

**REPORT OF THE HIGH POWER COMMITTEE  
ON THE COST OF  
CONDUCTING GOVERNMENT BUSINESS  
BY PUBLIC SECTOR BANKS**



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**RESERVE BANK OF INDIA**

**BOMBAY**

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## CHAPTER I

### Introduction

1.1 The Reserve Bank of India acts as banker to the Central and State Governments in terms of the provisions of Sections 21 and 21A of Reserve Bank of India Act, 1934. The functions are discharged by the Bank through its own offices, branches of the State Bank of India and its associate banks and the scheduled commercial banks nationalised in 1969. The terms and conditions subject to which the agency functions are discharged by the State Bank of India are contained in the agreement entered into between the Reserve Bank and State Bank of India. The agreement provides for payment of remuneration to the 'agency banks for conducting government business and the rate of remuneration is required to be reviewed every five years. Till the year 1970, State Bank was being paid remuneration for conducting government business in accordance with the formula laid down by Sir James Taylor, a former Governor of the Reserve Bank of India. Under this formula, known as Taylor formula, each branch of the agency bank was required to arrive at a basic percentage, representing a ratio between the volume of government business and the total business (on account of government and bank business) handled by the branch. The basic percentage was arrived at as a mean of the following two percentages:

- (i) percentage of total number of vouchers on account of government work to the total number of vouchers for both government and bank work
- (ii) percentage of government turnover to the total turnover of the branch on account of government and bank work.

The basic percentage so arrived at was applied to the total expenditure of the branch to arrive at the cost of conducting government business. The cost of conducting government business for all branches put together was worked out, to which expenses of a general nature were added to arrive at total cost.

1.2 The Taylor formula was in force till 1969-70. For the quinquennium 1970-75, agreement on the terms of remuneration could not be reached since the State Bank of India felt that the Taylor formula did not take into account several items of expenditure such as cost of stationery, 'common services' of employees like dufftries, clerks, watchmen, cost of staff amenities for the

purpose of computing the cost of conducting government work. The Reserve Bank felt, on entirely different grounds, that the formula did not reflect the true cost of conducting government business since the cost of several specialised departments such as development, inspection, advances, personnel, premises, etc. with high staff cost required to be maintained to support its wide range of functions such as agricultural advances, industrial advance, advance to Small Scale Sector etc. tended to be loaded over it. A Committee under the Chairmanship of Shri Rameshwar Thakur, a practising Chartered Accountant was, therefore, appointed by the Reserve Bank of India in 1973 to investigate the cost of conducting government business by State Bank of India and to recommend the rate of remuneration for the period 1971 to 1978. The Committee was also requested to recommend a scientific and fairly simple formula for computing cost and also to suggest the lines on which future reviews of the cost of conducting government business should be made. The Committee organised a Survey and collected relevant data relating to cost of conducting government business from selected sample branches. The data collected from branches was processed and on the basis of results arrived at, the Committee recommended a commission of 9.25 paise per Rs.100/- of government turnover. The Committee's report was accepted by Reserve Bank of India and State Bank of India as it was in the nature of an award, although both Reserve Bank and State Bank did have some reservations on some of the recommendations. The commission at the basic rate of 9.25 paise per Rs.100/- as recommended by the Committee was paid to State Bank of India. Later, when the 14 major scheduled commercial banks were appointed as the agents of the Bank for the conduct of government and other business, the same rate of commission was made applicable to them. The agency agreements entered into with these banks, provided that the Reserve Bank shall pay to the banks remuneration at the rate payable to State Bank of India for the time being and that it shall be determined by mutual discussions and the rates fixed for a period of 5 years. The rate remained in force upto 1978 for both State Bank of India and the nationalised banks.

The Study undertaken by the Thakur Committee revealed that the cost of conducting government business varied according to the volume of turnover. When the turnover was more, the rate for conducting government work came down. The volume of government turnover handled by Associate Banks was less when compared to the volume of government turnover handled

by State Bank of India. The cost data relating to government business conducted by Associate banks was, therefore, collected from them and they were processed to determine the cost of conducting government business. Different rates of remuneration were arrived at for the Associate Banks and they were made applicable for the period upto 1978.

The volume of government turnover, amount per voucher and scale of total expenses differed from bank to bank and these gave rise to different rates of commission received by Associate Banks.

1.3 One of the recommendations of the Thakur Committee was that a review of the basic rate of commission payable to State Bank should be made for the quinquennium 1979-83 by collecting fresh cost data. The Committee suggested maintenance of suitable records at the branches/Local Head Offices/Central Office for collection of data for the annual/quinquennial review of remuneration as under :

- 1) No. of vouchers and amount of turnover handled by branch for bank work and government work,
- 2) No. of staff under each category and salaries paid to them by the branch,
- 3) Allocation of staff for government work, bank work and common services,
- 4) Time spent by employees engaged partly in government work and partly in bank work,
- 5) Other overhead expenses of the branch, and
- 6) Local Head Office/Central Office cost.

For revising the rate applicable for 1979-83, in accordance with the recommendation of the Thakur Committee, State Bank collected data relating to 1978-79 and furnished them to Reserve Bank of India in 1983. State Bank felt at that time that the returns prescribed by the Thakur Committee for collection of cost data were complicated. Correct and complete data could not be, therefore,

obtained by them from all the requisite branches. Based on the available data, State Bank put up a rate of 10.75 paise per Rs.100/-. Reserve Bank after a scrutiny of this rate and adjusting it for correction arrived at a rate of remuneration of 9.35 paise per Rs.100/-. Though all the necessary statistics could not be gathered, considering the various relevant factors such as increase in wage rate and other overhead costs, it was agreed by mutual discussions between officials of the Reserve Bank and the State Bank that commission may be paid to the State Bank at the rate of 9.80 paise per Rs.100/- of turnover for handling government work during the quinquennium 1979-1983. There was to be no annual review of the rate of commission for adjustment of variable costs, etc. during this period. The same rate was made applicable to the 14 nationalised banks. The rates applicable to associate banks of State Bank of India were stepped up on a proportionate basis. While accepting the turnover commission report, State Bank reiterated the difficulty in collecting data in the manner prescribed in the Thakur Committee Report and listed several factors which had resulted in an increase in the cost of handling government business. State Bank of India, therefore, requested the Reserve Bank to take into account all factors which should go into the computation of cost of conducting government business. The following additional points were brought out by State Bank of India :

- (1) The mode of collection of data, nature of information gathered and the technique of working out the basic rate recommended by the Thakur Committee are cumbersome and complicated. The data collected under the Thakur Committee guidelines were found to be inconsistent and not readily amenable for verification.
- (2) Since the time the recommendations were made by the Thakur Committee (1974), the nature and content of government work handled by the banks had undergone a "sea-change", both in qualitative and quantitative aspects. The Central Government Accounts were departmentalised in 1976. Under this arrangement transactions of Central Government were to be accounted for in the accounts of concerned Departments of the Ministry. The accounts had to be rendered to the Drawing & Disbursing Officer who is the cheque drawing authority and to the Pay & Accounts Officer, who is the accounting authority. Reconciliation of

accounts and submission of detailed accounts had to be attended to by banks. (Under the erstwhile system the branch had to render accounts and scrolls with documents to the Treasury/ Sub-Treasury to which the branch was linked).

- (3) Due to departmentalisation of Central Government work and the different types of government transactions now entrusted to the banks, the role, responsibility and costs of handling government transactions have shown tremendous increase.
- (4) The revised system has cast a greater responsibility on the banks in regard to rendering of accounts, reconciliation of discrepancies etc. without adequate compensation.
- (5) The compilation of vast amount of data required by the government has necessitated installation/hiring of sophisticated computers which involve additional expenditure.

1.4 The Reserve Bank was aware that the formula laid down by the Thakur Committee was based on the proportion of time spent by the staff for attending to government work and to bank work and this factor introduced a subjective element. The differential rate system for payment of remuneration to associate banks of State Bank of India tended to discriminate against the 14 Nationalised Banks.

1.5 Considering the various aspects, Governor appointed a high power Committee under the Chairmanship of Bank's Executive Director to look into the question of remuneration for Government business undertaken by the agency banks.

The Committee as constituted in May 1985 comprised :

- |        |  |            |
|--------|--|------------|
| \$ (1) | Shri T.N. Anantharam Iyer<br>Executive Director<br>Reserve Bank of India | - Chairman |
| (2)    | Shri K.G. Patkar<br>Chief Accountant<br>Reserve Bank of India            | - Member   |



- \$ (3) Shri C.S. Ramachandran - Member  
Adviser  
DESACS  
Reserve Bank of India
- £ (4) Shri V.K. Sibal - Member  
Joint Secretary  
Government of India  
Department of Banking
- (5) Shri R. Sinha - Member  
General Manager  
Banking Operations Department  
State Bank of India
- \* (6) Shri K. Thanu Pillai - Member  
General Manager  
(Inspection and Finance)  
State Bank of Travancore
- @ (7) Shri M.N. Kini - Member  
General Manager  
F & GA Wing  
Canara Bank
- \*\* (8) Shri S.N. Gupta - Member  
General Manager (Admn.)  
Punjab National Bank
- @@ (9) Shri P.Y. Padhye - Member Secretary  
Jt. Chief Accountant  
Reserve Bank of India

\$ Since retired from Reserve Bank but requested to continue on the Committee as Chairman/Member.

£ Shri M. Jha succeeded Shri V.K. Sibal.

\* Shri S. Srinivasan succeeded Shri K. Thanu Pillai.

@ Shri P.T. Kuppaswamy succeeded Shri M.N. Kini.

\*\* Shri K.L. Dua succeeded Shri S.N. Gupta.

@@ Shri B.A. Patil succeeded Shri P.Y. Padhye.

1.6 The terms of reference of the Committee are as under :

- (i) to review the existing system and determine the cost of conducting government business by the agency banks;
- (ii) to study and determine the various cost components that should enter into business;

- (iii) to suggest a scientific but fairly simple formula for computing cost;
- (iv) to suggest the lines on which a review of the proposed system of ascertaining the cost for the next quinquennium is to be made;
- (v) to make a cost benefit study on the maintenance of currency chests and small coin depots and recommend a suitable technique for incorporating this in the turnover commission;
- (vi) to study and assess cost of conducting Reserve Bank of India remittance transactions and recommend a suitable technique for incorporating this element; and
- (vii) to study and make recommendations in other matters that may be relevant to the issue.

#### **Procedure followed by the Committee**

1.7 The Committee held five meetings to discuss the various issues connected with the cost of handling government work and the studies made available to it by the Department of Statistical Analysis and Computer Services, Reserve Bank of India and Management Science Department of State Bank of India. In Chapter 2 of the Report Cost Studies undertaken by State Bank of India have been analysed. In Chapter 3 Cost Studies undertaken by DESACS, Reserve Bank of India have been discussed. Committee's observations on the cost of maintenance of currency chests, reimbursement of charges incurred by banks in transporting remittance of treasure, charges incurred in handling transactions under RBI Remittance Facilities scheme are contained in Chapter 4. The Committee's recommendations are contained in Chapter 5.

#### **Acknowledgements**

1.8 (1) The Committee wishes to place on record its thanks to DESACS, Reserve Bank of India and Management Science Department of State Bank of India for having undertaken the Studies on the cost of handling government work and making their reports available to it to facilitate its task.

- (2) The Chairman of the Committee also wishes to place on record his thanks to Shri D.N. Ghosh, Chairman, State Bank of India for sparing his valuable time for useful discussion. The Chairman of the Committee also wishes to place on record his thanks to Shri P.V. Subbarao, Dy. Managing Director, State Bank of India and his officials for sparing their valuable time for exchanging of notes and for the very useful discussion with the Reserve Bank of India officials.
- (3) The Committee wishes to place on record its appreciation of the keen sense of devotion to duty displayed and the hard work put in by Sarvashri P.Y. Padhye, S.D.K. Santoskar, B.A. Patil, Jt. Chief Accountants, S. N. Prasad, Director (DESACS), M.K. Prabhu, Dy. Chief Accountant, S. Venkateswaran, Director-in-Charge (N.C.C.), K. Ventatappa, P.B. Mathur, Dy. Chief Accountants, M.S. Aradhey, S.V. Subramanian, Asstt. Chief Accountants, F.T. Pereira, Accounts Officer and M.S. Vohra, Accounts Officer, Deptt. of Govt. & Bank Accounts who with their knowledge of the subject assisted the Committee in completing its task.

