICIENCY

AVERAGE RATIOS

Bank	X - (Productivity) (6)				Y_1 - (Social Objective-Spatial) (4)				Y_2 - (Social Objective-Sectoral) (5)				Z - (Profitability) (4)			
	a		b		a		b		a		b		a		b	
	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank
1	17	(1)	95.26	(2)	9	(2)	99.61	(2)	67	(14.5)	9.93	(14)	26	(4)	73.51	(11)
2	43	(6)	78.74	(3)	33	(9)	35.94	(10)	50	(10.5)	38.97	(9)	28	(5)	33.81	(6)
3	36	(3)	56.55	(5)	43	(11)	31.43	(12)	23	(5)	73.04	(5)	30	(7)	36.77	(7)
4	38	(4.5)	61.46	(4)	47	(13)	20.09	(13)	28	(6)	62.34	(6)	21	(2)	10.60	(2)
5	38	(4.5)	55.39	(6)	24	(4)	73.78	(4)	51	(12)	20.92	(13)	42	(12.5)	84.56	(13)
6	26	(2)	113.87	(1)	50	(14)	-9.62	(15)	48	(8.5)	38.12	(10)	19	(1)	19.42	(3)
7	50	(9)	54.24	(7)	28	(5)	54.46	(6)	58	(13)	21.35	(12)	44	(14)	76.25	(12)
8	52	(10)	43.49	(8)	53	(15)	11.59	(14)	67	(14.5)	-3.09	(15)	45	(15)	85.44	(14)
9	65	(13)	37.36	(10)	37	(10)	38.11	(9)	16	(1)	93.73	(3)	22	(3)	9.12	(1)
10	45	(7)	38.94	(9)	30	(8)	43.53	(8)	21	(4)	75.24	(4)	33	(9.5)	46.83	(8)
11	54	(11)	36.91	(11)	29	(6.5)	45.50	(7)	48	(8.5)	33.33	(11)	30	(7)	50.88	(9)
12	46	(8)	27.88	(12)	46	(12)	31.95	(11)	20	(3)	97.63	(1)	35	(11)	60.65	(10)
13	62	(12)	16.34	(14)	16	(3)	87.64	(3)	19	(2)	94.93	(2)	33	(9.5)	30.75	(4)
14	73	(14)	26.84	(13)	6	(1)	121.80	(1)	50	(10.5)	42.29	(8)	30	(7)	31.51	(5)
15	75	(15)	6.75	(15)	29	(6.5)	64.19	(5)	34	(7)	51.29	(7)	42	(12.5)	99.91	(15)
Factor Loading Matrix			0.9037				0.8986				0.9738				0.8355	
			-0.1925				0.9219				0.8264				-0.7845	
			0.9406													
			0.7832				0.9381				0.8781				-0.8023	
			0.6396								0.7494					
			0.1783				0.9001				0.3382				-0.9085	
Eigenvalue			2.7928				3.3483				3.0782				2.7827	
Percentage variation explained			46.55%				83.71%				61.56%				69.57%	

a - Ranking based on ordinary scores.

b - Ranking based on standard scores (mean 50 and standard deviation 10) for first factor according to principal component method.

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TABLE - 2: RANKING OF PUBLIC SECTOR BANKS WITH RESPECT TO PROFITABILITY AND OPERATIONAL EFFICIENCY MARGINAL RATIOS

Bank	X - (Productivity) (6)				Y_1 (Social Objectives - Spatial) (4)				Y_2 (Social Objectives - Sectoral) (5)				Z - (Profitability) (4)			
	a		b		a		b		a		b		a		b	
	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank
1	.9	(1)	189.57	(1)	18	(2.5)	71.61	(2)	53	(12.5)	40.50	(8)	27	(5.5)	75.44	(11)
2	36	(3)	62.52	(2)	44	(12)	35.30	(11)	43	(8)	40.35	(9)	31	(8)	27.73	(4)
3	38	(4)	52.38	(4)	45	(13)	30.63	(13)	27	(4.5)	68.77	(5)	26	(4)	36.15	(6)
4	42	(6)	47.54	(5)	43	(11)	33.54	(12)	47	(9.5)	25.0	(13)	22	(3)	19.55	(2)
5	32	(2)	58.90	(3)	18	(2.5)	69.[illegible]	(3)	57	(14)	16.10	(14)	41	(12.5)	90.59	(15)
6	46	(7.5)	42.39	(7)	49	(14.5)	24.66	(14)	32	(7)	59.91	(7)	20	(2)	23.51	(3)
7	46	(7.5)	46.86	(6)	23	(5)	56.41	(7)	50	(11)	36.53	(11)	47	(15)	87.82	(13)
8	47	(9)	41.71	(8)	35	(9)	43.63	(9)	73	(15)	-3.53	(15)	41	(12.5)	78.22	(12)
9	54	(10)	34.89	(10)	25	(6)	59.44	(5)	18	(2)	98.77	(1)	19	(1)	13.03	(1)
10	58	(11)	34.81	(11)	36	(10)	40.92	(10)	27	(1)	78.38	(4)	37	(11)	54.85	(10)
11	41	(5)	41.31	(9)	31	(8)	49.85	(8)	47	(9.5)	38.22	(10)	27	(5.5)	42.86	(9)
12	62	(12)	30.08	(12)	49	(14.5)	22.88	(15)	27	(4.5)	30.02	(2)	29	(7)	39.34	(7)
13	67	(14)	29.03	(13)	28	(7)	57.91	(6)	25	(3)	79.15	(3)	35	(10)	31.94	(5)
14	65	(13)	28.94	(14)	14	(1)	93.56	(1)	31	(6)	61.69	(6)	34	(9)	40.29	(8)
15	77	(15)	10.06	(15)	22	(4)	60.06	(4)	53	(12.5)	35.15	(12)	44	(14)	88.68	(14)

	X	Y_1	Y_2	Z
Factor Loading Matrix	0.9818	0.5189	0.9603	0.7370
	0.8867	0.6424	0.8752	-0.7880
	0.9636			
	0.9447	0.9474	0.6710	-0.8149
	0.5406		0.6627	
	0.2818	0.5648	0.4302	-0.8908
Eigenvalue	3.9428	1.8984	2.7624	2.6217
Percentage variation explained	65.71%	47.46%	55.25%	65.54%

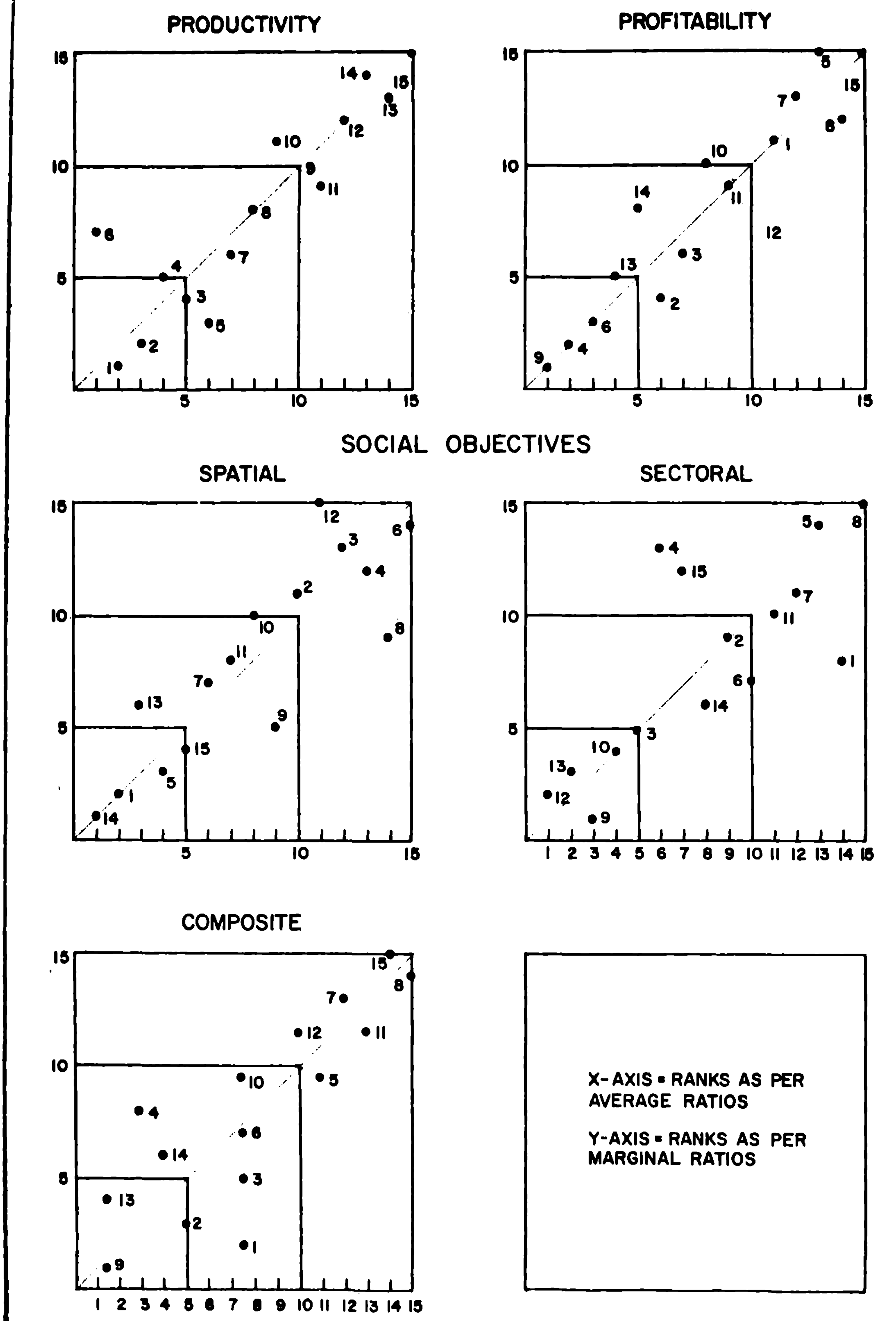
a - Ranking based on ordinary scores

b - Ranking based on standard scores for first factor according to principal component method (mean 50 and standard deviation 10)

TABLE - 3: COMPOSITE INDEX OF OPERATIONAL EFFICIENCY OF PUBLIC SECTOR BANKS

Bank	Ranks based on standard Scrores (mean 50 & standard deviation 10) for first factor according to Principal component method											
	Average Ratios - Ranks				Total Ranks	Ranking as per total Ranks	Marginal Ratios - Ranks				Total Ranks	Ranking as per total Ranks
	X	Y_1	Y_2	Z			X	Y_1	Y_2	Z		
1	2	2	14	11	29	7.5	1	2	8	11	22	2
2	3	10	9	6	28	5	2	11	99	4	26	3
3	5	12	5	7	29	7.5	4	13	5	6	28	5
4	4	13	6	2	25	3	5	12	13	2	32	8
5	6	4	13	13	36	11	3	3	14	15	35	9.5
6	1	15	10	3	29	7.5	7	14	7	3	31	7
7	7	6	12	12	37	12	6	7	11	13	37	13
8	8	14	15	14	51	15	8	9	15	12	44	14
9	10	9	3	1	23	1.5	10	5	1	1	17	1
10	9	8	4	8	29	7.5	11	10	4	10	35	9.5
11	11	7	11	9	38	13	9	8	10	9	36	11.5
12	12	11	1	10	34	10	12	15	2	7	36	11.5
13	14	3	2	4	23	1.5	13	6	3	5	27	4
14	13	1	8	5	27	4	14	1	6	8	29	6
15	15	5	7	15	42	14	15	4	12	14	45	15

RANKING OF PUBLIC SECTOR BANKS



CHAPTER V

ANNUAL ACCOUNTS OF BANKS, STATUTORY AUDIT AND TAX LAWS

5.1 The Committee considered certain aspects relating to the existing format of the balance sheet and profit and loss accounts of the banks, presentation of annual accounts, the provisions relating to statutory audit of the annual accounts as also the existing legal provisions relating to taxation of the income of banks. In this, the Committee had the benefit of the views of the banks as well as a detailed report prepared by Shri Rameshwar Thakur covering the above aspects. These matters are dealt with in the following paragraphs.

Annual Accounts of Banks

5.2 The balance sheet basically represents the sum total of the items of assets and liabilities of a bank systematically arranged under certain broad major heads for enabling shareholders, monetary/governmental authorities and others to get a true and fair picture of the corporate body and its importance as an instrument in assessing the financial strength and annual performance has been universally accepted. The format of the balance sheet for banks, prescribed in the III schedule to the Banking Regulation Act, represents an adaptation of the form originally prescribed in the Companies Act, 1956 for companies in general with modifications to bring it in conformity with the scheme of the Banking Regulation Act. Since 1949, considerable changes have taken place in the scope, perspective and objectives of banks and banking. These changes have been more rapid and conspicuous during the last few years which saw the nationalisation of the major banks. The nature and magnitude of these changes suggest that basic assumptions and purposes which formed the basis for the existing format no longer hold good. This calls for a restructuring of the format of the balance sheet, its design and manner of presentation so as to bring it in tune with the role, functions and responsibilities of the banks. In its format, scope and presentation, the balance sheet etc. of banks in several countries has undergone changes and substantia refinements to keep pace with the changed conditions in those countries.

5.3 Before discussing the actual format of the balance sheet to be adopted by the banks, a few general issues which have recently assumed importance need to be looked into :

The first point concerns the contents of the annual (or directors') reports of the banks which forms an integral part of the annual accounts. Though a few instructions have been issued occasionally on matters to be brought out in the report, particularly in respect of public sector banks, the Committee find that there is no uniformity in the actual presentation of the salient aspects of the working of each bank during the year under report. As such, an assessment of the comparative performance of banks is rendered difficult. The Committee, therefore, recommend that the Reserve Bank of India should lay out the actual skeleton of the annual report which should be followed by all banks. This should cover, inter alia, some highlights on the actual operating performance of the bank for the year as compared to the broad objectives set before it, future strategies of growth, branch expansion, particularly specifying the rural and semi-urban areas covered; extension of credit to priority sectors; cost of bank services; commentary on the human assets, their deployment and training, bank's future plans in this regard and any other topical issues. The form of annual report should be reviewed periodically and changes effected therein as the situation may demand. This is to ensure that the standardisation is made flexible enough to accommodate changes which may take place in banking industry. The banks are, however, at liberty to add any pertinent information to highlight individual performances in areas not covered by the standardised report. The banks could be advised to adopt the standardised form of annual report by means of administrative instructions from the Reserve Bank of India.

The other point relates to the publication of the balance sheet and the profit and loss account in full in accordance with the provisions contained in Section 31 of the Banking Regulation Act, 1949. There has been criticism that this exercise, apart from being expensive, hardly serves the purpose of publicity or as a document for the public to make critical assessment of the working/financial position of the banks. The Committee do not agree entirely with these arguments. They,however, feel that the balance sheets as they are being published to-day look lengthy and complicated as they contain too many details and are not fully appreciated by the common man who has no detailed knowledge of accounts. The Committee suggest that only an abbreviated form of balance sheet and profit and loss account need be published. This should also do towards statutory compliance, the relative provisions in the relevant enactments being amended, if necessary. The balance sheet including the profit and loss account as in Annexure I should, however, continue to be prepared by banks and filed with the Reserve Bank/Government Departments as per statutory requirements.

The other aspect relates to the time-lag between the signing of the balance sheet and the year-end. Presently the time lag is unduly long. The need for prompt compilation of the balance sheet of banks cannot be overemphasised. Any undue delay defeats the very purpose for which these accounts are being drawn up. The main reason for the delay, apart from the delay in compilation and consolidation of the accounts of a large number of branches, is the non-completion of the statutory audit by the statutory auditors which again is attributed to the delay involved in branch audit. This problem is becoming more and more acute with the continued branch expansion by banks. This aspect has been discussed in detail later in the Chapter under 'AUDIT'.

5.4 The Committee has given careful consideration to the issues discussed in paragraph 5(2) & (3) above and have suggested a suitable proforma for the balance sheet and profit and loss account which could be adopted by banks (vide Annexure) Y. In devising the format, we have kept the following two main aspects in view:

(i) uniformity in presentation of accounts to make for meaningful comparison as well as a rational presentation of important items of liabilities and assets.

(ii) classification of income/expenditure in tune with the various activities which, by itself, would make for an analysis of the sources of income, profitability of individual activities, etc.

A note has been appended to the format by way of explanation of the main changes from the existing format.

5.5 The Committee note that it may be necessary to have a suitably modified format for the Regional Rural Banks who are expected to follow simplified accounting procedures. In this context it is suggested that the existing provisions of the relevant Acts may be examined and, if necessary, suitable powers may be assumed by Reserve Bank/Government to vary the format for particular categories of banks.

5.6 The Committee are aware that the format for annual accounts suggested by them may necessitate certain changes in the existing accounting procedures followed by the banks particularly in regard to accounting of income and expenditure But they are of the opinion that this is necessary for the banks themselves to have sufficient data to analyse the income and cost of each activity.

SECTION II - STATUTORY AUDIT OF ANNUAL ACCOUNTS

5.7 The statutory auditors' certificate vouching the financial statements as revealing a true and fair view of the financial position of a bank is necessary for the continued trust of the shareholders/depositors, etc. Banks have, of late, enlarged their operations substantially both functionally and territorially. Their expansion has been unprecedented and the deposits mobilised from public are many times their owned funds. After the introduction of social control over banks and subsequent nationalisation of the larger ones, banks have the added responsibility of channelising their resources towards socially desirable purposes apart from the usual commercial and other considerations normally attached to their operations. This adds a positive dimension (both qualitative and quantitative) to the responsibility of the auditors as well. The responsibilities of banks are bound to increase from time to time in keeping with the aspirations of the nation, so also the task of the auditors. It is, therefore, desirable that the role of the auditors is examined with a view to making it more positive and meaningful, in the context of the anticipated growth-oriented policies to be pursued by the banks in the near as well as foreseeable future and in this connection to suggest such rationalisation/ streamlining as may be considered necessary and desirable.

5.8 (i) State Bank of India

<u>Existing Arrangements</u>

In the case of State Bank of India only the circle offices (presently nine) including the respective main offices, are being audited by separate independent external auditors. The other 3,000 odd branches are not being audited for the purpose of certifying the annual accounts. The external auditors depend on returns/ certificates from the branch offices covering their various activities.

(ii) Associate banks of SBI

As for the associate banks, the statutory auditors audit only the Head Office and the main branch of the bank and certify the annual accounts.

(iii) Nationalised banks

The banks continue to follow generally the procedure which was prevalent prior to their nationalisation and continue to employ two or more firms of auditors as their statutory auditors. It is the combined responsibility of these auditors to give the requisite professional certificate. To assist them many other auditors selected from the list maintained by the Central Government are appointed as "branch auditors". While the external auditors personally undertake audit of about 10% of the branches, 30% of the branches are audited by branch auditors; about 60% of the branches remain unaudited by the external auditors.

(iv) Private sector banks

In the case of these banks, the provisions of section 288 of the Companies Act are applicable and all branches are to be compulsorily audited. However, the bigger banks with large number of branches have been allowed exemption under the Companies (Branch Audit) Exemption Rules for quite a number of their branches. These banks have also statutory and branch auditors.

It is evident from the above that no uniform procedure is being followed for audit of banks. While the auditors of all banks are obliged, more or less, to produce the same type of certificate, it is based, in the case of State Bank of India (with over 3000 branches) on the audits carried out by the external auditors themselves of only the circle offices and the respective main offices, in respect of the associate banks (most of them having over 200 branches each) by auditing only their Main Offices, with regard to nationalised banks (having branches ranging between 500 and 1200 each) based on the audit of 40% of branches, the major portion of which are audited by others (branch auditors) and in the case of non-nationalised banks the certificate is based on the audit by statutory and branch auditors of such branches as are not specifically exempted. Paradoxically it appears that bigger the bank the lesser is the audit coverage of branches. However, the certificate furnished by the auditors has been relied upon equally in all cases and carries equal weight. Further, the cost involved in conducting the audit of a large number of branches of nationalised banks is also rather high as compared to the expenses incurred by State Bank of India Group in this behalf.

5.9 While the Committee concede that the external auditors in certifying the financial statements do perform a useful role, they do not see any reason why different systems should be followed in respect of nationalised banks, private sector banks, the State Bank of India and the associate banks of the State Bank of India. Viewed from the utility angle, the existing elaborate external audit of branches of banks does not seem to be necessary. Also, the cost of this operation is rather high, apart from being a time-consuming procedure, which in effect delays the finalisation of the accounts and publication. The SBI, since 1955, has been getting only its circle offices audited and the associate banks of SBI only their Head Offices and main branches. Even then the quality of the certificate of their external auditors and the utility thereof have never been subject of criticism.

Moreover, having been in existence for so many years now, most of the banks have substantially improved their own internal systems and procedures which have sustained them over long years without giving rise to much difficulties. Further, these are being reviewed and are being subjected to modifications, rationalisations, etc. from time to time. As such the external auditors' job is simplified to the extent of ensuring that these systems are being put into practice. Therefore, we feel that substantial reduction in the coverage of branch audit by external auditors is possible without affecting the quality of their certificate. This will also be justified by the economy in cost achieved. Another specific advantage which may be gained immediately from reduction in the coverage of branches by the external auditors is the avoiding of the delay in the finalising of the annual accounts which is generally attributed to the non-completion of branch audit in time.

5.10 The Committee, therefore, strongly feel that the system of audit of all categories of banks should be made uniform. They are of the view that the system of audit for all banks should be on the lines of State Bank of India. However, some of the banks have yet to build-up an adequate internal inspection machinery. As this may take some time, the Committee would recommend that the systems of branch audit by statutory/ branch auditors may be dispensed with in stages.

<u>Nationalised Banks</u>

<u>Stage No.1</u> (2 years)

As against the present coverage of about 40% only, the following offices may be subjected to audit by external auditors :

(a) the Head Office,

(b) the Regional/Zonal/Divisional Offices, and

(c) 20% of the branches.

(Branches should be so selected that those having advances of less than Rs 1 crore or with less than 0.5% of the advances are not subjected to audit, unless absolutely essential to cover the stipulated percentage).

<u>Stage No.2</u> (2 years)

The branches to be covered under this stage should include

(a) the Head Office,
(b) Regional/Zonal/Divisional Offices; and
(c) 10% of the branches.

(Branches should be so selected by the auditors that those with advances of less than Rs 5 crores and/or with less than 1% of the advances are not included unless the inclusion of smaller branches becomes essential to complete the coverage.

Stage No.3 (2 years)

The audit should cover only the Head Office, the Divisional/Zonal/Regional Offices and all main branches coming under each Division/Region/Zone.

When 3rd stage is completed the audit work of all commercial banks will be more or less on par with those of the State Bank of India and the associate banks.

5.11 The Committee also suggest that the larger private sector banks (having 200 branches or deposits of over Rs 50 crores) could be exempted from the provisions of Section 288 of the Companies Act, 1956, provided that the Reserve Bank is satisfied that the systems and procedures of these banks are satisfactory and that they possess a strong internal audit machinery. These banks can be treated on par with nationalised banks. The Committee would suggest that the Reserve Bank may be empowered to grant necessary exemption to banking companies under Section 228(5) of the Companies Act.

5.12 With the progressive elimination of branch audit, the central statutory auditors will have to carry out the audit of the branches from the returns submitted by them as at the end of each financial year. The Committee feel that a standard set of returns could be prescribed for the purpose. The standard returns may be so devised as to meet not only the purpose of audit but also provide the Head Office with a complete set of control returns. In other words, banks need not have to call for one set of returns for audit purposes and another for control purposes. A small group consisting of auditors, bank representatives and nominees of RBI may be entrusted with the task of devising the standard set of forms.

5.13 Another aspect which the Committee would like to stress is in regard to the format of the auditors' certificates to the Balance Sheet and Profit & Loss account. At present, the protection available to the Statutory Auditors under Section 227(5) of the Companies Act, 1956 regarding disclosure of certain matters has been made available to the Auditors of State Bank of India and its associates. Similar protection should be provided in the case of nationalised banks. The Committee understand that this question is under consideration.

5.14 One of the important aspects of the Committees' recommendations is that the internal audit machinery should be as competent as possible. Towards this end, the Committee feel that an independent external expert agency like recognised firms of auditors could, with advantage, be involved in the checking of the working of the branches. This would be supplementary to the internal audit by the bank's own inspections. Such independent audit could be spread over the year. This would be introduced in 2 stages coinciding with the second and 3rd stages of our earlier suggestions of relaxing the territorial coverage of external audits. To begin with only 5% of the medium-sized branches be allotted to the external agency on an experimental basis for a period of say 3 years. These are to be taken up on any day convenient to the external agency. During this experimental period the comparative cost escalation involved in this experiment vis-a-vis its usefulness can be assessed. If found worthwhile the same can be extended gradually to cover about 20% of the branches annually. This experiment is not intended to supplant the existing internal audit machinery but only to supplement the same.

A common objection which may surface against the drafting of an external agency for doing the internal auditor's job is the element of secrecy of the state of the customers accounts. If it is ensured that proper oath of secrecy and undertakings are obtained from the auditors and if this is incorporated in the contract to be entered into by the bank, this may not pose any serious problems.

5.15 The Committee's recommendations will have the effect of bringing out a complete change in the role hitherto played by the external auditors. From mere passive certifiers of annual accounts, the audit is expected to play a very positive and useful role. For this purpose, the auditors, it is hoped, will develop the necessary expertise.

SECTION III : TAX LAWS AND PROCEDURES AS APPLICABLE TO BANKS

5.16 Since long banking industry has been clamouring for several tax relaxations and a number of suggestions have been put forth towards this end concerning the treatment of certain types of income, incidence of taxation and other procedural matters. There has been, for long, a continuous dialogue between the Indian Banks' Association, the Reserve Bank and the Government on several of these matters. It has been argued that banking industry cannot be treated differently from other corporate trading/manufacturing bodies. This has probably been due to the lack of a proper appreciation of the special feature of the banking industry. Another problem facing the authorities has been the varied systems of accounting followed by different banks.

Since the nationalisation of 14 major banks in 1969, the structure of the banking system has undergone a radical change. Ever increasing social responsibilities have been cast on banks in general and the public sector banks in particular. This has made them undertake several activities which strictly are not sufficiently remunerative. Further, substantial portion of the investments of the banks is in Government securities/securities of Government associated bodies and a large amount of advances is made to Government bodies/agencies or undertakings. A major part of the charges levied by the banks is under direct control of the Reserve Bank of India and/or Government and the banks are not in a position to increase their earnings by way of enhanced interest rates or service charges. As such the banks' complaint that their profitability has been unduly squeezed is not unjustified. In the light of these, a review of the tax laws and procedures, so far as banks are concerned appears to be called for.

5.17 One of the important suggestions received by the Committee is that banks may be allowed tax relief in respect of amounts transferred from yearly income to reserves under statutory requirements or under directions of the Reserve Bank of India. The suggestion has been made in the context of strengthening the capital base of the banks. The argument advanced is that the present system of taxation of bank's income leaves insufficient amount of profits after tax to augment the reserves to any substantial extent. The case for a strong capital base (i.e. capital plus free reserves) for banks needs no emphasis. This has long been a point of criticism against Indian banks. Foreign banks who also deal with the Indian banks have often been found to complain that the capital base of Indian banks is very thin and that they are wary about extending adequate credit limits.

<u>Relief for amount transferred to reserves</u>

There are several criteria to decide the adequacy of capital funds of banks. The more common methods adopted have been (i) capital funds vis-a-vis deposits, (ii) capital funds as a proportion of the risk assets and (iii) capital funds vis-a-vis investments in fixed assets. The Reserve Bank has been generally relating the capital funds to deposits. The norm prescribed by the Bank has been 6% of total deposits. As against this, because of the fast expansion of banks, the present average of such funds has been around 1% which is woefully low. One method of augmenting the capital funds is to increase the transfer from profits to reserves substantially.

This will obviously be facilitated if banks are given tax relief in respect of amounts transferred to reserves from the yearly income.

The aggregate amount transferred by the scheduled commercial banks with deposits of over Rs 10 crores during the three years 1973 to 1975 has been of the order of Rs 6.74, Rs 12.03 and Rs 16.25 crores respectively. The incidence of tax on these amounts would amount to Rs 3.88 crores, Rs 6.92 crores and Rs 9.34 crores respectively. Full relief in taxation would have enabled the banks to transfer about Rs 20.14 crores more to reserves during the above period. Considering the responsibilities cast on the banks, in the context of national development, the Committee is of the view that it would be useful to strengthen the capital base of the bank even at the cost of the limited diminution in Government revenues. This, of course, will raise the issue of additional dividends being declared or the amount being otherwise distributed by way of bonus shares, etc. by the private sector banks. This is unlikely to happen, as all these banks have to take the approval of the Reserve Bank of India before declaring a dividend on shares. And the Reserve Bank has not been in favour of issue of bonus shares of banks. The Reserve Bank could also be vested with statutory powers to regulate the dividend and issue of bonus shares by banks. Further, to ensure absolute safeguard and to encourage larger transfer to reserves, we suggest that a specific condition be stipulated before the relief is made available viz., this relief will be available only to such of the banks who transfer at least 40% of their disclosed profit to statutory reserves. We feel that this will encourage banks to transfer larger amounts to reserves.

As regards foreign banks, they do not create any reserves in their Indian books from out of Indian profits. These banks would, therefore, not be eligible to the above benefit.

5.18 Another oft-repeated suggestion relates to whether banks may be allowed tax relief in respect of amounts utilised to make usual and necessary provisions, such as provisions for bad and doubtful debts, depreciation in investments, etc.

<u>Relief for provision for bad debts and depreciation in investment</u>

At present provision made by banks for bad and/or doubtful debts is not allowed as a charge while assessing their income. Bad debts are allowed as a charge only when they are written off and the tax authorities are satisfied that all possible steps have been taken to recover the dues without success. This is possible only when banks have taken recourse, not only to the available securities, but also the personal assets of the borrowers and/or guarantors, etc. When the borrowers are declared insolvent or are in liquidation, the banks have to await the distribution of the realisation of the assets of the borrowers by the receivers/liquidators. While these proceedings will necessarily be long drawn out, banks have to and do make adequate provision for such advances once the relative accounts become difficult of recovery. Provision for such advances is made by banks either at the instance of the statutory auditors or on an analysis made by the management itself of individual advances. The banks have, therefore, been asking for relief in respect of these provisions, if necessary, by treating banks as a separate category for the purpose as their main business is dealing in credits. The Committee feels that the time is now ripe to accede to this request and is inclined to recommend that banks may be allowed to charge the amount of provision made for specific advances, which either in the judgement of the management or that of the statutory auditors have/will prove irrecoverable. The Committee notes in this connection that there is no loss of revenue but only in the timing of the incidence of taxation if this recommendation is accepted. It will not be difficult to devise a suitable procedure to have a control over such provisions by calling for annual statements supported by auditors' certificates, etc. As a measure of further control, the question of treating a percentage of the advances (to be fixed in consultation with the RBI) as allowable provision could also be considered.

The Committee also considered the treatment of income by way of interest or discount credited to a suspense account. Either this interest may relate to debts which are difficult of recovery but which are considered fully realisable in due course or debts which are partly or wholly considered irrecoverable. In either case the interest charged to the borrowers accounts is a notional income which is held in interest suspense accounts. The Income-tax Authorities, however, it is stated, take this item into account for computing the total income, although from a strict point of view, tax can be levied only when the income has actually been earned during the period. This procedure of taking the hypothetical income needs review. The Committee is of the view that banks should be given the option of not charging interest on such advances or the relative interest income, if charged and kept in a suspense account, should be considered as provisions for doubtful debts and given the same treatment as suggested for provision for doubtful debts. The income, if and when earned, could be taken for tax purposes, during the relevant accounting year.

As regards the request for relief for the amount provided to cover the depreciation in the value of investments it is normally argued that the major part of investments is in Government and other (approved) trustee securities. While in respect of investments in unapproved securities, banks have by law, to make adequate provisions from profits, in respect of investments in approved securities as well, banks endeavour to make adequate provisions for depreciation in such investments by yearly allocations. It is understood that the tax authorities treat such investments as stock-in-trade and permit bank to revalue the relative investments every year at current market rate or cost whichever is lower and claim relief for or offer for taxatiom the resultant loss or profits, provided the same practice is followed every year. The question which then arises is whether relief should be afforded to banks when they write off the depreciation in investments or make provisions for a part of the depreciation. The Committee is of the view that banks may be allowed rebate in respect of depreciation to the extent it is actually written off or provided for in the books. The Committee is of the further view that depreciation in respect of either assets like immovable properties, furniture and fixtures should also be allowed only if the relative depreciation is actually created and held in the books.

<u>Relief for provisions towards estimated exchange losses</u>

5.19 As regards provision towards estimated exchange losses, it is the normally accepted accounting procedure followed by all banks that necessary provisions are made in accounts at the end of year, after reviewing all the outstanding forward exchange contracts, correspondents' accounts, etc., in respect of the profits or losses arising on such transactions. While the provisions made towards estimated profits and credited to profit on exchange account in the profit and loss account is treated as taxable income and taxed, the provisions made towards estimated exchange loss arising on such transactions in any particular year are not, however, allowed as deduction in computing the taxable income. The Income-tax Officer views this provision towards loss as only a "Contingent liability" and hence this is disallowed. As this stand places the bank in double disadvantage i.e., income is taxed and provision for loss is disallowed, suitable amendment to the Income-tax Act appears to be called for in this respect.

5.20 The provisions of the Income-tax Act, 1961 require the commercial banks to pay the last instalment of the advance income tax by the 15th December of the relative accounting year, and submit revised estimates of the income, in case of fluctuations from the original estimate. Practically, on all advances accounts as well as the deposits accounts, the calculation of interest chargeable/payable is calculated during the last days of December, taking into account, the operations during the last quarter. The other difficulty in assessing the estimated income by the stipulated date is on account of the delay in receiving data from the branches spread all over the country, apart from the foreign branches of some of the larger banks. Many of the provisions to be made in respect of bad/doubtful debts, retirement benefits, ex-gratia payments, etc., are possible only after assessing the actual liabilities. The tax laws, as they stand require the banks to pay heavy interest on the amount of difference between the actual liability and that estimated, in case the estimate is less, while the refunds for the excess tax paid, are long drawn processes.

<u>Advance Payment of Income-tax</u>

Commercial banks, therefore, may be allowed to submit estimates of chargeable income and to make the last instalment of tax payment by the 15th March of the following year, which would give them sufficient cushioning period. In the alternative, commercial banks may pay the quarterly instalment on the basis of the estimates of income for the previous quarter. The Government will however, continue to receive the revenue in the same financial year, if the above proposal is given effect to.

5.21 The recent amendment of Section 4(43)(A) which has come in force with effect from 1st June 1976 entitles the Life Insurance Corporation to receive dividends in respect of any securities or shares owned by it, without

<u>Deduction tax at source on banks' investments</u>

deduction of income tax at source. In so far as the commercial banks are concerned although the tax authorities do treat such investments as stock-in-trade, this facility of receiving the gross dividends has not been extended to them. In this context, it is pertinent to state that banks are exempt from deducting tax at source on the amount of interest paid on their deposits. The Committee is of the opinion that similar treatment can be accorded to the interest, dividend, etc., the banks receive on their investment portfolio. This suggestion if accepted will reduce drastically the unproductive book work at the banks. The loss of receipt of such taxes deducted at source can easily be offset by advance tax the banks would be paying on their self assessed income.

<u>Provident Fund Returns</u>

5.22 At present the trustees to the employees' provident fund in banks are required to file a return in Form 41 in respect of each individual employee and this casts a heavy burden on the trustees. Effective control over the accounts can be exercised by requiring the provident fund trustees to file their income returns, and carrying out random examination of some of the individual accounts. To give relief to the trustees, it is worth considering the change in the procedural aspect of furnishing the returns

<u>Expenses incurred by foreign branches of Indian Banks</u>

5.23 The provisions of Section 35B(1)(b)(iv) of the Income-tax Act relating to export market development allowance have been extended to the banks having foreign branches. Some of the major items of expenditure incurred by the foreign branches, like legal charges, entertainment expenses, proportionate share of head office expenses, for supervision, ~~etc.~~, bad debts written off, depreciation, foreign income tax, etc., are not admitted as deductible business expenditure for tax purposes. These items could be allowed in full, without imposing any monetary ceiling, since they are essential for business development and sales promotion.

The Committee also recommends that the depreciation on foreign made motor cars maintained by the branches of Indian banks abroad, be allowed for tax purposes.

5.24 Commercial banks, with a large number of foreign branches with substantial annual income, are affected in the matter of double tax relief since the Income-tax Department views it as a post-assessment matter. As the tax assessments of the foreign branches is completed normally much later than the assessment in India, and the tax amount or income of the foreign branches being large, there is a considerable time lag before the banks actually get the double-tax relief from the Indian tax authorities. The banks having a larger number of overseas branches find that a large portion of their funds are thus locked-up with the tax department. The existing provisions do not provide for payment of interest on such amounts by the Government.