## CHAPTER II

### **Cost Studies undertaken by the State Bank of India**

2.1 The Committee had the benefit of the reports of two studies on the cost of conducting government business undertaken by the Management Science Department of State Bank of India, besides the two studies conducted by the Department of Statistical Analysis and Computer Services of the Reserve Bank of India. Based on these in-depth studies of the cost of conducting government work, approach papers were made available to the Committee. This chapter deals with the two studies undertaken by the State Bank of India. The first study related to a cost study carried out for 1984 applying the methodology of sampling and estimation recommended by the Thakur Committee and the second was an on-going study on the cost of conducting various banking services including government work undertaken for 1984 by the State Bank of India. The methodology adopted and results obtained through these studies are briefly discussed in this chapter.

### **Cost Study No.1 undertaken by SBI**

2.2 The study carried out by the State Bank of India (Annexure I) of the cost of conducting government business was based broadly on the lines recommended by the Thakur Committee. The State Bank selected 1112 branches out of the 2050 branches handling government business in 1983, keeping in view the undernoted requirements spelt out in the Thakur Committee Report viz. that the selected branches should cover:

- (a) fifty per cent of the branches conducting Government business;
- (b) sixty per cent of the total cost of conducting Government business; and
- (c) seventy five per cent of Government business turnover.

For the purpose of selecting the sample, the State Bank of India classified the branches conducting government work into six turnover groups which were the same as those adopted by the Thakur Committee in 1974. Out of the 1112 branches selected for the study, it used the information supplied by only 550 branches.

2.3 The direct staff cost for Government work (including common services) at the branch level was estimated by State Bank of India for the bank as a whole at Rs.54.51 crores. The estimated Government turnover was arrived at Rs.79,813 crores, as against the actual turnover of Rs.69,022 crores. A rate of 7.90 paise per Rs.100 of Government business at branch level was arrived at by State Bank of India by dividing the branch staff cost of Rs.54.51 crores by the actual government turnover viz. Rs.69,022 crores. Including 'other' expenses at the branch level, the branch level cost was estimated at 9.64 paise per Rs.100 of Government business. After loading the Central Office and Head Office cost on the branch cost the State Bank of India arrived at an overall cost of 11.35 paise per Rs.100 of Government business.

#### **State Bank of India Study No.2**

2.4 A study to assess the cost of conducting various banking services, including Government work was undertaken in 1984-85 for all banks by the Management Services Department of the Reserve Bank of India (Annexure II). Requisite data were collected from various Public Sector Banks and processed. State Bank of India has been conducting similar studies on an on-going basis to assess the cost of different banking activities. On the basis of the data relating to the year 1984 in respect of selected branches of S.B.I., the cost of conducting Government business was estimated by S.B.I. at 8.2 paise per Rs.100/- of turnover. The S.B.I. study estimated that the staff cost for conducting government business was Rs.51.03 crores including controlling office cost of Rs.10.31 crores on an estimated government turnover of Rs.75,000 crores, it arrived at a cost rate of 8.2 paise per Rs.100/- of government turnover. It will be seen that by using a different method, the cost rate of conducting Government work has been arrived at by the S.B.I. as 8.2 paise per Rs.100/- of government turnover.

#### **Analysis of State Bank of India Study No.1**

2.5 An analysis of the S.B.I. Study No.1 reveals the following :

- (i) (a) Though the S.B.I. Study was designed to cover 50% of branches, data were available from only 550 branches out of 2050 branches conducting Government business, covering only 26.8 per cent as against 50 per cent of the branches stipulated by the Thakur Committee. In other words, data relating to

1025 branches should have been collected for the purpose of the study.

- (b) The cost of conducting Government business of the sample (550) branches works out to Rs.19.3 crores on the basis of branch-wise estimate furnished by State Bank. The total estimated cost of conducting Government business is given as Rs.66.65 crores in the State Bank study. Thus, the coverage of the sample in terms of cost is only around 30 per cent as against the Thakur Committee's stipulation of 60 per cent of the total cost.
  - (c) The turnover of Government business of 550 sample branches is around Rs.32,000 crores which is about 46 per cent of the actual turnover of Government business of Rs.69,022 crores. The coverage did not satisfy the requirement of 75% of Government turnover prescribed in the Thakur Committee formula. Thus all the three basic requirements presented by the Thakur Committee are not fulfilled.
  - (d) The apportionment (Thakur Committee Formula) of costs not directly attributable to government work is stated to be based on direct staff cost. S.B.I. had not furnished the direct staff cost. The group-wise staff cost as made available in Thakur Committee Report is not available.
  - (e) The total branch overheads, the items included under overheads are not available.
- (ii) Based on the information supplied by 550 branches, State Bank have estimated the direct staff cost at the branch level as Rs.54.51 crores. The corresponding estimate of government turnover for 1984 has been obtained at Rs.79,813 crores. When compared against actual government turnover at Rs.69,022 crores, it showed an overestimate in the government turnover of the order of 15.6 per cent. S.B.I. have arrived at the cost rate by relating the estimated cost (Rs.54.51 crores) with the actual turnover (Rs.69,022 crores). Instead, if both the estimates of cost and turnover obtained were

used to determine the estimate of cost rate, it would have worked out to a cost rate of 6.83 paise ( $100 \times 54.51/79,813$ ) per Rs.100 of government turnover. On the other hand the State Bank of India arrived at an overall estimate of cost rate using the estimated cost Rs.78.30 crores divided by the actual turnover (Rs.69,022) to arrive at the rate of 11.35 paise per Rs.100 of turnover. If estimated turnover figures of Rs.79,813 or with estimated cost of Rs.78.30 crores were used, the overall cost rate would work out to 9.80 paise per Rs.100/- of turnover, instead of 11.35 paise. This was also the rate fixed in 1983.

- (iii) The study adopted the sampling design of Thakur Committee Report of 1973-74. The sampling design in 1974 was evolved by stratifying the branches transacting government business according to six size groups of government turnover. In these groups, the activities of the branches with regard to Government business and efforts involved in putting through the transactions were supposed to be homogeneous. The population of branches in each group was identified and sample branches selected by simple random sampling method according to specification of sampling design, for each of the groups. In actual practice, the desired sample size in each group could not be achieved in the specified time because of non-response from the branches. 502 branches were included out of the desired 563 for analysis, giving an overall coverage of 89%. There were marginal departures in the size of the sample branches as per the design and as actually obtained in various groups. This resulted in an over estimation in the estimate of aggregate government turnover by about 5.5% (vide para 4.6, page 46 of the Thakur Committee Report). Even when the coverage under Thakur Committee study was of the order of 43% of branches there was an over-estimation in the volume of government turnover. In the present study coverage of branches is only 26.8% as against 50% prescribed under Thakur Committee formula.

(iv) The turnover group would be affected over a period of time due to increase in the current value of turnover on account of increase in the activities and increased number of vouchers as discussed below.

(a) The Government turnover during the period 1974 to 1984 went up by 4.65 times (from Rs.14,848 crores in 1974 to Rs.69,022 crores in 1984). The distribution of branches according to volume of Government turnover in 1984 would not, therefore, be the same as in 1974. The branches having a turnover of Rs.1 crore in 1974 would be generating a turnover of almost Rs.5 crores in 1984. Similarly, branches conducting government business of the order of Rs.10 crores in 1974 would be transacting government business in 1984 to the tune of Rs.50 crores or so. The sampling of branches for 1973-74 study which has been adopted for the 1984 study will not therefore reflect the correct size/class distribution. The distribution of branches according to government turnover for the year 1974 and 1984 are as under :

**TABLE 'A'**

**No. of branches and Government turnover as at the end of;**

Turnover Group	1974		1984	
	No. of branches	Turnover in crs. of Rs.	No. of branches	Turnover in crs. of Rs.
1. Below Rs.1 crore	204 (36)	120	448 (72)	127
2. Rs.1 crores to Rs. 3 crores	385 (86)	696	215 (66)	433
3. Rs. 3 crores to Rs. 10 crores	331 (147)	1860	542 (140)	3184
4. Rs.10 crores to Rs. 25 crores	148 (136)	2262	344 (97)	5483
5. Rs. 25 crores to Rs. 50 crores	61 (56)	2070	198 (53)	7069
6. Rs. 50 crores and above	52 (41)	5462	302 (122)	52720
	<u>1181</u> (502)		<u>2049</u> (550)	

(The figures in bracket indicate the sample branches)



The selection of branches in terms of 1974 stratification would give rise to non-representative character to the sample list for 1984. This would be so because many branches represented in the turnover groups of Rs.10 crores and above in 1974 would find place in the Rs.50 crores and above group in 1984, commensurate with the increase in their activities and other factors affecting them over the decade. According to the stipulation of sampling design given in the Thakur Committee Report, branches have to be stratified according to size of turnover to constitute homogeneous groups. The turnover group of Rs.50 crores and above taken by State Bank in 1984 does not constitute a homogeneous group as may be seen from the Table 'B' below:

TABLE 'B'

Size or Class of turnover group	No. of branches transacting government business	Cost rate paise per Rs.100/-
Rs. 50 crores to Rs. 100 crores	149	8.57
Rs. 100 crores to Rs. 200 crores	92	4.56
Rs. 200 crores to Rs. 500 crores	46	3.16
Rs. 500 crores and above	15	1.34
	<u>302</u>	

It would be seen that distribution of branches as given by the number in each of the groups is not uniform i.e. they are not equal in all three groups.

- (b) There were 1181 branches of S.B.I. in 1974 handling a total government turnover of Rs.14,848 crores. Out of these, 52 branches had a turnover of over Rs.50 crores per branch and out of these 41 branches were selected for the 1974 study. The data collected from the sample 41 branches represented 5% of total number of branches

and 40% of total turnover (Rs.5462 crores out of Rs.14,848 crores). There were 2050 branches of S.B.I. in 1984 with a total government turnover of Rs.69,022 crores. Out of these 302 branches were in the turnover group of Rs.50 crores and above accounting for 15% of the total number of branches of S.B.I. and 75% (Rs.51,000 crores) of the total government turnover handled by S.B.I. S.B.I. could collect data from only 122 branches in this turnover group of above Rs. 50 crores. The non-response of such a high degree would tend to distort the estimates, particularly when all the branches above Rs.50 crores are considered as one group.

- (v) An analysis of the composition of direct staff cost data for the branches indicated that it took into account payments of arrears to some of the staff in 1984. They have not made any correction for this element included in the cost estimates. An attempt was made to ascertain this element by looking into annual growth in the payment of salaries and wages including bonus, between 1980 to 1986. This is given in Table 'C' below:

TABLE 'C'

Year	Salaries & Allowances (Rs. in crores)	Rate of increase for the previous year
1974	113.81	
1980	272.17	15.64%
1981	315.30	15.80%
1982	352.94	12.10%
1983	406.51	15.60%
1984	532.00	31.00%
1985	656.12	23.30%
1986	700.84	6.70%

While long-term growth in salaries between 1974 and 1986 worked out at 16.36 per cent, the short-term growth over the period between 1983 and 1986 worked out to 19.9 per cent per annum. This leaves an excess of 11.1 per cent (31.0 - 19.9) over the normal index of wages and salaries including its annual increase of 19.9 per cent. The abnormal increase in cost is attributed to pay revision. The pay revision of workmen staff was made effective from July 1983 while that of officers from February 1984. Arrears to workmen staff were paid in 1984. (The amount relating to July 1983 to December 1983 worked out to Rs.17 crores. Total arrears of Rs.42 crores were paid for the period July 1983 to September 1984 for workmen staff). Arrears for officer staff for the period February 1984 to December 1984 were paid in 1985. As arrears relating to workmen staff for 1983 have actually been included in 1984, the salary cost of 1984 requires to be adjusted. Even when the arrears of Rs.17 crores are excluded from the salary cost of Rs.532 crores for 1984, the salary cost (Rs.515 crores) shows an increase of 26% over the previous year. There is, therefore, reassurable scope for reducing the salary cost by 9.3% (Rs.515 x 9.3%). It has, however, been argued by S.B.I. that the arrears relating to 1984 (11 months) paid to officer staff in 1985 have not been included in the salary cost of 1984. If this element is included it will offset the 'excess cost' on account of arrears paid to workmen staff. This argument may not be correct on account of the following:

- (i) Quantity of salary cost increase of officers and workmen staff may not be the same. The quantum of increase for officers and workmen staff was not furnished.
- (ii) The effect of salary cost increase for officer staff would have been normally provided for in the annual accounts. Thus the estimates of direct staff cost and the apportionment of other expenses made in the State Bank study needs to be scaled down by 9.3 per cent at the minimum.