<u>Double Tax Relief</u>

Banks have a fairly good estimate of the tax liability of their foreign branches and the double tax relief they would be entitled to. The Committee feels that the total estimated tax liability of all the foreign branches which the bank would be entitled to as double tax benefit might be excluded from the banks' income for tax purposes, in India. The actual amount of double income tax relief, to which the bank would be entitled to, could be determined and adjustments made, upon the completion of the assessments of all the foreign branches, and on production of conclusive evidence of tax paid abroad.

5.25 Under Section 285 of the Income-tax Act, commercial banks have to furnish to the tax authorities particulars of depositors receiving interest over Rs 400.

<u>Information under Section 285 of the Income-tax Act</u>

Now that the exemption limit of interest income (including dividends, etc. on securities), under Section 80 of the Act, has been raised from Rs 1,000 to Rs 3,000 per annum, this limit of Rs 400 as interest, which itself was determined long ago, certainly needs revision. This suggestion, if accepted, would result in saving of tremendous labour. In this context, it may be mentioned that the amount of Rs 400 as interest on deposits was fixed when the general interest rates were much lower. Further, other companies are asked to furnish to the tax authorities a list of only those shareholders receiving dividends of Rs 5,000 and above.

<u>Interest Rates Tax</u>

5.26 Banks take recourse to borrowings under various schemes for refinance from RBI/IDBI and ARDC. The institutions providing refinance have prescribed the maximum rates of interest that can be charged by the banks on these advances as well as that paid for the refinance facility. The banks contend that their actual income on such operations is only the spread between the interest charged to their constituents and that paid by them on the borrowings from the refinancing institutions, and hence, desire that the total amount of interest recovered on such advances should not be taken into account for tax purpose.

Banks, by the very nature of their business, have to mobilise resources, and are required to pay interest on the funds so tapped as well as the deposits mobilised. If the arguments put forth by the banks, that they only do a collecting job in respect of part of interest which is being remitted to the refinancing institutions, as a corrollary, it would follow that only such of the income spread between the average yield on their normal lending operations and cost of deposits alone be offered for tax purposes would follow. The Committee is thus unable to accept this argument that borrowings from RBI, etc. should be treated differently from other resources mobilised.

No change in the present system is, therefore, called for and in case any of the banks have been following the practice of computing only the amount of net difference between the interest rate charged on advances and the rate paid to the institutions providing refinance, thev may be directed to offer the entire interest on the advances for interest for tax purposes.

ANNEXURE

BALANCE SHEET (PROPOSED FORMAT)

(000's omitted)

Previous Year	LIABILITIES	As at 31.12.19
	1. Capital	
	2. Reserves	
	3. Deposits	
	4. Borrowings	
	5. Bills Payable	
	6. Other Liabilities	
	T o t a l ...	

Contingent Liabilities

(Please see notes for individual items)

(000's omitted)

Previous Year	ASSETS	As at 31.12.19
	1. Cash	
	2. Balances with and Loans to banks	
	3. Investments	
	4. Advances (excluding those for which adequate provision has been made)	
	5. Bills purchased and discounted (excluding those for which adequate provision has been made)	
	6. Fixed Assets	
	7. Other Assets	
	8. Non-banking assets acquired in satisfaction of claims	
	9. Balance of Loss	
	T o t a l ...	

(Please see notes for individual items)

NOTES TO THE ACCOUNTS

NOTE 1 - CAPITAL

Authorised capital

(...................... shares of Rs each) ____________

Issued and subscribed capital

(...................... shares of Rs each) ____________

Paid-up capital

(......................shares of Rs each) ____________.

Note: In case of change in any of the items during the years such as increase in authorised capital, issue of fresh capital, calling up of uncalled capital etc. details thereof may be given by way of a note.

NOTE 2 - RESERVES

Previous Year		Current Year
	(i) Statutory Reserves	
	(ii) Other Reserves (Please specify)	
	(iii) Balance of Profit	
	Total ...	

NOTE 3 - DEPOSITS

Previous Year		Current Year
	I. From Banks	
	i) Demand	
	(a) In India	
	(b) Outside India.	
	ii) Time Deposits	
	(a) In India	
	(b) Outside India	
	Total ...	
	II. From Others	
	i) Current Accounts	
	(a) In India	
	(b) Outside India	
	ii) Savings Bank Deposit	
	(a) In India	
	(b) Outside India	
	iii) Fixed Deposits	
	(a) In India	
	(b) Outside India	
	iv) Other Deposits	
	(a) In India	
	(b) Outside India	
	Total ...	

NOTE 4 - BORROWINGS

Previous Year		Current Year: In India	Current Year: Outside India
	(i) Call and [illegible] loans at notice of 15 days or less		
	(ii) Others		
	Total ..		

NOTE 5 - BILLS PAYABLE

Previous Year		Current Year: In India	Current Year: Outside India
	(i) Drafts Payable		
	(ii) Others		
	Total ..		

NOTE 6 - OTHER LIABILITIES

Previous Year		Current Year: In India	Current Year: Outside India
	(i) Branch adjustments		
	(ii) Interest payable		
	(iii) Unclaimed dividends		
	(iv) Unexpired discounts		
	(v) Sundry creditors		
	(vi) Others		
	Total ..		

NOTE 7 - CONTINGENT LIABILITIES

Previous Year		Current Year: In Indian branches	Current Year: In branches overseas
	Bills for collection		
	Payable in India		
	Payable ~~in~~ Outside India		
	Claims against the bank not acknowledged as debt		
	Outstanding forward exchange contracts		
	Outstanding letters of credit (Inland)		
	Outstanding letters of credit (Foreign)		
	Guarantees local currency		
	Guarantees foreign currency		
	Acceptances, endorsements and other obligations		
	In respect of partly paid securities		
	Participation certificates sold		
	Bills rediscounted with Reserve Bank and others		
	....		
	....		
	Total ..		

NOTE 8 - CASH

Previous Year		Current Year	
		In India	Outside India
	(i) Cash in hand (including foreign currencies notes)		
	(ii) In current account with Reserve Bank/Central Banking Institutions		
	Total ..		

NOTE 9 - BALANCES WITH & LOANS TO BANKS

Previous Year		Current Year	
		In India	Outside India
	Deposits with Reserve Bank, Central Banking Institutions other than in current accounts		
	- in current accounts with State Bank of India, its associates and nationalised banks		
	- in current accounts with other banks		
	Lent at Call		
	Lent at notice/term deposits		
	of 15 days or less		
	of 16 to 45 days		
	of 46 to 90 days		
	of 91 days and more		
	Deposits with other banks		
	Total ..		

NOTE 10 - INVESTMENTS

Previous Year		Current Year Book Value	Current Year Redeemable or market value
	Investments		
	Central Government Securities		
	State Government Securities		
	Foreign Government Securities		
	Other "approved" securities (Inclusive of shares (paid-up value) at Rs ....)		
	Other municipal securities and securities of state associated bodies (inclusive of shares (paid-up value at Rs ....)		
	In subsidiaries/associate companies		
	Fully paid equity		
	Partly paid equity		
	Trade Investments		
	Quoted fully paid equity		
	Quoted partly paid equity		
	Quoted fully paid loans/ debenture stock		
	Quoted partly paid loan/ debenture stock		
	Unquoted fully paid investments		
	Unquoted partly paid investments		

Note: In the case of Government and other approved securities which are redeemable, the redeemable value may be shown. In the case of shares/stocks which are approved securities, the paid-up value may be shown. In the case of other shares/stocks, either the market value or the realisable value, as the case may be, may be taken.

NOTE 11 - ADVANCES AND BILLS

Previous Year		Current Year In India	Current Year Outside India
	I. Advances		
	Less:(1) Refinance from		
	(a) R.B.I.		
	(b) I.D.B.I.		
	(c) A.R.D.C.		
	(d) Others (specify)		
	(2) Participation certificate sold		
	Add: Participation certificate bought		
	II.(a) Due from banks		
	(b) Due from employees		

III. Classification of advances

	No. of accounts In India	No. of accounts Outside India	Balance outstanding In India	Balance outstanding Outside India
(i) Accounts with balances upto Rs 5,000				
(ii) Accounts with balances of over Rs 5,000 and upto Rs 10,000				
(iii) Accounts with balances of over Rs 10,000 and upto Rs 25,000				
(iv) Accounts with balances of over Rs 25,000 and upto Rs 1 lakh				
(v) Accounts with balances of over Rs 1 lakh and upto Rs 10 lakhs				
(vi) Accounts with balances of over Rs 10 lakhs and upto Rs 25 lakhs				
(vii) Accounts with balances of over Rs 25 lakhs and upto Rs 1 crore				
(viii) Accounts with balances of over Rs 1 crore				

Contd...

Previous Year		Current Year Payable in India	Current Year Payable outside India
	IV.(i) Bills purchased and discounted		
	Less:		
	Rediscounted with		
	(a) R.B.I.		
	(b) I.D.B.I.		
	(c) Others		
	V. Bills		
	(i) Demand bills		
	(ii) Bills of 90 days usance or less		
	(iii) Bills of 91 - 180 days usance		
	(iv) Bills of 181 - 365 days usance		
	(v) Bills of over 365 days usance		
	Total ..		

NOTE 12 - PREMISES ETC.

(i) Premises

At cost as at 31st December ....

Add: Additions during the year

Less: Deductions to date

Less: Depreciation to date

(ii) Furniture and Fixtures etc.

At cost as at 31st December .....

Add: Additions during the year

Less: Deductions during the year

Less: Depreciation to date

(iii) Non-banking assets acquired in satisfaction of claims

At cost as at 31st December .....

Add: Additions during the year

Less: Deductions during the year

Less: Depreciation to date

NOTE 13 - OTHER ASSETS

Previous Year		Current Year
	(i) Branch adjustments	
	(ii) Stationery	
	(iii) Interest accrued on Investments/advances	
	(iv) Tax paid in advance, and deducted at source	
	(v) Prepaid expenses	
	(vi) Others	
	Total ..	

PROFIT & LOSS ACCOUNT (PROPOSED FORMAT)

Profit & Loss Account for the year ended 31st December .....

(000's omitted)

Previous Year		Current Year
	I. Income	
	(Less usual and necessary provisions)	
	1. Interest income (Note 1)	
	2. Other income (Note 2)	
	Total ...	
	II. Expenditure	
	1. Interest expense (Note 3)	
	2. Other operating expenses(Note 4)	
	III. Profit	
	Profit Appropriation	
	Profit (Loss) brought forward	
	Net profit (Loss) for the year	
	Total ...	
	Proposed dividend at %	
	Staff bonuses/ex-gratia payments	
	Transfer to statutory reserves	
	Transfer to other reserves	
	Balance carried over	

NOTE TO PROFIT AND LOSS ACCOUNT

(000's omitted)

Previous Year		Current Year In India	Current Year Outside India
	NOTE - I - INTEREST INCOME		
	Interest and fees on advances (other than to banks)		
	Interest and discount on bills (")		
	Interest on participation certificate bought		
	Discount on bills rediscounted with the bank		
	Interest on bank deposits and loans to banks		
	Income from Government and other approved securities		
	Dividend/Income from other investments		
	Other interest income		
	NOTE - II - OTHER INCOME		
	Fees & commissions on banking services		
	Fees & commissions on consultancy and other services		
	Commissions, brokerage etc. in dealing in securities		
	Net profit on sale of investments		
	Exchange, commission, brokerage and other income on foreign exchange transactions		
	Rent and other income		
	Net profit on sale of land, premises & other assets		
	NOTE - III - INTEREST EXPENSES		
	Interest on savings accounts		
	Interest on term deposits		
	Discount/Interest on refinance and borrowings from Reserve Bank		
	Discount/Interest on refinance from other financial institutions		
	Interest on participation certificates sold		
	Other interest payments		

Previous Year		Current Year In India	Current Year Outside India
	NOTE IV - OTHER EXPENSES		
	Staff salaries/wages	Rs	
	Terminal benefits payments/ contributions	Rs	
	Other staff costs	Rs	
	Directors' fees and allowances	Rs	
	Auditors fees	Rs	
	Depreciation on banks' property	Rs	
	Rent, taxes, insurance and other expenses on fixed assets	Rs	
	Printing and stationery	Rs	
	Water, light and fuel	Rs	
	Communication expenses (telephones, postages, telegrams, telexes etc.)	Rs	
	Legal expenses	Rs	
	Advertisement	Rs	
	Net loss on sale of securities	Rs	
	Net loss on sale of land, premises, etc.	Rs	
	Other expenses	Rs	
	Total		

NOTE TO BALANCE SHEET AND PROFIT AND LOSS ACCOUNT (FORMATS)

The Balance Sheet and Profit and Loss Account will only contain broad heads, the details/break-up being given by way of notes to the accounts. The intention is that for the purpose of statutory compliance regarding publication of balance sheets etc., in news papers/periodicals the details need not be published. The material changes suggested cover the following items :

(1) The business of Banks has grown substantially. To simplify the presentation of the balance sheets, the Committee has suggested that the figures shown im the profit and loss accounts and balance sheets be rounded off to the nearest 1000 (3 zeroes omitted).

(2) The Committee are also of the opinion that the balance sheets, if these are presented in a vertical form, may be more easily readable.

(3) The Committee are of the view that the annual accounts should clearly indicate the business inside and outside India. The formats have been devised with this end in view.

(4) Deposits : Only pure deposits will be included under the head against the present practice of including provisions and such other items under current contingency accounts etc., these items will now be shown under "Other Liabilities".

(5) Borrowings: The present classification required borrowings to be classified on the basis of situation i.e., in India or outside India. As the sources and nature of borrowings of banks are equally important from the point of view of their resources it would be useful to make a provision for this information. In view of the changes suggested, the classification by way of secured or unsecured borrowings could be dispensed with.

(6) Other Liabilities: There is no uniformity in classifying returns under this head. Apart from the different practices of classifying items under 'deposits' and other liabilities, some banks show all the items of other liabilities clubbed together. The Committee have suggested classification under certain broad sub-heads.

(7) Contra items :

(i) Bills for collection being Bills Receivable (as per contra)

and

Bills Receivables being Bills for Collection (as per contra)

(ii) Acceptance, Endorsements and other obligations (per contra)

and

Constituents Liabilities for Acceptances, Endorsements, and other obligations (per contra)

In the interest of simplicity and brevity, it would be advantageous to exclude 'contra items' from the balance sheet. For the purpose of accounting, it would be adequate, if the contras are shown as footnotes to the Balance Sheet.

(8) Contingent Liabilities: To simplify the balance sheet, the Contingent Liabilities need not be shown therein. The total of these liabilities may be shown in the footnote to the balance sheet. The Committee have suggested that the break-up may be given by way of note.

(9) Investments :

(i) The Committee have suggested a break-up of the investments in such a way as to indicate investments in Government/approved securities, in subsidiaries/associate companies and other trade investments.

(ii) In the form of balance sheet prescribed under the Banking Regulation Act, 1949 it has been provided in the note (f) appended thereto that when the book-value of investments of banks is higher than the market value, the market value should be shown separately. In cases where banks hold adequate provision for this depreciation they visualise no difficulty in showing the market value. However, where the provision is not adequate, it has been argued by the banks concerned that since the apparent loss arising out of fluctuations in the market value is mainly notional in nature and does not accrue unless the securities are actually sold, the requirement of showing the market value of investments, disclosing thereby the uncovered depreciation would adversely affect their image in the financial circles. They have therefore been seeking exemption from the Reserve Bank from complying with the requirements of Note (f).

Considering that the depreciation in such cases is largely notional and actual loss hardly arises and also that fluctuations in the market value of securities are caused by changes in Government's monetary policy, the Reserve Bank has been granting exemptions to the banks from the requirement of note (f), thereby enabling them to show the securities in the balance sheet at cost price only. Although such exemptions were being granted to banks almost continuously upto 1972, when the matter was reviewed in 1973, it was felt that with the bulk of the banks being in the public sector, the possibility of any adverse effect on their image following the disclosure of a small amount of depreciation no longer existed. There was also a need to exhort banks to build-up adequate reserves to cover all kinds of actual or likely losses. When the Reserve Bank announced its decision of discontinuing the practice of general exemption and instead granting selective exemptions on the basis of merits of each case, many banks, particularly those banks operating in foreign countries, contended that having regard to the custom adopted by banks in foreign countries in assessing the net worth and financial strength of their correspondents the disclosure of depreciation would tend to be an adverse factor and therefore not desirable. Since the requirements of note (f) have in effect never been enforced almost since the enactment of the Banking Regulation Act, it is not worthwhile retaining this provision. Instead of granting an exemption from year to year, it would be more realistic to do away with this requirement which has been held in abeyance since its inception or does not serve any valid purpose. In view of these considerations, it is recommended that note (f) may be deleted from the format of the balance sheet prescribed under the Banking Regulation Act, 1949. The balance sheet itself may also contain provision for showing the redeemable value of the securities.

(10) Advances and Bills: Banks follow different practices in showing advances, particularly in respect of refinance, participation, certificates sold/bought, bills discounted/rediscounted etc. The form suggested by us will be more informative and will also ensure uniform presentation.

(11) Other Assets : The Committee have suggested certain broad heads for classification of other assets.

(12) Form of Profit & Loss Account: The existing format of profit and loss account is too brief and it is difficult to get a clear idea as to the net operating profit/loss which the bank has made. If this information is available readily, it will help the authorities concerned to locate the exact spot where 'the shoe pinches' and take prompt remedial measures. In keeping with the developments in the developed countries, it is advantageous to get from the profit and loss accounts of banks the cost of the other services which banks have ventured into recently, such as, sale/purchase of participation certificates, consultancy services, etc. It is also felt that the revenue accounts should reveal separately the cost of refinance obtained by the banks from Reserve Bank of India and other institutions. Keeping these requirements in mind we have suggested a new format for the profit and loss account to be used by both the public and private sector banks.

CHAPTER VI

TRENDS IN EARNINGS AND EXPENSES

In sustaining and widening their role in national development, banks cannot afford to ignore their overall viability over a period of years. A study of the trends in earnings and expenses of banks is hence necessary. Such an analysis, covering the decade 1965-75 based on the special return on Earnings and Expenses (Form A2) received from banks individually for each accounting (Calendar) year is attempted here. The data supplied in this return are not comparable with those given in the published balance sheets as they include certain appropriations/transfers made at the time of the annual audit. Also, these data are provided in somewhat greater detail and are available separately for Indian offices of all banks and foreign offices of Indian banks.

6.2 For the purpose of analysis, banks have been grouped into ~~7~~ 8 categories. This grouping is based on the constitution or ownership factor - (Viz. whether a bank is in the State Bank group or is a nationalised bank, Indian private sector bank or foreign bank) as also on size as indicated by the quantum of deposits. The composition of the groups is given in Appendix 1.

Overall trends

6.3 The overall trends for the system as a whole, reveal a substantial increase in the decade 1965-1975 in the total value of business as also in the earnings and profits of commercial banks, as may be seen from the following figures :

Compound Annual Growth Rates (Per cent)

	Ten-Year Period 1965-75 (1)	Five-Year Period 1965-70 (2)	Five-Year Period 1970-75 (3)	Three-Year Period 1970-73 (4)	Two-Year Period 1973-75 (5)
1. Total business*	16.4	14.9	17.9	18.0	17.8
2. Working funds @	16.4	14.3	18.5	19.3	17.4
3. Total earnings	21.5	16.4	26.6	21.5	34.0
4. Total expenses	22.0	17.9	26.5	22.7	32.3
5. Balance of profit	17.5	8.7	27.2	12.8	52.3

---

* Average deposits plus average advances.

@ Average deposits plus average borrowings.

6.4 The contrast between the pace of growth in the latter half of the decade (1970-75) as against the period 1965-70 is sharp. The contrast is more marked in earnings, expenses and profits than in the increase in business or in funds. This, however, needs to be considered more closely. The latter two years of the second half of the decade (1974 and 1975) showed a very different trend from the previous three years, which would suggest that the year 1974 witnessed something of a turning point in the business of banks. It may be seen that upto that year, the increase in expenses was faster than that in earnings. During 1974 and 1975, earnings increased at a much higher rate than expenses. The increase in balance of profits was consequently striking. The principal reason for this increase in earnings and in profits in 1974 and 1975 was the hike in lending rates which accentuated the effect of the brisker growth in business. Thus in the years 1970-73, while business increased by 18% per annum, the rate of increase in earnings was only three percentage points higher, at 21%. In 1973-75, on the other hand, the difference between the two rates was dramatic: ~~19%~~ 18% in the case of total business as against 34% in total earnings.

6.5 Some qualifications to these general conclusions need to be recognised. In the first place, this represents an overall trend for the system as a whole. Inter group comparisons, to be discussed later, reveal some interesting differences. Secondly, the impact of the ceiling on lending rate, introduced in March 1976, combined with further pressure on expenses is likely to be such as to cause a shift, if not reversal, of the trend in the future.

Composition of Expenses

6.6 In the expenses incurred by banks, interest payments has always been the most important component. Interest, which could be called the "raw material cost" of banking, is paid on deposits as well as on borrowings. The latter, necessary on occasions to tide over day-to-day operational difficulties, is not of much significance as compared to the interest paid on deposits. Interest cost as a whole (of deposits and borrowings) constituted just over half of the total expenses of banks (51.2%) in 1965. In 1970, the significance declined, with the proportion at 48.6%. This could be attributed to the spurt in establishment and other expenses, consequent on the geographic and functional diversification of banking since 1967. This effect was, however, transitory. In 1974, there were two major upward revisions in the deposit rates structure; also, for the first time, the higher rates on fixed deposits were made applicable to deposits held by banks on the date of the revision of the rates for the unexpired portion of the deposits' term. Interest payments in 1974 hence rose to form 55% of total expenses. In the following year, when the impact of the higher deposit rates was felt more fully, the proportion went up further by nearly 2 percentage points (to 56.7%).

<u>Interest charges</u>

6.7 The reason for this increase lies not only in the higher rates paid on deposits but also in the change in the composition of deposits, in the wake of the offer of more attractive returns. There is evidence of a change in the maturity pattern of deposits with a pronounced shift to longer term deposits viz. deposits of over 5 years, which now yield 10%. The following table illustrates this :

<u>Significance of long-term deposits</u>

	1972	1975	1976
(1) Fixed deposits as per cent of total deposits	50.7	54.0	56.8
(2) Deposits of over 5 years as per cent of total fixed deposits	13.4	27.4	37.5
(3) Deposits of over 5 years as per cent of total deposits	6.8	14.8	21.3

Thus, banks have to pay the maximum rate of 10% on over a fifth of total deposits.

6.8 This shift to long-term deposits is likely to continue and grow more pronounced, before stabilising perhaps at around 30 per cent of total deposits. The recent change ~~at~~ in deposit rates with a reduction in the interest rates of short-term deposits might further accentuate this trend. This trend has an important implication for the expenses of banks; even without further increases in the deposit rates, interest costs are likely to rise in proportion to total costs. The increased "burden" will have to be borne by banks, not only in wider national interests, but even with the limited objective of acquiring more operating funds.

6.9 There are some notable differences in the significance of interest cost between the different size-groups of banks. (Statement 1 appended). In some cases, the increase in the importance of interest charges is sharp. For example in the first group (SBI and large nationalised banks), the rise is from 51.8% in 1965 to 56.5% in 1975. In foreign banks, the proportion has risen from 48.5% to 54.5%. On the other hand, in the case of the small private sector banks (deposits upto Rs 25 crores) the proportion has declined from 55.6% to 54.1%. In the other private sector groups there was an increase in the proportion but this was not as marked as in the case of the larger bank groups. In consequence, the differences among the bank groups in the proportion of interest cost has narrowed between 1965 and 1975. This could be attributed to the change in the deposit pattern being felt more keenly by the larger banks. The preferences of the clientele of the smaller banks are probably more steady, and the shift to deposits of longer maturity has perhaps not affected them to the same extent as the larger banks. In the case of smaller banks, the impact of the increase in deposit rates has probably been felt without much of the further pressure arising from a shift in deposit pattern.

<u>Inter-group differences</u>

6.10 In 1975, the bank group with the lowest proportion of interest ~~rate~~ cost was the associates of the State Bank. This group's expenses pattern is rather different from that of others because of the impact of government business traditionally undertaken only by the State Bank group. In the case of the State Bank itself, the influence of this factor is somewhat diffused because of the larger scale of overall business. But even so, it is evident;

if the State Bank is excluded from the first group (SBI and large nationalised banks), the proportion of interest cost increases while that of establishment expenses goes down to a corresponding extent.

6.11 For most bank groups as well as for the system as a whole, the proportion of establishment expenses has declined.

Establishment Expenses

Establishment expenses now form about a third of total expenses of banks; in 1965 the proportion was 35.6% and by 1970 it had risen to 39.2%. The decline in 1975 is attributable entirely to the greater prominance of interest charges.

6.12 Establishment expenses are subject to increase from two factors - the increase in the number of employees and in the scale of their emoluments. It is common knowledge that both have undergone substantial increases in recent years. The increase in the number of employees is a necessar concomitant of the large scale branch expansion and functiona diversification of banking since the nationalisation of the major banks. However, because the expansion has been mainly in rural areas where the manpower required is less than in areas where banking business is more intensive, the average number of employees per branch has declined from 26 in 1965 to 19 in 1975 (Statement 2). The decline is very marked in the public sector bank groups. In the case of private sector banks the decline is less pronounced; in one group (large private sector banks) there is actually a small rise in the average number of employees per office between 1970 and 1975, reflecting the importance of metropolitan expansion of these banks. The average number of employees per office is highest in foreign banks, with an increase in the average between 1970 and 1975. This follows from the concentration of their operations in metropolitan areas and an increase in business without a further spread of their branch net work. The average establishment expenses per employee, on the other hand, has increased substantially from Rs 4626 in 1965 to Rs 12,393 in 1975 (Statement 3). This increase was more marked in the latter half of the 10 year period. In the period 1970-75, the increase was roughly at the rate of Rs 1000 per year, as against Rs 500 per year in the preceding 5 years.

6.13 Any assessment of the return on establishment expenses is inhibited by the fact that it is difficult to arrive at a satisfactory measure or indicator of productivity in a service industry like banking. One relationship that could be considered is that between establishment expenses and total business, the relevant concept being the 'output' by way of deposits and advances yielded per unit of outlay on staff. Statement 4 appended gives the trend in business (deposits plus advances) per rupee of establishment expenses in the different categories of bank. It may be seen that this has recorded a fairly sharp and steady decline since 1965, from Rs 68.6 in that year to Rs 54.6 in 1970 and Rs 46.3 in 1975. That there was no indication of any reversal of the trend in 1975 is shown by the decline over 1974. This would serve to illustrate that banks are spending more not only in acquiring resources through increase in interest charges, but in the conduct of their business as well. The expansion in rural areas has meant increase in employment without proportionate increase in business.

<u>Trend in Productivity</u>

6.14 Since interest and establishment expenses are the main elements of banks' expenses, other working expenses (such as rent, postage, travel, advertisements, etc.) are relatively small. Consequent on the growth in interest charges, the proportion of other

<u>Other working Expenses</u>

working expenses to total expenses for the system as a whole has declined from 10.2% in 1965 to 8.9% in 1975. In this case also, the decline is mainly on account of public sector banks. In private sector banks, other working expenses have gone up in some cases substantially, In 1975, the highest proportion of other working expenses among Indian banks was in the case of medium private sector banks (Group 6). This again is partly due to diversification of the business of these banks. The high proportion of other working expenses of foreign banks (17% in 1975) has to be viewed in conjunction with that group's relatively low share of establishment expenses (25%).

6.15 However, some items in this group catch the eye of the public and the adverse "demonstration effect" causes damage to the image of banks, especially of public sector banks. In 1974, banks incurred expenses totalling about Rs 72 crores on account of some major items of working expenses, which together formed about 6% of total expenditure. The details are as follows :

	Amount (Rs. lakhs)	% to total expenses
1. Rent, lighting charges, maintenance and repairs to office equipment/bank property	3142	2.7
2. Printing and Stationery, postage, telegrams, stamps and telephones	2551	2.2
3. Advertisement, periodicals and newspapers and entertainment expenses	407	0.4
4. Conveyance charges, motor car expenses and travelling expenses (including LFC)	1073	0.9
	7173	6.2

It may also be added that these items together accounted for the major part (70%) of other working expenses. Economy in these expenses is necessary and desirable as a part of the overall discipline.

6.16 In earnings, as in expenses, interest constitutes the most important item although, unlike in expenses, the pattern on earnings has remained remarkably steady for the system as a whole since 1965. The share of total interest (earned on loans, advances and bills and on investments and deposits with banks) has risen only marginally from 86.8% in 1965 to 87.2% in 1975 (Statement 5) However, if the State Bank is excluded from the totals, the picture is rather different. Such an exclusion can be justified because of the markedly different business pattern of the State Bank, whose earnings from sources other than interest have always been proportionately higher than in the other banks. The importance of these other earnings has grown sharply in the past two years partly on account of higher commission on Government business. Besides, the pace of growth in State Bank's interest income has been less marked because the interest rate structure of that bank was not levered up to the same extent as in several other banks subsequent to 1973, when the minimum lending rate was first introduced. These factors had the combined effect of deflating the growing significance of interest income for the system as a whole. If State Bank's figures are excluded, it is seen that the proportion of interest income in total earnings has increased from 87.6% in 1965 to 89.5% in 1975.

<u>Composition of Earnings</u>

6.17 The increase in interest costs and that in interest income, especially in 1974 and 1975, reflect the impact of the high interest rates policy. Until last year, the increase in interest income has been such as to enable banks to sustain the increase in costs. This is best illustrated in terms of the per cent cost of raising funds (deposits plus borrowings) and the return therefrom.

Cost of funds and return ~~of~~ on funds per cent

YEAR	Interest Cost	Cost		Total cost	Earnings		Total Earnings	Net Earnings
		Establishment cost	All other costs		Interest Earnings	Other Earnings		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1965								
Including SBI	3.4	2.4	0.9	6.7	7.0	1.1	8.1	1.4
Excluding SBI	3.6	2.3	1.0	6.9	7.3	1.0	8.3	1.4
1970								
Including SBI	3.8	3.0	1.0	7.8	7.7	1.2	8.9	1.1
Excluding SBI	3.9	2.8	1.0	7.7	7.8	1.0	8.8	1.1
1973								
Including SBI	4.4	3.1	1.0	8.5	8.2	1.2	9.4	0.9
Excluding SBI	4.5	2.9	1.8	8.4	8.3	1.0	9.3	0.9
1974								
Including SBI	5.5	3.4	1.1	10.0	9.9	1.5	11.4	1.4
Excluding SBI	5.6	3.2	1.2	10.0	10.1	1.2	11.3	1.3
1975								
Including SBI	6.1	3.5	1.2	10.8	10.8	1.6	12.4	1.6
Excluding SBI	6.3	3.4	1.2	10.9	10.9	1.3	12.2	1.3

6.18 Between 1965 and 1970, the cost of funds went up mainly on account of establishment charges, which followed from the new responsibilities assumed by the banking system. Interest charges also went up, although to a lesser extent. Between 1970 and 1973, the increase in interest cost was more marked than that in establishment expenses. On the side of earnings, while other earnings remained static, interest income rose to some extent between 1965 and 1973 but not adequately to cover the increased costs so that the "spread" between income and expenditure (or return and cost) declined from 1.4% to 0.9%. In 1974, despite a sharp increase in interest cost, interest income rose substantially to restore the "spread" to the 1965 level.

6.19 In 1975, the same trend was further accentuated for the system as a whole. There was no marked difference between the position of all banks and of banks excluding the State Bank in 1965 as well as 1970. But in 1975 and 1974, the relative position of banks other than State Bank of India deteriorated entirely because their 'other income' did not record any material increase. Even so, 1975 was a better year than 1974 for these other banks; but the improvement was not such as to restore their net income, or 'spread', to the 1965 level.

6.20 The above analysis brings out the vast difference in the degree of elasticity of the two components of income-interest and 'other income'

<u>Income from other sources</u>

For banks other than the State Bank, the proposition of 'other income' has remained virtually static over the decade while the increase in costs has been met entirely by increasing interest charges. As the name suggests "other income" is an omnibus group, consisting of such diverse elements as commission on bills and remittances and letters of credit, commission and profit on foreign exchange dealings, rental charges on locker facilities etc.

6.21 The following table gives the composition of income from other sources. :

<u>Income from other sources</u>

(Rs lakhs)

		1965	1970	1975
Commission on letters of credit	..	382 (12.1)	715 (10.5)	1761 (8.2)
Inland Bills, TTs and DDs	..	892 (28.2)	1793 (26.4)	4269 (20.0)
Foreign Bills, TTs and DDs	..	263 (8.3)	609 (9.0)	1678 (7.8)
Other Service charges	..	1146 (36.2)	2641 (38.8)	9313 (43.6)
Other income	..	480 (15.2)	1045 (15.3)	4357 (20.4)
		3163 (100.0)	6803 (100.0)	21378 (100.0)

(Percentage to total income from other sources given in brackets).

6.22 It may be seen that the increase in this head of income has arisen mainly from other service charges, the most important component of which is commission on foreign exchange dealings, and 'other income'. Bills and remittances, which constitute an important service rendered by banks and the volume of which grows with business and the spread of the banking habit, now account for a much lower share of the income in this group than in 1965.

6.23 The absence of elasticity in one component of earnings, while all the components of other income have grown, albeit at somewhat different rates, has affected the profitability of banks. The growth rates given at the outset show a much higher rate for balance of profit than for earnings or expenses. This is somewhat misleading. A more meaningful picture emerges by relating the balance of profit to total earnings. This shows the proportion of gross income that remains with the banks, after the operating costs are met. From Statement 6, it is seen that this has declined fairly markedly, from about 18% in 1965 to 13% in 1975. Between 1974 and 1975 there appears to be an improvement, but if the State Bank, (whose unique position has already been explained) is excluded, there is actually a slight deterioration.

6.24 Another feature of operations that has sustained profitability in recent years is the income generated by the branches of Indian banks abroad

<u>Share of Foreign Branches</u>

In 1965, 7 Indian banks had foreign branches. In 1975, there were 8 such banks but consequent on various developments, Indian banks had to make certain institutional adjustments, which meant their exit from some countries. Nonetheless, foreign branches came into greater prominence in banks' total earnings and profits as may be seen from the following :

Share of foreign offices in the total business of scheduled commercial banks

	1965	1970	1974	1975
1. Percentage of earnings of foreign branches to total earnings:				
(a) Indian banks with foreign branches	5.9	4.6	5.9	6.2
(b) All scheduled commercial banks	3.1	2.5	3.1	3.3
2. Percentage of expenses of foreign branches to total expenses:				
(a) Indian banks with foreign branches	6.0	4.4	5.0	5.4
(b) All scheduled commercial banks	3.1	2.4	2.6	2.8
3. Percentage of profit of foreign branches to total balance of profit :				
(a) Indian banks with foreign branches	5.5	5.9	12.6	10.6
(b) All scheduled commercial banks	3.2	3.1	6.7	6.3

Thus, while the contribution by foreign offices to the gross earnings of all banks did not alter materially, the contribution to the balance of profit doubled over the period, which is indicative of the relative deterioration in the profitability of Indian operations. While it is necessary and desirable to expand the foreign operations of Indian banks and also derive the maximum benefit from such expansion, the income from foreign offices should not be allowed to blur the performance of Indian offices.

6.25 It is clear that banks have been able to sustain the profitability of their internal operations only through raising the cost of their principal service, viz. lending. This degree of elasticity in interest income has largely been imputed by policy. With the reversal of policy in 1976

Role of Interest Rates

and the imposition of a ceiling on interest rates, manoeuvrability available to banks to adjust income to meet expenses has been considerably restricted. Interest income would also be affected by the increasing importance of credit to sectors requiring preferential treatment in interest rates. On the other hand, all the items of cost are likely to continue to exert pressure. Interest costs will continue to rise, as already noted, on account of the increasing public preference for high cost deposits. Although the efforts to increase productivity and restrict resort to overtime etc., would have some effect in curbing the growth in establishment expenses, other factors would have the opposite effect. The geographic spread to low potential areas where banking requires time to take root and break even, and the assumption of new social responsibilities requiring more labour input might increase establishment charges. As already noted, no substantial benefit can be expected to emanate from a curtailment of other working expenses.

6.26 The immediate future for the banking system, from the view point of profitability is, therefore, not very promising. Swift action is needed to sustain the utility of this crucial sector, prevent it from becoming a drag on the economy and sustain and enhance its inherent earning capacity. In this, increased labour productivity alone will not be adequate. For one thing, the immediate impact of an improvement in labour out-turn would only be in the quality of service rendered. It would require time for the improved service to have a tangible effect on banks' profitability, through an increase in the quantum of business and restraint on the increase in establishment costs. The urgent requirement is hence to consider an increase in earnings and reduction in expenses through cost control and other methods.

APPENDIX 1 - GROUPING OF BANKS

Sl. No.	Group	Size of deposits (Rs. Crores)	No. of ~~deposits~~ Banks	Total deposits of the banks in the group (Last Friday of Dec. 1975) (Rs. Crores)	Total deposits of the bank in group as % of grand total of deposits
1.	2.	3.	4.	~~6~~ 5.	6.
1.	State Bank of India and Large Nationalised Banks	Over 750	5	6736	49.4
2.	Medium Nationalised Banks	400 - 750	5	2566	18.8
3.	Small Nationalised Banks	200 - 400	5	1465	10.7
4.	Subsidiaries of State Bank of India	-	7	719	5.3
5.	Large Private Sector Banks	50 - 200	6	706	5.2
6.	Medium Private Sector Banks	25 - 50	11	395	2.9
7.	Smaller Private Sector Banks	Below 25	20	201	1.5
8.	Foreign Banks	-	12	839	6.2
9.	All Commercial Banks	-	71	13628	100.0

Appendix 1A

Grouping of Scheduled Commercial Banks
(Based on deposits as of December 1975)

***

I. S.B.I. and Large Nationalised Banks

1. State Bank of India
2. Bank of Baroda
3. Bank of India
4. Central Bank of India
5. Punjab National Bank

II. Medium Nationalised Banks

1. Canara Bank
2. Syndicate Bank
3. Union Bank of India
4. United Bank of India
5. United Commercial Bank

III. Small Nationalised Banks

1. Allahabad Bank
2. Bank of Maharashtra
3. Dena Bank
4. Indian Bank
5. Indian Overseas Bank

IV. Subsidiaries of S.B.I.

1. State Bank of Bikaner & Jaipur
2. State Bank of Mysore
3. State Bank of Patiala
4. State Bank of Hyderabad
5. State Bank of Travancore
6. State Bank of Saurashtra
7. State Bank of Indore

V. Large Private Sector Banks

1. Andhra Bank
2. New Bank of India
3. Punjab & Sind Bank
4. Vijaya Bank
5. Corporation Bank
6. Oriental Bank of Commerce

VI. Medium Private Sector Banks

1. Hindustan Commercial Bank
2. Bank of Rajasthan
3. South Indian Bank
4. Bank of Madura
5. Karur Vysya Bank
6. United Western Bank
7. Karnataka Bank
8. Sangli Bank
9. Laxmi Commercial Bank
10. Federal Bank
11. Jammu & Kashmir Bank

VII. Smaller Private Sector Banks

1. Bank of Karad
2. Lakshmi Vilas Bank
3. Vysya Bank
4. Nedungadi Bank
5. ~~Tanjore Permanent Bank~~ Bank of Thanjavur
6. United Industrial Bank
7. Bharat Overseas Bank
8. Bareilly Corporation Bank
9. South India Bank
10. Kumbakonam City Union Bank
11. Tamil Nadu Mercantile Bank
12. Miraj State Bank
13. Benares State Bank
14. Punjab Co-operative Bank
15. Ratnakar Bank
16. Narang Bank of India
17. Traders Bank
18. Catholic Syrian Bank
19. Lord Krishna Bank
20. Purbanchal Bank

VIII. Foreign Banks

1. Grindlays Bank
2. Chartered Bank
3. Bank of America
4. American Express
5. Mercantile Bank
6. Citibank N.A.
7. Bank of Tokyo
8. Banque Nationale De Paris
9. British Bank of the Middle East
10. Mitsui Bank
11. General Bank of Nederlands
12. Sonali Bank

***

STATEMENT-1 : SHARE OF INTEREST COST, ESTABLISHMENT EXPENSES, OTHER EXPENSES IN TOTAL EXPENSES

(Amount in lakhs of rupees)

BANK GROUP	1965				1970				1973	
	Total Expenses	Interest paid	Establishment Expenses	Other Expenses	Total Expenses	Interest paid	Establishment Expenses	Other Expenses	Total Expenses	Interest paid
	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.
I. S.B.I. and Large Nationalised Banks										
i) Including S.B.I.	9755	5049 (51.8)	3665 (37.6)	1041 (10.6)	23280	11338 (48.7)	9506 (40.8)	2436 (10.5)	41690	21387 (51.3)
ii) Excluding S.B.I.	5742	3143 (54.7)	1980 (34.5)	619 (10.8)	12651	6661 (52.7)	4594 (36.3)	1396 (11.0)	22350	12545 (56.1)
II. Medium Nationalised Banks	2863	1384 (48.3)	1050 (36.7)	429 (15.0)	7239	3448 (47.6)	2814 (38.9)	977 (18.5)	14480	7679 (53.0)
III. Smaller Nationalised Banks	1949	1049 (53.8)	640 (32.9)	260 (13.3)	4305	2135 (49.6)	1593 (37.0)	577 (13.4)	8205	4390 (53.5)
IV. Subsidiaries of S.B.I.	1378	718 (52.1)	526 (38.2)	134 (9.7)	3139	1445 (46.0)	1373 (43.8)	321 (10.2)	5674	2724 (48.0)
V. Large Private Sector Banks	505	271 (53.7)	169 (33.5)	65 (12.8)	1314	669 (50.9)	463 (35.2)	182 (13.9)	3562	1924 (54.0)
VI. Medium Private Sector Banks	483	252 (52.2)	164 (33.9)	67 (13.9)	1087	570 (52.4)	394 (36.3)	123 (11.3)	2233	1198 (53.7)
VII. Smaller Private Sector Banks	261	145 (55.6)	83 (31.8)	33 (12.6)	589	314 (53.3)	206 (35.0)	69 (11.7)	1165	634 (54.4)
VIII. Foreign Banks	2515	1219 (48.5)	722 (28.7)	574 (22.8)	3904	1869 (47.9)	1230 (31.5)	805 (20.6)	5845	2756 (47.2)
All Scheduled Commercial Banks										
i) Including S.B.I.	19709	10087 (51.2)	7019 (35.6)	2603 (13.2)	44857	21788 (48.6)	17579 (39.2)	5490 (12.2)	82854	42692 (51.5)
ii) Excluding S.B.I.	15696	8181 (52.1)	5334 (34.0)	2181 (13.9)	34228	17111 (50.0)	12667 (37.0)	4450 (13.0)	63514	33850 (53.3)

BANK GROUP	1973			1974				1974		
	Establishment Expenses	Other Expenses	Total Expenses	Interest Paid	Establishment Expenses	Other Expenses	Total Expenses	Interest Paid	Establishment Expenses	Other Expenses
	11.	12.	13.	14.	15.	16.	17.	18.	19.	20.
I.. S.B.I. and Large Nationalised Banks										
i) Including S.B.I.	15758 (37.8)	4545 (10.9)	57247	31648 (55.3)	20035 (35.0)	5564 (9.7)	70880	40015 (56.5)	24323 (34.3)	6542 (9.2)
ii) Excluding S.B.I.	7433 (33.3)	2372 (10.6)	30801	18273 (59.3)	9478 (30.8)	3050 (9.9)	37491	22299 (59.5)	11655 (31.1)	3537 (9.4)
II. Medium Nationalised Banks	5065 (35.0)	1736 (12.0)	21128	11764 (55.7)	6825 (32.3)	2539 (12.0)	27277	16173 (59.3)	8340 (30.6)	2764 (10.1)
III. Smaller Nationalised Banks	2829 (34.5)	986 (12.0)	11740	6805 (58.0)	3677 (31.3)	1258 (10.7)	15012	8979 (59.8)	4456 (29.7)	1577 (10.5)
IV. Subsidiaries of S.B.I.	2421 (42.7)	529 (9.3)	7468	3585 (48.0)	3095 (41.4)	788 (10.6)	9130	4688 (51.4)	3664 (40.1)	778 (8.5)
V. Large Private Sector Banks	1123 (31.5)	515 (14.5)	5131	2780 (54.2)	1594 (31.1)	757 (14.7)	7288	3958 (54.3)	2204 (30.2)	1125 (15.5)
VI. Medium Private Sector Banks	771 (34.5)	264 (11.8)	3164	1696 (53.6)	1058 (33.4)	410 (13.0)	4489	2456 (54.7)	1365 (30.4)	668 (14.9)
VII. Smaller Private Sector Banks	400 (34.3)	131 (11.3)	1622	877 (54.1)	549 (33.8)	196 (12.1)	2263	1225 (54.1)	731 (32.3)	307 (13.6)
VIII. Foreign Banks	1708 (29.2)	1381 (23.6)	7691	4206 (53.3)	2030 (25.7)	1655 (21.0)	8797	4797 (53.5)	2218 (25.2)	1782 (20.3)
All Scheduled Commercial Banks										
i) Including S.B.I.	30075 (36.3)	10087 (12.2)	115391	63361 54.9)	38863 (33.7)	13167 (11.4)	145136	82291 (56.7)	47301 (32.6)	15544 (10.7)
ii) Excluding S.B.I.	21750 (34.2)	7914 (12.5)	88945	49986 (56.2)	28306 (31.8)	10653 (12.0)	111747	64575 (57.8)	34633 (31.0)	12539 (11.2)

Note: Figures in brackets indicate percentages to total expenses.

BANK GROUP	1965			1970			1973		
	No. of Offices	Total No. of Staff	Staff per Office	No. of Offices	Total No. of Staff	Staff per Office	No. of Offices	Total No. of Staff	Staff per Office
	1.	2.	3.	4.	5.	6.	7.	8.	9.
I. State Bank of India and Large Nationalised Banks									
i) Including S.B.I	2529	77221	30.5	4660	130168	27.9	6694	174963	26.1
ii) Excluding S.B.I.	1262	39237	31.1	2552	62985	24.7	3689	81212	22.0
II. Medium Nationalised Banks	906	23205	25.6	2040	40361	19.8	3036	59285	19.5
III. Smaller Nationalised Banks	644	14334	22.3	1309	23106	17.7	2059	33547	16.3
IV. Subsidiaries of S.B.I.	653	14266	21.8	1144	21941	19.2	1625	29333	18.1
V. Large Private Sector Banks	281	4419	15.7	621	7732	12.5	1132	14392	12.7
VI. Medium Private Sector Banks	407	5685	14.0	644	7487	11.6	1000	11215	11.2
VII. Smaller Private Sector Banks	341	3688	10.8	457	5136	11.2	628	6658	10.6
VIII. Foreign Banks	85	8918	104.9	121	10179	84.1	127	11227	88.4
All Scheduled Commercial Banks:									
i) Including S.B.I.	5846	151736	26.0	10996	246110	22.4	16301	340620	20.9
ii) Excluding S.B.I.	4579	113752	24.8	8888	178927	20.1	13296	246869	18.6

BANK GROUP	1974			1975		
	No. of Offices	Total No. of Staff	Staff per Office	No. of Offices	Total No. of Staff	Staff per Office
	10.	11.	12.	13.	14.	15.
I. State Bank of India and Large Nationalised Banks:						
i) Including S.B.I.	7340	189437	25.8	8099	195119	24.1
ii) Excluding S.B.I.	3958	87026	22.0	4298	89907	20.9
II. Medium Nationalised Banks	3361	65212	19.4	3790	57641	15.2
III. Smaller Nationalised Banks	2302	36278	15.8	2630	40305	15.3
IV. Subsidiaries of S.B.I.	1710	31669	18.5	1803	32837	18.2
V. Large Private Sector Banks	1348	18273	13.6	1653	22621	13.7
VI. Medium Private Sector Banks	1100	11948	10.9	1322	13481	10.2
VII. Smaller Private Sector Banks	712	7444	10.5	866	8435	9.7
VIII. Foreign Banks	128	11315	88.4	128	11244	87.8
All Scheduled Commercial Banks:						
i) Including S.B.I.	18001	371576	20.6	20290	381683	18.8
ii) Excluding S.B.I.	14619	269165	18.4	16489	276471	16.8

STATEMENT 3 : AVERAGE ESTABLISHMENT EXPENSES PER STAFF

BANK GROUP	1965			1970			1973		
	Total No. of Staff	Establishment Expenses (Rs.lakhs)	Establishment Expenses per Staff (Rs.)	Total No. of Staff	Establishment Expenses (Rs.Lakhs)	Establishment Expenses per Staff (Rs.)	Total No. of Staff	Establishment Expenses (Rs.Lakhs)	Establishment Expenses per Staff (Rs.)
	1	2	3	4	5	6	7	8	9
I. State Bank of India and Large Nationalised Banks:									
i) Including S.B.I.	77221	3665	4746	130168	9506	7303	174963	15758	9006
ii) Excluding S.B.I.	39237	1980	5046	62985	4594	7294	81212	7433	9153
II. Medium Nationalised Banks	23205	1050	4525	40361	2814	6972	59285	5064	8543
III. Smaller Nationalised Banks	14334	640	4465	23106	1593	6894	33547	2829	8433
IV. Subsidiaries of S.B.I.	14266	526	3687	21941	1373	6258	29333	2421	8254
V. Large Private Sector Banks	4419	169	3824	7732	463	5988	14392	1123	7803
VI. Medium Private Sector Banks	5685	164	2885	7487	394	5263	11215	771	6875
VII. Smaller Private Sector Banks	3688	83	2251	5136	206	4011	6658	400	6008
VIII. Foreign Banks	8918	722	8096	10179	1230	12084	11227	1708	15213
All Scheduled Commercial Banks									
i) Including S.B.I.	151736	7019	4626	246110	17579	7143	340620	30075	8829
ii) Excluding S.B.I.	113752	5334	4689	178927	12667	7079	246869	21750	8810

BANK GROUP	1974 Total No. of Staff	1974 Establishment Expenses (Rs.lakhs)	1974 Establishment Expenses per Staff (Rs.)	1975 Total No. of Staff	1975 Establishment Expenses (Rs.lakhs)	1975 Establishment Expenses per Staff (Rs.)
	10	11	12	13	14	15
I. State Bank of India and Large Nationalised Banks:						
i) Including S.B.I.	189437	20035	10576	195119	24323	12466
ii) Excluding S.B.I.	87026	9478	10891	89907	11655	12963
II. Medium Nationalised Banks	65212	6825	10466	57641	8340	14469
III. Smaller Nationalised Banks	36278	3677	10136	40305	4456	11056
IV. Subsidiaries of S.B.I.	31669	3095	9773	32837	3664	11158
V. Large Private Sector Banks	18273	1594	8723	22621	2204	9743
VI. Medium Private Sector Banks	11948	1058	8855	13481	1365	10125
VII. Smaller Private Sector Banks	7444	549	7375	8435	731	8666
VIII. Foreign Banks	11315	2030	17941	11244	2218	19726
All Scheduled Commercial Banks:						
i) Including S.B.I.	371576	38863	10459	381683	47301	12393
ii) Excluding S.B.I.	269165	28306	10516	276471	34633	12527

STATEMENT-4: AVERAGE DEPOSIT@ AND CREDIT@ PER RUPEE OF ESTABLISHMENT EXPENSES

BANK GROUP	1965 Total of Average Deposit & Credit (Rs.Lakhs)	1965 Establishment Expenses (Rs.Lakhs)	1965 Deposit & Credit per rupee of establishment expenses (Rs.)	1970 Total of Average Deposit & Credit (Rs.Lakhs)	1970 Establishment Expenses (Rs.Lakhs)	1970 Deposits & Credit per rupee of Establishment expenses (Rs.)	1973 Total of Average Deposit & Credit (Rs.Lakhs)	1973 Establishment Expenses (Rs.Lakhs)	1973 Deposit & Credit per rupee of establishment expenses (Rs.)
	1.	2.	3.	4.	5.	6.	7.	8.	9.
I. S.B.I. & Large Nationalised Banks									
i) Including S.B.I.	256800	3665	70.1	508008	9506	53.4	803734	15758	51.0
ii) Excluding S.B.I.	145956	1980	73.1	282703	4594	61.5	441519	7433	59.4
II. Medium Nationalised Banks	66591	1050	63.4	153928	2814	54.7	275284	5065	54.4
III. Smaller Nationalised Banks	46081	640	72.0	90542	1593	56.8	154510	2829	54.6
IV. Subsidiaries of S.B.I.	29934	526	56.9	61731	1373	45.0	97951	2421	40.5
V. Large Private Sector Banks	10148	169	60.1	25823	463	55.8	63463	1123	56.5
VI. Medium Private Sector Banks	9221	164	56.2	19078	394	48.4	39027	771	50.6
VII. Smaller Private Sector Banks	4403	83	53.1	10544	206	51.2	19465	400	48.7
VIII. Foreign Banks	58357	722	80.8	90853	1230	73.9	126575	1708	74.1
All Scheduled Commercial Banks									
i) Including S.B.I.	481535	7019	68.6	960507	17579	54.6	1580009	30075	52.5
ii) Excluding S.B.I.	370691	5334	69.5	735202	12667	58.0	1217794	21750	56.0

@ Including inter-bank.

BANK GROUP	1974 Total of average deposit & credit Rs.lakhs)	1974 Establishment expenses (Rs.lakhs)	1974 Deposit & credit per rupee of establishment expenses (Rs.)	1975 Total of average deposit & credit (Rs. Lakhs)	1975 Establishment expenses (Rs.Lakhs)	1975 Deposit & credit per rupee of establishment expenses (Rs.)
	10.	11.	12.	13.	14.	15.
I. S.B.I. & Large Nationalised Banks						
i) Including S.B.I.	951869	20035	47.5	1102671	24323	45.3
ii) Excluding S.B.I.	517144	9478	54.6	5583922	11655	50.1
II. Medium Nationalised Banks	330615	6825	48.4	403749	8340	48.4
III. Smaller Nationalised Banks	189776	3677	51.6	224654	4456	50.4
IV. Subsidiaries of S.B.I.	109580	3095	35.4	125758	3664	34.3
V. Large Private Sector Banks	78467	1594	49.2	101969	2204	46.3
VI. Medium Private Sector Banks	48075	1058	45.4	58637	1365	43.0
VII. Smaller Private Sector Banks	23486	549	42.8	28914	731	39.6
VIII. Foreign Banks	136852	2030	67.4	145294	2218	65.5
All Scheduled Commercial Banks:						
i) Including S.B.I.	1868720	38863	48.1	2191646	47301	46.3
ii) Excluding S.B.I.	1433945	28306	50.7	1672897	34633	48.3

STATEMENT 5 : SHARE OF INTEREST EARNINGS AND OTHER EARNINGS IN TOTAL EARNINGS

(Rupees lakhs)

Bank Groups	1965			1970			1973		
	Total Earnings	Interest Earnings	All other Earnings	Total Earnings	Interest Earnings	All other Earnings	Total Earnings	Interest Earnings	All other Earnings
	1	2	3	4	5	6	7	8	9
I. S.B.I. & Large Nationalised Banks									
i) Including S.B.I.	12177	10541 (86.6)	1636 (13.4)	26759	22940 (85.7)	3819 (14.8)	46421	39870 (85.9)	6551 (14.1)
ii) Excluding S.B.I.	7087	6271 (88.5)	816 (11.5)	14569	13008 (89.3)	1561 (10.7)	24635	22434 (91.1)	2201 (8.9)
II. Medium Nationalised Banks	3425	2942 (85.9)	483 (14.1)	8154	7125 (87.4)	1029 (12.6)	15750	13914 (88.3)	1836 11.7)
III. Smaller Nationalised Banks	2240	2019 (90.1)	221 (9.9)	4686	4279 (91.3)	407 (8.7)	8571	8002 (93.4)	569 (6.6)
IV. Subsidiaries of State of India	1607	1379 (85.8)	228 (14.2)	3497	2989 (85.5)	508 (14.5)	6190	5194 (83.9)	996 (16.1)
V. Large Private Sector Banks	558	480 (86.0)	78 (14.0)	1461	1312 '89.8)	149 (10.2)	3830	3502 (91.4)	328 (8.6)
VI. Medium Private Sector Banks	539	468 (86.8)	71 (13.2)	1218	1085 (89.1)	133 (10.9)	2372	2149 (90.6)	223 (9.4)
VII. Small Private Sector Banks	287	256 (59.2)	31 (10.8)	664	585 (88.1)	79 (11.9)	1248	1118 (89.6)	130 (10.4)
VIII. Foreign Banks	3142	2727 (26.8)	415 (13.2)	4914	4235 (86.2)	679 (13.8)	7798	6331 (81.2)	1467 (18.8)
All Scheduled Commercial Banks									
i) Including State Bank of India	23975	20812 (86.8)	3163 (13.2)	51353	44550 (86.8)	6803 (13.2)	92180	80080 (86.9)	12100 (13.1)
ii) Excluding State Bank of India	18885	16542 (87.6)	2343 (12.4)	39163	34618 (88.4)	4545 (11.6)	70394	62644 (89.0)	7750 (11.0)

Bank Groups	1974@ Total Earnings	1974@ Interest Earnings	1974@ All Other Earnings	1975@ Total Earnings	1975@ Interest Earnings	1975@ All Other Earnings
	10	11	12	13	14	15
I. S.B.I. & Large Nationalised Banks						
i) Including S.B.I.	65523	56238 (85.8)	9285 (14.2)	83371	71603 (85.9)	11768 (14.1)
ii) Excluding S.B.I.	34335	30951 (90.1)	3384 (9.9)	41650	38182 (91.7)	3468 (5.3)
II. Medium Nationalised Banks	22848	20466 (89.6)	2382 (10.4)	29764	26627 (89.5)	3137 (10.5)
III. Smaller Nationalised Banks	12590	11763 (93.4)	827 (6.6)	16056	14992 (93.4)	1064 (6.6)
IV. Subsidiaries of State Bank of India	8119	7037 (86.7)	1082 (13.3)	10452	8828 (84.5)	1624 (15.5)
V. Large Private Sector Banks	5686	5085 (89.4)	601 (10.6)	7806	7112 (91.1)	694 (8.9)
VI. Medium Private Sector Banks	3618	3243 (89.6)	375 (10.4)	4878	4342 (89.0)	536 (11.0)
VII. Small Private Sector Banks	1802	1571 (87.2)	231 (12.8)	2438	2036 (83.5)	402 (16.5)
VIII. Foreign Banks	11021	8994 (81.6)	2027 (18.4)	12006	9853 (82.1)	2153 (17.9)
All Scheduled Commercial Banks						
i) Including State Bank of India	131207	114397 (87.2)	16310 (12.8)	166771	145393 (87.2)	21378 (12.8)
ii) Excluding State Bank of India	100019	89110 (89.1)	10909 (10.9)	125050	111972 (89.5)	13078 (10.5)

Note: Interest earnings represents interest earned on loans and advances, bills purchased/discounted and investments.

@ Interest earnings have been adjusted for the interest tax.

Statement 6: Balance of profit as percentage of total earnings

(Amount in Rs.lakhs)

Bank Group	1965			1970			1973		
	Balance of Profit (+) or Loss (-)	Total Earnings	Percen- of Col. (1) to Col.(2)	Balance of Prifit (+) or Loss (-)	Total Earnings	Percen- of Col. (1) to Col.(2)	Balance of Profit (+) or Less (-)	Total Earnings	Percen- of Col. (1) to Col.(2)
	1	2	3	4	5	6	7	8	9
I. S.B.I. & Large Nationalised Banks									
i) Including S.B.I.	2422	12177	19.9	3479	26759	13.0	4731	46422	10.2
ii) Excluding S.B.I.	1345	7087	19.0	1918	14569	13.2	2285	24636	9.3
II. Medium Nationalised Banks	562	3425	16.4	914	8154	11.2	1270	15750	8.1
III. Smaller Nationalised Banks	291	2240	13.0	381	4686	8.1	366	8571	4.3
IV. Subsidiaries of S.B.I.	229	1607	14.3	357	3497	10.2	516	6190	8.3
V. Large Private Sector Banks	53	558	9.5	147	1461	10.1	268	3830	7.0
VI. Medium Private Sector Banks	57	539	10.6	131	1218	10.8	139	2372	5.9
VII. Smaller Private Sector Banks	25	287	8.7	75	664	11.3	84	1248	6.7
VIII. Foreign Banks	628	3142	20.0	1011	4914	20.6	1952	7797	25.0
All Scheduled Commercial Banks									
i) Including S.B.I.	4267	23975	17.8	6495	51353	12.7	9326	92180	10.1
ii) Excluding S.B.I.	3190	18885	16.7	4934	39163	12.6	6880	70394	9.8

Bank Group	1974@			1975@		
	Balance of profit (+) or Loss (-)	Total Earnings	Percentage of Col.(10) to Col.(11)	Balance of profit (+) or Loss (-)	Total Earnings	Percentage of Col.(13) to Col.(14)
	10	11	12	13	14	15
I. S.B.I. & Large Nationalised Banks						
i) Including S.B.I.	8276	65523	12.6	12491	83371	15.0
ii) Excluding S.B.I.	3533	34335	10.3	4160	41650	10.0
II. Medium Nationalised Banks	1720	22848	7.5	2487	29764	8.4
III. Smaller Nationalised Banks	850	12590	6.8	1044	16056	6.5
IV. Subsidiaries of S.B.I.	650	8119	8.0	1323	10452	12.7
V. Large Private Sector Banks	554	5686	9.7	518	7806	6.6
VI. Medium Private Sector Banks	455	3618	12.6	389	4878	8.0
VII. Smaller Private Sector Banks	180	1802	10.0	174	2438	7.1
VIII. Foreign Banks	3130	11021	28.4	3209	12006	26.7
All Scheduled Commercial Banks						
i) Including S.B.I.	15815	131207	12.1	21635	166771	13.0
ii) Excluding S.B.I.	11072	100019	11.1	13304	125050	10.6

@ Earnings have been adjusted for the interest tax.

Chapter VII

Assessment and Analysis of Banking Costs

The terms of reference of the Committee require a systematic survey to provide estimates of the cost of various banking services. This is necessary to evolve guidelines on the policy of pricing of various banking services, which is also a part of the terms of reference. A study of banking costs would further enable the establishment of a relationship between the cost or expense of a particular service and the return received for it. This approach is now conspicuous by its absence in the banking industry in India. The first cost study for the system as a whole was conducted by the Banking Commission in 1970. Among individual banks, apart from the State Bank, which has been conducting a full fledged cost study on a continuing basis since 1972, only few others have attempted even partial cost studies.

7.2 The development of a degree of "cost consciousness" in banks is of the utmost importance for their continuance as corporate entities, playing an increasingly important role in national development. This is so not only from the point of view of profitability, which though vital for the totality of banks' operations, is less relevant in the provision of individual services. Since 1969, banks in India have expanded their operations to areas hitherto unexposed to commercial banking. This process will continue and banks will be required to take up new tasks. The return received from such services ~~provided~~ will, in most cases, be lower than the costs incurred in providing them. An awareness of the cost implication of the new responsibilities is necessary so that banks as well as the Government have an idea of the subsidies that banks are called upon to provide to different sectors. Also to the extent possible, a relationship should be consciously sought to be established between the different services provided and the returns received therefrom.

7.3 Within the limited time available to this Committee a full fledged cost study, covering all banks and areas, which would provide firm estimates of costs for individual banks was not possible. However, in keeping with the terms of reference requiring the estimation of average costs for different types of banks, a limited survey was undertaken covering 21 selected ~~of the 71 of the~~ scheduled commercial banks. In selecting the banks, due consideratic was given to factors such as size, ownership, area of operation and composition of business. A representative sample of 1000 offices, giving due weightage to location and volume of business was chosen for the purpose of the study. Data for the study were collected through suitably designed schedules relating to the time spent by employees different categories on various banking activities, the volume of business transacted and the overall costs. This formed the basis for an assessment of the cost of different services. Details of the sampling technique adopted and the methodology of the study alongwith the schedules used are given in the technical note on the subject.

7.4 The processed results of the study provide the following indicators of costs.

1. Share of different services in total costs
2. Cost per unit of monetary output, viz.cost in terms of the money value as represented by the outstandings or amount of business transacted
3. Cost per physical transaction in terms of vouchers
4. Cost per account

The cost inputed to each service takes account of the value of the services put in at the branch level with appropriate loading for head office expenses.

7.5 It may be emphasised that the reference here is exclusively to servicing cost which would not include interest cost on deposits.

7.6 Based on the cost pattern of the 21 selected banks revealed by the study, separate estimates have been made, for 3 broad bank groups - SBI and large nationalised banks, other nationalised banks and foreign banks and other banks (subsidiaries of SBI and Indian private sector banks). Data are also available for the costs of services extended by offices in different population groups.

7.7 The Committee has had an advantage in that the results of the cost study conducted by the Banking Commission in 1970 were available for comparison. There is close correspondence between the pattern yielded by the results of the Banking Commission's study and the present study. There are some differences between the two which are explainable by the diversification in banking activities since the date of the Banking Commission's study. Thus, lendings to some priority sectors were not very prominent in 1970 and hence the significance of these services in overall costs was relatively low in the Banking Commission study and has risen substantially in the present study. Apart from this, the divergences in the servicing cost per transaction fully reflect the increase in establishment expenses since 1970.

7.8 The details of the methodology and the results of the present study and their comparison with the Banking Commission's study are given separately in the technical note relating to the study. The salient features are summarised here.

7.9 The business of a bank may be classified into two broad groups - funds activity, comprising deposits and loans (including bills) and other activity, which would include all other services like remittances, cheque and bill collection, foreign exchange dealings etc. Funds activity - accounts for 70% of total servicing costs, 41% for deposits and 29% for loans and bills. Among other activities, remittances and bills account for 16%, foreign exchange for about 4% and others ~~activities~~ including government business ~~handled~~ by the State Bank group for the balance of 10%.

7.10 Although the share of deposits in overall servicing cost is remarkably similar in both the Banking Commission study and the present study, there is a marked variation in the pattern. In 1970, current deposits emerged as the activity that accounted for the largest share not only in the different deposit groups but among all activities, accounting for 23% of total servicing costs. In the present study, this position is taken by savings deposits with 19% of total servicing costs (Statement 1 appended). The reason for this may lie mainly in the growing importance of savings deposits, relative to current deposits.

7.11 In Chapter II, mention was made of the change in deposit pattern, with a marked shift to term deposits, especially of longer maturity. There is another facet to this change; current deposits have declined fairly markedly in importance. In 1970, this category formed around 25% of total deposits and 12% of overall deposit accounts. By 1975, the proportions had declined to 19% and 8% respectively. On the other hand, savings deposit accounts now form 67% of the total as against 64% in 1970, while the amount of such deposits continued around 26%. It is also noteworthy that while fixed deposits have always had the highest share in total deposit amount (51% in 1970 as against 55% in 1975), in the number of deposit accounts, savings deposits are more important. The average size of a savings deposit account is thus lowest at Rs.920 as against Rs.5100 in the case of fixed deposits and Rs.5820 in current deposits. In the servicing of deposit accounts, the relevant factors are the number of accounts and the turnover of business, as indicated by the number of transactions in these accounts. Fixed (or term) deposits have virtually no turnover and hence require very few transactions. For this reason, they are the cheapest type of deposits from the view point of the cost of servicing. This is revealed not only in the low share of this group in overall servicing costs but in the high cost per transaction per account. Both in the Banking Commission study and in the present study, the cost per transaction is highest in term deposits; since transactions are so few the distribution of the total cost incurred in averaging yields a high figure. The opposite is the case in current deposits; by nature, these deposits are frequently operated; hence the cost per transaction is lowest in this case. In 1970, the intensity of the operations also made these deposits the most costly of banks' activities. But the declining significance of current deposits in overall deposits has now counteracted this factor to some extent. This is also seen in the fact that expressed as percentage of outstanding balance, cost is highest for current deposits a combined result of high cost and relatively small balances outstanding. On the other hand, the preference for savings deposits, indicated by the growth in the number of accounts in this category, has pushed up its servicing cost. The cost per transaction of savings deposits shows markedly little variation between bank groups as well as population groups, which is indicative of the consistency of the work load involved in the servicing of these deposits in the entire system (Statement 2).

7.12 The question would suggest itself if the growing popularity of savings deposits and the tendency to use them frequently has increased the transactions involved and hence the servicing cost. The data provided by the present study do not substantiate this. The cost per transaction is higher than in current deposits suggesting the lower turnover of savings deposits. At the same time, between 1970 and the present study, the difference in cost between savings and current deposits ~~in the cost~~ expressed as per cent of outstanding balance has narrowed indicating the growing importance of savings deposits relative to current deposits.

7.13 In contrast to deposits, as a whole, whose share in total servicing cost has remained constant between 1970 and the present study, the share of advances has gone up. While the increase is shared by all types of advances, it is most marked in those areas where banks involvement has grown in recent years. The most pronounced increase is in the case of direct agricultural finance which formed only 1.8% of total servicing cost in the Banking Commission study and now accounts for 4.3%. That this is the most expensive type of lending is seen in the cost expressed as a percentage of outstandings. This is highest for agricultural loans in all bank groups and population groups (Statement 3).

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The cost of loans to small scale industry, in terms of the outstandings, is next ~~second~~ to agricultural loans, lending to other priority sector being less expensive. Loans to medium and large industry have the lowest per cent cost to ~~per~~ outstanding. Their share in total servicing cost is, however, high because of the large share of this sector in total lending. It is noteworthy that despite their smaller share in overall credit, loans to small scale industry account for a higher proportion of total servicing cost than medium and large industry.

7.14 The cost of raising resources for lending, or the interest cost of funds, is going up, as pointed out in Chapter II. These data prove that the involvement in new areas of lending add considerably to servicing cost. They also show that lending to the traditional sector of medium and large industry is the one factor that counteracts the cost effect of diversification of credit, the servicing cost of this activity being low.

7.15 The other direction in which banks have broken fresh ground in recent years is the expansion in rural areas. In this again, the cost implications are significant. The servicing of deposits as well as advances taken as a whole involves more cost in rural areas than in the other population groups. This is especially so in the case of advances. The cost of servicing of all advances considered together, expressed as percentage of total outstanding ~~total~~ credit, is 1.17 in metropolitan and urban centres and 2.36 in semi urban centres as against 3.24 in rural areas (Statement 3). The range in regard to deposit activity is less wide, because deposit business is more evenly spread among the different population groups, except for current deposits.

7.16 Based on the information collected for the present cost study, it is possible to relate the servicing cost of deposits and advances in the different population groups to the total business (deposits + advances) in those groups It has to be borne in mind firstly that the servicing costs represent the combination of establishment and other working expenses and secondly, that the servicing cost give here are exclusively for deposit and advances activity, and exclude the cost incurred for remittances etc. The data show that the "output" of deposits and advances related to the "input" of servicing costs, varies sharply between the population groups. The amount of business per rupee of servicing costs incurred, which is only Rs.48 in rural centres, rises to Rs.58 in semi urban areas and to Rs.72 in urban and metropolitan centres.

7.17 The obvious conclusion that may be drawn from all the data given above is that rural offices are more expensive to maintain and operate than urban or even semi-urban offices. With further spread of banking in rural areas, to centres hitherto unbanked, this tendency is likely to grow more pronounced. However, it can also be argued that the high cost indicators in rural offices reveal a degree of "excess capacity". That is to say, it would be possible to increase the business in these branches with a less than proportionate increase in servicing cost.

7.18 As is to be expected, the business in rural offices is heavily tilted towards funds activity, that is deposits and advances, ~~and, to a lesser extent~~, bills, remittances, collection of cheques etc. do not constitute a sizeable proportion of rural branch business. As a result, the cost per transaction and the cost per Rs.100 of remittances is relatively high in rural areas (Statement 4).

7.19 Between bank groups, the pattern of servicing cost varies considerably which follows from differences in their business mix. The important factors here are the concentration of Government business in the State Bank group and the relative insignificance of foreign exchange business in the smaller banks.

7.20 The position of smaller banks is closely similar to that of rural offices, since both deposits and advances activities are more expensive for these banks than for other bank groups. Servicing cost as percent of average deposit balance was 1.3% for SBI and large nationalised banks as against 2.1% for the smaller banks. In advances the relative proportion was 1.5% and 2.0% respectively. In remittances and bills, however, there is no significant variation between the bank groups. Also this activity is not unimportant for the smaller banks.

7.21 The other activities of banks which yield income fall under the head of remittances (issue and collection of drafts, TTs and MTs), bills (collection and purchase of cheques, and demand and usance bills) and foreign exchange business. The residual business (such as Government business, issue and encashment of travellers' cheques, safe deposit lockers etc.) is grouped under "all other activities. Income through bills business contains an interest element since there is an outlay of funds.

7.22 Between the Banking Commission's cost study and the present study, the proportion of each of these services to total service costs has declined (from 42% to 35%).