- (iii) The share of branch overhead to Government work has been indicated as Rs.12.30 crores. The methodology followed in working out the overhead cost as also the element of cost included have not been indicated. Similarly an amount of Rs.9.12 crores has been apportioned to government work as pertaining to Controlling Office costs. While an amount of Rs.1.89 crores has been shown as directly attributable to government work, an amount of Rs.7.23 crores has been allocated as the share from the Local Head Office/Central Office cost of Rs.160 crores. There appears to exist an element of excess LHO/CO cost to government work.
- (iv) Further, there was a decline in the number of branches handling government work in 1984 (about 101 branches). The decrease in the number of branches should also affect the cost. This does not appear to be so. The State Bank of India method of computation of overhead expenses is not on the lines recommended by the Thakur Committee. It may be noted that in the Thakur Committee Report (paragraph 6.11) the Committee had recommended allocation of a reasonable portion of cost of other controlling departments at Central Office and Local Head Office ascertained through a method similar to that adopted for branch (i.e. direct staff cost method). In other words, the total overheads of the bank should first be apportioned to all the branches (6879 branches). The overhead cost attributable to the branches conducting government work (2424 branches) should be further apportioned between government and bank work in the ratio of direct staff cost method.

## CHAPTER III

### Studies undertaken in the Reserve Bank of India

3.1 DESACS (RBI) have attempted two independent studies, applying appropriate statistical techniques and models to arrive at the cost rate of conducting government business. They submitted two technical notes detailing their studies. These are :

- (i) Cost rate based on regression analysis and updated stratification of branches transacting government business. (Annexure III).
- (ii) Cost rate based on analysis of branch-wise cost of conducting government business as estimated by the State Bank of India. (Annexure IV).

### Methodology of Study No.1

3.2 The technique of regression method has been adopted in developed countries as early as in 1960 and 1965 to estimate cost of various activities of banks. The study by DESACS is an application thereof confining the activities to government and bank business. The regression technique of estimation of cost of conducting government business, adopted by DESACS uses models of branch cost, determined by aggregate output indicators of the two activities, viz. (i) government business and (ii) bank business, simultaneously for the whole year. The model utilised is of the form given below:

$$\begin{array}{rcl} C & = & C_1 \quad \quad \quad X \text{ (output indicator of} \\ \text{(Branch cost)} & & \text{government business)} \\ & & \text{(cost per unit} \\ & & \text{output of} \\ & & \text{govt. business)} \\ & + & C_2 \quad \quad \quad X \text{ (output indicator of} \\ & & \text{bank business)} \\ & & \text{(cost per unit} \\ & & \text{output of bank} \\ & & \text{business)} \\ & + & C_0 \\ & & \text{(other common cost)} \end{array}$$

The output indicators used were no. of vouchers generated in the whole year and corresponding amount of turnover for each of the activities.

The model gave an apportionment of average branch cost of a group into cost of conducting government business and bank business. The apportionment is given for the two activities for every Rs.100/- of branch cost, for each turnover group. For example, in the Government turnover group of Rs.25/- crores to Rs.50 crores, the cost and output apportionment for every Rs.100/- of cost given by the model was as shown in the table below :

TABLE 'A'

Output/Cost	Direct staff cost for		Other common cost at branch level	Total branch cost
	Govt. Business	Bank Business		
1	2	3	4	5
	Rs.	Rs.	Rs.	Rs.
1. Cost	18.10	78.50	3.40	100.00
2. No. of vouchers generated for Rs.100/- of branch cost	3.67	9.05	-	12.72
3. Cost per unit voucher	4.935 (C <sub>1</sub> )	8.671 (C <sub>2</sub> )	-	7.86 (C)

Sl-1 and 3 of the table are given directly by the model. The output parameters in Sl-2 are obtained by dividing elements in Sl-1 by elements of Sl-3.

If the average branch cost for the group of Rs.25 crores to Rs.50 crores turnover were Rs.16.2 lakhs and the average government turnover (per branch) Rs.37 crores, the estimate of average direct staff cost of conducting government business for the group would work out to Rs.(16.2 x 0.1810) lakhs or Rs.2.93 lakhs. The cost rate would work out to Rs.2.93 lakhs divided by Rs.37 crores i.e. 7.92 paise per rupees 100 of government turnover. If, other branch cost, common to both activities were apportioned in proportion to the direct staff cost for government business and bank business, the estimate of branch level cost of conducting government business, including common cost apportionment

would work out to Rs.3.03 lakhs. The cost so obtained divided by the amount of government turnover of Rs.37 crores would give the branch level cost rate of conducting government business at 8.2 paise per Rs.100/- of turnover. The result of the Regression Method would, according to DESACS, be more objective than that of the method adopted by State Bank of India wherein output measures are sampled in terms of value of human efforts on selected dates in one month of the year.

3.3 The data utilised in the above study are based on returns received from selected branches of State of Bank of India. A separate circular was issued by the State Bank of India to all the branches selected for their Study No.1 to furnish data to the Reserve Bank of India on (a) total branch cost including other expenses debited to charges account (b) the number of government transaction vouchers put through by the branch (c) number of other transaction vouchers put through by the branch (d) amount of turnover of government business and (e) amount of turnover of bank business (other than government). DESACS received completed returns from 410 branches out of 1181 branches addressed by State Bank of India. In addition, the data on aggregate establishment cost of the bank giving break-up of Local Head Office and Central Office costs and other expenses of the bank as a whole were obtained to work out 'overhead' cost.

3.4 DESACS classified the sample branches into ten size groups of government turnover for 1984, ranging from less than Rs.1 crore to greater than Rs.500 crores. The main difference between the stratification adopted by DESACS and that followed by State Bank of India is that the branches with turnover of Rs.50 crores and above have been treated as one group by State Bank of India while they have been classified into four groups viz. Rs.50 - Rs.100 crores, Rs.100 - Rs.200 crores, Rs.200 - Rs.500 crores and above Rs.500 crores in DESACS Study. The stratification thus adopted gave a sampling criteria of homogeneity condition within the group, as determined by the branch activities and costs following a cost-output relationship. The group average cost of conducting government work multiplied by total number of branches gave the total cost for the group. Sum of costs for all the groups gave the total cost of conducting government business as a whole. DESACS have arrived at a branch level aggregate cost of Rs.52.25 crores. This included common services cost

and other expenses accounted at branch level itself but does not include the Central Office and Local Head Office control costs. They obtained an estimate of government turnover of Rs.65,452 crores. The actual turnover of government business was Rs.69,022 crores. The estimate of government turnover arrived at by DESACS was thus close to the actual value in the range of 5 per cent on the lower side. The cost rate of 7.98 paise per Rs.100/- of government turnover was arrived at by taking the ratio of both the estimates of cost and turnover.

3.5 DESACS worked out the overhead expenses apportionment of Local Head Office and Central Office cost to the Government business at Rs.6.67 crores. The methodology adopted for arriving at this figure is as follows. For every Rs.100 of total expenditure by the State Bank in 1984, the share of branch office cost was Rs.66 and the share of Local Head Office and Central Office cost was Rs.34. This was loaded to branch office cost in direct proportion to their share i.e. 66 per cent. Thus the Local Head Office and Central Office cost loading to all branch office cost was  $Rs.34 \times 0.66$  or Rs.22.44. This cost was further apportioned to the branches transacting government business and bank business (other than Government business) in proportion to their numbers. There were 2424 branches transacting government business out of 6879 branches in 1984. Thus  $2424/6879$  of Rs.22.44 would be levied as overhead expense to branches transacting government business. This worked out to Rs.7.90. This overhead expense of branches transacting government business was further apportioned between the activities of branches in proportion to output indicator by which the branches are stratified. The proportion of government turnover to total turnover of branches transacting government business was estimated at about 12.22 per cent. This would give the overhead apportionment to government business as  $Rs.7.82 \times 0.1222$  or Rs.0.965 per Rs.100 of total bank expenditure for the year 1984. The total expense of the bank was around Rs.692 crores. The overhead expense apportionment to the government business was accordingly estimated at  $Rs.692 \times 0.965$  or Rs.6.67 crores.

#### Comments on DESACS Study No.1

- 3.6 1. The regression method used is objective and scientific. It does away with the subjective element of apportioning time spent on government work and bank work on the basis of information collected for a few days in a month.



2. The total branch cost is apportioned simultaneously into component costs of government business, bank business and other common costs of the branch, thereby accounting for total branch cost and providing consistency in the estimates.
3. Use of stratification of branches conducting government business in 1984, commensurate with the size of business evolved upto the current period, makes the grouping relevant to current activities of the branches. It minimises the effect of non-response error in the estimates of group averages.
4. The branches which are mis-classified in a turnover group in terms of higher cost branches, could constitute a separate group. A high cost branch would be of large size, transacting bank business at larger scale and government business at relatively lower scale. Regression techniques adopted for this group could provide closer estimates of cost of government business.
5. The sampling criterion adopted for selection of branches by this process provides closer estimates of the true value of government turnover. The estimated government turnover was close within 5 per cent limit from the true value.
6. The methodology adopted for estimation of overhead expense appears to be simple and logical. It could be improved to be more general.
7. The regression method, though scientific, is not easily understood by the banking and administration personnel. It could be used with advantage for cross checking the results obtained through other methods.

#### **DESACS Study No. 2**

#### **Cost rate based on analysis of branch-wise data of cost of conducting Government Business estimated by SBI**

3.7 DESACS analysed the branch-wise data of conducting Government business collected and supplied by State Bank of India. They distributed the

branches selected by State Bank of India into 10 size classes of Government turnover in 1984. The sampling design for selection of branches from various groups adopted was similar to the one adopted in their study. In this approach the branch data in a group was examined for conformity or otherwise to two standard deviation limits from the average (per branch) cost or cost rate for the conduct of Government business estimated using CGB returns. In this process the branch data with large possible errors in the method of time apportionment of cost and/or branch cost itself was identified. Branches with higher than normal range of cost thus get excluded from the sample for the purpose of estimation of average cost. Such branches do not conform to homogeneity conditions of the group and if included could lead to unknown bias in the estimates. The estimate of group average cost of conducting government business was thus obtained from those branches which satisfied the condition of homogeneity stated above. In this process group-wise total cost of conducting government business for all branches within the group including those, whose data did not satisfy the homogeneity condition was obtained. In this analysis actual amount of Government turnover in the groups was used to work out the cost rate for each of the groups, following the approach adopted by the State Bank of India for the purpose of comparison. The total cost of government business obtained by this modified sampling design and use of branchwise data of cost of conducting government business at branch level was obtained at Rs.51.1 crores. It was close to the one obtained by the DESACS using regression method and one obtained by (the MSD) SBI themselves.

### **Comments on DESACS analysis**

3.8 Analysis of the data indicated that high cost branches were distributed in different government turnover groups. Such branches could be grouped separately to represent a homogeneous group of branches which were transacting government business and/or bank business at large scale. Distribution of such branches in the government turnover groups may unduly inflate the estimates of average cost in the groups and hence affect the estimates of total cost. Such branches were more manifest in higher turnover groups. In these branches generally the branch cost was 200 per cent higher than the average cost of other branches. In the table given below, number, average branch costs for large and normal branches, and their ratios are given for the five higher turnover groups.

TABLE 'B'

Govt. turnover group (Rs. crores)	No. of sample branches	Average branch cost of large branches (Rs. in lakhs)	Average branch cost of normal branches (Rs. in lakhs)	Total No. of branches	Ratio of (3)/(4)
(1)	(2)	(3)	(4)	(5)	(6)
1. 500	2	182.63	60.78	13	3.00
2. 200 - 500	3	120.94	55.49	43	2.18
3. 100 - 200	6	80.08	32.39	86	2.47
4. 50 - 100	7	70.35	34.52	143	3.03
5. 25 - 50	7	57.18	16.20	191	3.53
All group Total	25	84.05	31.15	476	2.70

It would be seen that these 25 branches in the higher turnover group have an average branch cost which is 2.70 times the average cost of all the normal branches in the five groups. The average of Rs.8405 thousands is even higher than the average of the normal branches in the highest turnover group. These branches could, therefore, form a separate group. If this arrangement was resorted to and corresponding reduction in total number of branches in each of the groups made, the exercise could give the aggregate cost of conducting the analysis. This shows the need and importance of homogeneous grouping of branches by criteria other than government turnover. The gain in this method of analysis has been of the order of 3 per cent. The figure of Rs.52.67 crores is closer to Rs.52.25 crores obtained by the regression approach.

## CHAPTER IV

### **Cost of maintenance of Currency Chests**

4.1 In terms of the agreement between the Reserve Bank of India and the State Bank of India, the latter maintains Currency Chests of RBI and small coin Depots of Government of India at such of its branches as are approved by RBI. The Currency Chest branches are generally entrusted with agency functions such as provision of remittance and exchange functions, government transactions etc. The agency bank is free to deposit surplus notes and rupee coins into the Currency Chest and Small Coins into the Small Coin Depots and withdraw funds therefrom to meet its cash requirements. Payment is made by agency bank to Reserve Bank for any withdrawal of funds from currency chests and agency bank is reimbursed by Reserve Bank of India for any surplus cash deposited by it into the Currency Chest. Operations on the Currency Chests are advised daily by agency bank's branches to the respective Link offices for financial settlement with Reserve Bank. The Link offices of agency banks are situated at the State Capitals where Reserve Bank also has an office. Operations on the currency chests are effected by agency banks not only to meet agency transactions but also for meeting the agency bank's own need for funds or deposit of surplus funds on account of commercial business. In the case of Associate banks also similar arrangements exist. The agreement, however, is executed by SBI even on behalf of its Associate banks. State Bank of India and its Associate Banks were being reimbursed actual expenditure incurred by them in remitting currency to Reserve Bank of India/Mints etc. The expenditure covered such items as Pay and allowances of Potdars accompanying the remittance, Railways and Steamer fares of Potdars, Police and escort charges, Insurance, Freight, Cartage and Mazdoor hire on remittance boxes, telegram charges etc. The Thakur Committee, which studied the cost benefit aspects of currency chests observed that the following advantages accrued to the banks maintaining Currency Chests viz.

- (a) Unrestricted facility of drawing upon Currency Chest balances to meet the bank's cash requirements all the time not only for performing agency functions such as payments on Government Account, Payment of drafts, etc. but also for performing its own normal commercial banking functions.

- (b) Elimination of the need for frequent physical remittances of cash from centre to centre, thereby saving the remittance costs besides avoiding transit etc. risks.
- (c) Facility of transfer of funds from one currency chest centre to another without physical movement of cash.
- (d) Capacity to work with fine cash balance, Surplus Cash balance can be deposited into currency chest and this will enable the bank to employ gainfully the funds which would have been idle otherwise.

The benefits accruing from maintaining currency chest will be evident from the fact that bank branches without a currency chest are generally required to maintain a cash balance ranging from 1 to 2% of their deposit liabilities. As against such branches, bank branches having a currency chest can manage without any significant till balances. Thus the funds which otherwise would be locked up as till or cash balance can be put to use and earn interest.

The deposit liabilities of banks in the public sector exceed Rs.1,00,000 crores. About 1 to 2% of the bank's deposit liabilities are locked up as till balances. In an ideal situation where all the major branches are allowed to maintain a currency chest not less than Rs.500-700 crores of idle funds can be put to profitable use. In the specific case of State Bank of India group which maintains about 2600 currency chests on a rough estimate, it is quite possible that State Bank of India is able to employ daily a sum of about Rs.200 crores, which in the absence of currency chests they would be required to maintain as cash/till balances.

4.2 In consideration of the benefits stated above the banks were obliged to provide at their cost the following viz.

- (a) adequate strongroom facility;
- (b) adequate security to guard the treasure all the time;
- (c) staff and other infrastructure for receipt and examination of remittance.

The Thakur Committee came to the conclusion that benefits accruing to the banks maintaining currency chests far exceeded the cost on account of these obligation. The Thakur Committee, therefore, recommended discontinuance of reimbursement of expenditure incurred by agency banks barring the item of railway fares of police escorts and railway freight on the Treasure/Treasure boxes. The reimbursement of expenditure on remittance of Treasure except to the extent stated above was discontinued with effect from 1st July 1976.

4.3 The Currency chests held by State Bank of India and other banks in 1973, 1985 and 1987 (December) were as under :

	No. of Currency Chests		
	1973	1985	1987
State Bank of India and Associate Banks	2084	2577	2661
Nationalised Banks	20	480	577

The operations on the currency chests and their accounting are independent of the operations in Government Account. The cost of maintenance of currency chests and operations thereof do not have any direct bearing on the cost of conducting government work. Even in the absence of currency chest or small coin Depot, the bank will still require a vault or strong room to store its cash and make necessary security arrangements etc. The branch maintaining currency chest will have to bring about some refinements in this regard. However, as stated earlier the benefits accruing from maintenance of currency chests and small coin depots adequately compensate the cost incurred by banks.

4.4 The following items of expenditure are incurred by agency banks in connection with the receipt and despatch of currency chest remittances. These expenses were not being reimbursed by Reserve Bank. State Bank of India and Associate Banks time and again requested reconsideration of the decision of Reserve Bank.

- (i) Expenditure (Transportation and Mazdoor Charges) incurred by banks in sending remittances by road.

- (ii) Transportation of remittances by road between chest and nearest railway station, where the chest is located far away from the railway station.
- (iii) Mazdoor Charges, in handling the treasure boxes at the time of receipt/despatch of remittance.
- (iv) Remittances between chests arranged by Reserve Bank of India.

4.5 In 1984 the position was reviewed and RBI agreed to reimburse, as a special case charges incurred by agency banks in transporting by road currency chest remittances in the NE Region subject to the condition that the actual transportation charges do not exceed the charges that would be payable if they were transported in police van/State transport. In 1987 RBI further agreed to reimburse cost of transportation of currency chest remittances in the other parts of the country in similar manner, in case these have been ordered or approved post facto, by the concerned currency <sup>chest</sup> chest. In addition reasonable cost in respect of wooden boxes purchased by the currency chest branches for sending currency chest remittances is also reimbursed.

4.6 In the recent years mazdoor charges have also gone up. The agency banks are also making use of improved communication system like telexes, etc. for reporting currency chest transactions for enabling RBI to make opposite transfers and settling the accounts. Lately, on security considerations the agency banks are required to take a number of steps for improving guarding arrangements and physical barrier to currency chest strong rooms. The agency banks have been expressing concern that if the measures for improving security as desired by Government have to be implemented their profitability on account of maintenance of currency chests will not be the same as before. It is the view of SBI and Associate banks (as well as the nationalised banks) that the RBI or State Government or Central Government should bear the additional expenditure in this regard without which it will not be possible for the banks to bear the burden. In the changed context RBI feels that a fresh cost benefit analysis of currency chest maintenance by the agency banks be made and some fresh norms for reimbursing expenditure worked out.

#### **Reserve Bank of India Remittance Facilities Scheme**

4.7 An integrated remittance facilities scheme known as 'Reserve Bank of India Remittance Facilities Scheme' was brought into effect from 1st October 1940 to facilitate transfer of funds between different centres in the country expeditiously and at minimum cost. The scheme is being administered through the Bank's offices, agencies and treasuries and sub-treasuries having custody of permanent currency chests.

4.8 The cost of operation of the scheme depends on (a) the magnitude of transactions, (b) lock up of funds, (c) expenditure incurred on printing stationery and establishment charges.

4.9 The Thakur Committee also made a cost-benefit study of the scheme and expressed the opinion that the cost and benefit of maintaining currency chests, those of remittances and exchange work vis-a-vis the funds cost and yield would practically offset each other and that no payment need therefore pass between the two banks. Accordingly, out of pocket expenses, commission paid on the remittances by Reserve Bank of India and recovery of commission in respect of inter-state remittances of State Bank of India stand discontinued. State Bank of India have submitted that consequent on increase in establishment cost, the cost of handling remittances under Reserve Bank of India Scheme has gone up. The bank should be paid out of pocket expenses.

4.10 The Remittance Facilities Scheme does not have a direct bearing on the cost of conducting government business. Inclusion of the element of cost on account of cost of handling remittances under Reserve Bank of India Remittances Facilities Scheme transactions are conducted by agency banks having currency chests so that funds required by them can be withdrawn from the currency chests or funds received under the scheme are deposited into the currency chests. The working of Remittance Facilities Scheme was recently reviewed and it was decided to withdraw the remittance facilities available to general public under the scheme from 1st March 1986. Considering the benefits accruing to the agencies due to maintenance of currency chests, which enable them to issue remittance to the public under their own scheme at



commercial rates while continuing to avail themselves of the chest facilities for cash management, there appears to be no case for payment of any commission/out of pocket expenses to agency banks for conducting Reserve Bank of India Remittance Facilities Scheme transactions.

## CHAPTER V

### Review of various estimates and cost rates arrived at by SBI and DESACS (RBI)

5.1 The agency agreement entered into by RBI with the respective public sector banks provides for payment of turnover commission to agency banks for conducting Government business. The rate at which the remuneration is to be paid is required to be reviewed every five years.

5.2 The previous Committee organised a cost study based on representative sample of branches conducting Government business and after a detailed analysis of all aspects relating to the cost of conducting Government business, recommended a rate of 9.25 paise per Rs.100 of Government turnover valid for the period 1973-78. The basic rate so recommended was to be subjected to annual adjustment for variation in amount per voucher and cost. The Committee also suggested review of the rate on a quinquennial basis and maintenance of suitable records at branches/Local Head Offices for collection of data for such reviews. The rate was revised to 9.80 paise and made applicable for the period 1979-83 by mutual discussions between RBI and SBI.

5.3 The Committee presently looking into the cost of conducting Government business has had the benefit of 4 cost study reports two each submitted by SBI and RBI. The salient features of these four cost studies are discussed below.

#### **SBI Cost Study No.I**

5.4.1 The SBI carried out a study of the cost of conducting Government business with reference to the base year 1983 on the lines of Thakur Committee formula. The Thakur Committee in its report (Para 6.30) recommended that the sample branches selected for study should cover -

- (i) at least 50% of the branches conducting Government business;
- (ii) 60% of the total cost of conducting Government business; and
- (iii) 75% of Government turnover.

5.4.2 SBI selected a representative sample of 1112 branches out of 2050 branches conducting Government business. However, SBI could use the data in respect of 550 sample branches only. It estimated the branch level costs at Rs.66.65 crores and after loading Head Office/Central Office costs (at Rs.9.12 crores) and Bonus (Rs.2.52 crores) arrived at 11.35 paise per cent as overall cost of conducting business, using their actual turnover figure of Rs.69,022 crores instead of its own estimated turnover of Rs.79,813 crores. There was a deviation from the accepted statistical principle in so far as the estimated cost data was compared to actual (turnover) data.

5.4.3 On an analysis of the report of SBI, it was observed that the overall cost rate arrived at by SBI was inflated to a certain extent. The study did not conform to the triple criteria laid down by Thakur Committee and it was also deficient in several other respects. As such the rate could not be recommended for acceptance as the standard cost.

5.4.4 The deficiencies are briefly as under :

- (i) Out of 2050 branches conducting Government business, SBI used data of 550 branches only i.e., 26.8% as against 50% of branches as per Thakur Committee. SBI should have used data of 1112 branches or at least of 1025 branches.
- (ii) Cost of 550 selected sample branches taken up for analysis works out to Rs.19.3 crores as against total estimated cost of Rs.66.5 crores of 2050 branches. Thus the cost coverage of 550 branches is 30% as against 60% of total cost stipulated by Thakur Committee.
- (iii) The Government turnover of the 550 branches was Rs.32,000 crores which is about 46% of the total turnover of Rs.69,022 crores. The study should have covered 75% Government turnover, as suggested by Thakur Committee.
- (iv) SBI, for purpose of study, stratified the sample branches into 6 turnover groups; it has not, however, collected and furnished group-wise direct staff cost as well as total branch overheads.