This is entirely on account of the increase in cost of advances, the share of deposit activity remaining stable. The decline is evenly spread between the various individual items in the group. This, however, refers only to the distribution pattern of total costs and not to the level of the costs which are uniformly higher than in 1970. The cost per transaction is highest for usance bills (Rs.31) and lowest for drafts (Rs.8). The cost per Rs.100 of remittance bills is highest for demand bills (28 paise) and lowest for TTs, being just 1 paise. The low incidence of cost on TTs is because of the high average amount per TT (Statement 5).

7.23 The comparison of the results of the present study with those of the Banking Commission clearly shows the impact of the increase in establishment expenses on banking costs. The charges levied by banks on various services rendered by them is seldom related to the costs involved. The result of the present study could be the basis for a rational schedule of service charges. This is developed further in Chapter XI.

7.24 The changing nature of banking with vast geographic coverage and functional diversification require more than ever before, a scientific approach to the assessment of costs and the pricing of services. It would be necessary to conduct a cost study for the system as a whole at regular intervals. It is suggested that such studies should be undertaken every 3 years and rate schedules adjusted accordingly.

7.25 The success of the present study may be largely attributed to the encouraging response from individual

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employees. The "self logging" system adopted here may be used for future surveys also. At the individual bank level, more detailed studies may be undertaken to determine the cost impact of specific services. The need for such studies will be increasingly felt in the context of new services required of banks.

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STATEMENT -I

PATTERN OF SERVICING COST - BANK-GROUP-WISE

(Percentage to total cost)

Activity	Banking Commission (1970) Average	71 Banks Average	State Bank of India & Big Nationalised Banks (Gr.I)	10 other Nationalised Banks & Foreign Banks (Gr.II)	Other Banks (Gr.III)
	1.	2.	3.	4.	5.
1. DEPOSITS					
1.1 Current	22.9	14.5	15.0	13.3	15.0
1.2 Savings	12.3	18.7	17.4	21.2	18.1
1.3 Term, Recurring and others	5.1	7.4	5.9	10.2	7.2
1.4 All Deposits	40.3	40.6	38.3	44.7	40.3
2. ADVANCES					
2.1 Medium & Large Industries	2.7	6.1	5.7	6.9	5.8
2.2 Small Scale Industries	5.4	6.3	8.5	3.9	4.0
2.3 Direct Finance to Agriculture	1.8	4.3	5.0	3.9	2.9
2.4 Other Priority Sectors	1.8			4.2	2.9
2.5 Others	6.3	7.7	5.0	6.2	7.6
2.6 All Advances	18.0	24.4	24.2	25.1	23.2
3. REMITTANCES					
3.1 Drafts	8.7	8.2	8.6	6.3	10.1
3.2 M.Ts.	1.7	1.5	1.8	1.3	1.0
3.3 T.Ts.	1.5	0.6	0.7	0.5	0.5
3.4 All Remittances	11.9	10.3	11.1	8.1	11.6
4. BILLS					
4.1 Cheques, Drafts, etc.	7.2	5.4	4.9	5.8	5.8
4.2 Demand Bills	6.4	4.1	4.7	3.1	4.0
4.3 Usance Bills	1.2	1.2	1.0	1.7	1.1
4.4 All Bills	14.8	10.7	10.6	10.6	10.9
5. FOREIGN	-	3.7	4.3	4.0	1.7
6. ALL OTHER ACTIVITIES	15.0	10.3*	11.5*	7.5	12.3*
7. ALL ACTIVITIES	100.0	100.0	100.0	100.0	100.0

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* Includes Government Business

STATEMENT - 1A

PATTERN OF SERVICING COST - POPULATIONGROUP-WISE

(Percentage to total Cost)

ACTIVITY	All Population	Metropolitan and Urban	Semi-Urban	Rural
	1.	2.	3.	4.
1. DEPOSITS				
1.1 Current	14.5	16.2	13.5	9.0
1.2 Savings	18.7	17.8	18.9	26.0
1.3 Term, Recurring & Others	7.4	7.2	7.6	8.8
1.4 All Deposits	40.6	41.2	40.0	43.8
2. ADVANCES				
2.1 Medium & Large Industries	6.1	7.3	3.4	2.2
2.2 Small Scale Industries	6.3	6.4	6.1	4.4
2.3 Direct Finance to Agriculture	4.3	1.6	7.4	10.5
2.4 Other Priority Sectors 2.5 Others	7.7	7.4	6.7	11.6
2.6 All Advances	24.4	22.7	23.6	28.7
3. REMITTANCES				
3.1 Drafts	8.2	8.1	8.8	7.3
3.2 M.Ts.	1.5	1.5	2.2	1.5
3.3 T.Ts.	0.6	0.8	0.5	0.2
3.4 All Remittances	10.3	10.4	11.5	9.0
4. BILLS				
4.1 Cheques	5.4	5.8	4.8	3.7
4.2 Demand Bills	4.1	4.5	4.0	2.1
4.3 Usance Bills	1.2	1.7	0.6	0.3
4.4 All Bills	10.7	12.0	9.4	6.1
5. ALL OTHER ACTIVITIES	14.0	13.7	15.5	12.4
6. ALL ACTIVITIES	100.0	100.0	100.0	100.0

STATEMENT - 2

SERVICING COSTS OF DEPOSITS

	Current	Savings	Term	All Deposits
	(Cost in rupees per transactions)			
Banking Industry				
P1. Average - Present Study	2.70	3.60	5.28	3.40
P2. Average - Banking Commission	1.88	1.78	6.29	1.93
Bank Groups				
P3. SBI & 4 Big Nationalised Banks	3.09	3.83	6.64	3.72
P4. 10 Nationalised Banks & Foreign Banks	2.28	3.27	4.33	3.05
P.5 Other Banks	2.47	3.77	5.63	3.31
Population Groups				
P6. Metropolitan & Urban	2.54	3.53	5.21	3.21
P7. Semi-urban	2.89	3.52	5.63	3.51
P8. Rural	3.64	3.88	4.40	3.92
	(Cost ~~in %~~ per annum of balance)			
Banking Industry				
M1. Average - Present Study	3.22	2.87	0.49	1.56
M2. Average - Banking Commission	3.93	1.85	0.22	1.56
Bank Groups				
M3. SBI & 4 Big Nationalised Banks	2.75	2.64	0.35	1.34
M4. 10 Nationalised Banks & Foreign Banks	3.85	2.90	0.69	1.74
M5. Other Banks	4.38	3.73	0.67	2.11
Population Groups				
M6. Metropolitan & Urban	2.90	2.92	0.48	1.54
M7. Semi-Urban	3.84	2.38	0.49	1.48
M8. Rural	5.42	3.85	0.50	1.68

P - Physical Output M - Monetary Output

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STATEMENT - 3

SERVICING COST OF ADVANCES

	Medium & Large Industries	Small Scale Industries	Direct Finance to Agriculture	Other Priority Sectors	Others	All Advances
	(Cost ~~in %~~ per annum of outstanding)					
Banking Industry						
M1. Average - Present Study	0.70	3.42	4.41	2.32		1.64
M2. Average - Banking Commission	0.32	3.42	2.72	1.90	1.88	1.16
Bank Groups						
M3. SBI & 4 Big Nationalised Banks	0.51	3.58	4.14	2.84		1.46
M4. 10 Nationalised Banks and Foreign Banks	1.02	2.73	4.68	3.03	1.94	1.85
M5. Other Banks	1.30	4.00	5.47	2.49	1.76	2.02
Population Groups						
M6. Metropolitan & Urban	0.57	3.25	4.29	1.82		1.17
M7. Semi-Urban	0.75	3.69	4.29	3.10		2.36
M8. Rural	0.98	2.78	4.06	4.71		3.24

M - Monetary Output

Note: As the number of transactions is not an indicator of physical output in respect of advances, cost per transactions is not computed.

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STATEMENT - 4

SERVICING COST OF REMITTANCES

	REMITTANCES			
	Drafts	M.Ts.	T.Ts.	All Remittances
	(Cost in rupees per transaction)			
Banking Industry				
P1. Average - Present Study	8.39	10.54	13.18	8.85
P2. Average - Banking Commission	5.18	5.55	13.90	n.a.
Bank Groups				
P3. SBI & 4 Big Nationalised Banks	8.39	11.59	12.67	~~8.99~~ 8·69
P4. 10 Nationalised Banks & Foreign Banks	9.04	8.74	17.47	9.28
P5. Other Banks	7.74	10.40	10.46	8.01
Population Groups				
P6. Metropolitan & Urban	6.36	12.28	12.03	7.11
P7. Semi-Urban	5.78	12.26	5.34	6.42
P8. Rural	8.13	8.73	7.09	8.19
	(Cost in paise per Rs.100 of Remittances)			
Banking Industry				
M1. Average - Present Study	14.44	17.46	0.99	7.95
M2. Average - Banking Commission	16.67	10.21	1.50	n.a.
Bank Groups				
M3. SBI & 4 Big Nationalised Banks	14.16	~~16.16~~ 16·66	0.90	7.23
M4. 10 Nationalised Banks & Foreign Banks	19.15	19.53	0.97	8.69
M5. Other Banks	11.81	17.61	1.84	9.65
Population Groups				
M6. Metropolitan & Urban	10.44	15.66	0.65	4.97
M7. Semi-Urban	10.31	31.89	0.65	6.96
M8. Rural	14.74	19.47	0.89	10.95

P - Physical Output M - Monetary Output

n.a. - Not available.

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STATEMENT - 5

SERVICING COST OF BILLS

	Cheques, Drafts, etc.	Demand Bills	Usance Bills	All Bills
	(Cost in rupees per transactions)			
Banking Industry				
P1. Average - Present Study	10.94	19.07	31.75	14.37
P2. Average - Banking Commission	4.89	8.48	10.89	n.a.
Bank Groups				
P3. SBI & 4 Big Nationalised Banks	9.87	20.28	30.59	13.92
P4. 10 Nationalised Banks & Foreign Banks	12.09	20.06	29.35	15.31
P5. Other Banks	12.15	15.01	48.29	14.18
Population Groups				
P6. Metropolitan & Urban	11.36	15.64	29.17	14.05
P7. Semi-Urban	8.95	13.19	12.51	10.63
P8. Rural	10.62	15.31	25.25	12.29
	(Cost in paise per Rs.100 of Bills)			
Banking Industry				
M1. Average - Present Study	24.61	27.85	24.82	25.78
M2. Average - Banking Commission	20.77	24.07	25.52	n.a.
Bank Groups				
M3. SBI & 4 Big Nationalised Banks	21.44	24.90	19.40	22.60
M4. 10 Nationalised Banks & Foreign Banks	38.43	34.76	29.65	35.63
M5. Other Banks	19.36	32.03	36.52	23.96
Population Groups				
M6. Metropolitan & Urban	22.89	12.86	14.74	16.67
M7. Semi-Urban	17.37	20.56	15.83	18.49
M8. Rural	17.27	27.53	16.81	19.74

P - Physical Output M - Monetary Output

n.a. - Not available

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STATEMENT - 6

SERVICING COST PER ACCOUNT

	Deposits		Advances			Other Priority Sectors & Others
	Current	Savings	Medium & Large Industries	Small Scale Industries	Agriculture	
	Average Amount per account (In rupees) ~~per annum~~					
Banking Industry						
P1. Average - Present Study	7,485	950	4,87,742	22,516	2,190	6,083
P2. Average - Banking Commission	5,798	813	n.a.	n.a.	n.a.	n.a.
Bank Groups						
P3. SBI & 4 Big Nationalised Banks	10,687	1,080	6,49,048	21,543	2,670	7,767
P4. 10 Nationalised Banks & Foreign Banks	5,387	890	3,71,579	25,642	1,375	5,185
P5. Other Banks	4,358	728	2,22,911	22,510	4,022	6,417
Population Groups						
P6. Metropolitan & Urban	9,124	1,066	5,81,323	39,371	5,466	11,818
P7. Semi-Urban	5,239	930	2,60,988	40,889	3,452	3,037
P8. Rural	3,606	640	2,58,329	9,702	1,312	1,861
	Annual Servicing Cost per account (In Rupees) ~~per annum~~					
Banking Industry						
M1. Average-Present Study	241	27	3,215	479	97	141
M2. Average - Banking Commission	227	15	n.a.	n.a.	n.a.	n.a.
Bank Groups						
M3. SBI & 4 Big Nationalised Banks	293	28	2,997	413	112	220
M4. 10 Nationalised Banks & Foreign Banks	207	26	3,794	701	64	155
M5. Other Banks	191	27	2,895	901	220	123
Population Groups						
M6. Metropolitan & Urban	265	31	3,290	1,281	232	215
M7. Semi-Urban	201	22	1,969	512	107	94
M8. Rural	188	25	2,539	270	53	81

P- Physical Output M - Monetary Output

n.a. - Not available

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CHAPTER - VIII

SYSTEMS, PROCEDURES AND EFFICIENCY

8.1 This chapter on Systems, Procedures, etc. deals with the multidimensional factors which affect the efficiency and cost of operations.

8.2 A study conducted by the Committee on banking costs reveals that 40 per cent of the establishment expenses incurred by banks is on the maintenance of deposit accounts. 25% of the expenses is on processing credit proposals and maintenance of borrowal accounts, while the remaining 25% is on rendering of services such as issue and payment of drafts, mail transfers and telegraphic transfers, collection and purchase/discount of cheques, demand bills and usance bills, foreign exchange business and other miscellaneous services. A break-up of total expenses is given in Chapter VII.

8.3 Out of the 25 per cent of the expenses incurred on advances, about 10 per cent is on the maintenance of accounts and 15 per cent is on the processing of applications and the post-sanction follow up. Thus, 50 per cent of the total expenses incurred by banks is on customers' accounts which involves maintenance of ledger accounts, writing up of day books, despatch of statements, balancing of ledgers and so on. An improvement in the systems and procedures of banks will result in considerable saving in costs.

8.4 The Committee has examined the problems of bank operations not only from the unit level but also from the industry level. The observations and recommendations of the Committee are given in the Sections that follow.

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Section I - Systems & Procedures

8.5 With the shift in emphasis on mass banking as opposed to conventional banking, there is an imperative need for rationalisation of internal operations of banks in tune with the idea of mass banking. Mass banking cannot be done under the archaic modes of conventional system. The Committee notes that the Working Group on customer service in banks has made a number of recommendations which, while improving customer service to a substantial extent, would also go towards simplification and rationalisation of procedure and result in reduction in costs of bank operations.

Rationalisation of systems & procedures

8.6 With the penetration of banks into rural areas and unbanked centres, the number of small branches is increasing rapidly. Any attempt made to simplify the procedures at these small branches which number more than 10,000 will have a salutary effect on reduction of cost, improvement of efficiency and profitability. The banks may consider the feasibility of introducing similar procedures for their rural and other very small branches. A Committee appointed by the RBI had recently suggested simplified accounting and other procedures for the branches of Regional Rural Banks.

Improved systems for small branches

8.7 With the expansion in the net-work of branches and the manifold increase in transactions not only in the larger branches but also between branches, a stage has come for banks to have recourse to machines in an increasing measure. This is necessary for posting of ledgers, issue of statement

Improved systems of accounting, etc.

of accounts, inter-branch reconciliations, data processing etc. There is even a case for banks to own computers individually or jointly. The Committee recommends that each bank may make a comprehensive review of the scope for mechanisation and prepare detailed plans for its implementation.

8.8 As a banking service, collection of upcountry cheques has been subjected to severe criticism. The time lag between presentation of th instrument and realisation varies anywhere between 7 to 40 days. This service being a source of perennial customer dissatisfaction, banks are examining their systems and procedures to narrow down the time lag. The Indian Banks Association has also considered the problem from the industry level and circulated to member banks guidelines for quick realisation of upcountry cheques, bills, etc. The major constraint for improving the efficiency of banks in this area has been the inability to enforce mandatory time discipline f presentation and clearing of upcountry cheques/bills, in contrast to local cheques presented through clearing.

<u>Central Remittance House</u>

8.9 In order to enforce time-discipline for collection of upcountry cheques, it is necessary to have a centralised agency which apart from giving the necessary facilities to act as a clearing centre also has the mandatory authority to enforce time discipline. The committee supports the suggestions of the Working Group on customer service to create a central clearing authority.

8.10 The four metropolitan cities of Bombay, Calcutta, New Delhi and Madras account for 40% of the total deposits and 50% of the total credit. The volume and amount of cheque clearance in these metropolitan cities have

<u>Clearing Houses</u>

also registered a phenomenal increase since 1960-61 as may be seen from the following table:

Year	Bombay	Calcutta	New Delhi	Madras
		(Number in lakhs)		
1960-61	193.85	96.41	26.76	49.23
1965-66	243.50	122.19	42.17	61.18
1970-71	366.47	129.95	65.21	80.57
1975-76	508.13	184.30	90.02	89.91
		Amount in crores of rupees		
1960-61	4514.69	4182.03	594.36	665.39
1965-66	7493.76	5855.13	1154.11	1225.12
1970-71	13342.02	6923.30	2625.53	2138.94
1975-76	27439.25	12716.64	8197.71	5228.27

Note: Data relate to clearing centres managed by the Reserve Bank of India.

Clearing Houses in Metropolitan Cities

8.11 There is only one clearing house each in the metropolitan cities of Bombay, Calcutta and Madras, while there are two separate clearing houses in Delhi, one in New Delhi and the other in Delhi. With a view to relieving the pressure on the existing clearing houses, some proposals were examined in the past by the Indian Banks' Association for establishing separate local or full clearing houses in Bombay, one in Dadar for the suburban areas both along the Central and Western Railways and another in Mandvi for the business areas of Kalbadevi and Mandvi. The proposals were dropped because it was thought that (i) they did not solve the problems and difficulties of the banks and customers to any significant extent, (ii) they did not make clearing arrangements more efficient, and (iii) they would increase the costs and demands on staff tremendously. In Madras, a proposal for opening a second clearing house in Mount Road has been under the consideration of the local bankers for the last three years, but they have not yet succeeded in their efforts.

Opening of additional clearing houses

8.12 The consensus among banks, as seen from their replies to the questionnaire submitted to the Committee, is that there should be more than one clearing house in metropolitan cities to relieve the pressure on the existing clearing houses. The Committee endorses this view. The increasing volume of cheques passing through the clearing houses is posing a serious threat to the clearing operations of banks which have to process a large number of outward and inward clearing cheques in a short time. In this context, the bankers may consider opening additional local clearing houses in Bombay (say, Dadar and Mandvi areas), Calcutta (say, one for metropolitan/city branches and another for branches at Howrah proper and those in the Howrah district) and Madras (say, Mount Road). The local clearing houses will handle cheques presented by the local branches and payable in that area only. These local clearing houses may be managed by one of the nationalised banks. The question of converting them into full clearing houses (to deal with all cheques received anywhere in the metropolitan city but payable in that area) may be considered in due course in the light of the experience gained in their working. The Committee is of the view that the present atmosphere of staff discipline is conducive to the betterment of banking services and recommends that this scheme should be given a fair trial.

Reduction in the number of clearings

8.13 There is also a consensus among banks, as seen from their replies to the questionnaire submitted to the Committee, that the clearing timings which have remained unchanged over the years (except for marginal adjustments) should be suitably changed so that there may be only two clearings. This will suit the convenience of banks and relieve the pressure of work on clearing houses in the metropolitan cities. The Committee endorses this view. The present timings observed for clearing in Bombay and Calcutta on week days are as under:

	Bombay	Calcutta
Delivery clearing	11.00 a.m.	10.30 a.m.
Main clearing	1.15 p.m.	12.15 p.m.
Special clearing	3.45 p.m.	2.45 p.m.

(Saturday : Main Clearing only)

The timing of the third clearing, i.e. special clearing for "return" cheques is such that it leaves very little elbow room for the drawee banks to verify the signatures, balances, etc. and return the unpaid cheques before time. As per the rules of the clearing houses, if a cheque is not returned in the special clearing, it is deemed to have been passed by the drawee bank and the collecting bank generally allows withdrawal against such clearing cheque. The stipulation that cheques should be returned the same afternoon puts tremendous pressure on paying banks. Very often branches are obliged to return cheques only across the counter in view of the paucity of time available. The special clearing may, therefore, be abolished and the return clearing may take place the following morning, as part of the first clearing. This would dispense with avoidable haste and anxiety in returning unpaid cheques. This will also give banks more time to balance their inward clearing - bank-wise, branch-wise and department-wise - and pass the cheques, which in turn, will eliminate the chronic problem of unadjusted clearing differences.

Proposed changes in clearing timings

8.14 At present, only a very few cheques deposited by customers on any day are put through the clearing on the same day. Over 90% of cheques are put through the clearing on the next day and can be drawn against only on the third day, since the 'return' clearing takes place in the afternoon after the banking hours. This is a highly unsatisfactory-state of affairs. Clearing of cheques is a very important aspect of customer service and it is essential to ensure that the cheques presented on any day within the banking hours are put through the clearing on the same day. For this purpose, the clearing timings also could be changed suitably. With the abolition of the special clearing, the delivery clearing (including the return of unpaid cheques of the previous day) could be held one hour after the commencement of busines hours and the main clearing one hour after the close of business hours. If the clearing timings are changed as recommended, all the cheques deposited during the day upto the closing of business hours could be put through the clearing the same afternoon. While credits could be afforded to the respective accounts on the same day, drawings thereagainst may be allowed after the return clearing on the following morning. This procedure will reduce by one day the time taken at present to allow drawings against a fairly large percentage of clearing cheques.

Mechanisation

8.15 The processing of cheques for clearing purposes in a bank involves the following steps. Cheques received at the counters are to be sorted according to paying banks. Bank-wise lists of the clearing cheques are to be prepared giving corresponding totals. As there is very little time between receiving the cheques from the branches as well as from the customers at the counter, and presenting them at the clearing house and processing of these cheques are to be completed expeditiously. This is particularly so because, once the instruments are passed on at the clearing house, they will not be available for balancing purposes. The Committee examined whether some machines could be used for sorting, listing and adding of cheques for clearing. Some branches are using 'proof machines' for this purpose. These machines provide for adding of cheque amounts entered through keyboard simultaneously with sorting of cheques bank-wise. These machines are ideal for outward clearing and could be used in inward clearing also. Unfortunately, these machines are not availble indigenously. Besides, there is a limitation in using these machines when the workload on a particular day goes beyond the optimum level prescribed for this machine, it would be difficult to augment the machine capacity.

8.16 It is reported that one bank is handling the sorting of cheques manually while subsequent listing and adding is undertaken on accounting machines. This system is reported to be working satisfactorily and few other banks are also planning to switch over to this system.

8.17 The Committee observes that there is no alternative to manual sorting of cheques and recommends that subsequent listing and totalling may be done expeditiously on the accounting machine already installed in the branch. In addition, Cash Register machines may be introduced at the receiveing counters while accepting clearing cheques for credit of accounts. This will enable the branches to balance their outward clearing as to totalling mistake, if any, committed by the customer while filling in the paying-in-slip.

8.18 The clearing departments in metropolitan cities of some banks are reported to be having untraced differences for large amounts in clearing, outstanding in their books of account.

<u>Untraced clearing differences</u>

The abolition of special clearing and the revision in the clearing timings as recommended earlier, will bring about a substantial improvement in this respect. If every member bank balances its inward clearing daily and immediately informs the concerned bank about the payable, difference may not arise. It is reported that there are instances where some member banks who locate payable differences in clearing are reticent until the relative claim is made on them by the presenting bank. This attitude should be discouraged. Banks should periodically exchange lists of outstanding differences at the clearing houses so that the corresponding differences could be eliminated expeditiously.

8.19 A microfilming system should be made available to banks at clearing centres where all the cheques cleared could be micro-filmed bank-wise. This will help relieve the pressure on the clearing houses and also facilitate easier reconciliation of clearing differences by making available all the records. Micro-filming equipment for banking applications, where simultaneous photography of the face and reverse of the cheque are available with leading manufacturers of microfilming equipment. Banks may consider the proposal to introduce such equipment at clearing centres.

8.20 In order to quicken the process of transfer of funds between two persons who have accounts with different banks, the Committee recommends that banks may evolve a scheme for Credit Clearing. At present, the cheques put through the Clearing House are in the nature

<u>System of Credit Clearing</u>

of a Debit Clearing, where member banks receive cheques which have to be debited to the customer's account. As a corollary to this, if banks could exchange a credit instrument whereby they can exchange instruments to credit the customers' accounts, it would result in a speedier system of transfer of funds between two banks. In Western countries, this has been experimented in the form of a Giro System and has proved successful. In this context the proposal as recommended by the Banking Commission in its report submitted in 1972 may be considered.

8.21 At the Clearing House banks will exchange the credit instruments payable to one another and settlements will be made between member banks in the same manner as inter-bank cheque clearing. Where the beneficiary's account cannot be traced owing to a wrong account number or for any other reason the relative credit instrument will be returned at the Clearing House, in the return clearing. If there is any delay in the return of the credit instrument, the defaulting bank will have to pay interest to the remitting bank. The Credit Clearing System can also be used for transfer of funds relating to bill proceeds, payment of Inward Telegraphic Transfers, etc.

8.22 The Committee recommends that the Indian Banks' Association should take up this matter on a priority basis and evolve a scheme in consultation with member banks.

Section II - Cost of operations

8.23 Banks have been conscious of the need to have control over costs of operations and explore all possibilities for reduction in costs. However, the means by which cost control is to be effected, the organisational set-up required to monitor operational costs, the departments/committees which should be assigned prime responsibility for achieving the objective of cost control are areas which have not been given adequate attention by bank management. While some banks have set up internal expenditure committees to monitor, on an on-going basis, the capital and revenue expenditure incurred in the bank's operations, other banks have left the responsibility for reduction in costs to the branch level management. Reduction in operational costs through improved procedures is being effected by the O & M Departments wherever such departments exist in banks.

8.24 The Committee is of the view that the control over operational costs by banks has to be a two-pronged drive. At the macro-level there should be specialised departments such as O & M, Management Services, etc., which will, on an on-going basis, examine the work organisation, systems and procedures of a bank with a view to minimising the cost of operations. At the micro-level, it will be necessary for every branch of a bank to draw up a plan for the essential expenditure for carrying out its operation. To a large extent, this aspect has been taken care of in the system of performance budgeting.

<u>Cash management</u>

8.25 In the context of optimum use of resources, management of cash at the branch level has become an important tool for reducing cost for the banking industry. However, in the responses made by banks to the question on "Cash Management", it was observed that there is no uniform structural approach by banks for maintaining the minimum level of inventory of cash at the branch level. The Committee, therefore, recommends that banks may consider the following steps to ensure efficient management of cash:

i) Cash management at branch level should be subjected to inventory control techniques. Banks should lay down branch-wise upper limits of cash balances to be held, by rural/semi-urban branches taking into account the peculiarities of cash demand in each case. These limits should be periodically revised to meet with the changing pattern of demand/supply of cash. The limits may be prescribed by the Regional Offices who have a fairly good idea of branch business.

ii) Cash balances at all branches should be closely monitored by the Regional/Zonal offices of big banks or by the Head Office of small and medium size banks. For this purpose, a weekly return should be called for from the branches giving cash balances. The controlling office should take immediate corrective action where excess cash balances are maintained by branches.

iii) In some banks there exists a strict compartmentalisation of Day's Cash Receipts and Day's Cash Payments which necessitates handling a large number of pieces of currency notes. As far as possible, in small and medium size branches, cash received on the same day should be used for the day's payment. This will cut down the cost in terms of man-hours spent on handling of cash.

iv) Nationalised banks must open currency chests at branches where the volume of cash transactions warrants such currency chests. Although the

Reserve Bank of India has taken a policy decision to encourage nationalised banks to open currency chests, the progress in this regard has been slow. As a long term objective, the Reserve Bank of India should plan in such a manner that at all district head quarters, there will be a currency chest (apart from that managed by the State Bank of India) maintained by at least one another nationalised bank.

v) In order to provide flexibility to cash balance at the branch levels, the Head Offices/Regional Offices of banks must prescribe branch-wise limits for discounting Telegraphic Transfers with State Bank of India or any other approved commercial bank. In times of emergency, these Telegraphic Transfer limits can be utilised by the branches to replenish cash.

vi) Banks may also introduce a system of "cash collection centres" for a cluster of branches in remote areas where physical movement of cash presents problems of safety and security of cash. At these centres vans or jeeps will lift excess cash from or supply cash to all branches nearby the collection centre. Where the volume of cash held by these centres warrants, currency chest may be opened at these centres.

8.26 The Committee's recommendations on the subject of cost reduction cover mainly labour costs and servicing cost of bank operations. They specifically exclude interest cost of money. The recommendations are given under the two sub-headings, viz. (a) Staff Costs, (b) Servicing Costs.

st control/
Reduction

A. Staff Costs:

8.27 Banking in India is highly labour-intensive. Cost of man-power constitutes a major portion of the total costs of bank operations. On an average, the salaries and wages bill forms 75% of the total establishment costs of the nationalised banks. Maximum utilisation of this main resource, which is an expensive resource, would be a good starting point for establishing control over costs.

Work Measurement

8.28 Banks must adopt work measurement techniques to arrive at norms for daily output for each activity in the Bank. While admittedly it would be difficult to establish norms for "staff" functions, for all "line" functions standard or norms should be laid down for each activity. In regard to "Staff" functions also a rough approximation of a fair day's output should be laid down. The Committee is well aware of the fact that such norms may at best be only indicative and cannot probably be applied uniformly. Even so, such norms will serve two purposes - for the employee to appraise his own performance and for the Manager to ensure that a fair day's work is turned out by all employees. Some banks have developed norms to relate staff strength with workload - similar exercises may be made by other banks.

Method study

8.29 Banks must systematically carry out "Method Study" of all operations in banks to examine the scope for improving the method of performing the tasks. By elimination of wasteful activity or by combining activities, a better method can be evolved and productivity increased. Such method studies should precede work measurement to ensure that norms are set up on the basis of improved methods and procedures.

Staffing pattern

8.30 Banks should evolve a standard staffing pattern

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for branches based on the business mix as reflected in the volume of transactions. The basis for arriving at a correlation between staff and business could be the number of vouchers or number of transactions. This criterion is preferred to business as expressed in monetary terms, as the latter does not give an indication of the size of the account, the labour input for servicing such accounts, etc.

Rural cadre

8.31 The study on banking costs reveals that although rural branches account for 9% of the total business (deposit plus advances), the corresponding servicing costs at these branches are higher at 12% of the total expenses of all branches. The volume and mix of business at rural branches often does not justify the staff costs incurred by them, even though minimum staff is posted by most banks at rural branches. In order to make a rural branch a viable unit of the bank, the Committee recommends that banks have a separate cadre of staff to work at rural branches. The pay scales of rural clerks and officers may be geared to be in tune with the rural economy. Although a differential pay scale for rural staff may cause some organisational problem in relation to promotion, placement, etc., such a rural cadre is a necessary measure to bring down operational costs.

Bank Apprenticeship Scheme

8.32 The Committee notes that the question of introducing apprenticeship scheme in banks is under consideration. The Committee would recommend early legislative and administrative action in this regard.

Progressive reduction in employment of messengers, peons, etc.

8.33 The category of sub-staff in banks is a large proportion of total work force - roughly it is estimated at 20% . The staffing pattern of banks' branches - particularly the large offices - shows that there is considerable scope for reduction of such employees and for progressively bringing down their numbers. This could be initiated by introducing a change in the work culture, starting from the Top Management.

Concept of self-supervision

8.34 The Working Group on Customer Service has recommended "An excellent way of motivating staff is the idea of self-supervision". The system of checks and balances in banks in India is based on the colonial pattern of checking and counter checking of all jobs right up the hierarchy. The need to eschew this system of work organisation is long overdue and a reasonable amount of responsibility assigned to each worker. The effect of such organisation of work will be felt not only in increased productivity but also in substantially reducing the cost of operations. The number of man-hour spent on counter checking trivial jobs where the counter checking official has no special input to provide other than initiating the original entry made by the previous clerk/official are too many to enumerate. Banks may, on a priority basis, examine these jobs. Random or sample checking of self-supervised jobs should also be introduced.

"Peer level" checking

8.35 In the previous paragraph, we have referred to the existing system of checks and balances in the organisation of work in banks which is hierarchial in nature - i.e. the work of junior will be checked by a senior. A detailed examination of some jobs in banks shows that the idea of checking the primary work is for the purpose of ensuring accuracy and therefore such checking although important need not necessarily be done by a superior. The Committee recommends that in such areas, banks must introduce checking of work by "peers" which will result in reduction in costs. Besides, it will also result in better utilisation of senior staff who can be assigned more responsible work than mere checking accuracy of calculations.

Norms for establishment charges

8.36 Banks can make use of averages or ratios for comparison of similar branches and their establishment charges. The ...

ratios suggested are:

(a) Ratio of establishment expenses to total expenses

(b) Ratio of establishment expenses to average level of business (annual average of Deposit and Advances).

(c) Staff required category-wise for Rs.1 crore of business.

Such inter-branch comparisons should be made on an annual basis. Efficient branches should be suitably rewarded while suitable corrective action taken at other branches.

B. Servicing costs

8.37 The major expenses in servicing costs of bank operations relate to the acquisition of suitable premises, providing the necessary furniture and fixtures, stationery, etc. The Committee has observed that there is considerable scope for economy in such expenditure.

8.38 In order to enable banks to acquire premises at reasonable rates, the Committee recommends that the State Governments should provide the necessary governmental support for such acquisition. Particularly, in rural areas, the Public Works Department should be asked to construct the premises on the basis of the standard pattern on ~~the~~ a 'no profit; no loss' basis. It is the experience of banks that when they are looking for banking premises, the rentals have a tendency to escalate beyond reasonable levels.

Furniture and Fixtures

8.39 For equipping branches with the necessary furniture and fixtures, banks have laid down norms for expenditure for rural, semi-urban, urban and metropolitan branches. While it is not necessary to lay down any uniformity among banks for norms of expenditure, the Committee after examining the norms of all public sector banks, is of the view that any expenditure in excess of the amounts specified below would not be warranted.

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Metropolitan	...	Rs.1,00,000/-
Urban	...	Rs. 75,000/-
Semi-urban	...	Rs. 50,000/-
Rural	...	Rs. 25,000/-

It was noticed by the Committee that there is a marked tendency on the part of private sector banks to spend in excess on furniture for their metropolitan branches. This should be avoided.

Stationery

8.40 Banks must introduce a system of annual indenting by branches for stationery items. The indents to be properly scrutinised at the Head/Regional office and supplies made in time. In the case of large banks, the printing and distribution of low-cost stationery items should be decentralised at the Regional/Zonal offices. High cost items should be centralised and economic inventory be held of these items.

Advertisement and Publicity

8.41 Banks must structure a programme for getting a feedback on the advertisements released by them to ensure maximum impact on the public. In the absence of qualified professional marketing research agencies, banks may use direct mailing advices, questionnaires to be distributed in the banks' hall, reply coupons as part of the advertisement, to measure the impact of the advertisement on the public. Based on the responses they will be able to revise their advertising media and strategy.

8.42 In order to regulate the expenses under this head, the Reserve Bank of India may consider fixing ceiling limits on advertisement and publicity expenditure of banks which must have a relation to its deposit base.

8.43 Similarly, donations given by banks to attract deposits must be related to the size of banks. Here again, the Reserve Bank of India may consider fixing ceiling on donations - both on the annual budget as also ceiling on the amount per beneficiary. As far as possible, donations by banks except for educational/research/staff welfare purposes must be discouraged as it leads to unethical competition besides adding to the cost of operations.

Section III - Productivity

8.44 The concept of measuring productivity in banking through specific norms has been much thought of, discussed and deliberated. Only a few banks have concrete norms evolved so far. The need to adopt work measurement techniques and set up work norms has already been recommended as a means to reduction in costs.

8.45 Such standard norms of work for various types of activities will also be useful for assessing the staff requirements at branches.

8.46 There is a need for preparing an exhaustive list of all clerical activities and calculating the time required for each of the activities. From the data, the optimum output of staff during the day at various desks should be arrived at while giving allowance to monotony, relief intervals and other routine chores, on a percentage basis. Preparation of a Master Clerical Data for the banking industry as a whole will help in preparing work norms, regulating work distribution, utilising manpower fully and optimising productivity thereby. The Committee recommends the preparation of a Master Clerical Data by an agency at the industry level- the NIBM or the Indian Banks Association.

<u>Master Clerical Data</u>

8.47 Laying down the general routine of work for various types of activities is the first requisite to maintain productivity of staff. Banks have done this through Books of Instructions or Service Mannuals. It is necessary to ensure that the Manuals are updated. The Committee recommends that banks should take necessary steps to create a Cell to attend to this task on an on-going basis.

<u>Steps to ensure productivity</u>

The next step is to ensure that the manpower availabl at a branch is put to the optimum use by proper allocation of work. This is to be followed by effective supervision a each level and strict enforcement of discipline so that eacl member of the staff completes the task assigned to him and nothing is left in arrears.