- (v) Classifying the branches into six turnover groups according to the size of Government turnover should be in homogeneous groups. The Government turnover in 1984 was higher by 4.65 times (Rs.69,022 crores) as compared to 1974 (Rs.14,848 crores). The distribution of branches into various turnover groups according to the volume in 1984 would not, therefore, be the same as in 1974. The branches having a turnover of Rs.1 crore in 1974 would be generating a turnover of almost Rs.5 crores in 1984. Similar is the case with other groups. Thus selection of branches in terms of 1974 stratification would give rise to non-representative character to the sample list for 1984. According to Thakur Committee, branches have to be stratified according to size of turnover to constitute homogeneous groups. Accordingly, the turnover groups of Rs.50/- crores and above taken by SBI in 1984 do not constitute a homogeneous group as may be seen from the data shown in the following table.

Size or class of turnover group (Rs.)	No. of branches		Cost rate paise per Rs.100/-
	Total	Sample	
50 - 100 crores	149	46	8.57
100 - 200 crores	92	42	4.56
200 - 500 crores	46	24	3.16
500 and above	15	10	1.34
	<u>302</u>	<u>122</u>	

It would be seen that the distribution of sample branches as given by the number in each of the groups is not proportionate to the total number of branches in each group.

- (vi) SBI has arrived at a cost rate of 11.35 paise per cent by dividing **estimated** branch level cost of Rs.78.29 crores by **actual** Government turnover (Rs.69,022 crores) instead of using estimated figures in both cases. SBI should have used **both** estimated costs and estimated turnover and in that case it would have obtained a cost rate of 9.80 paise per cent and not 11.35 paise as claimed by them.

- (vii) Out of 2050 branches with total turnover of Rs.69,022 crores, 302 branches in turnover group of 50 crores and above as per the above table account for 15% to total branches of State Bank of India. In this group, the SBI has used data of 122 branches which constitutes 22% of the total branches (550) considered for study. Thus, the SBI has used a relatively larger number of branches in lower turnover groups (total 550 branches - 122 branches) resulting in a higher cost rate.
- (viii) The long term growth in salaries between 1974 and 1986 worked out to 16.36% and the short term growth between 1983 and 1986 worked out to 19.9%. As against this, the increase in salaries in 1984 over 1983 was of the order of 31 per cent. This abnormal increase may be attributed to pay revision in 1983-84 and payment of arrears to staff. The salary cost in 1984 is, therefore, required to be adjusted on the basis of annual average income between 1983-86 (19.9%) and actual increase including arrears (31.0 per cent). Therefore, the estimated direct staff cost by SBI study needs to be scaled down by  $\frac{31.0 - 19.9}{119.9} \times 100 = 9.3\%$
- (ix) There is an element of excess loading of Local Head Office Central Office cost to Government work. The Government work involved merely receipts and payments on Government account at branch level and submission of prescribed information relating thereto. As regards controlling office e.g. Regional Office/Head Office, the work that devolves is minimal and is mostly confined to routing the circulars/instructions issued by Reserve Bank and transfer of funds or obtaining reimbursement from the Reserve Bank. The work for a controlling office is not thus one involving elaborate decision-making and has no relevance to bank's own normal work and as such, the controlling office costs cannot be apportioned in the same proportion as in the case of bank's normal work.

### **SBI Cost Study No.II**

5.5 SBI, Management Science Department undertakes annually a study to ascertain in a rough and ready method the cost of conducting various banking services including Government business. The results of the study for 1984 and the cost arrived at were furnished to the Reserve Bank Management Services Department by the Management Science Department of SBI for purposes of compiling data on cost of conducting various activities by commercial banks. The SBI furnished overall branch costs, controlling office costs, etc. aggregating Rs.51.03 crores, and arrived at a rate of 8.2 paise per cent for conducting Government business based on a turnover of Rs.75,000 crores. The study did not give separately the branch direct staff cost, branch overheads, etc. SBI is not accepting this study for purpose of comparison with the results of their quinquennial study stating that it is only a rough study and does not take into account several other relevant costs.

### **Studies undertaken by RBI, DESACS**

5.6 DESACS, RBI attempted two independent studies for the benefit of the Committee applying appropriate statistical norms to arrive at the cost rate of conducting Government business. They submitted two technical notes detailing their studies.

- (i) Cost rate based on regression analysis and updated stratification of branches transacting Government business and
- (ii) Cost rate based on analysis of branch-wise cost of conducting Government business as estimated by SBI.

### **RBI, DESACS Study I**

5.7 By using regression analysis method DESACS have arrived at the total cost at Rs.58.92 crores including branch costs and overheads (Rs.52.25 crores branch cost plus controlling office costs at Rs.6.67 crores) as against SBI's estimate of Rs.75.50 crores. DESACS has arrived at an overall cost rate of 8.54 paise per cent on a total turnover of Rs.69,022 crores. DESACS obtained data from SBI branches through a special circular. Out of 2043 branches doing Government business, the number of branches used for sample study was 312. The method is not acceptable to SBI.

## **RBI DESACS Study II**

5.8 DESACS, RBI, made a detailed and critical examination of the SBI study which listed the following methodological problems responsible for the higher estimate:

- (i) Staff costs were higher by about 15% on account of arrears payment made during the year 1984.
- (ii) Method of estimation of total cost using the six classes of Government turnover, with over Rs.50 crores as one group, has introduced an error of over-estimation in the cost estimate by about 5 to 6 per cent of the conduct of Government business.
- (iii) The method of computing controlling office cost is not rational. One important short-coming in SBI approach is that it does not adjust for the share of the Local Head Office/Central Offices' cost for their own maintenance cost.
- (iv) Bonus payment constitutes an element of profit and has been excluded from payment of compensation even by Thakur Committee.

In order to correct the above methodological deficiencies, RBI (DESACS) reclassified the sample branches of SBI into ten homogeneous classes and derived a total cost at Rs.57.77 crores and an overall rate of 8.37 paise on a turnover of Rs.69,022 crores.

## **Concluding Observations and Recommendations**

5.9 The rates of commission payable for the quinquennium 1983-88 as worked out by SBI differed widely from the rates derived by RBI. While RBI viewed that the arrears paid to workmen staff for the period 1983-84 should be excluded from the establishment cost for 1984. SBI claimed that the establishment cost for 1984 should be adjusted to include the salary increase effected from February 1984 to the officer staff, which was actually paid and accounted for in 1985. Similarly, the turnover handled by SBI as worked out by RBI differed from the figure furnished by SBI. A series of meetings were held between the officials of RBI and SBI in order to resolve the differences and there was agreement on the following points :

- (a) The total Government turnover handled by SBI during 1984 may be taken as Rs.72,827 crores. The total turnover includes not only Government transactions on which commission at 100% of the rate has been paid but also proportionate amount of transactions on which commission at 75% of the rate has been paid.
- (b) The branch level staff and overhead cost and controlling offices cost as worked out by SBI have been accepted since the bank has categorically claimed that these have actually been incurred and are as per their records.
- (c) The bonus element is not to be included in the cost of conducting Government business. The Thakur Committee, which determined the rates of remuneration for conducting Government business by SBI for the period 1973-78 had opined that profit was not a part of remuneration payable to staff for conduct of agency business and it therefore did not take into account the bonus element while determining the remuneration (para 6.22 of the Thakur Committee Report). Moreover it is accepted in all quarters that Government work will be conducted by banks at cost i.e. on no profit basis. The bonus amount included by SBI has accordingly been excluded from the cost of conducting Government business. The total cost of conducting Government business would thus work out as under :

Total cost of conducting Government business after excluding bonus element	Rs. 75.78 crores
Total Government turnover handled by SBI in 1984	Rs. 72,827 crores
Rate of remuneration	10.40 paise per Rs.100/- of turnover

5.10 Accordingly the Committee recommends that the remuneration for conducting Government business by all banks for the period 1984 to 1988 may be paid at the rate of 10.40 paise per Rs.100/- of Government turnover. The Committee further recommends that this rate may also be made applicable for the year 1989 since basic data for the year 1989 would not be available with banks in the manner envisaged under the Thakur Committee formula.



5.11 Associate Banks of SBI are being paid different rates of Commission on the basis of cost study made on the lines of the Thakur Committee formula. The nationalised banks which also handle government work are however being paid remuneration for handling government business at the rate applicable to SBI. The question of fixing an uniform rate of commission for all banks was discussed at length in the meeting of the Committee. The handling of government work is also a service to the members of public and Government. The charges for the services so rendered by banks are paid by Reserve Bank. The charges payable to banks for handling government work should also be uniform as in the case of charges recovered by banks for various other services a few of which are enumerated below.

- (a) Interest on Deposit/Advances: There is uniformity in the rate of interest payable/recoverable by banks on the deposits/advances.
- (b) Exchange/Commission on Foreign Exchange transactions. The amount of exchange/commission charged by banks on the foreign exchange transactions is governed by FEDAI Rules and there is uniformity in the rate of such charges recovered by banks.
- (c) Commission on Remittance transactions: The banks were charging commission on the remittance at different rates. This anomalous position has since been rectified. The banks now charge commission on the remittances at the rates charged by State Bank of India.
- (d) Various service charges: Various other services such as safe custody of articles, collection of outstation cheques etc. are also rendered by banks. The charges recovered for these services differed from bank to bank till recently. The banks now charge uniform rate for the various services rendered by them.
- (e) Cost of handling similar type of government transactions should be same for all banks. Cost could however vary according to the volume of transactions. The cost of handling a lower turnover may be more than the cost involved in handling a high turnover. The average cost of handling Govt. work should be such as to cover the cost of low turnover branches and high turnover branches. The cost study undertaken by SBI, which has been the basis for determining the rate of remuneration by the Committee, gave greater weightage to the lower turnover group. About 68%

of the branches from the total sample branches from whom data was collected, fall in the lower turnover group (Rs.1 crore to Rs.25 crores). The average cost of handling government work arrived at by the study gives a greater representation to the lower turnover groups.

- (f) The banks have to furnish to RBI daily/monthly branch-wise receipt and payment transactions effected by them on behalf of Govt. SBI continues to compile and furnish such statements. In the case of Associate banks of SBI and nationalised banks the work of compilation of daily/monthly statements relating to Central Government (including CBDT/CBEC/DM, Railway, P & T and Defence) transactions is attended to by CAS, Nagpur on their computer. The overhead cost on account of such backup department is less for Associate and nationalised banks. However, the cost data used by SBI for determining the rate of remuneration does not exclude this element of cost and hence it is advantageous to Associate banks of SBI and nationalised banks.
- (g) The volume of Government work handled by Associate banks of State Bank of India and nationalised banks has considerably increased due to more and more government work being entrusted to them. Considering all these aspects, it is recommended that the charges payable for handling government work, which is similar to any other service rendered by banks, should be uniform. Accordingly, it is recommended that the rate of remuneration of 10.40 paise per Rs.100/- of turnover applicable to SBI should be made applicable to Associate banks of SBI and nationalised banks.

5.12 There has been, in the recent past, a number of changes in the reporting, accounting and reconciliation of Government transactions such as Central Board of Direct Taxes, Departmentalised Ministries' transactions etc. These changes would affect the cost of handling Government work. It will, therefore, be necessary to collect the cost data for 1989-90 from the selected branches of banks. It is recommended that a small technical group consisting of officials of RBI, SBI and a few other public sector banks, may be constituted to lay down the sampling design, information to be collected from sample branches, procedure to be followed for collection of data etc. so that the study could be made on sound basis.

**Cost of maintenance of Currency Chests and reimbursement of charges towards remittance of treasure :**

5.13 The operations on the Currency Chests and their accounting are independent of the operations in Government Account. The cost of maintenance of currency chests and operations thereof do not have any direct bearing on the cost of conducting government work. The benefits accruing to the banks from the maintenance of currency chests and small coin depots more or less compensate the cost incurred by banks. The cost of conducting government work does not include the element of cost of maintenance of currency chests. It is recommended that a separate detailed study about the cost of maintenance of currency chests, the benefits accruing to the banks etc. may be undertaken by the Bank.

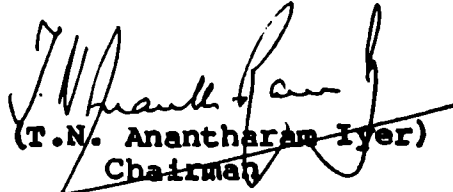
It is recommended that the costs incurred by agency banks in transporting remittances by road, where the places are not connected by train or where the Chest is located far away from the Railway Station may be reimbursed by the Bank to the extent of what Police Van/State Transport would have cost if the remittance has been transported in Police Van/State Transport between the places. If the Currency Chest and Railway Station are located within city/town/village limits transportation charges by road should be borne by the agency banks. Mazdoor charges for handling treasure boxes which form part of the maintenance cost of currency chests should be borne by agency banks.


**RBI Remittance Facilities Scheme**


5.14 The issue and encashment of remittances under RBI Remittance Facilities Scheme are entrusted to those agency bank branches which are maintaining Currency Chests to facilitate transfer of funds remitted/received under the Scheme. The Remittance Facilities Scheme does not have a direct bearing on the cost of conducting government business and therefore inclusion of the element of cost of handling remittances under RBI Remittance Facilities Scheme does not arise. Considering the recent changes made in the RBI Remittance Facilities Scheme, which enable banks to issue remittances to members of public under their own scheme at commercial rates as also the benefits accruing to the banks from the maintenance of currency chests it is recommended that no commission or out of pocket expenses be paid to agency banks for conducting RBI Remittance Facilities Scheme transactions.

**Rationalisation of Government Schemes**


5.15 At present the pension payments and receipts and payments under Special Deposit Scheme made by banks are reported to State Bank of India or Reserve Bank of India, which acts as focal point bank, as the case may be, for the purpose of reimbursement/accounting. Therefore, the banks handling these transactions do not receive full commission. The Committee recommends that the procedure for reporting and accounting of the above transactions may be revised on the lines of procedure followed for accounting of Central Board of Direct Taxes and Central Board of Excise and Customs transactions.

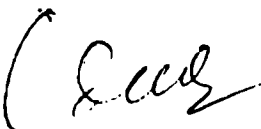
  
(T.N. Anantharam Iyer)  
Chairman  
27.10.88


  
(R. Sinha)  
Member

  
(K.G. Patkar)  
Member


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Member

  
(S. Srinivasan)  
Member

  
(K.L. Dua)  
Member

  
(C.S. Ramachandran)  
Member

  
(P.T. Kuppaswamy)  
Member

  
(B.A. Patil)  
Member-Secretary

**SBI COST OF CONDUCTING GOVERNMENT BUSINESS****Quinquennial Study 1984 - 1988****Background of the Study**

1. The Committee for Determining the Cost of Conducting Government Business (hereinafter called 'Committee') under the Chairmanship of Shri Rameshwar Thakur had recommended in their Report dated the 30th August 1975 that every fifth year beginning from 1978, a review should be undertaken to estimate the cost rate for conducting government business. We had, accordingly, conducted a study for the quinquennium 1978 to 1983 and a copy of our note was sent to Reserve Bank of India. On the basis of our findings a mutually agreed rate was fixed by Reserve Bank of India for the entire quinquennium. We have now undertaken a similar study for the quinquennium 1984 to 1988 and accordingly we had collected data for the months of August 1983 and March/April 1984. The findings of the study are given below.

**Methodology**

2.1 The broad methodology for conducting the above study has been, more or less, suggested by the Committee in their Report. As per the recommendation contained in paragraph 6.30 of the Report, the sample of branches from which data should be collected for the quinquennial survey, should be such as will cover at least :

- a) fifty per cent of the branches conducting government business,
- b) sixty per cent of the total cost of conducting government business, and
- c) seventy five per cent of government business turnover.

Accordingly, out of the 2150 branches handling government business, 1112 branches were selected, as they satisfied all the above requirements.

2.2 As per paragraphs 3.4 and 6.30 of the Thakur Committee Report, the branches were grouped according to the volume of government business,

regardless of the corresponding turnover of Bank business or the volume of shroffing activity. The groups are as follows :

- i) Government turnover below Rs.1 crore per annum,
- ii) Government turnover between Rs.1 and Rs.3 crores per annum,
- iii) Government turnover between Rs.3 crores and Rs.10 crores per annum,
- iv) Government turnover between Rs.10 crores and Rs.25 crores per annum,
- v) Government turnover between Rs.25 crores and Rs.50 crores per annum,
- vi) Government turnover above Rs.50 crores per annum.

The distribution of total branches among the above groups, sample branches selected and the number of branches included in the final tabulation are indicated in the table below :

TABLE 1

Turnover	Total branches as at the end of 1983	Total branches as at the end of 1984	Sample branches selected Base:1983	No. of branches included in the final tabulation
Below Rs.1 crore	687	448	342	72
Rs.1 crore to Rs.3 crores	229	215	115	66
Rs.3 crores to Rs.10 crores	525	542	258	140
Rs.10 crores to Rs.25 crores	297	344	135	97
Rs.25 crores to Rs.50 crores	162	198	77	53
Above Rs.50 crores	250	302	185	122
TOTAL	2150	2049	1112	550

2.3 The total number of branches handling government business as at the end of 1983 was 2150, whereas it was 2049 as at the end of 1984 (the year of the study). For the purpose of sampling, the branchwise turnover data available with the Computer Centre at the material time was for the year ended 1983, when the number of branches handling government business was 2150.

2.4 On the basis of the sampled data, the total government turnover has been estimated by taking the total number of branches for 1984. The results on this basis are enumerated in the following paragraphs.

2.5 Data from the sampled branches were collected on returns (called CGB returns), more or less, similar to those used by the Thakur Committee. CGB Returns 1, 2, 11 and 12 are enclosed at Annexure I. For control costs at the Regional Offices, Local Head Offices and Central Office, we have used, as was done in our earlier quinquennial survey, our Cost Analysis of Bank's Services' returns, instead of CGB returns 6, 7 and 8 used by the Committee. However, the above returns are almost the same excepting that they are more elaborate because of bifurcation of previously existing departments and creation of new departments, during the period of one decade i.e. 1973 to 1983. Specimens of these returns are enclosed at Annexure 2.

#### **Processing of data collected from Branches**

2.6 The data was processed as per the recommended methodology outlined in Annexures G and H (Recommendation NO.6.31 of the Thakur Committee Report). The necessary computer programs were developed by a Computer Agency, a Bombay based firm, hired by our Bank and the data were analysed as per the steps prescribed in Statements A and B of Annexure G of the Committee's Report.

#### **Analysis**

3.1 The Committee had recommended three methods for allocating the common services staff cost at the branches to the following three items of work:

- i) exclusively engaged in government work;
- ii) exclusively engaged in Bank work;

- iii) exclusively engaged in shroffing of notes, accepting cash from other banks and providing exchange facilities.

(Steps 9, 10 and 11 of Annexure 'G' - Statement 'A' of the Report).

These methods would differ only in allocating the common services costs but the final rates would not vary very much. However, the Committee has not recommended any one method for fixing the rate at which commission has to be charged. We have, therefore, estimated the cost of servicing of government business on the basis of all the three methods.

3.2 By taking the data from the sample branches, the total government turnover for the year 1984 is estimated at Rs.79,812.75 crores. However, the actual turnover on the basis of settlement between RBI and SBI was of the order of Rs.69,022.47 crores. The estimation of the government business turnover in each group is given in the following table :

TABLE 2

Estimated and Actual Government Business  
Turnover in each Group

(Amount Rs. in Crores)

Group	Estimated government turnover	Actual government turnover	Percentage variation
I	145.28	127.08	14.32
II	440.04	433.15	1.59
III	3108.38	3189.90	- 2.56
IV	5245.85	5483.00	- 4.33
V	7179.15	7068.69	1.56
VI	63694.05	52720.65	20.81
TOTAL	79812.75	69022.47	15.63



The reasons for the large variation in the estimation of government business turnover especially in the sixth group are as follows :

- (i) Only 122 out of 302 branches have submitted the data. Since the group limits are unbounded (i.e. more than Rs.50 crores and above), the average amount per branch can vary to any amount and hence the high variation (20.81%). The same has happened in the first group, where the limits again are unbounded. Here also the variation between the actual and estimated turnover is about 14.32%. In other words, if the receipt of the sample branches is good, the estimation of the total turnover would have been very near to the actual data.
- (ii) Some branches where the transactions relating to revenue account of CBEC/CBDT are routed will have to report through the focal point branches for the purpose of settlement. Since both the focal point branches as well as the other branches have been selected in the sample, turnover data would have been duplicated to a certain extent, thereby resulting in a certain degree of over-estimation. We are unable to ascertain the extent of duplication.
- (iii) Some stray cases of settlement of transactions which were handled by the branches with GAS/GALO would not take place in the relevant calendar year and not come in the actual turnover but will be reported in the questionnaires by the branches.
- (iv) Some of UMALO accounts of various ministries were not allotted to our Bank whereas those banks may report through our focal point branch and in that case there will be a possibility of reporting the turnover by our selected branches although it may not reflect in the actual turnover.

3.3 On the basis of the methodology mentioned in Annexure G along with Statement A of the Report, the actual total government turnover, vouchers, amount per voucher, direct staff cost, total cost, cost per voucher and cost per Rs.100/- of turnover are given in Table 3.

TABLE 3

Sr. No.	Item	Unit	Estimated data for the year 1978	Method		
				1	2	3
				(for the year 1984)		
1.	No. of branches	Number	1250	2049	2049	2049
2.	Actual Govt. business turnover	Rs. in Crores	30733	69022	69022	69022
3.	Govt. vouchers	No. in '000	71130	87164	87164	87164
4.	Amount per voucher	Rs.	3523	7919	7919	7919
5.	Direct Staff Cost (including common services)	Rs. in '000	181886	545145	544337	543938
6.	Total Cost	Rs. in '000	236810	665698	664749	666540
7.	Cost per Rs.100/- of turnover	Paise	9.45	9.64	9.63	9.66
8.	Cost per voucher	Rs.	3.33	7.64	7.63	7.65

3.4 The Bank disbursed Rs.2350 lakhs as bonus for the year ended 1984. The bonus has to be allocated to branch level staff cost, Chief Regional Manager's/Local Head Office level staff cost and Central Office level cost in their respective proportions, and is given in the following table:

TABLE 4

Allocation of Bonus 1984

(Amount : Rs. in '000)

Type	METHOD I		METHOD II		METHOD III	
	Staff Cost	Bonus	Staff Cost	Bonus	Staff Cost	Bonus
A. Branch level staff cost :						
i) Govt. work	545145	25252	544337	25215	543938	25196
ii) Bank work	3811739	176566	3812547	176603	3812946	176622
B. LHO/CRM staff cost	592745	27457	592745	27457	592745	27457
C. Central Office staff cost	123592	5725	123592	5725	123592	5725
TOTAL	5073221	235000	5073221	235000	5073221	235000

3.5 The total direct staff cost for the Chief Regional Managers' Offices/ Local Head Offices for the year ended 1984 was Rs. 5927.45 lakhs. (The Committee got these data through the Returns III and IV). As per the methodology in the Report, this total cost has to be distributed under the five categories A, B, C, D and E delineated in Table 5. The bonus of Rs.275.67 lakhs for these Offices is distributed among the above categories on the basis of direct staff cost proportions of each to the total. Further, the 'other cost' as available in CGB Return No.V was allocated to the above categories in proportion to total staff cost. In this connection, as the expenses on Directors' fees and allowances of the Local Board Members relate to Bank work, the amount viz. Rs.7.56 lakhs was segregated and loaded exclusively on the Bank work. Irrespective of the method of estimation of loading, the distribution of the above expenses among the five categories would remain the same, as the expenses of Local Head Offices/Chief Regional Managers' Offices would not change with the method of estimation. The distribution of the above cost of Local Head Offices/Chief Regional Managers' Offices is given below:

TABLE 5

Allocation of LHOs and CRM Offices' Cost

(Amount in '000)

Category of Departments	Direct Staff Cost	Bonus	Other Cost	Total Cost	Total Cost after Allocation of 'E'
A. Exclusively for Govt. work	--	--	--	--	--
B. Exclusively for Bank work	250862	11620	242545	505027	627203
C. Exclusively for Shroffing	--	--	--	--	--
D. Common for Bank, Govt., and Shroffing	226346	10485	218160	454991	565062
E. Departments servicing A, B, C and D	115537	5352	111358	232247	--
All Departments	592745	27457	572063	1192265	1192265