8.48 Banks should introduce daily diaries wherein the work turned out by an employee should be incorporated every day for assessing whether a full day's work has been performed by him. This system is already in vogue in certain banks.

<u>Daily diaries</u>

8.49 The job content of most tasks in banks is more or less routine and leaves little scope for use of innovative skills. This has led to a certain amount of frustration, more so becaus the recruitment norms of banks calls for high entry skills and the new entrants are academically highly qualified. In order to increase productivity by making the jobs more interesting, work organisation in banks must be examined. One positive way in which the work organisation can be improved is by job enrichment through job redesign. The present pattern of "assembly line" work organisation where each person does a fragmented job - such as a scroll writer, supplementary writer, etc. - results in the tasks becoming repetitive, monotonous and not meaningful. It is important that every worker should be able to evaluate his importance in the total job organisation in order that he may give his best performance. The O & M or Personnel Departments in banks should examine the various jobs in banks and improve upon the design of the jobs.

<u>Job enrichment</u>

Job Enrichment Workshops

8.50 Banks should organise Job Enrichment Workshops at their branches for officers, clerks and subordinate staff. The aim of the workshops should be to create an awareness in the employees of the new needs of development banking as also the changes which have to be introduced in the organisation of work and role-relationships at the branches to respond to these needs. Once the vision of the employe is developed, and they are sensitised to the needs of mass banking, they will themselves be keen to come out with new ideas for bringing about changes in work organisation which would be conducive towards higher productivity in banking.

Self-supervision & "Peer Level" checking

8.51 The above two tools for reducing costs and improving productivity in banks have been discussed in Section II. The introduction of these two concepts in work organisation in banks will have a very significant effect on productivity.

Change in Bipartite Settlement

8.52 A serious constraint to implement job enrichment programmes is the Bipartite Settlement on the workmen staff. There has grown a tendency among the bank staff in the clerical grades to demand special allowances for any work involving checking and additional responsibility. The Committee is of the view that the Bipartite Settlement should be reviewed. A Working Group may be appointed by the Reserve Bank of India, in consultation with the Indian Banks' Association, to examine the various provisions of the awards, etc., and give specific recommendations for necessary changes through legislation or otherwise.

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8.53 Monotony or drudgery is inherent in certain banking activities. The Working Group on Customer Service has identified the cash department as one such and recommended free transfer of cashiers to clerical side at frequent intervals, in addition to making the cash department as the entry point for all new recruits. While implementation of the above recommendation might save the employee from prolonged exposure to drudgery, the activity itself continues to be tedious. In order to remove drudgery from the activity itself, Cash Counting Machines and Cash Registers may be introduced in the cash departments. This will reduce supervision and also eliminate the need to maintain scrolls, as an additional copy is automatically printed for bank's use.

<u>Relieving monotony in the Cash Department</u>

8.54 There is need for some change in the recruitment pattern. The emphasis is now on academic distinction. A large number of tasks in the banks are routine and do not call for high academic skills. In order to avoid frustration among highly qualified persons entering bank services, the minimum educational qualification may be relaxed for a small percentage of new recruits from a graduate to an S.S.C. or equivalent level. This will help non-graduates who are unable to pursue higher studies, to get into the banking service. After a minimum service of say 5 years, they may be asked to qualify in a merit test if they wish to move into the higher cadres. For rural areas, preference may be given to candidates knowing the local language.

<u>Recruitment</u>

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8.55 Attitudinal changes for officers to serve in rural areas may be brought about by giving proper orientation training and by making it known at the time of recruitment itself that they will have to compulsorily put in a minimum period of service in rural areas.

Increasing Productivity of Rural Staff

8.56 Banks may consider the feasibility of introducing a motivation element in the employee appraisal scheme by giving a higher weightage for promotion opportunities of individual officers who have successfully served in rural branches particularly in the areas of development finance. Such an appraisal scheme will motivate more and more employees to move to rural areas and become committed to the tasks arising in those areas.

8.57 Noteworthy achievements of staff in rural branches in respect of customer service, deposit mobilisation and advances to priority sectors may be highlighted in the house magazines with a view to impressing upon the employees in the urban and metropolitan branches that rural branches provide scope for greater challenges.

Section IV - Manpower Development and Training

8.58 The Bankers' Training College and the National Institute of Bank Management decide on their training programmes in the light of the needs of the banks' personnel as perceived by them. At times, it has been found that there is no identity of purpose between commercial bank needs and needs as perceived by the training institutions. There is a need to to dovetail the training plans of commercial banks with those of the other institutions so as to avoid duplication and make the training more purposive.

Co-ordination in Training

8.59 The National Institute of Bank Management which is well equipped for carrying out research activities may well be asked to concentrate in this area. This can be supplemented by providing training programmes for specialised subjects and also for offering consultancy services for banks on specific problem areas. As far as possible, banks must draw upon the expertise built up by this institution before calling in other outside consultants.

Co-ordinating Agency for Training

8.60 The Bankers' Training College should act as the co-ordinating agency and ensure that the training facilities provided in the College and those offered by the training institutions of the public sector banks adequately meet the short-term and long-term requirements of imparting the right type of knowledge, and necessary skills to the employees.

Co-ordination of training in different banks

8.61 There should be a system of co-ordination of the training activity in different banks and a proper clearing house for the exchange of training material. There should also be inter-exchange of faculty between the Bankers Training College, National Institute of Bank Management and the Training Colleges.

Bankers' Training College

8.62 The intake of trainees and the number of sessions held by this College have been found to be woefully inadequate. While the number of officers in the banking industry has been increasing at a phenomenal rate, the capacity of the institution to provide training has not kept pace with it. The Committee recommends that more training colleges on the pattern of Bankers' Training College may be opened in important centres.

8.63 It would also be useful if the Bankers' Training College faculty members could conduct courses/seminars/workshops exclusively for particular banks at different centres. This would bring the benefit of such training to a large number of trainees.

Post-training Placement

8.64 There should be synchronising of training and post-training placement. A job rotation scheme should be vigorously implemented to take care of the follow-up needs of trainees.

Faculty Development Programmes

8.65 National Institute of Bank Management and Bankers' Training College should arrange faculty development programmes in the areas of banking, functional management and general management, with a view to strengthening in company training systems of banks. The faculty should be given time and opportunity for development of new cases and for keeping themselves abreast of new developments in teaching techniques.

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Training School for Clerical Staff

8.66 It is observed that some non-nationalised and small-sized banks do not have or cannot afford to have training facilities for their staff. It is, therefore, recommended that banks could pool their resources for setting up training institutions. A beginning in this regard has been made for training officers in the banks in the southern and the northern regions.

CAIIB Examination

8.67 The syllabus for CAIIB Examination should be thoroughly revised in the light of the changed concept of banking as a service industry and the need to meet the challenge of a rising revolution of social expectations. Some more subjects such as costing, financial management and operational management should be added to the items of the syllabus.

Job Cards and Programmed Learning Texts

8.68 Post nationalisation banking is more service oriented and a highly skilled activity. To solve the problem of the ever increasing number of clerical staff to be trained, banks should prepare job description cards and programmed learning texts that can be used by the operational staff to gain proficiency in various fields of banking activity without their having to come to training schools/centres. One nationalised bank has prepared job cards for complex banking operations relating to foreign exchange business, advances, etc., which has enabled the learning process to be quickened and less painful. Other banks may also undertake a similar exercise. The job cards and programmed learning texts should be updated from time to time.

Job Rotation

8.69 One way of developing skills among clerical cadres is by job rotation in branches. This should be done on a compulsory basis as voluntary methods are likely to fail.

Job rotation is essential for developing a skilled personnel.

Training Sessions in Branches

8.70 Branch managers should hold training sessions for their staff. They should hold question and answer sessions, say once a fortnight on the bank's policy and procedural methods, and deploy whatever other methods deemed essential to shape and sharpen the skills and efficiency of their staff.

Career Progression

8.71 Individuals with high potential should be identified and after ascertaining their aptitudes, opportunities should be given to them to maximise their career progression.

Section V - Operational Efficiency

8.72 Operational efficiency of Banking services requires not only infrastructure facilities like good layout, rationalised systems and procedures, trained staff, etc., but also the involvement of the staff at all levels to maximise customer satisfaction by efficient service. Therefore, in this context, the branch staff who are the first points of contact with the customers have a very important role to play. They should have not only job knowledge but also product knowledge (i.e. services offered by the bank) - and customer knowledge, i.e. customer expectations. The Committee notes that some banks have been able to ensure a greater degree of involvement of branch staff in rendering services. Based on observations made by the banks, the Committee makes the following recommendations.

Informal Staff Meetings

8.73 Informal staff meetings should be periodically held at the branches to study the policies laid down by the Head Office in respect of business development, administrative efficiency, etc., and arrive at ways and means of implementing the same by the staff as a cohesive unit.

Group activities

8.74 With performance budgeting as an institutionalised system, there should be genuine efforts to make the employees feel that they are a part of a total process of achieving the overall objectives of the institution.

Meetings/Seminars with Staff

8.75 The Chief Executives of banks and other members of the Senior Management should as often as possible visit centres (having a number of branches and staff members) along with the top leaders of the Award Staff Union and the Officers' Association, and hold meetings/seminars with the staff. On these occasions they must emphasize the need for discipline, hard work and self-reliance in improving efficiency, productivity and profits, for reducing wasteful expenditure, and for the involvement of the staff. Such inter-action between the leaders and the operating personnel will have a visible impact on operational efficiency.

Inter-branch Comparison of Efficiency

8.76 A comparison of operational efficiency of the branches would help banks to identify those which are performing well and those where corrective action needs to be taken. In order to facilitate inter-branch comparisons, banks must do the following :

(i) Grouping of branches with similar business

(ii) Establishing norms for comparison

As regards item (i) above, branches should be classified into similar groups and comparison between groups should be made. The suggested criteria for grouping are

(a) Total business at the branch, i.e. deposits and advances

(b) Ratio of advances to total business

(c) Situational importance - i.e. State Capital, Lead District Headquarters, etc.

On the basis of these criteria, branches may be grouped into three or four categories. As regards item (ii), the norms for operational efficiency could be:

(a) Average time taken for cash payments and cash receipts

(b) Average time taken for processing loan applications

(c) Extent of statements/pass books in arrears, etc.

(d) Complaints from customers.

The above list is not exhaustive but only indicative of the norms for inter-group comparisons.

Customer Service

8.77 Operational efficiency of banks as perceived by customers is measured by the courtesy extended and the speed and accuracy with which their transactions are completed. Thus, banks must devote considerable time and effort to render service within these three parameters

8.78 The Working Group on Customer Service in its interim report has already given 97 recommendations for better customer service. Banks must ensure speedy implementation of these recommendations. A Customer Services Committee at the Apex level has been appointed in all banks under the directive of the Government of India, with representatives from the staff union and Officers' Association. It is desirable that similar committees should be appointed at the branch level to ensure the involvement of branch staff in rendering good service. Banks may consider appointing such Committees at all branches where the staff strength is 20 and above.

8.79 Some of the foreign banks in India have an official stationed in the customer lobby to handle customer traffic and complaints. A similar arrangement can be made by all banks, particularly to regulate the customer traffic during peak days like the first week of the month, Diwali, Puja, etc.

8.80 In improving the quality of Customer Service, banks too often pay attention only to counter service. It must be remembered that counter service requires an effective follow-up service in despatch, clearing and other related sections and thus the toning up of the entire administrative machinery in the branch is very necessary.

Inter-office Communication

8.81 Operational efficiency can be greatly improved by improving the inter-office communication system. Speedier communication in banking will result firstly in better customer service and secondly in reducing funds in transit. Crores of rupees are remitted daily from one place to another. The total amount remitted by telegraphic transfers alone works out to more than Rs.1,000 crores per annum. Any time lag in transmission will result in accumulation of 'Funds in Transit'. The customers and the banks can earn interest on these funds, if communication is speeded up. There are also other benefits, such as minimising the chances of undetected frauds, by speedier reconciliation of inter-branch transactions and more effective organisational control of branches.

In the banking industry with its large network of branches, there is definite need for a speedier communication system.

8.82 The banking industry has been depending on the Posts and Telegraphs network for all its communication needs. By and large, communication lines between major centres are inadequate. Barring exceptional cases, where some foreign banks have 'Dedicated Teleprinter Lines' connecting Bombay, Calcutta and New Delhi and one public sector bank which has leased a line connecting Bombay and Nagpur, the rest of the banking industry finds that the present system of communication seriously affects its operational inefficiency.

8.83 The Committee recommends that banks should avail of the teleprinter system. It is estimated that the introduction of teleprinter system will result in saving of sizeable cost besides increasing the efficiency of the communication system.

8.84 In India, the banking industry has not given a serious thought so far to the advantage it can gain by having its own network connecting at least the major centres, if not all the centres. The dispersal of branches and business is so uneven that the top ten centres account for more than 16 per cent of the offices handling 50 per cent of deposits and 60 per cent of advances. The top four centres viz., Bombay, New Delhi, Calcutta and Madras account for over 10 per cent of offices, 40 per cent of deposits and 50 per cent of advances. It would be a good beginning even if these four centres are well connected by telecommunication network for exclusive use of banks.

8.85 The Committee considered the matter of improving the communication system for banks and discussed the matter with the officials of the Overseas Communication Services. They are of the opinion that there is good scope and feasibility for developing a telecommunication network for the banks. It is understood that once a decision is taken to avail of telecommunication facilities to connect the four centres, viz., Bombay, Delhi, Madras and Calcutta, the job can be completed in a year or so. The Postal authorities are also developing capabilities to link the communications channels directly to computers of users (banks). This linkage will probably take about three to four years.

8.86 The Committee recommends that banks should be in constant touch with the Overseas Communication Services so as to take full advantage of the new technologies as and when they are introduced in India, and improve their operational efficiency and customer service.

Section VI - Organisation & Management

8.87 An effective organisational set-up should aim at (a) decentralisation of decision making authority, (b) effective control of the various branches of th organisation, (c) feed-back and review system and (d) functional specialisation.

8.88 Diverse organisational pattern are prevalent among banks depending upon the category, size and number of branches, etc. The State Bank of India is a class by itself with over 4000 offices. It has 9 full-fledged Local Head Offices under the overall control of the Central Office. The nationalised banks have regional offices variously designated as Divisional Office, Circle Office and Zonal Office which are further divided into Regional Office, Area Office and so on. The private sector banks, barring the very small banks, have been generally adopting the organisational set-up of their counterparts in the public sector according to exigencies. At the Central/Head Offices of the banks, the organisational basis more commonly adopted is a compromise between a wholly functional and geographical one.

8.89 The Chairman and Managing Director (Chief Executive Officer) for the nationalised banks is appointed by the Central Government in consultation with the Reserve Bank of India, while the Chief Executive Officer for the private sector banks is appointed by the respective boards of banks with the prior approval of the Reserve Bank. The functions and responsibilities of the Chief Executive Officer are more or less similar in all banks although the manner in which they are exercised may vary depending primarily upon the individual and the nature of the organisation.

8.90 In many banks the distinction between senior management level and officer-in-charge of the departments/ senior officer is very thin. The designations, status and the responsibilities of the officers coming under the category of departmental 'eads/senior officers who, by and large, oorstitute the middle management in banks vary from bank to bank. Banks, group-wise, should work out norms of work and responsibilities for this level of officers and adopt as far as practicable, uniform designations and confer identical powers, status and privileges.

8.91 The junior management level lies between the senior officers and the workmen staff. While the junior management cadre consists of only two grades in some banks, there are even upto five layers of such officers in others. It is observed that generally an officer moves into the higher grade almost automatically. Banks, group-wise, should adopt uniform designations for officers in this level and determine their responsibilities.

8.92 In many banks there is a frontline supervisory post known as 'Special Assistants'. These assistants are governed by the Bipartite Settlement and are deemed to be workmen staff although they actually carry out supervisory duties. As these employees are invariably those who have put in many years of service, they often draw higher emoluments than officers and are further entitled to overtime payment. The consensus among banks as seen from their replies to the Questionnaire, is that this post of Special Assistants should be abolished. The Committee endorses this view. The first line supervisor must be an officer.

8.93 Designating staff in the clerical cadre as Clerk/ Cashier/Cashier-cum-Clerk/Typist-cum-Clerk gives them little self esteem of their acceptability in the institution and thereby decreases their productivity level. A designation like "Bank Assistant" would improve the position.

8.94 The management of a bank is vested in its Board of Directors. The decisions and intentions of the Board have to be translated into action and this is done through the Chief Executive and various other functionaries by means of a system of delegation of authority. It is observed that there is either undue concentration of power at certain levels leading to avoidable delay in taking decisions or unfettered freedom of operation exposing the wielder of such authority to the temptation for misuse of power. A sound system of delegation of authority should aim at (a) quick and efficient discharge of work at all levels, (b) overall reduction in cost of administration, (c) development of the human resources from the point of view of sharpening the decision-making capabilities of the managerial personnel, (d) widening the scope for participative management and (e) providing encouragement for the innovative spirit among all the employees.

<u>Delegation of Authority</u>

8.95 It is necessary to lay down certain principles and norms for the evolution of a system of delegation of authority in banks. This involves identification of decision centres on a uniform asis for different categories of banks and categories of branches as well as roles specification and assessment of expectations of both the management and the public about the performances of decision centres.

8.96 Adequate discretionary powers to the operating personnel in banks are essential in order to speed up the process of decision-making. The scheme of delegation of powers in banks must be under constant vigil in order to ensure that delays do not occur due to not being equipped with adequate powers. The extent of delegation will depend on the size of the organisation, the quality of the man-power, etc. However, as a guiding principle banks must ensure that at least 80 per cent of the decisions are taken at the primary levels and only 20 per cent are passed on to the next higher authority.

8.97 Delegation of powers to officers in banks for granting loans, advances, etc., is fairly comprehensive. However, the delegation of powers for administrative and operational matters is neither comprehensive nor adequate. Banks must take immediate action to rectify this situation as it creates bottlenecks and impairs efficiency. Decisions on operational matters like repayment of balances in accounts of deceased customers, issue of duplicate demand drafts, etc., require to be taken quickly in order to gain customer satisfaction. Similarly, quick disp sal of administrative matters like travel bills, medical bills, etc., at the primary level will enable senior management to devote more attention to developmental and operational work of the bank.

8.98 In order to impart flexibility in the exercise of delegated authority, a tolerance limit of 10 per cent above the discretionary limit may be allowed to every authorised officer in the case of lending powers, subject to post- confirmation from the higher authority.

8.99 Delay in decision making due to the temporary absence of the authorised officer can be obviated by an arrangement by which two officials next below the rank of the authorised officer (i.e. the delegate) can exercise jointly the power. It should be possible to give effect to this proposal by incorporating suitable provisions in the scheme of delegation of powers to the concerned officers.

Effective Control

8.100 Any scheme of delegation should be supported by an effective control system. In the banking industry today, the control systems designed for conventional banking is on the verge of a breakdown with the emergence of mass banking. Banks must redesign the control system so as to ensure that control reports are timely and meaningful. Banks may appoint an in-house team or task force to look into this aspect.

Internal Inspection Audit

8.101 It is observed that in several banks the Chief of the Inspection Department is also the Chief Vigilance Officer. The work of Vigilance Officer is of a quasi-judicial nature and has to be in close collaboration with the Central Vigilance Commission. While the vigilance officer may utilise the services of the bank's internal inspectors/ auditors for purposes of investigation into any cases of corruption, it is recommended that vigilance should be placed in charge of a separate functionary who, apart from investigating complaints and frauds, may also initiate disciplinary proceeding, including charge-sheeting of employees, conducting enquiries, etc.

8.102 The audit and inspection machinery should be bifurcated with clear demarcation of work. The audit work may be carried out by an independent Audit Department at the Head Office under a senior executive of not less than the rank of a Deputy General Manager, who will be directly responsible to the Chief Executive Officer. This Department may lay down the policy guidelines in so far as they relate to audit and act as the co-ordinating unit for different types of audit/inspection work. In large banks the Department may have under its control independent Divisional/Zonal Offices in charge of a Chief Internal Auditor of not less than the rank of a Regional Manager. These offices can be situated in smaller towns having proper means of communications.

8.103 It will be the responsibility of the Chief Internal Auditor to ensure that all the branches under his jurisdiction are audited periodically. On completion of the audit of a branch, the Auditor will furnish a list of irregularities to the Branch Manager. There should be a time bound programme for the follow-up and rectification of irregularities. The Branch Manager should be made responsible for getting the irregularities rectified. The performance of a branch, inter alia, should be judged on the basis of a Zero Irregularity Programme.

8.104 Some banks have already introduced a system of concurrent audit of large branches in metropolitan cities where the daily transactions require care and attention. The concurrent audit is carried out by firms of external auditors specifically appointed for the purpose. Banks which have not adopted the systems should consider doing so at least for their larger branches where the volume of business would warrant daily audit.

8.105 The reporting system adopted by banks to bring to the notice of the Board of Directors the progress made in audit/inspection of branches and the action taken in the case of irregularities should be streamlined so that the Board is apprised of only the important features from time to time.

Chapter IX

CASH REMITTANCES AND CURRENCY CHESTS

Organisational set up.

The Reserve Bank of India has a statutory obligation to afford reasonable exchange and remittance facilities to banks and general public. This obligation is discharged by the Bank through its own Issue Offices and also through the currency chests established with the branches of its agency banks and treasury agencies. In accordance with a policy decision taken to appoint the nationalised banks as agents of the Reserve Bank, currency chests are also being opened with the branches of those banks. The progress of establishing currency chests with the branches of nationalised banks has, however, been extremely slow. Hence the entire responsibility for affording remittance and exchange facilities to banks and members of the public rests and will be resting for some time to come on the Issue Offices of the Reserve Bank and branches of the State Bank and its subsidiaries.

9.2. The Bank has established ten Issue Offices and four sub offices of the Issue Offices at important centres in the country which are primarily responsible for the supply of fresh notes on the one hand and withdrawal of soiled notes on the other. In addition, the Bank has currency chests with (i) branches of its agency banks, i.e., the State Bank of India and its subsidiaries and also the fourteen nationalised banks, and (ii) Government treasuries and sub-treasuries where in the absence of a branch of an agency bank, Government business is transacted by them. Currency chests have been established to cover all important centres in the country. Apart from currency chests there are also repositories which, unlike the currency chests, do not deal directly with Issue Offices but are linked to the main currency chests. At the end of June 1976, there were 2396 currency chests and 254 repositories. Additional currency chests are opened by the Bank at different branches of the State Bank or its subsidiaries or the nationalised banks according to requirements. The Issue Department also maintains small coin depots belonging to the Central Government for supplying subsidiary coins to the public at its offices and also at the branches of the agency banks and at the treasuries and sub-treasuries.

9.3. Despite all these organisations and arrangements, there is no denying the fact that there has been a steady deterioration in the quality of the service to the public. This has been due to a variety of reasons. The branches of the agency banks have not been able to augment their vault space to increase the holding capacity of currency chests, with the result that they are not in a position to accept cash remittances from other banks in full. The excessive centralisation of resource operations at about 2600 currency chests in a vast country like ours has resulted in a great deal of inconvenience all round as cash can neither by received nor paid out in large quantities, except at places where these chests are located. In the absence of facilities for paying cash into, or drawing cash from currency chests at a sufficientl large number of points, commercial banks find from time to time that idle cash, which cannot be remitted or used and does not earn any interest is accumulating in their hands, or alternatively large payments cannot be made by drawing on readily available cash balances. In emergencies the volume of cash available to banks outside the vaults of the Reserve Bank or the agency banks is so limited as to cause a great deal of inconvenience to the banking system. In eastern and north-eastern India where communications are difficult and the branch net work of commercial banks is not very widespread, while the need for currency has increased very considerably because of economic development and the requirements of local military units and installations, resource operations are difficult on account of the inadequacy of the number of currency chests.

9.4. In their day to day operations, the branches of banks may accumulate surplus cash or may require more cash than what is available in their till for meeting the payments to their customers. According to the existing procedure, the surplus cash is deposited with the nearest office of the Reserve Bank of India or branch of the State Bank of India or its subsidiary for credit of their current account and their requirements of additional cash are met by withdrawing from the account with its "agency branch". Further, the soiled notes and slightly mutilated notes exchanged by the banks from members of the public, in terms of the instructions issued by the Reserve Bank of India from time to time, have also to be exchanged by the banks, in turn, from the office of the Reserve Bank of India or agency bank. Thus the offices of the Reserve Bank of India and agency banks have to receive from the commercial banks their surplus cash and accumulations of soiled and mutilated notes exchanged by them from the public and also issue to the commercial banks their day to day requirements of fresh and re-issuable notes.

9.5. The banks are, however, experiencing difficulties when they go to the offices of the Reserve Bank of India or branches of the agency banks for exchanging soiled and mutilated notes or for obtaining their requirement of additional cash or for depositing their surplus cash/or fresh notes. Some of the difficulties which the commercial banks are reported to be facing in this regard are outlined in the following paragraphs.

Need for Additional Currency Chests

9.6. The exchange and remittance facilities provided by Reserve Bank of India and other agency banks to other banks is found to be inadequate in as much as the commercial banks in most cases are not free to pay-in their excess cash daily into the credit of their current account or remit it to their head office. In most cases the agency banks and at times even Reserve Bank of India put certain restrictions on the days of the week on which cash will be accepted from other banks and on the quantum thereof. As a result the commercial banks are compelled to keep higher level of cash with them than warranted. In some instances commercial banks are left with no alternative but to physically transfer the cash from their office to their neighbouring office.

9.7. Whenever cash is tendered by the commercial banks at an office of the Reserve Bank or a branch of the State Bank or agency banks, their representatives are detained for unduly long periods.

9.8. Cash tenderers from commercial banks are often diverted to the public counters by the agency banks and even by the Reserve Bank offices and commercial Banks' representatives are made to stand in the queue along with members of the public, instead of affording special facilities to them.

9.9. The Committee examined their difficulties and observed that the main reasons for the inability of Reserve Bank of India and Agency banks to handle all the cash tendered by Commercial banks is shortage of staff in Cash Department and want of space in the strong room. One solution could be to increase the number of currency chests.

9.10. Reserve Bank of India have been trying to increase the number of currency chests at the branches of the State Bank of India, its subsidiaries and those of the nationalised banks. Accordingly, in April 1971, it was suggested to the nationalised banks that currency chests should be opened at the more important places with a population in excess of one lakh each In October 1971, in view of the difficulties in arranging for supplies of notes and small coins to the eastern States and union territories at short notice, a list of places in eastern and north-eastern India was supplied to the banks with branches in the eastern India asking them to consider the establishment of currency chests at some of these places. State Bank of India was requested to consider the question of improving the standards and capacity of its currency vaults at each of the cities and towns with a population in excess of one lakh ~~cash~~ each according to the 1971 Census.

9.11. The commercial banks derive certain advantages in having currency chests. Banks with currency chests will be able to conduct their day to day business with a minimum cash balance and thus avoid accumulation of idle cash and consequent loss of interest. They can also minimise physical transfer of cash to and from Reserve Bank office or between their own branches thereby reducing the cost of operation. Currency chests also enable the exchange of rupee coins for notes and vice versa, or notes of one denomination for notes of another denomination, or old and soiled notes for fresh and re-issuable notes. From Reserve Bank's point of view also there are some advantages. By establishing more and more currency chests, storage space is shared. There is also some elimination of duplication of work and saving in labour by recycling the notes at the branches of public sector banks themselves. From statistical point of view also the amount of active notes in circulation will show a more correct picture by the exclusion of the idle cash with the banks through the mechanism of currency chests.

9.12. Further, it is in the banks' own interest that adequate cash should be available at a larger number of points, to be drawn in emergencies as and when necessary. Secondly, the facility of paying idle cash into currency chests and of withdrawing cash from currency chests, as and when heavy payments are to be made, will be very real and important. The alternative, in the context of the increase in the volume of notes in circulation and inadequate currency chests, may well be very heavy accumulation of cash and loss of interest on such accumulated cash, resulting in considerable inconvenience to the banks themselves. Thirdly, remittances between bank's own branches will be facilitated, as and when more currency chests are opened by the bank; the advantages in other words, are likely to be more real than apparent, as and when more currency chests are opened. Lastly, in the interest of equitable distribution of the available supplies of fresh notes among banks and their constituents, the opening of an adequate number of currency chests will be inevitable.

9.13 The progress, however, has not been very encouraging particularly in respect of the nationalised banks. About currency chests only have so far been established by the nationalised banks. In relation to the volume of currency to be handled and the rate at which it has been increasing, the arrangements for dealing with it continue to be extremely inadequate and the response to the Reserve Bank's suggestions and recommendations has not been very satisfactory.

9.14. The Reserve Bank is aware of the limitations within which improvements in the existing currency and financial system can be introduced. The major limitation is that the nationalised banks and the State Bank of India seem to be reluctant to undertake any additional burden or to incur any additional expenditure in regard to currency chests. So far as the nationalised banks are concerned, the benefits of having independent currency chests are deemed by them to be meagre in comparison to the expenditure involved - both recurring and non-recurring.

9.15. In view of the exorbitant cost of construction of vaults for setting up currency chests, it has been suggested by some of the banks that all the nationalised banks should pool their resources to establish currency chests at metropolitan centres so that the prohibitive initial cost on capital account could be spread among all the banks. Such an arrangement, however, may not work to the satisfaction of all contributing banks as the main advantage will be with the bank housing the currency chest and may also cause operational difficulties. Initial cost should not normally be a deterrent to opening of currency chests by banks in view of the long term advantages and better service they will be able to give to their customers and general public with the help of the mechanism of currency chests.

9.16. An important handicap in this regard, however, is the lack of suitable accommodation for vaults (for housing the currency chests) which are to be built according to the specifications prescribed by Reserve Bank of India. The nationalised banks have a feeling that the Reserve Bank's specifications for strong rooms are very stringent and the procedural requirements laid down for establishing currency chests are very protracted. Any dilution of the existing standards, however, may endanger the security of the treasure held in the vaults, which is the property of the Reserve Bank of India, particularly as the balances held in the currency chests are not insured. Relaxations are, however, being made by the Reserve Bank, wherever necessary, depending upon the merits of each case.

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9.17. It is recommended that Reserve Bank of India may create Development Fund out of their annual profit for the purpose of financing commercial banks for construction of strong rooms for housing the currency chests as per specifications laid down by Reserve Bank of India. No interest will be charged for lending from this fund. The details regarding the quantum of loans and the repayment schedule may be worked out by the Reserve Bank of India.

9.18. Yet another hurdle is the lack of suitable trained personnel with the nationalised banks for managing the currency chests and also lack of suitable arrangements for the training of the personnel. The Committee understands that the Reserve Bank of India is making arrangements for training the staff of the nationalised banks at the offices of the Reserve Bank and branches of the State Bank of India and its subsidiaries. The Reserve Bank should continue such arrangements.

9.19. The banks are also experiencing difficulties on account of the non-availability of police guards to guard the currency chests. This difficulty is genuine, because the various State Governments are not in a position to spare the necessary personnel to guard the currency chests in view of the more pressing demands on the police personnel. This issue has been taken up with the local Police Authorities, viz., Commissioner of Police, Inspector General of Police and also the Home Secretaries of State Governments. The matter should be pursued vigorously. To overcome this difficulty, the banks have been permitted to employ their own armed guards subject to certain stipulations. A connected issue is the high recurring expenditure of maintaining the required police guards which comes to about Rs.30,000 to Rs.40,000 per annum. Some banks have suggested that the expenditure should be borne by the Reserve Bank of India as they are acting as agents of the Reserve Bank of India.

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9.20. In view of the advantages accruing to the branches of the banks maintaining currency chests, particularly in regard to savings on interest charges, there does not appear to be any justification for reimbursement of such expenditure to the banks by the Reserve Bank of India.

9.21. It has been, suggested by some banks that the nationalised banks should be allowed to open currency chests at more places. It is understood, however, that the Reserve Bank of India has fixed certain norms in regard to setting up of currency chests at branches of nationalised banks. This has been examined by the committee and the committee feels that in the absence of some such norms, currency chests will be opened in a haphazard manner at all sorts of centres and locations without any plan or programme, with the result that they may not fully serve the real purpose. However, it is learnt that the norms fixed by the Bank are being relaxed wherever necessary depending upon the merits of the case.

Removal and Disposal of Soiled Notes:

9.22. As observed earlier one of the reasons for agency banks not accepting cash from other banks freely is want of storage space in their vaults which are already full with non-issuable notes. The heavy accumulation of soiled notes at agency banks vaults is due to difficulties experienced by Reserve Bank of India in withdrawing the soiled notes and in disposing them off.

9.23. With the phenomenal increase in circulation of currency notes year after year, the problem of cash management and disposal of soiled notes has also been increasing in magnitude. The value of currency in circulation which stood at Rs.172 crores at the inception of the Bank on 1st April 1935 increased to Rs.7461 crores on the 30th June 1976 i.e. an increase of more than 43 times. However, to have a correct idea of the magnitude of the problem of currency management, not only the total value of currency in circulation but the quantity of note pieces in circulation has also to be taken into consideration.

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The quantity of note pieces in circulation has increased from as low as 124 million pieces in 1935 to 7171 millions pieces in 197 i.e. by more than 57 times. Further, according to projections made by the Reserve Bank in April 1973, the value of currency in circulation is expected to increase to Rs.8,350 crores, consisting of 7,800 million pieces in 1978-79. In view of the higher rate of increase in money supply and prices since April 1973, when these projections were made, even these estimates may turn out to be rather conservative, but plans for increasing the capacity for the printing of notes are being made on the basis of these estimates, plus additional contingency provision of 10 to 15 per cent every year, over and above the estimates of requirements for the year, by way of abundant caution.

9.24. The number of pieces of currency notes in circulation in India is the largest in the world as can be seen from the statistics given below:

	(In millions of pieces)
India	7171.0
U.S.A.	5812.0
U.K.	1470.0
France	1097.0
Italy	1079.5
West Germany	823.0
Brazil	750.9
Canada	493.4
Japan	320.3
Australia	245.0

In a vast country with a large rural population who generally conduct their transactions on cash basis and have not yet developed banking habits, people use more currency notes of lower denominations than these of higher denominations. Actually one rupee and two rupee notes together account for nearly half the total volume of notes in circulation. The following table shows the composition denomination-wise:

(As on 30th June 1976)

Denomination	Value: Rupees in crores	Value: Percentage to total	Pieces: No. in millions	Pieces: Percentage to total
Re. 1	285	4	2846	40
Rs. 2	121	2	605	8
Rs. 5	542	7	1083	15
Rs. 10	1974	26	1974	28
Rs. 20	484	7	242	3
Rs. 50	245	3	49	1
Rs. 100	3710	50	371	5
Rs. 1000	100	1	1	-
	7461	100	7171	100

9.25 It is a common complaint from the public sector banks maintaining currency chests that the Reserve Bank of India is not prompt in removing the accumulations of soiled notes in the currency chests at their branches, with the result that the vaults at these branches become congested and they, in turn, are also not in a position to receive remittances of fresh and reissuable notes from the Reserve Bank/other currency chests and afford adequate exchange and remittance facilities to other banks not having currency chests and also to the general public. The banks feel that the Reserve Bank of India should lift the accumulations of soiled notes at their branches at regular intervals, at least once in six months. The complaint appears to be genuine and the Reserve Bank, no doubt, is required to lift the accumulation of soiled notes at least once in six months. In practice, however, this is not being done, because the vaults at the Reserve Bank Offices themselves are congested. The remedy appears to be further decentralisation of the work of examination and destruction of soiled notes. In this connection the question of opening full-fledged branches of the Reserve Bank of India at the remaining State capitals should be considered on a priority basis. In addition it will also be

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necessary to open sub-offices of the Issue Department at important ~~receiving~~ centres, so that soiled notes from surrounding chests could be removed to the sub-offices, examined and destroyed, the load thus reducing the load on the Issue Department.

9.26. The delay in disposal of soiled notes can be considerably reduced if instead of making a cent per cent examination, only a sample examination is carried out by application of suitable statistical quality control techniques. The percentage of sample examination should ofcourse be higher for higher denomination notes. In case of denomination of Rs.500/- and above examination should be cent per cent. A cent per cent quantity check may, however, be conducted in the case of all denominations by the Reserve Bank as Currency Authority before ~~report~~ the notes are finally written off and destroyed.

9.27. One of the main reasons for the accumulation of soiled notes in the vaults of the Reserve Bank of India and its inability to remove soiled notes from chests appears to be the low out-turn of work in the Note Examination and Verification Sections in the Issue Departments. A reputed firm of Industrial Consultants, namely IBCON, was engaged by the Bank sometime in 1958 to carry out a scientific study. The revised rates suggested by them, however, could not be implemented because of resistance from Employees' Association. The question was again studied by a High Power Committee appointed by the Bank in 1975 now known as the Rao Committee. The revised rates recommended by them could also not be implemented as the Employees' Association appealed to the Labour Commissioner against the increase in the rates proposed by the Bank and the matter is now pending with the Regional Labour Commissioner (Central) Bombay.