3.6 Similarly, the total direct staff cost for Central Office for the year ended 1984 was Rs.1235.92 lakhs. (This figure was obtained from Returns IV and V by the Committee). As per the method of allocation specified in the report, this cost has to be distributed into the five categories. Secondly, the bonus for Central Office which was of the order of Rs.57.25 lakhs has to be allocated in the above five categories on the basis of proportion of staff cost to total direct staff cost. As found in the Report of the Committee, the 'other cost' of Central Office was disproportionately high (Rs.2862.79 lakhs) as compared to salaries and allowances (Rs.1235.92 lakhs). Accordingly, as was done in the Committee's Report as well as in the previous quinquennial survey of 1978, the allocable portion of 'other cost' at Central Office was determined as a percentage of direct staff cost at Central Office; the percentage used was

the same as the percentage of other cost to staff cost obtaining at Local Head Offices/Chief Regional Managers' Offices (i.e. in Table 5, it would be column 4/ column 2). After allocating this cost to the five categories of work in proportion to the respective staff costs, the larger chunk of residual 'other cost' was exclusively loaded to Bank work. The cost allocated to the departments under category 'E' was re-allocated to the other four categories (A, B, C and D) in proportion to the total cost of these categories arrived as above (as per page 2 of Annexure H of the Report). The details are given below :

TABLE 6

## Allocation of C.O. Cost

Category of Departments	Direct Staff Cost	Bonus	Other Cost	Amount in '000	
				Total Cost	Total Cost after Allocation of 'E'
A. Exclusively for Govt. work	8819	409	8500	17728	18818
B. Exclusively for Bank work	54218	2511	219414	276143	293135
C. Exclusively for Shroffing	--	--	--	--	--
D. Common for Bank, Govt. and Shroffing	48571	2250	46814	97635	103643
E. Departments servicing A, B, C and D	11984	555	11551	24090	--
All Departments	123592	5725	286279	415596	415596

3.7 The combined costs of Local Head Offices/Chief Regional Managers' Offices and Central Office from the above two tables (Tables 5 and 6) are as follows :

TABLE 7

			Amount in '000
Category of Department	LHO/CRM Cost	Central Office Cost	Total Cost
A. Exclusively for Govt. work	--	18818	18818
B. Exclusively for Bank work	627203	293135	920338
C. Common for Bank, Govt. and Shroffing	565062	103643	668705

3.8 By taking the branch level and controlling costs (Local Head Offices/ Chief Regional Managers' Offices and Central Office costs) and the actual government turnover, the cost per Rs.100/- of turnover has been obtained and given below. This rate is arrived at for all the three methods of estimation. Further, the cost mentioned against category 'D' of Table 7 has been distributed as follows :

Let item 1+2+3 of Table 8 be x

Let cost at D of Table 7 be z

Let T be the total cost incurred by the Bank as a whole

Let  $y = T - x - z$

Now  $\frac{x}{x+y}$  of z is allocated for government (vide item 4 of Table 8).

TABLE 8

		Amount in '000		
Sr. No.	Cost Particulars	Method I	Method II	Method III
1.	Branch level cost on account of Government business (vide Table 3)	665698	664749	666540
2.	Bonus (vide Table 4)	25252	25215	25196
3.	LHO/CRM cost and Central Office cost (vide Tables 5 and 6)	18818	18818	18818
4.	Allocated to Government business from item D of Table 7	72361	72260	72441
5.	Total cost (Total of 1 to 4)	782129	781042	782995
6.	Total Government business turnover (Rs. in crores)	69022	69022	69022
7.	Cost per Rs.100/- of turnover (in paise) (item 5/item 6)	11.33	11.32	11.35

### Conclusion

4.1 From the previous paragraph, we would find that the cost per Rs.100/- of turnover is varying from 11.32 paise to 11.35 paise depending on the method of estimation. In this connection, in the earlier quinquennial study, the cost of conducting government business worked out to 10.75 paise for Rs.100/- of turnover. However, RBI compensated us at the rate of 9.80 paise per cent of the turnover for the entire quinquennium.

4.2 We consider that for implementation of the rate in future, it is reasonable to take the average of the three rates obtained on the basis of three methods which are as follows :

Method I	:	11.33 paise
Method II	:	11.32 paise
Method III	:	11.35 paise

By taking the average it works out to 11.3333 paise. We, therefore, consider that a rate of 11.35 paise would be reasonable for the year 1984 and for the subsequent years. While arriving at the above rate, we have not considered the effect of revision of salaries in respect of supervising staff which took place in the year 1985. The actual payment of arrears took partly in 1985 and the rest in 1986. On the other hand, the arrears paid during 1984 on account of the revision of award staff salaries have been included in the above study. While fixing the rate, the above two observations have to be kept in mind.

State Bank of India,  
Central Office,  
Bombay.

24th September, 1986.

Encls:



**Study undertaken by Management Services Department of  
Reserve Bank of India regarding the cost of conducting  
Government Business by Public Sector Banks**

Government business is one of the activity included in the uniform costing exercises taken up by public sector banks from the year 1984. The methodology, etc. adopted for working out costs are detailed below :

**I. Sampling**

The result is based on 'expenses' and time data collected from sample branches and control offices. The sampling plan has two basic steps :

A) Grouping of branches having homogeneous characteristics with respect to composition of business and expenses to form a cluster. The parameters taken into account for cluster Analysis are as under :

**1. Deposits**

(1) Current, (2) Savings, (3) Term

**2. Advances**

(4) SSI, (5) Agriculture, (6) Other Priority Sectors, (7) Trade, Industry and Commerce, (8) Other Advances

**3. Other Activities**

(9) Remittances, (10) Bills & Collections, (11) Foreign Exchange (Sales and Purchase), (12) Government Business, (13) Total expenses for the full year.

B) Selecting the number of branches from each cluster based on size of cluster, location of branches, business turnover, etc.

- |                                    |   |  |
|------------------------------------|---|--|
| 1) No. of branches in each Cluster | - | Proportion of selected branches declines with increase in number of branches in a cluster and vice-versa. Ensure that all population groups are equitably represented. |
|------------------------------------|---|--|

- 2) Total sample - 20% of total branches in a bank.  
- 10% for State Bank of India.

In addition to the above, to get better results certain specified large branches are also included on 100% sample basis. Accordingly, in the case of Government business all branches having turnover exceeding Rs.10 crores per year are included (State Bank of India and its subsidiaries are allowed to fix a higher cut off point as these banks have a large number of branches handling Government business of over Rs.10 crores).

## II. Data Collection Methodology

- 1) Collect data from sample branches for one month in a year.
- 2) Follow systematic random sampling method for selection of branches from each cluster.
- 3) Spread over the sample branches for data collection throughout the year, i.e. collect data from 1/12th of total sample branches each month.
- 4) In respect of control offices (viz. RO/ZO/HO/CO) collect data for all offices for the entire year.

## III. Data Processing Methodology

- 1) Data on establishment expenses from the branches (CA 1.1) gives cost per officer and clerk. This when multiplied by the number of officers and clerks performing particular activity (CA 1.2) gives branch level **direct staff cost** of that activity.
- 2) Branch overheads (i.e. sub-staff cost and other expenses including expenses on common staff) are loaded on the basis of direct staff cost to get **branch level total cost**.

- 3) Blow up branch level total cost for each activity to the cluster level. Add all cluster level costs and multiply by '12' to obtain **annual branch level estimated costs.**
- 4) Compare estimated branch level costs with the actuals and make adjustments upward or downwards as the case may be.

Thus, branch level costs + control office costs =  
Total bank costs. Also, total costs of all activities will agree with total bank costs.

- 5) Working out cost per voucher/Rs.100/- of business :
  - a) Cost per voucher -  $\frac{\text{Total activity cost}}{\text{No. of vouchers (estimated)}}$
  - b) Cost per Rs.100/- -  $\frac{\text{Total activity cost}}{\text{Annual turnover (actuals)}}$

#### IV. Some Important Features

- 1) Time devoted by all the staff at branch level/control office level is distributed to all the activities and the chance of overloading one activity is reduced.
- 2) Total expenses incurred for various activities during the year are available.
- 3) In the 2nd phase cost study, taken up from the year 1987 cost of conducting Government business is available for 'Receipts' and 'Payments' separately.
- 4) Break-up of costs at branch level and control office level are available separately.
- 5) In case it is desired to work out cost at branches/banks with different level of business the returns prescribed for uniform cost study can be made use of.

- 6) Statements showing bank-wise cost figures in respect of 'Government business' worked out for the years 1984 and 1985 are enclosed. The figures of State Bank of India are based on the data furnished by them.

Statement I

Statement showing the cost of conducting Government business  
by various banks during the year 1984

Bank's Name	Cost per Rs.100/- of turnover (Rs.)		
	Branch Cost	Controlling office cost	Total Cost
	1	2	3
<b>Group I</b>			
<b>Banks Nationalised in 1969 - larger banks (i.e. with more than 1500 branches)</b>			
1. Bank of Baroda	0.671	0.041	0.712
2. Bank of India	0.521	0.094	0.615
3. Canara Bank	0.368	0.073	0.441
4. Central Bank of India	0.154	0.030	0.184
5. Punjab National Bank	0.615	0.154	0.769
6. UCO Bank	NA	NA	NA
7. Union Bank of India	0.280	0.084	0.364
Group Average	0.350	0.070	0.420
<b>Group II</b>			
<b>Banks Nationalised in 1969 - smaller banks (i.e. banks with upto 1500 branches)</b>			
1. Allahabad Bank	2.057	0.461	2.518
2. Bank of Maharashtra	0.232	0.063	0.295
3. Indian Bank	0.727	0.115	0.842
4. Indian Overseas Bank	0.726	0.116	0.842
5. Dena Bank	1.013	0.033	1.048
6. Syndicate Bank	0.110	0.049	0.159
7. United Bank of India	0.402	0.096	0.498
Group Average	0.300	0.080	0.380

---

	1	2	3
<b>Group III</b>			
<b>Associates of State Bank of India</b>			
1. State Bank of Bikaner & Jaipur	0.056	0.011	0.067
2. State Bank of Indore	0.152	0.016	0.168
3. State Bank of Hyderabad	0.056	0.008	0.064
4. State Bank of Mysore	0.188	0.028	0.216
5. State Bank of Patiala	0.050	0.009	0.059
6. State Bank of Saurashtra	0.076	0.016	0.092
7. State Bank of Travancore	0.220	0.028	0.248
Group Average	0.090	0.010	0.100
All Public Sector Banks (excluding State Bank of India)	0.018	0.040	0.220*
State Bank of India	0.068	0.014	0.082*
Reserve Bank of India	0.005	0.002	0.007

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\* Rate arrived at by State Bank of India on the basis of study undertaken by them to determine the cost of conducting Government business.

**Note:** As data from United Bank of India and State Bank of India are received late these are not included for average purposes.

Statement II

Statement showing the cost of conducting Government business  
by various banks during the year 1985

Bank's Name	Cost per Rs.100/- of turnover (Rs.)		
	Branch Cost	Controlling office cost	Total Cost
	1	2	3
<b>Group I</b>			
<b>Banks Nationalised in 1969 - larger banks (i.e. with more than 1500 branches)</b>			
1. Bank of Baroda	0.564	0.080	0.644
2. Bank of India	0.482	0.117	0.599
3. Canara Bank	0.314	0.134	0.448
4. Central Bank of India	0.148	0.031	0.179
5. Punjab National Bank	0.704	0.159	0.863
6. UCO Bank	0.689	0.127	0.816
7. Union Bank of India	0.180	0.057	0.237
Group Average	0.330	0.078	0.408
<b>Group II</b>			
<b>Banks Nationalised in 1969 - smaller banks (i.e. banks with upto 1500 branches)</b>			
1. Allahabad Bank	2.022	0.686	2.708
2. Bank of Maharashtra	0.228	0.057	0.285
3. Indian Bank	0.251	0.259	0.510
4. Indian Overseas Bank	0.311	0.140	0.451
5. Dena Bank	0.884	0.320	1.204
6. Syndicate Bank	0.185	0.089	0.274
7. United Bank of India	0.269	0.070	0.339
Group Average	0.288	0.127	0.415

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	1	2	3
<b>Group III</b>			
<b>Associates of State Bank of India</b>			
1. State Bank of Bikaner & Jaipur	0.115	0.024	0.139
2. State Bank of Indore	0.188	0.038	0.226
3. State Bank of Hyderabad	0.052	0.003	0.055
4. State Bank of Mysore	0.133	0.015	0.148
5. State Bank of Patiala	0.021	0.002	0.023
6. State Bank of Saurashtra	0.077	0.019	0.096
7. State Bank of Travancore	0.233	0.037	0.270
Group Average	0.086	0.013	0.099
All Public Sector Banks (excluding State Bank of India)	0.168	0.042	0.210
State Bank of India	0.069	0.026	0.095
All Public Sector Banks (including State Bank of India)	0.092	0.030	0.122
Reserve Bank of India	0.006	0.002	0.008

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**Note:** As Union Bank of India has not furnished actual turnover figures the cost has been worked out on the basis of estimated figures.