9.28. The problem of accumulation of soiled notes at the currency chests as well as at the Issue Offices has assumed such a magnitude that introduction of both short term and long term measures for speedy disposal of the growing volume of soiled notes is urgently called for. The existing procedure for examination of notes is aimed at detecting shortages/excesses and forged and defective notes and salvaging re-issuable notes. In practice, however, it has been found that the actual number of re-issuable pieces in chest notes of Re.1 and Rs.2/- denominations as well as shortages/excesses and forged notes detected in all denominations in both chest notes and local tenders is negligible. Looked at from the cost-benefit angle, it is evident that the present system of quality ~~examination of~~ notes of lower denominations (Re.1 and Rs.2) in chest remittances does not yield commensurate results. The statistics show that incidence of forgeries in lower denomination notes is extremely negligible. After careful consideration of all these factors, it is felt that there is sufficient scope for a thorough upward revision in the rates for note examination and verification. Reserve Bank should take effective steps in this regard.

Higher Denomination Coins

9.29. It is observed from statistics that one rupee and two rupee notes together form nearly half the total volume of notes in circulation. The problem of accumulation and disposal of soiled notes could be minimised if the notes in these two denominations are substituted by coins. The Bank is already issuing one rupee coins side-by-side with one rupee notes. One rupee notes may be completely substituted by one rupee coins in a phased manner. To make it popular, the one rupee coin should be light smaller in size and convenient to handle. If necessary, the metal composition may be suitably changed. The Bank could also consider issuing of coins of two rupee denomination and the eventual substitution of two rupee notes by two rupee coins. The Committee is not inclined to recommend issue of coins in the higher denominations of Rs.5/- and Rs.10/- because of the risk of counterfeiting of coins, counterfeiting of coins being easier than counterfeiting of notes.

Guarantee Bonds System

9.30. Notes deposited with the Reserve Bank under guarantee bond system are not disposed of expeditiously. Undue delay in getting these notes examined by the Reserve Bank makes it difficult for the commercial bank to fix responsibility on their staff for any shortage or irregularity which may be detected at the time of actual examination of the tenders after the lapse of a considerable time. At times, the representatives of the commercial banks are made to work late hours by the Reserve Bank offices for watching the examination of remittances received from their banks, necessitating payment of overtime allowance to the representatives by their banks.

Duplication in counting of notes

9.31. It is observed that there is considerable duplication of work and wastage of man power in counting and reexamining notes received by one branch from another branch and also by one bank from another bank. Remittances between branches of the same bank could, perhaps, be simplified and counting at multiple points eliminated by introducing fool-proof checks and counter checks and by a system of affixing adhesive petro-chemical seals. It is understood that the State Bank of India has introduced this system with advantage. The system may not, however, be fool-proof in the case of remittances from one bank to another. Much of the duplication can be eliminated if the commercial banks sort the notes properly into non-issuables and re-issuables before they are remitted to the Reserve Bank of India or to the agency bank, so that, to that extent, the work of receipt and disposal of cash remittances from commercial banks can be speeded up at the offices of the Reserve Bank or branches of the agency bank.

Exchange of mutilated notes

9.32. Considerable delay is experienced by the commercial banks in getting multilated etc. notes exchanged from the Reserve Bank offices. After the lapse of a long period the commercial bank concerned finds it difficult to recover the amount of any note, which is ultimately rejected by the Reserve Bank, from their customer on whose behalf the note was originally exchanged by them. At times, some of the offices of the Reserve Bank even limit the number of pieces of multilated notes that will be accepted from the commercial banks. Defective notes are accepted at a special counter at the office of the Reserve Bank. Commercial banks, however, complain that the procedure of tendering the defective notes at this counter and getting the exchange value ultimately is a time consuming process and causes considerable inconvenience to the banks. They, therefore, suggest that special arrangements should be made by the Reserve Bank offices for receipt of defective notes from other banks and for disposing of those defective notes expeditiously, preferably on the day of receipt itself.

9.33. Commercial banks are experiencing some difficulties in obtaining exchange value on defective notes tendered by them at the Reserve Bank Offices. Under the Reserve Bank of India (Note Refund) Rules, 1975, powers have been delegated to the Agents/ Managers of all branches of public sector banks to pass for payment certain types of mutilated notes tendered by members of the public and other commercial banks. These notes exchanged by them are to be tendered by them to the office of the Reserve Bank of India or branch of the State Bank of India or its subsidiary having currency chest for reimbursement, if the public sector bank branches concerned are not having currency chests. At present there is considerable delay at the offices of the Reserve Bank of India in the re-examining of the mutilated notes exchanged by the public sector banks and making reimbursement of the amounts to them. The Reserve Bank could consider with advantage the question of extending the guarantee system to remittances of mutilated notes received from public sector banks also, so that reimbursement can be made to the banks without any time lag.

9.34. Special arrangements should be made at Reserve Bank of India offices to remove defective notes from public sector banks and to dispose of them expeditiously. The Reserve Bank may even consider giving provisional credit for the remittances of defective notes received from banks, under a guarantee system, the amount of notes subsequently found not payable on examination, being recovered from the concerned banks by debiting their accounts.

Miscellaneous Difficulties

9.35. Only a small percentage of notes indentedby the commercial banks is supplied in fresh notes by the offices of the Reserve Bank and branches of the agency banks and that too not according to the denominations indented. There is, therefore, a perpetual complaint from their customers that they are receiving only soiled notes. Some of the commercial banks even complain that they get only soiled notes. At times of seasonal rush, acute shortage of fresh and reissuable notes is being felt at some of the smaller centres. In rural and semi-urban areas, commercial banks find it difficult to obtain their full cash requirements and in required denominations from the branches of the State Bank of India or its subsidiary having currency chest facility.

9.36. Indents from commercial banks for higher denomination notes are often met by the offices of the Reserve Bank and branches of the agency banks by issuing notes of smaller denominations. There appears to be a shortage of notes of Rs.20, Rs.50 and Rs.100 denominations. This causes inconvenience to the banks' customers.

9.37. These difficulties will be reduced as and when more chests are opened. Further whenever fresh notes are received by State Bank of India branches having currency chests, the fresh notes should be distributed in some reasonable proportions to other commercial banks at the centre. While indenting for notes from the Reserve Bank, the State Bank of India and subsidiary bank branches should take into account the requirements of the other commercial banks also.

9.38. The Committee has carefully examined the suggestion made by some of the banks that commercial banks may be allowed to hold cash upto a stipulated limit on account of the Reserve Bank of India or State Bank of India or its subsidiary in safe custody and given credit for the amount of cash held under that arrangement on the basis of a declaration given by the concerned banks. Although prima facie this suggestion appears to be attractive, the proposed arrangement will not be practicable as the cash balance at every branch will, in such a case take the form of a miniature currency chest and reporting of daily balances to and their accounting by the circle Issue Department will be complicated and almost impossible to be carried out with any accuracy and if these balances are not promptly and accurately adjusted in the circle Issue Department, the currency accounts will be incomplete.

9.39. With the phenomenal increase in circulation, the work involved in counting and examining notes received at the Reserve Bank offices has become enormous and unmanageable manually. The efforts to mechanise the operations of note counting have been unsuccessful in the past because of the resistance of the Employees' Association. Mechanisation has been introduced in several foreign countries like France, Israel, Japan, Mexico, New Zealand and West Germany. The Bank could with advantage once again examine the feasibility of introducing mechanisation for counting of notes at various stages, at least at bigger centres.

CHAPTER X

PROFITABILITY OF OPERATIONS

In the analysis of earnings and expenses of banks given in Chapter VI, it was indicated that from the point of view of profitability, the immediate future for the banking system was not promising. This conclusion emerged from two main factors. First, the upward trend in expenses, consequent on a growing public preference for longer term and higher cost deposits and increases in establishment and other charges because of spread to rural areas and involvement in new services. Second, the downward pressure on earnings following from the ceiling on interest rates and the extension of credit at preferential rates to various sectors.

10.2 The data analysed in Chapter VI have revealed a declining trend in profitability in 1970-73. This trend would have persisted and perhaps become more pronounced but for the increase in lending rates in the year 1974 which reversed the trend and enhanced profitability. This has also resulted in a sense of complacency among banks. As noted above, the future may pose difficulties for banks, the full impact of which will be felt only over a period of years. The erosion in bank profits is seldom revealed in a sudden or dramatic fashion. But the erosion, once set in, is likely to persist and endanger the basic viability of the system unless corrective action is taken in time.

10.3 In general, banks in India have not so far adopted any positive approach towards profit planning. The tendency has been to meet requirements as they arise without adequate provision for the consequences. A significant indicator of this situation is the decline in reserves as a ratio of deposit liabilities. Capital and published reserves (owned funds) of banks which were extremely low by international standards even in 1970, forming 2% of deposit liabilities, declined further to 1.5% in 1975. This is far below the level of 6% recommended by the Reserve Bank in 1962.

10.4 In the interests of the soundness of the Indian banking system and for enhancing its image abroad, an improvement in the owned funds is very necessary. While this is not something that can be effected in the short run, a beginning should be made towards such improvement. It is suggested that by 1980, the ratio of banks' owned funds to deposits should rise to 3%. By that year, deposits are likely to be nearly double the present (March 1977) level of Rs.17,500 crores. The desired quantum of owned funds should be around Rs.1,000 crores, as against Rs.220 crores in 1975. The annual deposit growth rate is currently around 25 per cent. To reach a target of 3 per cent in the ratio of owned funds to deposits, the annual transfer

Profit Planning

to reserves should exceed 0.075 per cent (3 per cent of 25 per cent) of deposits. As stipulated earlier in Chapter V while dealing with taxation laws, the minimum quantum of transfer to reserves should be 40 per cent of disclosed profits. On this reckoning, disclosed profits of banks should be at least 2 per cent of deposits.

10.5 For achieving this increase in profits, banks' efforts will necessarily have to be multi-dimensional - reduction of costs, rationalisation of charges other than interest and improvement of efficiency. Many of these points have been discussed at length in the previous chapters. Proposals for revising service charges, which will help banks in meeting their rising operational expenses, are dealt with in the Chapter No.XI on Pricing. Certain other aspects relevant to profitability are discussed here.

Cash reserves

10.6 Under Section 42(1) of the Reserve Bank of India Act, every scheduled commercial bank is required to maintain, with the Reserve Bank, an average daily balance equal to 3% of its demand and time liabilities. This minimum cash ratio can be raised upto 15% which is obviously intended as a measure of monetary control. Although the authority to vary the required cash reserves between 3 and 15% was given to the Reserve Bank by the amendment to the Reserve Bank of India Act in 1962, the ratio continued at the minimum level of 3% until 1973. Since June 1973, the ratio has been changed several times, with the level being always above the minimum of 3%. The highest ratio prescribed so far is 7%, which prevailed for a period of 9 months between September 1973 and June 1974. In the current year, the ratio has been raised twice from 4% to 6%.

10.7 The Reserve Bank of India Act provides for the payment of interest "at such rate or rates as may be determined by the Bank from time to time" on the amount maintained as cash reserves in excess of minimum of 3%. Accordingly, a rate of 4.75% was paid on the additional reserves when the minimum lending rate was first raised in 1973. Subsequently, this was raised, in three stages, to 6.0%, which rate has been effective since June 1977.

10.8 Banks' assets portfolio distribution is further conditioned by Section 24 of the Banking Regulation Act, according to which banks have to maintain a specified proportion of their total liabilities in the form of certain liquid assets. Although the proportion as specified in the Act is 25% and the Act does not specifical empower any variation in the same. Through power of "moral suasion", the Reserve Bank has enhanced the requirement. The current level of assets known as Statutory Liquidity Ratio (SLR) is 33%. This includes the cash in hand or till money and balances with notified banks in current account maintained by banks for their operational requirements which is around 3%. The balance of the liquidity requirements has to be in the form of investment in unencumbered approved or trustee securities. Thus, 39% of a bank's total liabilities are pre-empted for fulfilling statutory requirements - 6% for minimum cash reserve and 33% for SLR. The proportion will be higher if deposits alone are considered, excluding other liabilities. Of this 39%, 6% is barren and yields no return (3% of minimum cash reserves and 3% held as cash in hand and balances); on a further 3%, which is the additional cash reserves, 6.0% is received; the average return on investments is 5.7%. The influence of this liquidity factor, covering as it does over a third of total deployable resources, is to lower banks' return on funds. Thus, while the average income from loans, advances and bills is 13.4%, the average income from all assets is 10.7%.

The variation of the cash reserves is doubtless an important tool of credit management. However, the payment of a realistic rate of interest, on the reserves does not in any way dilute the effectiveness of the weapons. It has already been noted that there has been a steady rise in the interest cost of banks' loanable resources. The cost, which was only 3.8% in 1970, rose to 4.4% in 1973, 5.5% in 1974 and 6.1% in 1975. These rates represent the average for the system as a whole whereas the cost for smaller banks is considerably higher, say around 7%. With the persistence and accentuation of the shift to long term and high cost deposits, the cost will undoubtedly rise further in the near future. It is estimated that the cost would be around 6.5 - 7% for the system as a whole for the year 1976.

10.9 The Committee, therefore, recommends that the rate of interest paid on the additional reserves, in excess of the minimum of 3%, should be related to the average cost of funds. The Committee strongly feels that the rate should be raised. It may be 6.5% for banks whose total deposits exceed Rs.400 crores and 7% for all other banks. The rates suggested are based on the estimated interest cost of funds in the recent past. The position has to be reviewed and the rates revised annually.

10.10 The Committee is also of the view that interest should be paid on the basic cash reserves of 3%. International precedence allows such a practice; the Reserve Bank of Australia is required to pay interest both on the basic and the additional reserves. In India, the legal provisions do not actually prohibit the payment of interest on the basic reserves. The Reserve Bank of India Act is silent on this subject. It would seem logical to allow a lower rate on the basic reserves than in the additional reserves. The rate of interest on the basic reserves may be the same as the yield on Treasury Bills which is around 4.6%.

10.11 Maximisation of profitability requires effort not only at the "macro" level - for the system as a whole or an individual bank but at the "micro" or branch level also. Individual bank offices have to develop and sustain a high degree of "cost consciousness". This depends primarily on the attitude of the head office and the extent of monitoring the viability and performance of the unit offices. In general, while all banks have an integral inspection and audit system, not many undertake any systematic evaluation of branch performance and stock-taking of loss incurring branches.

<u>Branch level profitability</u>

10.12 In order to gain a clearer appreciation of the factors affecting branch level profitability, the Committee undertook a study of loss-incurring branches in collaboration with five nationalised banks. The details of the study are given in the Technical Note on this subject ~~appended~~. The concept of "loss" or "profit" of branches varies between banks, depending on the interest debited/credited to the branches on the funds lent by or transferred to the head office. Since this is a crucial consideration affecting the proper appreciation of branch profitability, the Committee recommends the adoption of a uniform transfer price formula by all banks.. Such a formula has been worked out on the basis of the study and is given in the Technical Note. The formula takes account of all factors, affecting the cost of funds and the potential return on deployment and allows for the variations in the same between banks. Thus, what is recommended is not the adoption by all banks of the same rates of interest on the funds transferred from and to the head office, but the same methodology for arriving at the rates. The rates will have to be revised periodically in order to reflect the impact of changes in costs and return.

10.13 It was found that in the banks included in the study the adoption of the revised transfer price mechanism made a substantial reduction to the number of loss-incurring branches. A further analysis of the characterstics of the chronic loss incurring branches (over 5 years old and making losses continually for at least 3 years) has revealed some reasons for losses which have a bearing on the policy to be adopted, both at the bank level and for overall licensing of bank branches.

<u>Factors affecting profitability</u>

10.14 Two factors that were seen to be of considerable importance in determining profitability may be viewed together. They are: (i) the location of a branch and (ii) its staffing pattern. The study revealed that a large majority of loss incurring branches were in rural and semi-urban areas. The staff component of the branch, in terms of not only the number of employees but their age composition as well, was noted as another influence on the costs incurred at the branch level. Thus, where the personnel consists predominently of older employees drawing high emoluments in their grades, the establishment expenses tend to be unduly heavy. Also, there appears to be something of an irreducible minimum in the staff component of even the smallest rural branch.

Since banks operate with uniform pay scales for all types of offices, the number of employees in a branch related to its business potential is a consideration of significance to branch expenses.

10.15 The analysis of banking costs in Chapter VII brought out the proportionately higher cost of transactions in rural offices. The pattern of distribution of employment among the offices in the different population groups, related to the business in those offices as indicated by their total deposits and advances, further substantiates this position, as may be seen from the following table:

Distribution of employment and business between bank offices in different population groups

(December 1974)

Population Group	Percent to total employment	Percent to total business (Deposits + Credit)	Average number of employees per office	Average business (Deposits + Credit) per employee (Rs. in thousands)
Rural	10.2	7.2	7	381
Semi-Urban	25.2	19.5	16	424
Urban	27.3	23.6	29	473
Metropolitan	37.3	49.7	48	731
TOTAL	100.0	100.0	20	548

10.16 While the proportion of employees in metropolitan offices is nearly four times that in rural offices, the proportion of business handled by them is about seven times the rural business. Cogniscance would, however, have to be given to the basic functional differences between a metropolitan and a rural office. The latter is primarily concerned with the establishment and the spread of the banking habit and, in the process, has to develop more personal contacts, both with borrowers and depositors and deal predominantly with small accounts. The process of lending in rural areas is frequently one of seeking the potential borrowers and offering them banking facilities. Even allowing for these factors, judging by the quantum of business at present handled by rural/semi-urban offices, there would seem to be a certain degree of under-utilisation of staff in these offices. This is further supported by the fact that non-funds activity (remittances, bills, foreign exchange dealings, etc.) is heavily concentrated in metropolitan offices.

10.17 As pointed out in the Chapter VII on 'Assessment and Analysis of Banking Costs', these factors could indicate an extent of under-utilisation of capacity in rural offices. Efforts have hence to be directed towards increasing the business handled by small rural and semi-urban offices. However, it has to be recognised that there are significant differences in the business potential of centres and that even with the best efforts possible, the growth of some offices will be slow. Therefore, greater attention has to be paid to the staffing pattern of individual offices, relating the number of employees to the business possibilities that can be developed in the immediate future. It is also necessary that a review of branch staffing should be done on a continuing basis, so as to effect quick adjustment to changing circumstances. Some transfer of award staff (generally employed on a non-transferable basis) will be necessary but this may be effected within as narrow a geographic area as possible. It is understood that the agreement that some banks have with their employees' unions includes stipulations regarding the minimum number of employees that may be posted in any office. This position requires to be reviewed.

10.18 The study of loss incurring branches has also revealed that a high proportion of loss incurring branches were deposit-oriented. While deposits are of the utmost importance in banking, constituting the principal "raw-material" of the business, it is also necessary that banks should relate the quantum of deposits obtained by a unit to the cost of obtaining the same. A sizeable establishment component, principally utilised for collection of deposits, may not always be justified. Here again it would be necessary to expand business, especially in advances. Where the scope for such expansion is limited, a scientific assessment would have to be made of the utility of the branch to the bank as a whole.

10.19 Another factor seen from the study as influencing branch profitability is the maintenance of a high level of cash balances. The increase in the number of currency chests and arrangements for the expeditious removal of soiled notes, as discussed in Chapter IX, would be of a considerable assistance to banks in this regard.

10.20 In several instances, especially in smaller centres, banks are considerably handicapped by the absence of suitable premises and have often to pay exorbitant rentals. While in the totality of a bank's expenses, rent forms only an insignificant proportion, the incidence of high rent can be very heavy on a branch, especially one in a centre with limited business potential. In such instances, the high rent can continue for several years as the major factor preventing the branch reaching the profit-making stage. The Committee recommends that the respective State Government and district authorities may be moved to assist in acquiring suitable premises at reasonable rentals for banks operating in their area.

10.21 'Sticky' advances or 'protested bills' forming a high proportion of the assets of some branches is yet another reason for their incurring losses. On such advances no interest income is received and this also entails a reduction in the turnover of the branch resources. It is noteworthy that a branch of one of the banks included in our study, over 10 years old and located in a business area of a major metropolitan centre was yet incurring continuous and fairly heavy losses mainly on account of its substantial 'sticky' advances. This feature emerges from operational exigencies and while the bank as well as its individual branches should seek to minimise 'bad' advances, it may not be possible to eliminate them altogether. Hence, a heavy 'burden' of bad debts incurred in the past should not be allowed to unduly cloud the viability of a branch.

10.22 Another factor influencing profitability, ascribable again to operational necessities, is the preponderance of advances to priority sectors, involving both high servicing costs and relatively low returns. Losses on this account have to be viewed from an entirely different angle, and the branch given due weightage for assisting the bank in fulfilling social objectives.

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10.23 It is clear that diverse factors affect branch level viability. Not all are of equal significance or equally amenable to correction. However, it is important that every bank should be aware of the precise extent of its unit level loss, in terms of the number of its loss incurring branches and the principal reasons for the loss in each case. This is not to suggest that the total elimination of loss incurring units and the formulation of branch expansion schemes on the basis of the profit motive should assume the proportions of a policy objective. In the final analysis, what counts is the performance of the bank as a whole even if performance is to be judged solely on the basis of profits; the losses of some branches would have to be offset by the enhanced profits of others. Where other criteria also enter in the evaluation of performance, the number of losing branches that would have to be supported by profit elsewhere might increase.

<u>Assessment of performance</u>

10.24 All the same, an awareness in the head office of each bank of the financial position of each of its branches is essential. The Committee recommends that banks should assess the economic viability of each of its branches annually on the basis of the suggested uniform transfer price formula.

10.25 Banks should intensively study the working of loss incurring branches. For this purpose, branches which are (a) more than 5 years old and (b) incurring losses consecutively for 3 years may be considered.

The banks should report to the Reserve Bank annually before 30th June of the succeeding year giving

i) Names of loss incurring branches with particulars regarding location/ population etc.

ii) losses shown in the book following the uniform transfer price formula.

iii) reasons for incurring losses and suggestions for making the branches which show loss turn the corner.

The format for this return may be standardised by the branch licensing wing of the Reserve Bank.

10.26 The data drawn from the returns so submitted by banks should provide valuable information for both the formulation of branch licensing policy and the decisions regarding individual applications for licences. The working results of branch operating in an area (e.g. a cluster of villages, a particular locality in towns etc.) should be taken fully into account before new licences are issued.

10.27 Our study of loss incurring branches indicated that in some centres, where several banks were operating, more than one office were incurring losses. This feature should be examined in depth by the Reserve Bank on the basis of the data submitted annually by banks and where a branch appears redundant for the centre and a "drag" on the bank, the transfer of the business of the branch to one of the other offices in the centre may be considered.

10.28 This may not appear possible in centres with only one commercial banks office. However, even in such cases, if the loss of the branch is persistent, the closure of the office or its transfer to another centre may be considered provided in its present location it serves

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no socio-economic purpose. The relevant considerations in this regard would include the availability of institutional credit facilities (inclusive of co-operative banks and regional rural banks) in the area of operation of the branch.

10.29 There is a general impression that the bunching of offices in particular localities of metropolitan and large urban centres entails avoidable diffusion of resources, even if all the branches record profits. A feature of banking in large cities is a heavy concentration of business, both in funds and non-funds activity. The important consideration of good customer service may justify the clustering of branches in these areas. However, a detailed and comprehensive study of the concentration of bank branches would be necessary before any final conclusions can be drawn. It is suggested that such a study be undertaken for the purpose of drawing up norms for licensing metropolitan/urban offices.

CHAPTER XI

PRICING OF BANKS' SERVICES

Generally, banks tend to view their operations in totality, without compartmentalising costs of and returns from different categories of services. This is principally because the activities are inter-linked by nature and by the customers served. That is to say, it is not possible to associate each activity with a distinct and separate customer group. Thus, remittance facilities are used to a large extent by depositors and borrowers; borrowers are almost always depositors; only depositors are entitled to the use of safe deposit facilities and so on. From this follows the fact that a customer goes to a commercial bank for a "basket" of services, and tends to claim and receive preferential treatment in respect of charges on individual services. From the banks' point of view, the absence of a clear cut distinction between different services is justified by such facts as the availability for deployment, of funds in transit. Further, the segregation of the servicing costs of different activities cannot be easily done as the staff often handle more than one activity simultaneously and are also frequently shifted from one activity to another.

11.2 It was in this context that the Committee undertook a Cost Study to assess the costs of different banking operations. The results of the study, which are summarised in Chapter VII, throw light on the servicing cost incurred by banks towards various services. The data on which the analysis in Chapter VI (Trends in Earnings and Expenses) is based, are presented from a somewhat different angle. The data relating to expenses are categorised into broad general groups, more or less common to all the activities of banks. The data on earnings, however, do provide a break up of the income accruing to some of the major services groups. This information, when related to the data on servicing cost derived from the Cost Study, yields certain broad conclusions regarding the profitability of operations for each of the major services.

11.3 The following table gives a break-up of the income and the expenses of banks for the years 1970 and 1975 under the three broad service groups viz. funds activity, remittances and bills and 'other services' including foreign exchange business. These data are exclusive of the figures of the State Bank of India, whose pattern of income and expenses is very different from that of other banks, especially in 1975.

Profitability of banks' operations

(Rs.Crores)

	1970			1975		
	Earn-ings	Ex-penses	Balan-ces	Earn-ings	Expen-ses	Balance
Funds activity	445	380	+ 65	1454	1300	+ 154
Remittances and bills	16	43	- 27	45	95	- 50
Other services	53	26	+ 27	169	56	+ 113
	514	449	+ 65	1668	1451	+ 217

It will be seen that remittances and bills services rendered by banks (comprising issue and encashment of T.Ts., D.Ds., and purchase and discounting of bills and cheques) is a "drag" on banks, resulting in a net loss. The profit on account of "other services" is relatively small and is mainly attributable to foreign exchange business. The principal source of profit is funds activity; indeed, funds activity would appear as the sole source of profit, since the small profit from other services is not sufficient even to cover the loss on account of remittances and bills. One of the main conclusions of the analysis of the trends in earnings and expenses given in Chapter VI may be recalled in this context. It was pointed out that the spread between interest cost and interest income has been narrowing. There is little scope for economising servicing cost of funds activity; on the other hand, this cost is likely to increase with the further involvement of banks in new areas such as priority sector lending. Attention has hence to be given to the improvement of earnings fr m other services, to sustain banks' profitability.

11.4 There is at present no regular schedule of service charges adopted uniformly by all banks. Apart from variations between banks, even within a bank there is no consistency in the rates charged. This is because the levy of the charge itself, and not merely the rate, is left largely to the discretion of branch managers. In turn, this feature follows from the "bundling" of banks' services and the acceptance of the belief that important customers - depositors or borrowers - are eligible for concessions on other services because of the business they provide to the bank. This belief is sustained and fostered by the fact that the cost of rendering most of the services is not tangible in the sense that there is no outlay of funds involved. "Cost consciousness" is not so deeply ingrained in banking as to assess the implications of the concessions offered for different services in terms of the labour-input and the cost thereof.

11.5 In an industry like banking, which provides a variety of services to different classes of society and which serves a social as well as an economic purpose, the costing of services cannot be precise. That is to say, it will not be possible to fully recover through appropriate interest and/or service charges the cost of rendering each and every service to each and every customer group. It was seen in Chapter VII that the cost of servicing advances to different sectors varies from 0.7 per cent (medium and large industry) to 4.4 per cent (agriculture). The rate of interest charged on agricultural loans (12 per cent on an average, excluding interest tax) is not quite adequate to cover the service cost of the loan (4.4 per cent) plus the cost of raising and operating the funds (8 per cent). The return on advances to large and medium industry, on the other hand, yields a surplus.

11.6 The sharp differences in customer groups and in the volume of their business are factors which will not permit a close correlation between cost and return. There are certain services rendered by banks for which no charge can be made. What is necessary is to have a clear idea of the nature of services that are to be offered free of cost and those that are to be charged and further, the rates at which the charges are to be made.

11.7 Certain services rendered by banks are essentially developmental; those include the tasks that banks are now required to take on for area development etc. Some other services are inherent in the nature of banking business, being necessary for their operations. These include canvassing of deposits, clearing, cash transactions etc. The costs incurred in rendering both these services cannot be recovered through levy of charges and will have to be met out of the banks' operating surplus. But other services provided by banks in the course of their business have to be charged. This is not to be treated as a mere "revenue raising measure" to add to banks' income. The total liability of banks will be endangered if services continue to be provided for little or no return, unmindful of the cost of providing the services. If any sector or customer group is to be provided services free of charge or at rates not commensurate with the costs involved, banks should be aware of the rationale of the subsidies so granted, their dimensions and impact on overall profitability.

11.8 Among banks' activities, deposits constitutes a somewhat unique category. As was seen in Chapter VII, the cost of servicing deposits (as distinct from the interest paid on deposits) forms as much as 40 per cent of total service costs. However, since deposits constitute the "raw material" of banking, the costs incurred in acquiring the "raw material" consisting of both the interest on deposits and the servicing cost would appear as the "purchase price" of the same. As such, there would seem to be no case for collecting any service charges from depositors. However, in providing facilities for certain types of deposits, banks do render an important service. For instance, current deposits, though earning no interest, are allowed unlimited turnover, which is an essential requirement for commerce and industry. Excessive transactions in current accounts render such deposits unremunerative to banks. Fairly often, current accounts are used mainly as a media for cash collection. The levy of a service charge on current account transactions, in excess of certain limits, is hence justifiable. So far as savings and term deposits are concerned, there is no case for any levy of service charges as these are popularly accepted media for savings. Even a hint of a charge on these deposits might have an adverse effect on the spread of the banking habit.

However, in order to retain the essential "savings" character of savings deposits, it is necessary that the rules now specified limiting the turnover of such accounts should be strictly enforced.

11.9 The Cost Study undertaken by the Committee has shown that on an average there are about 100 transactions in a current account over a three month period. The average cost per transaction is around Rs.2.00. There are, however, instances of accounts where the number of transactions exceeds 100 per day; in such cases, the cost of servicing the account work out to over Rs.200 per day. Unless the average balance of such an account is more than Rs.5 lakhs, the account will not be remunerative to the bank (assuming a return of 10 per cent from the deployment of the deposit). The Committee, after a careful examination of the distribution of current accounts in selected branches and after detailed discussions with representatives of banks recommends the following scheme for operation of current accounts.

1. A nominal charge of Rs.10 per annum should be recovered from each current account holder towards service charges.
2. Four folios of approximately 50 entries each may be provided free for each customer per annum
3. Additional folios at the rate of one for Rs.1000/- of average balance will be permitted to each account holder.
4. Folios in excess of the permitted number will be charged at the rate of Rs.25 per page.

The data collected from a cross section of branches show that the bulk of the customers, particularly those who operate the current accounts for genuine banking needs will be covered within the permitted level and only a very small proportion of customers (less than 3 per cent of total current account holders) will have to pay folio charges as indicated in (4) above. Even here the bulk of the account holders will have to pay folio charges for less than five folios. Account holders who will have to pay folio charges for more than 10 folios in excess of the permitted level, will be less than half per cent of the total number.

11.10 The other part of funds activity consists of loans and advances. Since this involves the outlay of funds, an important element of the cost of this category of activity is the interest cost of raising the funds. The servicing cost, which is what is germane to this analysis, may be broadly classified into two parts. The first relates to the work of processing loan applications and would include such activities as the scrutiny of the application, appraisal of the proposal, verification of title deeds, documentation etc. The second part is related to post-sanction operations and maintenance of the loan accounts and would include verification of stock statements, inspection of godowns etc.

11.11 The Committee appointed by the Reserve Bank in March 1976 to examine Penal Rates and Service Charges has justified the recovery of the cost of processing of loan applications as also the out-of-pocket expenses incurred in inspection or visits to factories, godowns, etc. They have also tacitly approved of the levy of folio charges on the operation of loan accounts and suggested that the basis of such levy should be spelt out by this Committee.

11.12 The levy of processing fees recommended by the Penal Rates Committee is on a "once for all" basis, at a rate not exceeding 1/20 of 1 per cent, with a maximum of Rs.2500 at the discretion of the bank. The Committee have also indicated certain types of loans which should be exempted from the processing fees such as loans, upto Rs.2 lakhs, to priority sectors, all export credit and advances to weaker sections. Small banks, with total liability of less than Rs.25 crores have also been recommended for exemption from the suggested rates structure, on parallel with the exemption from the ceiling on interest. Since the processing fees charged by banks are not related to actual costs, the Penal Rates Committee have suggested the review of their recommendations by this Committee.

11.13 Actually the rates recommended by the Committee (1/20 of 1 per cent) is much below the costs involved in processing as revealed by the Cost Study both of the Banking Commission and of this Committee. The Banking Commission's study placed the cost of servicing loans at 1.1 per cent of the outstanding balance, roughly half of which was for pre-sanction processing, subsequent security supervision, godown inspection etc., while the other half represented the cost of ledger keeping. The study undertaken by this Committee has shown that the total cost of servicing loan accounts has gone up to 1.6 per cent. The break-up of the cost, however, on the lines of the Banking Commission Study is not available. Assuming the same proportion as between the two aspects, the cost of pre-sanction processing and subsequent maintenance (excluding ledger keeping) may be placed at 0.8 per cent of the outstanding balance. Since outstandings form around 70 per cent of credit limit, the processing cost of loan accounts would be 0.5 per cent of sanctioned limits. As against this, the Penal Rates Committee's recommendation of 0.05 per cent (viz. 1/20 of 1 per cent) seems overly modest. The income to the banks from the rate suggested estimated on the basis of the distribution of credit according to loan size, will be around Rs.5 crores, without allowing for any exemptions. If adjustment is made for the suggested exemption, the income may be around Rs.3 crores. On the other hand, based on the rate of 0.5 per cent indicated by the Cost Study, the cost of processing loan accounts works out to about Rs.50 crores.*

11.14 The Committee hence recommends that the rate suggested by the Penal Rate Committee 1/20 of one per cent or 0.05 per cent with a maximum of Rs.2,500 may be applied to loan accounts of above Rs.10 lakhs. For the rest, the Committee recommends a graduated scale of levy accepting the Penal Rates Committee's suggestion of a maximum charge with the further addition of a minimum for each slab as follows:

Size of loan	Rate	Maximum charge	Minimum charge
Upto Rs.10,000	0.5 per cent	Rs.50	Re. 1
Rs.10,000 to Rs.1 lakh	0.25 per cent	Rs.250	Rs.50
Rs.1 lakh to Rs.10 lakhs	0.1 per cent	Rs.1000	Rs.250
Above Rs.10 lakhs	0.05 per cent	Rs.2500	Rs.1000

11.15 As suggested by the Penal Rates Committee, the charge may be on a "once for all" basis, levied after the sanction of a loan. While agreeing, in principle, on the need for exemption, the Committee is of the opinion that such exemption should be given only to such advances as are charged rates of interest below the minimum lending rate.

* 0.5 per cent of total credit limits of loans, cash credit (including packing credit) and overdrafts amounting to Rs.10,000 crores in December 1975.

11.16 Actual out of pocket expenses, incurred in the course of visits to factories, godowns etc. in connection with the processing or maintenance of a loan account may, in addition, be recovered from the borrowers. No charges of any kind should be levied on borrowers whose loan applications are rejected for any reason. On the other hand, borrowers who are sanctioned limits but do not avail of them may be charged processing fees at double the suggested rate as recommended by the Penal Rates Committee.

11.17 The second aspect of servicing costs of loans relate to ledger keeping which is a post-sanction activity. Here, the principle suggested in regard to servicing charges of deposit accounts may be adopted. Here, a distinction was drawn between current deposits and savings/term deposits on the basis of turnover. A similar distinction may be made between cash credit~~s~~/overdrafts on the one hand and term/demand loans on the other. The latter do not require as much post-sanction work. The turnover on overdrafts and cash credit, particularly when the security is hypothecated is very heavy.

11.18 On this parallel, term and demand loans may be totally exempted from post-sanction. This is not because such accounts involve no post-sanction work. Indeed, this may require some effort and time from the banks' staff, especially when the accounts go out of order. But in view of the small proportion of this type of credit, it is felt that the volume of turnover involved can be ignored in fixing folio charges. Of total loans and advances (excluding bills) term and demand loans constitute about 25 per cent; the balance representing cash credit (including packing credit) and overdrafts.

11.19 The Committee recommends the levy of folio charges on cash credit, packing credit and overdrafts on the same lines as those recommended for current accounts. Although, the "health" of a cash credit account is judged by the extent of its turnover, such turnover entails time-consuming work which may be sometimes out of proportion to the amount of the loan. The following scheme of folio charges is recommended :

1. Four folios may be allowed free of charges for each account per annum;
2. In addition, one free folio per annum may be allowed for Rs.1,000 of limit sanctioned;
3. For folios used in excess of the above, a levy may be made at the rate of Rs.25 per folio.

The recommended rate of Rs.25 per folio is common to both current deposit accounts and loan accounts. It is relevant here to note that the cost study undertaken by this Committee has revealed that the cost per folio (of 50 entries) is around Rs.100, at the rate of Rs.2 per transaction.

11.20 The major part of non-funds activity (viz. other than deposits and advances) of banks consists of remittance and bills, including issue and encashment of M.Ts., T.Ts. and drafts and collection of bills and cheques. These activities account for as much as 20 per cent of banks' total servicing cost. While charges are being levied for these services, as mentioned earlier, the rates are arbitrary in principle, unrelated to the actual costs involved, and haphazard in application, with a large discretionary element.

11.21 Chapter VII includes a discussion of the relative costs of the different activities in the remittance group of services. It is necessary only to recall that the average cost per transaction in remittances works out to Rs.9 and for bills to Rs.15.

The important point is that the cost is incurred for each transaction, regardless of the amount involved. For example, the preparation, encashment and book-keeping involved in a draft remittance, whether it be for Rs.100 or Rs.1 lakh, costs the bank Rs.9. Obviously, the cost cannot be recovered in full from all customers. Some relationship would have to be established between the rates and the costs.

11.22 To enable the framing of an appropriate schedule of rates for remittances and bills, the Committee collected data from selected branches on the distribution of such business according to the size of the remittance. These data show that the bulk of the transactions under drafts are in respect of instruments of less than Rs.1,000. Telegraphic transfers, however, are for higher amounts, 70 per cent of the transactions being for over Rs.1 lakh each. Based on this size-wise distribution pattern a graduated scale of charges is recommended with the aim of recovering overall, as much of the actual cost as possible. The recommended rates are as follows :

	Range of Amount	Rate (Paise per cent)	Minimum charges (Rs.)
1. Drafts, M.Ts. and T.Ts.	Upto Rs.10,000	20	1
	Above Rs.10,000 but upto Rs.1 lakh	10	20
	Above Rs.1 lakh	5	100*
2. Collection/ Purchase of cheques	Upto Rs.10,000	30 (collection)	2
		40 (purchase)	3
	Above Rs.10,000 but upto Rs.1 lakh	20	30
	Above Rs.1 lakh	10	200*
3. Collection & purchase of demand and usance bills	Upto Rs.10,000	40 (collection)	3
		50 (purchase)	4
	Above Rs.10,000 but upto Rs.1 lakh	50	60
	Above Rs.1 lakh	10	200*

* Subject to a maximum of Rs.500.

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The charges prescribed represent a minimum and banks may prescribe higher rates, which may be necessary because of their individual cost structure.

11.23 The further points to be noted are :

(a) If the draft or M.T. is required by the party to be mailed, the bank may charge the actual registration charge plus handling charges upto Re.1/-.

(b) In the case of telegraphic transfers an additional charge of Rs.5 to Rs.10 for ordinary and Rs.10 to Rs.20 for express telegrams, may be levied depending upon the length of message to be sent.

(c) In the case of bills for collection, if the proceeds are to be remitted by draft or M.T., separate charges may be levied on such remittances.

(d) Charges should be totally waived when the remittances and realisation of bills are delayed beyond a reasonable time limit. The limits suggested are :

(i) Five working days between centres which are connected by IBA's night air-mail service.

(ii) 7 days between centres involving other capital cities.

(iii) 10 days if any other centre is involved.

(iv) For telegraphic transfers the time limit could be 3 working days between State Capitals and 5 working days involving other centres.

(e) For usance bills the usual discount rates will be applicable in addition to the charge prescribed for collection of such bills.

11.24 A feature of the schedule of rates suggested for remittance and bills is that there is no exemptions. The exemptions now being granted by banks - to small customers on the principle of providing subsidy and to big customers because of the privileges claimed - has been costing them dearly. What is proposed is actually a rationalisation of the service charge structure which is not very different from the charges prescribed, though not always applied, by many banks. The impact of the proposed charges on the small man, in this context taken as one making a small remittance, will be negligible. As noted already, most of the drafts sent are for amounts of less than Rs.1,000. At the prescribed rate, the charge per draft of Rs.1,000 would be only Rs.2. Were this amount to be sent by money order, the commission at Rs.2.50 per Rs.100 would amount to Rs.25.

11.25 The most important requirement for effectiveness of the rate structures recommended is their uniform and consistant application by all banks - or more precisely, by all branches of all banks. The principle of levying service charges should not be allowed to degenerate into a rate war. The specified rates should be mandatory and applied with the same rigour as interest on deposits and FEDA rates on certain foreign exchange dealings. One area of service charge where some element of discretion could be left to the banks is that relating to processing fees of advances, collected on a "once for all basis". The waiver or charge of this levy is not one that will materially effect the borrower - bank relationship or inter-bank competition.

11.26 The other part of non-funds activity, consisting of foreign exchange dealings, provision of guarantees,

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underwriting of equity issues, safe deposit locker facilities etc., have not been examined by this Committee. There appears to be need for the study of all aspects of foreign exchange transactions, of banks, of which the rates structure would form an integral part. It is recommended that an expert group may be asked to examine this whole question. In regard to other charges, these may be left to the discretion of banks until such time as a full fledged cost study, as recommended in Chapter VII, throws light on the actual costs involved in providing the services.

CHAPTER XII

RESUME AND CONCLUDING REMARKS

12.1 During the last decade, Indian banking has undergone a marked transformation. Judged by any criteria, its progress in quantitative as well as qualitative terms has been phenomenal. There has been considerable geographical penetration and functional diversification. Banks have made conscious efforts to become an instrument of growth by undertaking a number of innovative tasks. They have explored new fields in financing schemes which were considered clearly beyond their scope earlier.

<u>Background</u>

12.2 However, this rapid and dynamic growth has left some adverse effects too. There has been a virtual cost explosion and earnings have not been able to keep pace with it. As a result, profitability of the banking system has come under severe pressure. The quality of service has also deteriorated which inevitably has had an adverse impact on productivity and efficiency. Indian banking has, thus, reached a stage where it is necessary to make determined efforts to ensure the continuance of its growth without jeopardising its own stability. The objective is to maintain viability of the banking system so that its ability to bear the burden of development and diversification may be strengthened.

12.3 While the challenges posed to the banking system have increased, their choice in deploying funds has been severely curtailed. The statutory pre-emptions currently add up to 39 per cent of banks' resources. Of the remaining 61 per cent of deposit resources, over 48 per cent are deployed in the priority and preferred sectors on which the return is low. Thus, the choice of banks in adopting suitable rates of interest charges (subject to the maximum of 16.5 per cent) to cover up costs is limited only to about 13 per cent of their deposit resources.

12.4 Apart ~~from interest,~~ the other avenues for income are the charges levied by banks to their customers on various services such as issue of drafts and T.Ts., remittance collection of bills, etc. These service charges do not have any scientific basis nor are they related to actual costs. In fact there has been a lot of adhocism in this area with a rather striking absence of any coordination or uniformity.

12.5 The deposit mix in recent years has changed more in favour of term deposits with longer maturities which carry higher costs. Term deposits with a maturity of over 5 years formed over 20 per cent of total deposits in 1975 as against 7 per cent in 1972. Thus, the cost of resources has been continuously going up whereas the scope for a matching increase in earnings has shrunk considerably with the increasing proportion of low-yielding assets. This is a real dilemma before the banking system today.

12.6 It is not surprising that, in between the twin pressures of rising costs and decreasing returns, the increase in capital funds has not kept pace with the phenomenal growth in business. The ratio of owned funds to deposit liabilities formed only 1.6 per cent in 1975 as against 3.4 per cent in 1961 and 2.3 per cent in 1969.

12.7 It is in this situation that it has to be recognised that banks would have to make much greater efforts on a continuing basis to bring down costs and improve operational efficiency which alone can form an enduring basis for sustained profitability in the long run. At the same time, however, their lending rates would have to be restructured in a rational and viable manner so that such adjustments are not hastily adopted as convenient tools for boosting earnings at the cost of a complete disregard of the need to improve ioperational efficiency.

12.8 It is against this background, that the Working Group on Banking Costs, Operational Efficiency and Profitability of Banks has undertaken the manifold tasks of evolving practical and realistic criteria for evaluating the comparative performance of individual banks, determining the basis for assessment of cost of various banking services, providing guidelines on the pricing policy of banks in relation to the services rendered to the constituents and, generally, suggesting internal systems and procedures to control costs, improve operational efficiency, productivity and profitability of banks.

<u>Basic approach</u>

12.9 For the purpose of convenience as also of facilitating an understanding of the basic logic and pattern of the Report, the entire Report can be considered under four broad groups: viz.

(i) suggestions for an appropriate system of planning, control and performance evaluation

(ii) analysis of the main heads of cost, income and profit with a view to suggesting a basis for cost reduction and pricing policy and indicating certain measures and proposals to improve profitability

(iii) introduction of an improved pattern of Annual Accounts with suggestions for changes in principles and procedures of audit and taxation, and

(iv) reform of internal systems and procedures, practices and methods of work to maintain high levels of efficiency.

12.10 While the Chapter I provides the background, Chapters II, III and IV cover the first group. The second group is covered in Chapters VI, VII, X and XI. The third group deals with the problems of accounts, audit and taxation in Chapter V. The fourth group outlining systems and procedures aimed at improving operational efficiency is covered in Chapters VIII and IX.

12.11 Banks are used to the practice of evaluating their performance in terms of the conventional measures such as levels and rates of profitability, growth in deposits or ratios of cash balances and credit to total deposits, etc. Often certain banks have also been known to resort to window dressing in different forms at the close of the year to project a better image of their performance. With the transformation in Indian banking scene during the last decade, stemming from the conviction that banks can serve as powerful instruments of economic and social change, the concept of efficiency in relation to the performance of banks has come to acquire a wider meaning.

<u>Evaluation of performance</u>

12.12 While growth by itself was once taken to be a sufficient measure of progress and the main focus of achievement it is no longer so if it is not accompanied by and achieved through programmes which raise the production and employment levels of the vast majority of the poorest sections of our population. The progress has to be both quantitative as well as qualitative. In other words, the phenomenal growth in number of branches, deposits, credit, etc. will not mean much unless hopeful answers are found to questions such as how many of the new branches are located in hitherto unbanked centres, what proportion of overall deposits is from such areas, and what percentage of total credit is now deployed towards priority sectors and has actually resulted in the upliftment of weaker sections of the community. Accordingly, the evaluation of performance ~~efficiency~~ will have to be more broad-based and the measures (or indicators) chosen will have to be such as to throw sufficient light on varied facets of bank's performance relevant in the current context. It is in the light of these pressing considerations that the Committee has devised an experimental approach towards measuring the operational efficiency of banks and also provided an illustration of its practical application and implication on the basis of data for public sector banks for the period 1969-75.

12.13 After experimenting with several types of indicators available to the Committee, it was concluded that it will not be practical to evolve a single criterion for the evaluation of performance or operational efficiency of banks and any exercise to reduce the significant and conflicting indicators to one dimension is likely to be misleading. Faced with this situation, the Committee evolved acceptable system of assessment on the basis of four criteria viz.

(i) productivity,

(ii) social objectives (spatial),

(iii) social objectives (sectoral) and

(iv) profitability.

The rationale of this system is two-fold. Firstly, among the banks studied by the Committee an inverse relationship between operational efficiency with respect to productivity and their performance with regard to social objectives both spatial and sectoral, was discovered as an almost uniform pattern. Like-wise, there was a lack of any consistent relationship either between profitability and social objective or rather surprisingly, even between productivity and profitability.

12.14 For each of these four criteria a set of indicators aggregating to nineteen, in all, was chosen. Using the factor analysis technique, the efficiency factor for each aspect was determined and for each of these, the banks were ranked based on the factor scores. While the technique is useful to arrive at a broad order of ranking in situations where simple or more direct methods of weighting and aggregati fail to provide a satisfactory solution, it has also a few limitations in the sense that the choice of indicators is, to some extent, subjective and the indicators once chosen cannot remain invariant for all time to come and may have to be modified in step with the changing social objectives.

12.15 A composite measure of the overall performance was also attempted by a simple aggregation of the group-wise ranks Such a highly aggregate measure fails to bring out clearly the considerable degree of divergence noticed in the performance of banks as between groups. It is hoped that the approach suggested will help individual banks to know where they stand in regard to the overall performance as well as in relation to the different criteria of efficiency.

12.16 With the increasing role which banks are called upon to play in planned economic development with emphasis on reducing regional imbalances, it is necessary that banks should adopt an integrated approach aimed at achieving planned progress at national level. In this context, the Committee recognises the need for evolving a National Plan for the banking system dealing with the different aspects of resource mobilisation, deployment of funds, business and manpower planning, etc. to synchronise with the planning efforts of the Government both at the Centre and at the State level. It is recognised that this can be achieved only by having a perspective plan for the banking system as a whole spread over a period of three to five years.

<u>Planning process</u>

However crude or inaccurate may be the results of such an approach, it is hoped that these may form the basis for the formulation of annual plan and appraisal. Towards this end, it is necessary that planning should first begin at the individual bank's level on a uniform basis.

12.17 Although most of the banks are undertaking the planning exercise there are wide variations in terms of coverage, reliability and methodology. In fact, the work of business planning is done, in most of the banks, in a rather haphazard and disjointed manner. There is no proper appreciation at the top management level in banks of the significance and purpose of planning and the entire work is treated as once for all exercise and not as a yardstick for measuring and stimulating performance towards projected goals.

12.18 The Committee recommends that banks should adopt performance budgeting in a systematic manner and stresses the need for co-ordinating performance budgeting, credit budgeting, profit planning as also the follow-up and monitoring system. The credit budgets prepared in most of the cases do not seem to reflect even the consensus of various departments of the bank. Functionally, the credit budget has necessarily to be an integral part of the performance budget/business plan. However, it has been observed that these two differ in periods of coverage - one adopting the financial year and the other, the accounting year. As the basic objective of budgeting - 'credit' or 'performance' - is to motivate a planned approach to the bank's operations, a high degree of consistency between the two has to be necessarily ensured.

12.19 Traditionally, commercial banks in India have been organised to reflect their basic "products" or activities i.e. deposits, advances and banking services. The structure, systems and procedures, information systems, personnel policies and practices are framed treating these

<u>Market segmentation approach</u>

activities as independent entities. With the introduction of social control of banking, banks were asked to assume the role of providing credit for agricultural and related operation on the one hand and for mopping up savings which were till then usually channelised into non-banking sectors. Export activities and international trade also assumed considerable importance in terms of national economic policy and banks were also asked to provide credit required for the national export effort. With the nationalisation of 14 large commercial banks in 1969, the priority sectors, consistent with the priorities in economic development, received formal recognition as distinct components, for channelling credit, in a total scheme for revamping the operations of commercial banking. In the changed context it is now necessary to make an attempt towards a more precise delineation of the nature of the markets served and for improving the understanding of the nature of the customer needs. Such an approach is made possible by Market Segmentation by which we mean distinguishing segments as components of a total market, leading to better analysis and appraisal of performance and considerably improving management's ability to respond decisively and quickly to changing conditions of the market segments. With a view to serving better the needs of distinct categories of the clientele, it is considered desirable to adopt selectively and progressively the market segmentation approach. In the process, the management of the concerned organisation will be enabled to develop specialised knowledge and skills for meeting such needs and formulating the required strategies for growth and development.

12.20 An effective planning system implies a strong data base. Some of the banks have yet to build up an adequate organisational nucleus for planning and statistics. A systematic, prompt and regular flow of information and its analysis is considered important for banks to contemplate timely corrective actions for improving productivity, efficiency and profitability. The Banking Commission had examined this problem at length and recommended an integrated information system. The Committee endorses this recommendation and suggests that banks should adopt the Banking Management Information System (BMIS) which takes care of later developments in the field also. The Committee observes that the data requirements of the Reserve Bank and of the individual banks for internal management, control or otherwise, should have an articulated structure. The Committee recommends that appropriate organisational arrangements should be made both in the Reserve Bank and in the individual banks for the successful implementation of BMIS.

Information system

12.21 Under Section 42 of the Reserve Bank of India Act, banks are required to submit every Friday a statement indicating important items of asset and liabilities. It is learnt that the cost of collecting these data by means of telegram/telex from a large number of branches spread far and wide in the country is quite heavy. Further, a large number of the branches are not able to submit this statement within the prescribed period. As a result, in such cases, figures are to be repeated in view of the statutory obligation to file the return within five days. The Committee is of the view that this statement instead of being called on every Friday, should be called on the second and last Fridays of every month. This would reduce the workload as well as the cost of branches, improve the timely submission and also ensure accuracy of data. In making this recommendation, the Committee is also aware of the fact that the periodicity of the money supply and other statements in the Reserve Bank's Weekly commercial report may have to be modified in keeping with the above change proposed. However, the Committee feels that more accurate and reliable data are better than the data whose base is weak.

12.22 Another point of immediate and urgent importance is evolving a system of signals which would give advance indication of potentially "sick" units or irregular accounts and installing an organisational pattern of authority to respond quickly and effectively ~~to the~~ requirements of such units. The QOS system of monitoring data and careful scrutiny of monthly stocks statements no doubt provide information on large sick units. It is of utmost importance that apart from individual banks keeping track of sick units, the Reserve Bank itself should build up sufficient data files of individual large units on a continuous basis.

<u>Signals for sick units</u>

12.23 The terms of reference of the Committee require a systematic survey to provide estimates of the cost of various banking services. This is necessary to evolve guidelines on the policy of pricing of various banking services, which is also a part of the terms of reference. A study of banking costs would further enable the establishment of a relationship between the cost or expense of a particular service and the return received for it. This approach is now conspicuous by its absence in the banking industry in India. The first cost study for the system as a whole was conducted by the Banking Commission in 1970.

<u>Study of banking cost</u>

Among individual banks, apart from the State Bank, which has been conducting a full fledged cost study on a continuing basis since 1972, only a few others have attempted even partial cost studies.

12.24 The development of a degree of "cost consciousness" in banks is of the utmost importance for their continuance as corporate entities, playing an increasingly important role in the national development. This is so not only from the point of view of profitability, which though vital for the totality of banks' operations, is less relevant in the provision of individual services. It is also important from the point of developing awareness of the cost of each service. Since 1969, banks in India have expanded their operations to areas hitherto unexposed to commercial banking. This process will continue and banks will be required to take up new tasks. The return received from such services will, in most cases, be lower than the costs incurred in providing them. An awareness of the cost implication of the new responsibilities is necessary so that banks as well as the Government have an idea of the subsidies that banks are called upon to provide to different sectors. Also, to the extent possible, a relationship should be consciously sought to be established between the different services provided and the returns received therefrom.

12.25 Accordingly, a limited study of banking costs covering 21 banks was undertaken to arrive at cost estimates for various services. The results of the study provide a broad pattern of the cost of different services in relation to the total cost, the cost per unit of monetary output, the cost per physical transaction as well as the cost per account for each of the services rendered by the banks. A comparison of the results of the present study with those of the Banking Commission Study (1970) shows some interesting variations.

Though the share of deposits in the total servicing cost has remained the same, savings deposits has emerged as the single largest service accounting for nearly one fifth of the total servicing cost as against 15 per cent for current deposits. This pattern is considerably different from that obtaining in 1970. The main reason for this change is the relatively larger rise in the unit cost of servicing savings deposits vis-a-vis current deposits. This again is the offshoot of opening a large number of rural and semi-urban offices which have a relatively larger share of savings deposit business. Also there was an all-round increase in the servicing cost of advances which was more pronounced in the case of direct agricultural finance. Cost expressed as a percentage of outstandings also indicates that this is highest for direct finance to agriculture for all banks and in all population groups. That the involvement in new areas of lending has added considerably to servicing cost is proved by the data thrown up by the study. An important conclusion that may be drawn in the context of the rapid expansion of rural branches is that under present conditions rural offices are more expensive to maintain than urban or semi-urban offices

12.26 In addition to cost estimates for all banks as well as for the different bank groups, bank-wise estimates were also prepared for the 21 selected banks. It is observed that there are very wide variations in the estimates between banks and bank-groups. The Committee recommends that the Reserve Bank in collaboration with banks should organise regular and systematic sample surveys to estimate the cost of various services and profitability of different activities. The surveys should be designed in such a manner as to provide valid estimates of cost for individual banks. The results of such regular studies would enable individual banks to examine their cost structure and institute appropriate action for cost reduction and cost control.

12.27 Banks have been able to sustain the profitability of their internal operations only through raising the ocost of their principal services, viz. lending. Till 1976 the degree of elasticity in lending rates enabled banks to absorb the increasing cost on operations. However, since the imposition of a ceiling on interest rates in March 1976, manoeuvrability available to banks to adjust income to meet expenses has been considerably restricted. Interest income would also be affected by the increasing share of credit to sectors requiring preferential treatment in interest rates. On the other hand, all the items of cost are likely to continue to exert an upward pressure. In particular, interest costs will continue to rise on account of the increasing public preference for longer term deposits with higher yields. Although the efforts to increase productivity and restrict resort to overtime, etc., would have some effect in curbing the growth in establishment expenses, other factors would have the opposite effect. The geographic spread to low potential areas where banking requires time to take root and break even, and the assumption of new social responsibilities requring more labour input will tend to increase establishment charges.

<u>Profitability of operations</u>

12.28 The Committee is of the view that swift action is needed to sustain the viability of this crucial sector, prevent it from becoming a drag on the economy and sustain and enhance its inherent earning capacity.. In this regard, increased labour productivity alone will not be adequate. For one thing, the immediate impact of an improvement in labour out-turn would only be in the quality of service rendered. It would require time for the improved service to have a tangible effect on banks' profits through an increase in the quantum of business and restraint on the increase in establishment costs. The urgent requirement is hence to consider an increase in earnings and reduction in expenses through cost control and other methods.

12.29 With a view to bringing about an improvement in owned funds so as to achieve the expected international standards besides soundness of banking, the Committee recommends that by 1980, the ratio of banks' owned funds to deposits should rise to 3 per cent. Side by side, it is recognised that there is a dire need to improve the capital base of banks. While transfer from profit alone is not sufficient for this, the Committee stipulates that at least 40 per cent of the disclosed profits should be transferred to reserves free of taxation.

12.30 As regards payment of interest on additional cash reserves in excess of the minimum of 3 per cent, the

<u>Rate of interest on cash reserves</u>

Committee feels that the interest should be related to the cost of funds for banks. Accordingly, it has recommended that the rate may be raised to 6.5 per cent for banks having total deposits of more than Rs.400 crores and 7 per cent for others. The recent increase from 5.5 per cent to 6 per cent is on the lines of the thinking of the Committee already made available to the Reserve Bank. The position should be reviewed every year and the rates revised if necessary.

12.31 International practices allow the payment of interest on the basic cash reserves. The legal provisions in India also do not actually prohibit such payment. The Committee, therefore, considers it appropriate to allow interest on the basic reserves, although at a rate lower than those applicable to additional reserves. The rate of interest for this is suggested to be the same as the yield on treasury bills which is at present around 4.6 per cent. The interest so accrued should be straightaway credited to reserves for strengthening the capital base and thus be free from taxation.

Transfer price formula

12.32 In order to gain a clearer appreciation of the factors affecting the branch level profitability, the Committee undertook a study of loss-incurring branches in collaboration with five nationalised banks. On the basis of the findings of this study, the Committee recommends adoption of a uniform transfer price formula for all banks. Various remedial measures for making the loss-making branches viable have emerged from the study having a bearing on the policy to be adopted, both at the individual bank level and for the overall licensing of bank branches.

Service charge structure

12.33 A break-up of income and expenses of banks according to the three broad service groups viz. funds activities, remittance and bills as well as other services reveals that the services rendered for remittances and bills were found to be a 'drag' on banks resulting in a net loss. Besides economising the servicing cost of funds activities, the scope for which is very limited, attention has to be focused on improving the earnings from other categories of services.

12.34 It is observed that certain services rendered by banks are essentially developmental or inherent in the nature of banking business such as canvassing deposits, clearing etc.

While the cost incurred on such services cannot be recovered through the levy of charges, other services provided in the course of business have to be charged, as providing such services free or at concessional rates, not commensurate with the costs, would have an adverse impact on the overall profitability.

12.35 While there appears to be no case for collecting any service charges from depositors, the levy of a charge for service on current account transactions in excess of a certain limit is justifiable. Similarly, there is no case for the levy of service charges in the case of savings and term deposits, but it is necessary that the rules limiting the turnover of savings accounts need to be enforced strictly so as to retain the essential savings character of these accounts.

12.36 The Committee feels that the results of the cost study undertaken by it should form the basis for evolving a rational schedule of service charges. Accordingly, a graduated scale of charges is prescribed as follows for remittances and bills, with the aim of recovering as much of the actual cost as possible:

	Range of Amount	Rate (Paise per cent)	Minimum charges (Rs.)
	1.	2.	3.
1. Drafts, M.Ts., and T.Ts.	Upto Rs.10,000	20	1
	Above Rs.10,000 but upto Rs.1 lakh	10	20
	Above Rs.1 lakh	5	100*
2. Collection/ purchase of cheques	Upto Rs.10,000	30 (collection)	2
		40 (purchase)	3
	Above Rs.10,000 but upto Rs.1 lakh	20	40
	Above Rs.1 lakh	10	200*
3. Collection & purchase of bills	Upto Rs.10,000	40 (collection)	3
		50 (purchase)	4
	Above Rs.10,000 but upto Rs.1 lakh	30	50
	Above Rs.1 lakh	10	200*

* Subject to a maximum of Rs.500/-

Processing fees for loan applications

12.37 The committee reviewed the rates recommended by the Penal Rates Committee for the levy of charges for processing loan applications. The Committee is of the view that these rates are not commensurate with the cost involved in processing as revealed by the Cost Study both of the Banking Commission and of this Committee. The Committee hence recommends that the rate suggested by the Penal Rate Committee Viz 1/20 of one per cent or 0.05 per cent with a maximum of Rs.2,500 may be applied to loan accounts of above Rs.10 lakhs. For the rest, the Committee recommends a graduated scale of levy accepting the Penal Rates Committee's suggestion of a maximum charge with the further addition of a minimum for each slab as follows:

Size of loan	Rate	Maximum charge	Minimum charge
Upto Rs.10,000	0.5 per cent	Rs. 50	Re. 1
Rs.10,000 to Rs.1 lakh	0.25 per cent	Rs. 250	Rs. 50
Rs.1 lakh to Rs.10 lakhs	0.1 per cent	Rs.1000	Rs. 250
Above Rs.10 lakhs	0.05 per cent	Rs.2500	Rs.1000

As suggested by the Penal Rates Committee, the charge may be on a "once for all" basis, levied after the sanction of a loan.

Form of annual accounts

12.38 The assumptions and purposes which form the basis for the existing format for presentation of bank's annual accounts no longer hold good and a restructuring of the format of the balance sheet in design and manner of presentation is necessary. A proforma of the modified balance sheet and profit and loss account which could be adopted by banks is suggested by the Committee. In devising the format, the need for (i) uniformity in presentation for meaningful comparison and (ii) classification of income - expenditure in tune with the various activities leading by itself to an analysis of the source of income, profitability of each activity, etc. have been kept in view. Publication of the balance sheet and profit and loss accounts of banks in an abbreviated form is suggested for compliance with the provisions of Section 31 of the Banking Regulation Act.

12.39 After a careful and extensive study, it is found that the system of audit should be made uniform for all categories of banks, on the lines of the one prevailing in the State Bank of India. In order to achieve this, the existing system of branch audit by statutory auditors is recommended to be dispensed with in stages. Certain suggestions are also made after examining the role played by auditors with the intention of enabling them to play a more positive and useful role.

Role of statutory audit

12.40 Several suggestions have been put forth seeking tax relaxations and an examination of these leads the Committee to feel that a review of the tax laws and procedures, as far as the banks are concerned, appears necessary in the light of the social responsibilities cast on them. Various suggestions have been made for according reliefs to the banks in respect of (i) the amount transferred to reserves, (ii) the provision for bad debts and depreciation in investments, and (iii) the provision towards estimated exchange losses. In addition, changes in procedures in regard to advance payment of income-tax deduction of tax at source on banks' investments, submission of Provident Fund returns, treatment of expenses incurred by foreign branches of Indian Banks, double tax relief and submission of information under Section 285 of the Income-tax Act are also suggested.

Taxation principles and procedures

12.41 Simplification of systems and procedures in banks is considered by the Committee in the context of the need to bring about economy in expenditure and provide better customer service. This aspect has been considered in detail by the Working Group on Customer Service set up by Government of India and the Committee is of the view that their recommendations while improving customer service, will result in reduction of cost of bank operations. The Committee has also emphasised that banks should adopt appropriate technique for reconciliation of inter-branch transactions, as also improved institutional arrangements for speedier collection of upcountry cheques and clearing of cheques in general. In this context, the Committee has given careful consideration to a phased programme of mechanisation and computerisation in certain specific areas which should improve customer service as well as flow of information. For reducing the funds in transit and achieving better customer service, the Committee has dealt with the need for speedier communication in banking. The Committee is of the view that the technology developed and the facilities available with the Overseas Communications Service should be fully explored

<u>Improvement in systems and procedures</u>

12.42 Particular emphasis has been placed on the optimum utilisation of labour by resorting to work management techniques, method study etc. Further it is also pointed out that there is scope for economy in the acquisition of premises and provisions of furniture, fixtures etc.

12.43 Manpower development and training have a crucial role to play in discharging social obligations devolving on the banking industry and in attaining maximum productivity. The expansion of branch network and the increasing volume of work

<u>Manpower planning and development</u>

have resulted in large scale recruitment of personnel and quickened the pace of promotions of existing staff. Further, the diversification of banking activities has placed added responsibility requiring special skills. The absence of adequate arrangements for training and specialisation for the staff and the lack of proper communication of instructions has led to inefficiencies in the working of the branches. This is particularly true of the branches located in remote areas.

12.44 These developments have resulted in a considerable void in trained manpower. Apart from the sheer magnitude of work, the officers at middle and even higher levels have yet to acquire an attitude of mind conducive to the discharge of social obligations placed on the banking industry. Added to this is the factor of large recruitment of personnel with no experience worth the name. The text-book knowledge of banking has also been on the traditional lines.

12.45 It is in this context that the Committee has laid great stress on manpower development and training. Unless the staff at all levels understand the full implications of the new dimensions of banking, and are completely attuned to carrying out the new tasks efficiently and with full customer satisfaction, no amount of increase in the volume of business can achieve the goals set for the banking industry. Various suggestions have been made for the involvement of staff in the working of the banks so as to achieve a high level of operational efficiency and maximise customer satisfaction.

12.46 In addition to manpower development and training, the Committee considered several aspects of organisation and management relevant to the banks' working. The Committee stresses the need for evolving an appropriate system of delegation of authority in banks. This involves identifications of decision centres on a uniform basis for different categories of banks and categories of branches as well as roles specification and assessment of expectations of both the management and public about the performances of decision centres. Adequate discretionary powers to the operating personnel in banks are essential in order to speed up the process of decision making. To ensure effective working of the system of delegation of authority, banks should also ~~redesign~~ redesign the control system so as to make control reports timely and meaningful.

<u>Exchange and remittance facilities</u>

12.47 The Reserve Bank has a statutory obligation to afford reasonable exchange and remittance facilities to banks and the public. thorough review of the functioning of cash remittance procedure and opening and operation of currency chests has been made, and proposals are made to reorganise and restructure the prevailing system. They mainly deal with problems connected with opening of more currency chests, remittances of cash, tendering of cash at treasuries etc.

12.48 The recommendations made in this report follow from the basic premise of maintaining viability of the banking system. An attempt is also made to evolve a perspective view so that banks can take future developments in their stride. The scheme of recommendations is such that it could be implemented irrespective of monetary policy changes.

Some of the recommendations made in this report would have to be taken up with appropriate authorities. Given a fair trial to the scheme of recommendations contained in the Report, the Committee is confident that viability of the banking system will not only be maintained but also improved enabling the banks, in turn, to shoulder better the social responsibilities cast on them as a matter of national policy. It is a matter of crucial importance to ensure that in a developing economy, the cost of banking service including credit facilities are kept as low as possible in view of the widespread implications of this element of cost in all the industrial, commercial and development undertakings.

(J.C. Luther)

(V.V. Divatia) (P.N. Khanna)

(S.R. Avadhani) (O.T.M. Nambiar)

(Meenakshi Tyagarajan) (C.S. Ramachandran)

CREDIT PLANNING CELL

Working Group on Banking Costs, Operational Efficiency and Profitability of Banks

At a meeting with the chief executives of major scheduled commercial banks on March 12, 1976, Governor had indicated that the Reserve Bank will constitute a Working Group to examine the question of operational efficiency and profitability of banks.

2. Accordingly, the following Working Group is constituted:

1. Shri J.C. Luther Executive Director	Chairman
2. Shri V.V. Divatia Statistical Adviser Department of Statistics	Member
3. Shri A. Raman Adviser Credit Planning Cell	"
4. Shri P.N. Khanna Chief Officer Department of Banking Operations & Development	"
5. Shri S.R. Avadhani Addl. Chief Officer Department of Banking Operations & Development	"
6. Shri O.T.M. Nambiar Joint Chief Accountant Department of Accounts and Expenditure	"
7. Dr. Meenakshi Tyagarajan Director Banking Division Economic Department	"
8. Shri C.S. Ramachandran Director Credit Planning Cell	Member-Secretary

3. The terms of reference of the Group will be as under :

(i) to suggest practical and realistic criteria for the evaluation of the performance of individual banks with reference, inter alia, to the fulfilment of socio-economic objectives of national importance;

(ii) to determine the basis for assessment of cost of various banking services;

(iii) to plan and organise a systematic survey to provide estimates of average cost and income in respect of the different functions undertaken taking into account the special features of each of the large and medium sized banks, groups of small banks, and select types of branches;

(iv) to provide guidelines on the pricing policy of banks in relation to the services rendered to the constituents;

... 2

(v) to suggest internal systems and procedures to control banking costs, improve operational efficiency, productivity and profitability of banks; and

(vi) to advise on the nature of cost studies which may be undertaken by individual banks for evolving standards for cost control, rationalisation of service charges and evolving suitable methods for profitability analysis of branches.

4. The Chairman may take such assistance of specialists from other institutions including banks, Indian Banks' Association and the National Institute of Bank Management as may be considered necessary. The Working Group may also take into account the recommendations of the Banking Commission on banking costs, operational efficiency and profitability.

5. The Working Group should submit its report before the end of September 1976.

Sd/-
(K.S. KRISHNASWAMY)
DEPUTY GOVERNOR

CREDIT PLANNING CELL,
RESERVE BANK OF INDIA,
CENTRAL OFFICE,
BOMBAY.

April 2, 1976

QUESTIONNAIRE

PART I

OVERALL OBJECTIVES AND PERFORMANCE

Evaluation of performance

1.1 Kindly give an evaluation of the performance of your bank in meeting the socio-economic objectives set before the banking system in the post-nationalisation period.

1.2 What are the criteria (i.e., norms, ratios, etc.) adopted by your bank for the evaluation of the performance of (a) the bank as a whole and (b) the individual branches with particular reference to the following areas:

i) Deposit mobilisation
ii) Deployment of credit
- areawise
- purposewise
- sectorwise
iii) Employment generation
iv) Expansion of banking facilities
v) Profitability?

1.3 What tests or indices should be considered relevant for the purpose of inter-bank comparisons of performance in the sphere of efficiency and profitability?

Audit

1.4 What are your comments on the nature and role of external audit for promoting efficiency and propriety of the commercial banks with due reference to the changes in the scope of their activities?

Presentation of accounts

1.5 There is a suggestion that the balance sheet and profit and loss account of Indian banks should conform to international standards. In this context, do you have any suggestion for improvements?

Capital base

1.6 Do you support the suggestion that it is desirable to strengthen the capital base of Indian banks? If so, kindly indicate the measures that can be taken to achieve this objective.

Miscellaneous

1.7 What are your other suggestions or comments under this part?

PART II
BUSINESS PLAN AND PERFORMANCE BUDGETING

Annual plans and budgets

2.1 What is the procedure followed by your bank in preparing annual business plans/performance budgets with particular reference to involvement of Central Office departments, controlling offices and branches? Do you prepare such plans/budgets on a region-wise basis? What is the system for monitoring the performance?

2.2 Please furnish (i) a review of the performance for 1975 and (ii) performance budget for 1976.

2.3 Are any projections set for your offices for deposits advances? If so, what factors are taken into account in fixing the projections and how are the achievements followed up? Is there any system of rewards or penalties for good or poor performance in relation to targets?

Deposit mobilisation

2.4 What are the various methods employed in your bank towards mobilisation of deposits? Does your bank give any incentives in cash or in kind to depositors? What methods have you found most effective?

2.5 Are you in favour of banks continuing to accept long-term deposits of over 5 years? If so, what pattern of accrual of interest and accounting would you advocate?

2.6 What special efforts have been made by your bank for tapping the savings of the farming sector and what difficulties do you encounter in this regard?

2.7 How does your experience in mobilisation of deposits in semi-urban/rural areas compare with that in the large towns-metropolitan areas?

2.8 Apart from current accounts, savings bank accounts and fixed deposits, do you attract deposits in any other form? If so, kindly furnish the requisite particulars as well as the terms and conditions.

2.9 What is your experience in deploying the deposits of your branches in their areas of operation?

Industry level credit planning

2.10 An analysis of the pattern of distribution of bank credit to industries reveals that usually a group of banks finance the bulk of the credit requirements of a particular industry. To what extent is it possible to evolve a common approach among such financing banks? What are your suggestions for undertaking more effective industry level credit planning and supervision over the use of credit in such cases? What procedures and arrangements would you suggest for this purpose?

Miscellaneous

2.11 What are your other suggestions or comments under this part?

PART III

SYSTEMS AND PROCEDURES

Organisation and delegation of powers

3.1 Please furnish an organisational chart of your bank as a whole showing the Departments in the Central Office and their relationship with the Controlling Offices in different regions and the branches and furnish a brief description of the functions and responsibilities of each Department in the Central Office and of the Controlling Offices.

3.2 Please describe briefly the pattern of delegation of powers by your Board of Directors to (a) the Chairman/Managing Director, (b) the Local Boards/ Committees, if any and (c) General Manager (management level next to the Chairman/Managing Director). Are you satisfied with the existing system of delegation of powers and what are your suggestions for further improvements?

3.3 Please indicate the limits beyond which the Board's sanction is needed for the various categories of business listed below:

a) Investments
b) Pledge advances
c) Hypothecation advances
d) Term Loans
e) Clean advances against guarantees with and without collateral
f) Clean advances without guarantees with and without collateral
g) Bill business - different categories
h) Guarantees and letters of credit
i) Expenditure including that on premises and furniture
j) Staff appointments
k) Writing off of bad debts.

What matters have invariably to be referred/reported to your Board? What is your assessment about the scope for further delegation of authority to various levels of management?

3.4 Below the level of the Chairman/Managing Director, General Manager and Local Boards/Committees, if any, what is the system of delegation of powers in your bank? Please indicate the levels down to which powers are delegated purposewise and the extent of powers delegated to each authority.

3.5 Are you satisfied that the delegated powers are being exercised by the concerned officials in the manner intended?

3.6 How do you fix limits upto which a Branch Manager can sanction credit limits without prior approval from the higher authorities? Is it on the basis of the status/grading of the Manager or the classification/grading of the branch? Is the basis different for different types of loans/customers?

3.7 What is the extent of the latitude allowed to the Branch Managers to exceed delegated authority under special circumstances?

O & M Studies

3.8 Do you have in your bank a separate unit/cell/department working solely on Organisation and Methods? If so, when was it established? Please indicate its contribution in improving the working of your bank in the following areas:

a) Simplification of forms
b) Simplification of returns
c) Cost reduction
d) Introduction of new systems
e) Other innovations

What is your assessment about the attitude of the other departments to the suggestions made by O & M?

3.9 In case you do not have a separate unit/cell/department for O & M, have you felt the need to consult outside specialists on O & M?

3.10 In case you have neither an O & M unit/cell/department nor regular consultations with outside specialists, have you made any other systematic efforts to improve the working of your bank?

3.11 Is there any system in your bank of obtaining suggestions from your employees as to ways of improving services? If so, kindly state the procedures for the working of the scheme and the practical gains achieved by it.

Economic and statistical set-up

3.12 Do you have a separate Economic/Statistics department/section/cell to collect and analyse various types of statistical data? If so, describe its organisational set-up briefly. In case there is no separate unit to collect and analyse statistical information in your bank, how are the data now collected and analysed?

Information system

3.13 Describe briefly the various types of data collected from your branches, over and above the data submitted to the Reserve Bank of India statutorily or otherwise.

3.14 Are these data used by you to make a regular assessment of the performance of your branches? If so, how frequently? Do you circulate this information to your Branch Managers?

3.15 It has been suggested that the control data prescribed for internal use of the bank and the periodical reports required to be submitted to the Reserve Bank of India should be so co-ordinated and devised as to minimise workload and facilitate expeditious appraisals. Kindly give your detailed comments and suggestions in this regard.

3.16 Have you introduced the Management Information System in your bank? If so, please describe the major changes the MIS has introduced in the bank and how these changes have assisted the management at various levels in decision making

3.17 Do you call for regular as well as ad hoc reports from your branches, Controlling Offices and Central Office departments to obtain an overall assessment of the working of the bank? If so, please give details. At what level are these reports studied and policy actions, if any, taken?

3.18 Do you have a system of imparting information regularly to the lower line management about the results of various studies carried out in your bank?

3.19 Do the executives of your Central Office/Controlling Offices periodically visit all your branches, discuss problems with your managers, meet constituents, hear their grievances and explore possibilities of avenues for development of business? If so, how often is a branch visited in a year?

3.20 Do you involve your staff in group discussions or meeting with a view to explaining the various developments which are of interest to your bank?

Staffing pattern

3.21 What is the inter-se ratio laid down by your bank for different categories of staff, i.e. subordinate staff, clerks and officers for -

a) Branches
   - Rural
   - Semi-urban
   - Urban
   - Metropolitan

b) Administrative Offices

c) Bank as a whole

3.22 What criteria do you adopt for sanctioning additional staff or for asking staff requirements at each branch?

3.23 Is there any machinery to determine at any point of time whether your bank is understaffed/adequately staffed/overstaffed?

Control returns

3.24 What are the control returns called for from your branches? To whom are they submitted and at what level are they scrutinised?

3.25 How do you ensure that the branches submit the returns promptly? What is the action taken against defaulting branches? What, according to you, are the reasons for the defaults? What corrective action have you taken in this regard?

3.26 At what level are the returns scrutinised? Are you satisfied that the scrutiny is carried out promptly and that the work does not fall into arrears?

3.27 Is it your experience that the returns are generally adequate to keep a watch over the functioning of the branches?

3.28 What is the system adopted by your bank for following up the irregularities revealed by the scrutiny of the returns? Are serious irregularities brought to the notice of the Chairman and the Board?

Internal Inspection/Audit

3.29 What is the set-up of the Internal Inspection and Audit Department in your bank?

3.30 Have you appointed any outside agencies (like firms of auditors) for carrying out inspection of your branches? What is the nature and scope of work entrusted to them?

3.31 What is the usual periodicity of the internal inspection of your branches? How do you ensure that there is no overlapping of the inspection of the branches by the Internal Inspection and Audit Department and the outside agencies appointed for the purpose?

3.32 What are the arrangements in your bank for ensuring that the element of surprise is effectively maintained in carrying out the internal inspections?

3.33 Are the Controlling Offices also subjected to internal inspection? If so, by which agency and at what intervals?

3.34 Have you prescribed any proforma for preparation of the internal inspection reports? Does it ensure that all the aspects of the working of the branches or Controlling Offices, including development of business, are covered by the personnel deputed for the inspection?

3.35 Do you, in addition, have any system of carrying out ad hoc verification of stocks, cash, etc., at your branches? If so, by which agency and at what intervals?

3.36 What is the system for apprising the Chairman and the Board of the findings of the internal inspection reports - both the good aspects and the serious irregularities?

3.37 What is the follow-up action taken on the internal inspection reports? Are the irregularities pursued till their rectification?

3.38 What is your assessment of the impact of the internal inspection/audit system in your bank on improving the efficiency of your branches/Controlling Offices and in toning up the administration?

3.39 Do you prepare a consolidated inspection/audit report on your bank periodically (say half-yearly or annually) for being placed before the Board? If so, when was it last done? Please furnish a copy of the last such report?

<u>Internal controls</u>

3.40 What is the system followed by your bank for accounting inter-branch transactions?

3.41 What is the position in your bank with regard to reconciliation of inter-branch accounts? What difficulties have you experienced in this regard and what are your suggestions for improving the system?

3.42 What is the periodicity prescribed by your bank for the balancing of various books of account relating to deposits, advances, drafts payable, etc., at your branches? How do you ensure that the balancing work is kept up-to-date by the branches?

3.43 What is the extent of arrears in balancing the books of account at your branches, particularly the bigger branches? What are the difficulties experienced by them in maintaining the work up-to-date? What corrective measures have you taken in this regard?

3.44 What is the system for reviewing the arrears in balancing of books of account at your branches? Do you consider that the risks involved in allowing accounts to remain unbalanced are (i) negligible or (ii) great?

3.45 It is understood that some banks send teams of officers from the Central Office or "task force" to the branches affected to clear up the arrears speedily. Have you taken any similar action or is any proposal under consideration?

Clearing

3.46 Taking into account the increasing number of cheques passing through the Clearing Houses, what are your suggestions for relieving the pressure on the Clearing Houses in metropolitan cities?

3.47 The Clearing Departments in metropolitan cities like Bombay of some banks are reported to be having untraced differences for large amounts in clearing, outstanding in their books of accounts. What is the position in this regard in your bank? What suggestions would you make to overcome the problems relating to handling of clearing transactions at metropolitan branches?

Miscellaneous

3.48 Do you think that there is any need for simplification/rationalisation of loan applications/documents especially in the case of small loans? If so, what are your suggestions? In case your bank has devised any simplified forms for this purpose, please furnish specimens.

3.49 What are your other suggestions or comments under this part?

PART IV
BANKING COSTS

Cost control/reduction

4.1 Please give details of the cost control/reduction mechanism adopted by your bank.

4.2 What measures have been taken by your bank in streamlining cash management as a tool for reducing cost?

4.3 What is the arrangement made by your bank in replenishing the branches with cash? Have you experienced any difficulties in this regard?

4.4 What is the scope for reducing/controlling cost of operation by modification of the existing business rules of your bank relating to deposit accounts, lockers, etc.?

Establishment

4.5 Apart from the remuneration payable to your employees under the respective Bi-partite agreement, what are the monetary or other benefits given to your employees? Please specify the types of work for which such benefits are given indicating the cost thereof during the last three years.

4.6 What are your suggestions for controlling establishment costs? What are your views in regard to formulation of a norm for establishment expenses?

Furniture and fixtures

4.7 What are the norms prescribed by your bank for equipping your different types of branches with furniture and fixtures?

4.8 What is the average cost of furniture and fixtures incurred in opening a new branch in different centres (rural, semi-urban, urban and metropolitan)?

Premises

4.9 On what terms and conditions do you usually take on lease premises for opening new branches?

Stationery

4.10 What is the arrangement for printing and supplying forms and stationery to your various offices?

Advertisement and publicity

4.11 What are the usual media adopted by your bank for advertisement and publicity? Is the work relating to advertisement and publicity centralised at Central Office? Do you have a system of obtaining a feedback on the effectiveness of the publicity work from the branches?

4.12 Please indicate the expenditure incurred on advertisements during the last three years (year-wise) together with budgeted figure for the current year (1976).

Other expenditure

4.13 What are the other important heads of cost associated with the general administration of your bank?

Miscellaneous

4.14 What are the difficulties faced by your bank in exchanging soiled notes, obtaining fresh notes, deposit of cash, etc. at the Reserve Bank of India or its agencies and what remedial action would you suggest?

4.15 What are your other suggestions or comments under this part?

PART V

PRICING POLICY.

Service charges

5.1 Please furnish the schedule of rates charged by your bank for the various services rendered by it as per proforma given in Annexure 1.

5.2 What are the criteria adopted by your bank in the fixation of the service charges? Is it on the basis of -

(a) Cost
(b) Ad hoc
(c) Volume of business?

What are the factors taken into account in charging differential rates for the same service to different customers? What is the extent of discretion allowed to the Branch Managers in this respect?

5.3 What is the system for reviewing the charges periodically?

5.4 What is the effect of inter-bank competition on the service charges levied by your bank?

5.5 How far is it practicable to introduce uniformity in regard to pricing of services among all the banks?

5.6 Please indicate the services which are rendered by your bank without regard to profit motives.

Interest and discount on borrowal accounts

5.7 Please give a schedule of the rates of interest/discount charged by your bank for different types of loans and advances and bills as in the proforma given in Annexure 2.

5.8 On what criteria do you fix these rates of interest/discount?

5.9 What are your suggestions for reducing the unit cost of borrowal account especially where supervision cost is high as in the case of agriculture, small-scale industry and small borrowers?

Miscellaneous

5.10 What are your other suggestions or comments under this part?

PART VI

OPERATIONAL EFFICIENCY

Measuring/improving efficiency

6.1 What are the methods or techniques used for measuring operational efficiency in your bank?

6.2 What specific steps have been taken by your bank during the last five years to improve operational efficiency and what measures are presently under consideration?

6.3 In your view does efficiency and/or profitability increase with the size of the branch?

6.4 How far is the efficiency of a branch of your bank governed by its proximity to the Controlling Office?

6.5 What is your opinion about a bank opening branches in centres far remote from the Central Office?

6.6 What, in your view, are the ways of providing competitive services both on a priced and non-priced basis?

Customer service

6.7 Have any studies been made by your bank to ascertain the maximum, minimum and mean waiting time of customers? If so, what are the findings?

6.8 What measures have been taken by your bank to reduce the waiting time of customers in the payment of cheques and drafts, issue of receipts covering credits to accounts, etc.

6.9 Do you operate the teller system in your bank? Has it improved customer service?

6.10 What internal checks operate at your offices to see that customers are attended to promptly?

6.11 How are complaints regarding the quality of service dealt with in your bank?

Disposal of applications for credit

6.12 What steps are taken and what controls exercised to ensure speedy disposal of applications for credit? What is the normal time taken in your bank for processing of application and sanctioning of a limit (cash credit, overdraft, loan, etc.) for different categories of borrowers such as large and medium scale industries, small scale industries, agriculture, export sector, etc.?

6.13 Kindly furnish the following data in respect of limits sanctioned during 1975 above Rs.50 lakhs and during December 1975 for all limits (a) below Rs.5 lakhs, (b) Rs.5 to Rs.10 lakhs, (c) Rs.10 to Rs.25 lakhs, and (d) above Rs.25 lakhs.

A. All limits above Rs.50 lakhs sanctioned during 1975 (calendar year)

Period within which sanctioned	No. of limits sanctioned
i) In less than one month	
ii) In one to 3 months	
iii) In 3 to 6 months	
iv) In more than 6 months	

B. All limits sanctioned during December 1975

Period within which sanctioned	No. of limits sanctioned			
	Below Rs.5 lakhs	Rs.5 to Rs.10 lakhs	Rs.10 to Rs.25 lakhs	Above Rs.25 lakhs
i) In less than one month				
ii) In one to 3 months				
iii) In 3 to 6 months				
iv) In more than 6 months				

6.14 If there are undue delays in processing and sanctioning of limits, what according to you are the reasons for the delay and what remedial measures would you suggest?

6.15 What generally are the reasons for refusal of applications for credit limits especially from the small scale and the agricultural sector and new entrepreneurs? In the context of the developmental role expected of your bank, what follow-up action do you take after rejection to assist the applicants?

Follow-up of advances

6.16 What are the arrangements in your bank to spot out danger signals in individual advances?

6.17 What follow-up measures do you take in respect of advances showing sticky tendencies?

Miscellaneous

6.18 Is your bank maintaining any currency chests? What are the advantages in having the chests? Do you experience any operational difficulties? What are your suggestions to overcome them?

6.19 What are your other suggestions or comments under this part?

PART VII

PROFITABILITY

Overall profitability

7.1 What factors do you take into account in determining profitability? What are the main profit yielding activities of your bank?

7.2 What are the areas in which losses are incurred by your bank?

7.3 Consequent upon the imposition of a ceiling rate of 16.5% or 17.5%, as the case may be, on advances, what specific steps have been taken by your bank to maintain the level of profitability?

7.4 What do you think should be the most appropriate basis for inter-bank comparison of profit? For this purpose, do you think profits should be reckoned before or after provision for taxation and bonus to staff?

Branches

7.5 In your view, what the reasonable period of time within which a new branch should be able to break even?

7.6 What is the system in your bank of charging/allowing interest on Head Office funds lent to/borrowed from branches? What is the formula in force for determining the rate of interest for the purpose?

Investments

7.7 What steps have been taken by your bank to maximise its profit in the investment portfolio?

7.8 What system do you follow in providing for depreciation in Government securities?

Miscellaneous

7.9 Please give a statement of earnings and expenses of your bank for 1975 in the proforma given in Annexure 3.

7.10 What is the amount of bad/doubtful debts written off/ provided for by your bank during the last five years (year-wise)?

7.11 Do you think that there is any case for reform or modifications in income-tax law and procedures as applicable to banks? If so, please give your specific proposals.

7.12 What are your other suggestions or comments under this part?

PART VIII

PRODUCTIVITY

Staff efficiency

8.1 Is the internal organisational set up of your bank as at present conducive to attaining the optimum efficiency level? If not, what improvements would you suggest?

8.2 Do you have any system of prescribing norms of work for the various types of activities? How do you ensure that productivity is maintained?

8.3 Could you list the various factors in the order of importance which act as a drag on productivity of your staff at various levels?

8.4 In what Departments/Sections of your bank have you introduced the use of accounting/tabulating equipments, etc.? What is your assessment of its contribution in increasing productivity?

Manpower development

8.5 Do you have proper manpower planning? If so, please give details.

8.6 What arrangements do you have in your bank for imparting training to various levels of employees? How far do you avail yourself of training facilities provided by other banks, Reserve Bank of India, NIBM, etc.?

8.7 What is your assessment of the adequacy of (a) the arrangements existing in your bank and (b) the training facilities provided by other institutions, in meeting the increased need for trained manpower? What are your suggestions for improvements in this regard?

8.8 How do you bring about attitudinal changes in your staff for working in rural areas?

Industrial relations

8.9 Do you have any suggestion for improving the set up and operations of industrial relations in your bank?

8.10 What are your suggestions for involving the employees at the operational level in determining duties and norms of work, assuming higher responsibility, self-supervision, etc., thus contributing to higher productivity?

Staff welfare

8.11 What are the specific staff welfare measures taken by your bank to make the work atmosphere conducive for the employees to give of their best in the day-to-day operations?

8.12 What steps have been taken by your bank in solving the difficulties faced by your staff in securing suitable housing accommodation at their places of posting?

Miscellaneous

8.13 What are your other suggestions or comments under this part?

PART IX

FOREIGN EXCHANGE BUSINESS

(This part of the questionnaire need be answered only by authorised dealers in foreign exchange)

Organisation

9.1 Please describe the set up in your bank for handling foreign exchange transactions. In which place is the co-ordinating Foreign Department (or a department with such responsibility) located? Which are the branches permitted to conduct foreign exchange business? What is the type of control exercised by the co-ordinating Foreign Department over the branches?

9.2 Please indicate the pattern of delegation of powers pertaining to foreign exchange business prevalent in your bank.

9.3 What discretion has been vested in your Branch Managers regarding quotation of rates and what machinery exists to ensure proper exercise of the discretion? How often are rates advised?

9.4 Foreign exchange business being a speciality, what steps are taken in your bank to ensure requisite staff skills?

9.5 What special aptitudes are required of your officers attending to foreign exchange business? How long are they retained in their jobs?

9.6 Does your bank aim at maintaining a pool of officers trained in foreign exchange business? What are the training arrangements?

9.7 Do your foreign correspondents offer training facilities to your officials? If so, what use is made of these facilities and what efforts are made to ensure proper placement of these officials on their return?

9.8 Do your officers regularly call on your foreign correspondents? In what way has this been beneficial? How many visits took place in the years 1973, 1974 and 1975 and to which countries?

9.9 Do you have any special problems in dealing with overseas banks in any particular country or currency area? If so, what are they?

<u>Procedures</u>

9.10 Are the sanctioning of limits for opening of letters of credit, negotiation of foreign bills, issue of guarantees, etc., regarded as a foreign exchange or a credit function? What departments are responsible for this work?

9.11 Have you fixed any lmits for confirming letters of credit opened by individual banks and, if so, on what basis are such limits fixed?

9.12 In respect of letters of credit advised or confirmed by your bank to beneficiaries who are not your constituents, what precautions do you take at the time of negotiating the documents?

9.13 Have you prepared a check-list for negotiation under letters of credit? What is the normal time lag involved in handling the documents? What are the difficulties faced by you in negotiating documents?

9.14 What is the procedure followed by your bank for handling inward remittances? How do you ensure that the time lag for giving credit to the beneficiary is reduced to the minimum?

9.15 What arrangements have you made to ensure that performance guarantees, bid bonds, etc., on behalf of exporters are issued without delay? What are the difficulties faced by you in this respect?

Pricing and profitability

9.16 What is the cushion taken into account by your offices in quoting rates for currencies other than sterling and on what basis?

9.17 Rates of exchange for sterling transactions (except forward sales) have been fixed by the Foreign Exchange Dealers' Association (FEDA) whereas rates for the other currencies are determined by authorised dealers. Do you consider it necessary to change this practice?

9.18 To what extent do the FEDA rules operate as a cartel arrangement? Do you consider that it would be better to give banks freedom in regard to rates, charges, etc.?

9.19 Do you consider that the FEDA rules require amendment? If so, what amendments would you propose? Do you have any particular comments to make on the schedule of charges for various kinds of service?

9.20 What is the range of interest rates charged on bills covering imports under your letters of credit from the date reimbursement is made to your foreign correspondents to date of retirement in India?

9.21 Please furnish the following information pertaining to your foreign exchange business for the years 1973, 1974 and 1975:

(separate figures for different currencies)

(a) Rupee value of :-

(i) export business and remittances inward;

(ii) import business and remittances outward; (value of merchant business alone to be furnished)

(b) Total value of letters of credit advised by you and the bills negotiated thereunder.

(c) Net profit earned on foreign exchange transactions analysed as to:-

(i) commission and interest charged on various types of transactions, and

(ii) exchange profit (including profit on cover operations)

9.22 How is the exchange profit on foreign exchange transactions computed in your bank? On what basis is the profit allocated to the individual offices handling the business?

9.23 What was the yield of the gross exchange profit earned by you bank on foreign exchange transactions on the total rupee funds employed in the years 1973, 1974 and 1975?

9.24 What was the total expenditure incurred by your bank in maintaining the Foreign Exchange Department in the years 1973, 1974 and 1975?

Miscellaneous

9.25 Do you consider that any of the exchange control regulations/procedures need amendment in the interests of the smooth operation of foreign trade and assistance to exporters/importers?

9.26 There are frequent complaints that the returns required by the R.B.I. pertaining to foreign exchange business (e.g., 'R' returns) are not sent to them in time. Has your bank received such complaints? If so, what steps have been taken to eliminate delays? What particular difficulties do you encounter in the timely submission of these returns?

9.27 Do you consider that there is scope for rationalising the above returns (i) by consolidating certain returns, (ii) by omitting certain returns, (iii) by changing the periodicity of certain returns, or (iv) by a combination of the above methods? If so, what are your specific suggestions?

9.28 What are your other suggestions or comments under this part?

PART X

FOREIGN BRANCHES

(This part of the questionnaire need be answered only by Indian banks having branches abroad)

10.1 Please give an assessment of the working of your foreign branches with reference to the growth of their business and the contribution made by them in foreign exchange to India during the last three years

10.2 What is the nature of supervision and control exercised by your bank over the foreign branches? Are you satisfied that the arrangements are effective or do you have under consideration any improvements in this regard?

10.3 What is the staffing pattern of your foreign branches in relation to Indian nationals and foreign nationals?

10.4 Are your foreign branches solely dependent on the business directed to them from your other branches and by Indians resident in the countries concerned? Or, are they able to compete for local business? If the latter, what types of business have been secured; also whether and if so to what extent, deposits have been attracted from local nationals?

10.5 Do your foreign branches encounter any difficulties in transacting business? If so, what are they? Are any steps to remove these difficulties feasible?

10.6 Have your foreign branches played any role in helping the promotion and setting up in foreign countries of joint ventures and/or financing investment of Indian industries which are operating abroad either singly or jointly with foreign industrial concerns?

10.7 What is the contribution made by your foreign branches in promoting exports of capital goods, construction jobs, consultancy services, etc. from India? Do you try to ensure that the credit facilities extended by the foreign branches are generally linked to imports from and exports to India?

10.8 What is the quantum of remittances made by you to foreign branches on account of capital and working expenses during 1973, 1974 and 1975 and to which countries? Under what circumstances were the remittances necessitated?

10.9 Do you have any representative offices abroad? If so, in which cities? Please furnish an appraisal of their usefulness and, to the extent possible, quantify the benefits in relation to costs.

AP/

Part V, Question No.5.1

ANNEXURE 1

Schedule of rates charged for various services rendered

Particulars of services (1)	Schedule of rates (2)	Concessions, if any, allowed in the rates (3)
1. Remittances		
1.1 Issue of drafts		
1.2 Mail transfers		
1.3 Telegraphic transfers		
2. Local cheques/bills for collection		
2.1 Local clearing cheques		
2.2 Cheques on non-clearing banks		
2.3 Clean demand hundies or bills		
2.4 Clean usance hundies or bills		
2.5 Demand documentary bills		
2.6 Usance documentary bills		
2.7 Supply Bills		
2.8 Collection of pay bills and pension bills from Government Treasuries		
3. Outward bills for collection		
3.1 Cheques and clean demand bills		
3.2 Clean usance bills		
3.3 Documentary demand bills		
3.4 Documentary usance bills		
3.5 Bills covering parcels		
3.6 Supply bills		
3.7 Inward bills received from upcountry non-customers for collection and remittance of proceeds		
4. Purchase and sale of Government securities and shares		
4.1 Purchase and sale of securities		
4.2 Collection of interest and dividend		
4.3 Payment of calls and collection and repayment of capital		

ANNEXURE I (Contd.)

Particulars of services	Schedule of rates	Concessions, if any, allowed in the rates
(1)	(2)	(3)
5. Safe custody facilities		
5.1 Shares and securities (on the face value of Govt. securities and debentures, etc., and paid-up value of shares at the time of withdrawal of securities)		
5.2 Banks's own fixed deposit receipt		
5.3 Sealed envelopes		
5.4 Sealed packets containing documents, valuables, etc.		
5.5 Boxes		
6. Periodic payments under standing instructions		
7. Incidental charges		
7.1 Current Account		
7.1.1 Return of cheques		
7.1.2 Closing of account		
7.1.3 Service charges		
7.2 Savings Bank Account		
7.2.1 Closure of account within one year of its opening		
7.2.2 Copy of statement of account		
7.2.3 Issuing duplicate pass book		

Part V, Question No.5.7

ANNEXURE 2

Schedule of rates of interest/discount charged on advances/bills

Category of advances	Rates of interest/discount charged Minimum	Maximum
1. Large and Medium-scale Industries		
2. Wholesale trade		
3. Direct finance to agriculture (excluding plantations)		
3.1 Short-term (including crop loans)		
3.2 Medium/long-term		
4. Allied Activities		
4.1 Short-term		
4.2 Medium/long-term		
5. Plantations		
6. Indirect finance to agriculture		
6.1 Distribution of fertilisers, pesticides and seeds		
6.2 Distribution of agricultural implements and machinery (including financing hire-purchase arrangements)		
6.3 Other types of indirect finance		
7. Small-scale industry		
8. Retail trade other than those included under (6)		
9. Transport		
9.1 Cycle rickshaws, hand and animal drawn carts		
9.2 Taxis, autorickshaws and scooters		
9.3 Other land transport (lorry,bus, etc.)		
9.4 Other transport		
10. Personal and professional services		
10.1 Education		
10.2 Professiomal service (doctors, lawyers, accountants, engineers,architects,etc.)		
10.3 Repair works		
10.4 Artisans and craftsmen		
10.5 Custom service units other than agricultural custom service units		
10.6 Hotels and restaurants		
10.7 Other services		

ANNEXURE 2 (Contd.)

Category of advances	Rates of interest/ discount charged Minimum	Maximum
11. Miscellaneous		
11.1 Purchase of consumer durables		
11.2 Other personal loans		
11.3 Rural industries projects		
12. Inland bills		
12.1 Purchase of bills		
12.2 Discount of bills		
12.3 Advances against bills		
13. All others		

Part VII, Question No.7.9

ANNEXURE 3

Statement of Earnings and Expenses for the year ended December 31, 1975

(Amounts in rupees thousands)

Earnings	Indian offices	Foreign offices	Total
I. Interest, discount, dividend, commission and exchange earned on			
(a) Bills purchased & discounted			
i) Inland bills			
ii) Export bills			
iii) Import bills			
(b) Loans and advances			
(c) Investments (inclusive of taxes paid at source)			
i) Government securities (Central and States)			
ii) Others			
(d) Deposits with banks			
II. Recoveries on assets previously written down and gains from other revaluation or sale of assets			
III. Other sources			
(a) Commission on letters of credit			
i) Export bills			
ii) Import bills			
(b) Bills for collection			
i) Inland bills			
ii) Foreign bills			
(c) T.T's and D.D's sold			
i) Inland			
ii) Foreign			
(d) Other service charges			
(e) Other income			
Total ..			

ANNEXURE 3 (Contd.)

Expenses	Indian offices	Foreign offices	Total

IV. Interest, Commission and brokerage paid on

	Current	Savings	Fixed	Others
a) Deposits – Indian offices: i) Interest; ii) Commission & brokerage				
a) Deposits – Foreign offices: i) Interest; ii) Commission & brokerage				
b) Borrowings				
c) Other accounts (to be specified)				

V.(i) Establishment expenses(to be specified in the attached Appendix I)

(ii) Other working expenses (to be specified in the attached Appendix II)

VI. Taxes and dues of the nature of operating expenses (e.g.municipal charges on land and buildings, District/Local Board rates paid, etc.but excluding taxes on profits)

VII. Depreciation written off and loss incurred on sale of assets

VIII. Bad debts written off

IX. Balance of profit (+) or loss(-) (i.e.Earnings minus items IV to VIII)

T o t a l ..

Disposal of Profit & Accumulated Surplus

X. Source of sums made available

i) Balance of profit (+) or loss (-) as per item IX

ii) Surplus (+) or Deficit (-) brought forward from preceding year(if any)

iii) Taken from Reserves (if any)

T o t a l ..

ANNEXURE 3 (Contd.)

	Indian offices	Foreign offices	Total
XI. Allocation of sums made available	X	X	X
a) Provision for taxes (inclusive of taxes paid at source on investments)			
b) Carried to reserves			
i) Statutory reserves			
ii) Other reserves such as general reserve, dividend equalisation and other funds in the nature of reserves (to be specified)			
c) Allocated to other special purposes			
i) Provision for bad and doubtful debts			
ii) Investment fluctuation fund			
iii) Other special purposes (to be specified)			
d) For payment of gratuity in future years			
e) Dividend, bonuses, etc. to share-holders/Amount transferred to Government (percentage may also be shown)			
f) Employees' share (bonus) in the profit			
g) Amount remitted to head office			
i) By way of normal profits for the year			
ii) Other remittances such as administrative expenses paid by foreign offices (Please specify)			
h) Balance carried forward to the next year's account			
Total ..			

N.B. In compiling the statement please follow the instructions for filling up BSR A-2.

APPENDIX I (Ref.item V(i) of Annexure 3)

(Amount in rupees thousands)

	Subordinate Staff		Clerical Staff		Officers and others		Total	
	Indian Offices	Foreign Offices	Indian Offices	Foreign Offices	Indian Offices	Foreign Offices	Indian Offices	Foreign Offices
1. Total number of staff employed								
2. Establishment charges								
i) Basic pay								
ii) Dearness allowance								
iii) House allowance								
iv) Contribution to provident/ pension funds								
v) Gratuity								
vi) Medical aid								
vii) Leave-fare concession								
viii) Other items such as overtime allowance etc.								
Total ..								
3. Bonus paid or payable for the year 197								
4. Total of 2 and 3								

Contd....

APPENDIX II (Ref.item V(ii) of Annexure 3)

(Details of 'Other Working Expenses')

Sr. No.		Amount in Rupees thousands	Sr. No.		Amount in Rupees thousands
1.	Directors' & Local Committee members'		10.	Auditors	
	i) Fees ..			i) Fees ..	
	ii) Allowances ..			ii) Allowances ..	
2.	Rents paid for		11.	Postage, telegrams, stamps and telephones ..	
	i) Office premises ..		12.	Law charges (including court fees) ..	
	ii) Other premises ..		13.	Clearing house charges ..	
3.	Lighting charges ..		14.	Maintenance and repairs to office equipment/Bank's property ..	
4.	Insurance				
	i) Premium paid to D.I.C. ..		15.	Conveyance charges ..	
	ii) Other premiums ..		16.	Motor car expenses ..	
5.	Taxes (excluding those reported against item VI & XI(a) of the return)		17.	Travelling expenses (excluding leave-fare concession) ..	
6.	Printing and stationery ..		18.	Head office supervision, Administration and other charges ..	
7.	Advertisements ..		19.	Other (Please specify) ..	
8.	Periodicals and Newspapers ..				
9.	Entertainment expenses ..				
				Total ..	

Date :

A. Studies undertaken by the Committee on its own or in collaboration with other banks

Description of the Study	Remarks
1. Banking Costs Study	In collaboration with 21 selected banks.
2. Study of loss incurring branches	In collaboration with CBI, Bank of India, PNB, Bank of Baroda and Indian Overseas Bank
3. Scope for Mechanisation and computerisation in banks	Sub-Committee consisting of officers from RBI, SBI and Indian Banks Associations
4. Composite Efficiency Index	Internal study undertaken in Department of Statistics
5. Trends in Earnings and Expenses	Internal study undertaken in Economic Department
6. Systems & Procedure in different size of branches	Internal study undertaken in DBOD

B. Studies entrusted to outside agencies

Agency	Description of study	Persons who were associated
1. IIM (Ahmedabad)	Applicability of the concept of market segmentation to the banking industry in India	Prof. S.K. Bhattacharya
2. IIM (Ahmedabad)	Detailed analysis of branch activity with suggestions to improve efficiency	Prof. S.K. Bhattacharya and Dr.A.H. Kalro
3. Shri Rameshwar Thakur	Annual Accounts, Statutory Audit, Internal Audit, Taxation Laws	Shri Rameshwar Thakur
4. Institute of Cost & Works Accountants (Calcutta)	Stationery, Printing and Advertisement	Shri Ray Choudhury
5. Bankers' Training College	Impact of pipe-line funds on cost and pricing	Dr. Srivastava
6. Bank of Baroda	Branch Net Work Study in a Metropolitan Centre (Ahmedabad)	Dr. Dave

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STAFF MEMBERS ATTACHED TO THE SECRETARIAT OF THE PEP COMMITTEE ON BANKING

	NAME	DESIGNATION
1.	Shri P.E. John	Deputy Chief Officer
2.	Shri P. Diwakar	Assistant Chief Officer
3.	Shri S.T.V. Chary	Research Officer
4.	Shri S.R. Krishna Iyer	"
5.	Shri S.G. Chittar	"
6.	Shri M. Shinde	Banking Officer
7.	Shri M.K. Joglekar	"
8.	Smt. S. Nalini	Assistant Research Officer
9.	Shri M.G. Kadam	Research Superintendent
10.	Shri A.D. Jagadeesan	"
11.	Shri I.J. Tiwari	Staff Officer Grade 'A'
12.	Shri M.V. Murkunde	Economic Assistant
13.	Kum. S.J. Agrawal	Statistical Assistant
14.	Shri H.N. Chaturvedi	"
15.	Shri R.T. Seshadri	"
16.	Shri G.R. Subramanya	"
17.	Shri B.B. Bharadwaj	"
18.	Shri K.N. Sharma	"
19.	Shri S.T. Baadkar	"
20.	Shri B.G. Patil	Banking Assistant
21.	Shri A.R. Ambani	"
22.	Shri M.V. Vadiraja	"
23.	Smt. S. Varghese	Stenographer
24.	Shri P. Rajaratnam	"
25.	Smt. Annie Paul	"
26.	Shri T.O. Thomas	Comptist
27.	Shri S. Murali	"
28.	Shri C.C. Dias	Clerk
29.	Shri K.N. Narayanankutty	"
30.	Shri H.S. Karkera	"
31.	Shri T. Gopalakrishnan	"
32.	Shri P.G. Wagmare	"
33.	Shri D.V. Godse	"
34.	Shri A.C. John Singh	"
35.	Shri A.S. Kalekar	"
36.	Shri A.M. Chitre	"
37.	Shri R.K. Shettigar	Typist
38.	Shri V. Krishnamoorthy	"
39.	Shri R.P. Dobhal	Peon
40.	Shri M.V. Thombre	Mazdoor

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