**Cost rate based on regression analysis and updated stratification  
of branches transacting Government business**

**1. Introduction**

The Reserve Bank has set-up a Committee to Review the rate of turnover commission payable to Public Sector Banks for conducting Government business and to go into various aspects of cost associated with such services. One of the important terms of reference of the Committee is to review the Thakur Committee formula and evolve a scientific and fairly simple formula for computing cost. A scientific study of cost of banking services would warrant estimation of marginal costs of various output indicators of specific types of services. For example, per voucher cost or cost per unit turnover of a business activity relating to Government or public transaction could be estimated. These estimates are required to be obtained following relevant statistical methods. As early as in 1965, Benston, G.J. of Federal Reserve Bank of Chicago, used multiple regression analysis to obtain cost structure of commercial banks. In this econometric study, Benston used data obtained by the Federal Reserve Bank of Boston for cross sections of approximately 80 New England member banks of small and medium size for each of the three years 1959-61. After suitable transformation, these data were used to estimate long-run cost functions for separate types of bank services, demand deposits, time deposits, mortgage loans, instalment loans, business loans, investments and three categories of indirect expenses: Administration, Business promotion and occupancy. Benston's empirical results were encouraging and he obtained almost same parameters of marginal costs for these years. The present study also uses objective method of estimation of marginal costs for output measures viz. number of vouchers and amount of turnover for two classes of business, one pertaining to the government and other pertaining to operations other than those of Government. For this purpose the data made available by State Bank of India and other public sector banks for selected branches are analysed to arrive at estimates of various cost parameters.

## 2. Cost and output measures

The statistical cost-output relationship of banking services is a method which links cost of services to relevant output generated by such services. There is inherent variation in the cost of services of branches depending upon various factors and types of services. Some transactions may require only a couple of entries while others may generate chain of entries and handling by number of personnel such as advancing of loans etc. Besides, the variety of banking services which give rise to various other output measures also add to the variations of a branch cost. Formulations of suitable model to explain the total cost incurred by branch in rendering the variety of services would warrant that the activities and type of the services be suitably classified or grouped such that the average cost rate for types of banking activities, related to generation of an average amount of turnover for the group over a given interval of time, can be determined by suitable method of estimation with least variation. Marginal cost for each type of activities and turnover for the group can then be estimated by using formulated statistical cost output relationship. Within the group of turnover such a relationship could be linear. Average cost for the bank as a whole then could be worked out by giving due consideration to the size of turnovers to which the branches of the group form homogeneous units. The statistical relationship enters into picture because data involve measurements and have both systematic and random sources of variations in the output measures and costs for such services. As is known, the variation in cost, at times, is very much related to productivity of staff which may vary from branch to branch even within a group. Average cost of branches with such variations would need weeding out of unproductive units (branches) and corresponding data from the analysis, if cost rate is to be based on normal branch functioning. This is essential to get good cost output relationship as measured by the **degree of determinancy** given by the measure of multiple correlation of the cost output relationship. Cost is to be distributed amongst various services which generate more than one type of output measure. Cost is an aggregate quantitative measure of value of services rendered, whereas customers' satisfaction in totality gives the aggregate measures of quality of services. The introduction of new technology to serve the customer better adds to the cost of service both directly and indirectly. A proper supervision and control mechanism at local head office and head office level improves the

quality in rendering of such services and such costs are only indirect. Since it is difficult to get a quantitative measure of quality of services and cost of administrative supervision to individual activities of bank branch precisely, indirect cost of administration of functioning of bank branches therefore needs to be modelled separately. This could be done by suitably working out such overhead cost per branch, aggregated for branches in question and cost per unit of aggregate measure of output apportioned in proportion to output measure of an activity. The aggregate measure of output indicator may be given as sum of the outputs generated by various services/transactions of all activities over a given period of time. The aggregate measure of output for a bank branch over a given period of time may be given by number of vouchers generated by such services and aggregate amount of turnover, taken as sum of the amount of the vouchers included in the aggregate measure of number of vouchers.

### 3. Description of model

The present study relates to bank branches of State Bank of India conducting Government business besides other commercial banking functions. Such branches constitutes about one-third of the total number of bank branches of State Bank of India in 1984, the period to which the study relates. Regression models linking cost to various output measures of government and bank business following considerations in the earlier para for a homogeneous group of government turnover may be formulated. The cost may be described suitably as a sum of cost of different activities of a branch. For example, if  $c_1$  is the marginal cost (cost per unit of output) of transacting government business voucher and  $c_2$  that of the bank business vouchers, the total cost of the branch in terms of the vouchers of the activities viz. government business and bank business would be given as the sum of marginal costs multiplied by number of vouchers of the respective business or activities. Similarly, in a range of turnover where it is the amount of turnover which bears a high correlation to the cost, the marginal cost per unit of turnover for each type of activity could be multiplied to the amount of turnover of the respective activity and aggregated to give the total cost. Because of inherent variations in the type of services and activities and productivities of staff, there may be a large part of branch cost unexplained by the output units generated and accounted for as direct cost. A part of such unexplained cost may be constant and part of which may be varying randomly from branch to branch which may be beyond the control of either branch administration or the local head office or head office but may arise

out of random sources of variation but such costs have to have low share. The constant cost of the branch may be on account of services which are not directly linked to generation of output measures but may be in the nature of common services to the production unit of the activities and such other costs as rent, furniture and other infrastructure cost which are incurred whether or not business is transacted. The details of formulation and regression break-up of various units of output measures which are relevant to the different types of activities of bank branches conducting government business may be seen below. The common set of cost functions linking cost to various output of activities and aggregate levels of branches output are briefly stated below.

Total branch cost	= C <sub>0</sub> (Constant cost)	+ C <sub>1</sub> (NVG) (Cost of government business)	+ C <sub>2</sub> (NVB) (Cost of bank business)	+ e. . . . (4.1) (random variation in the branch cost)
	= C <sub>0</sub>	+ g <sub>1</sub> (AG)	+ g <sub>2</sub> (AB)	+ e. . . . . (2)
	= C <sub>0</sub>	+ a <sub>I</sub> (AT)	+ a <sub>V</sub> (VT)	+ e. . . . . (3)
Total branch cost	=(Constant cost)	+ (Cost apportionment of total turnover amount (AT) of branch)	+ (Cost apportionment of total number of vouchers (VT) of branch)	+ random variations in cost.
	= C <sub>0</sub>	+ a(VT)	+ e. . . . . (4)	
	= C <sub>0</sub>	+ b(AT)	+ e. . . . . (5)	
(C/AT)	= C <sub>0</sub>	+ a <sub>g</sub> (NVG/AG)+a <sub>b</sub> (NVB/AT)	+ e. . . . . (6)	
Cost per unit of total turnover	=(Constant cost per unit of total turnover )	+ (Cost of Government business per unit of total turnover )	+ (Cost of bank business per unit of total turnover)	+ (random variation in cost per unit of total turnover)

The various notations are explained as below :

- C = Total cost of conducting all business by a bank branch.
- NVG = Number of Government vouchers transacted by the bank branch.

NVB	=	Number of other (bank) vouchers transacted by the bank branch.
VT	=	NVG + NVB
AG	=	Amount of turnover (value) of Government vouchers.
AB	=	Amount of turnover (value) of other bank vouchers.
AT	=	(AG + AB) : Total amount of turnover of Government and bank vouchers.
$C_1$	=	Cost of conducting Government business for the branch.
$C_2$	=	Cost of conducting bank business for the branch.
$C_0$	=	Other costs.

The constant cost  $C_0$  and random variation may be different in different cost equations. Suitable method of estimation for cost rate parameters in the linear regression model for cost function for homogeneous group of turnover may provide estimated values of various parameters in the cost-output relationship. A significant value of multiple correlation for the cost function may suggest a representative character to the estimates. As is known, the least square method of estimation provides a representative value of the various parameters with least of variation in the expected cost with actual cost of the branches. The cost of such branches are commensurate with the output measures. A low or insignificant value of multiple correlation would suggest lack of pattern or weak structural dependence of cost per unit of output measures. In other words for such group of branches cost of conducting government and bank business may vary from branch to branch without in any way bearing relationship to output measures of the branch. For such group of branches, it is only the least square marginal value of cost parameters that could be considered representative but cost aspects of such branches would need to be scrutinized carefully to determine lack of pattern or conformity of branch level cost to output measures vis-a-vis those of the other branches outside the group conforming to such relationships.

#### 4. Scrutiny of data

In all a total of 410 special returns from the bank branches of the State Bank of India transacting government business for the year 1984 (January to

December) were received and scrutinized. The basic data of total establishment cost of the branch and output measures of government and bank business in terms of number of vouchers and amount of turnover were examined for consistency. The total number of 410 sample branches were found to be complete in respect of all the 5 entries needed for the regression analysis of cost output relationship. The sample branches were distributed amongst various groups of range of government turnover starting from less than Rs.1 crore to ending with greater than Rs.500 crores. Regression analysis for various cost function was done for the sample branches in each of the turnover groups. A number of computer runs were made to identify and weed out branches whose cost did not conform to the cost output relationship found good for other branches within the group. The standard criterion of discrepancies between observed cost and explained cost to be more than twice the standard error of the random residual error given by the model for the groups was utilised for identification of such branches. The large variation between observed cost and expected cost could be on account of error of reporting in the units of output or the branch being over staffed in relation to the output generated by the branch and at variance with the average expected cost output behaviour of most of the other branches in the group. In this process around one fourth of the sample branches were identified. The data of these branches needed deeper scrutiny both for the purpose of correcting the error of reporting in the units of output measures and for reviewing the man power deployment at such branches vis-a-vis the magnitude of business being transacted by these branches. The list of branches with their data so identified is enclosed in Annexure 2. A sample of branches covering medium and large group of turnover among those, which were identified for data problems were visited by a study team comprising officers of Reserve Bank of India and State Bank of India. It was observed that there were conceptual problems at branch level in properly understanding the amount of turnover in relation to bank business of the branches. There were under-reporting in the bank turnover to the tune of 9 times at the highest. Cases of under-reporting error in respect of Government turnover were also observed. But these were transcription errors and it vindicated usefulness of cost output model in identifying large number of branches conforming to average cost output relationship and isolating the branches with the data problems. However, there were minor no under-reporting in the data on number of vouchers. Since the identified branches are not included in the analysis and estimation of aggregate measure

of cost and output units, the estimates obtained with the 318 branches data, found compatible with the various cost functions and output units are free from data deficiencies. The finalised set of equation representing cost function for various groups are given in Annexure 1.

#### **5. Analysis and discussion of results**

It would be seen that cost functions are mostly explained by output indicators with high multiple correlation for all the groups. Various cost measures and cost parameters viz. branch mean measures of output, cost of conducting government business and bank business etc. are obtained for different groups using apportionment of total establishment cost of the branch between government and bank business and other common cost of branch given by the models. The estimated total cost for the groups and cost rate for transacting government and bank business are given in Statements 1 and 2. It would be seen that except for marginal fluctuations in the trend of cost rate, there is consistency in the rates estimated. The average cost for the government business for the branches included in the study is estimated at about 7.98 paise per Rs.100/- of turnover. This also includes the other common costs at the branch level which are included in the total establishment cost of the branches. The cost of conducting government business has a share of 22.6 per cent of total cost of branches conducting government business. The corresponding estimate in Thakur Committee which include direct staff cost and common service cost to corresponding total for the Bank in 1974 was at 22.1 per cent. Thus it lends credibility to the objectivity of the approach.

## Statement 1

Group-wise Aggregate output measures of Bank Branches  
conducting Government Business (1984)

Sr. No.	Government Turnover Group (Rs. crores)	Total No. of Branches	No. of Sample Branches	Estimate of Output Measures of all Branches						Estimates of Cost Measure of all Branches (Rs. '000)		
				Turnover on (Rs. crores)			Vouchers in thousands			Government*	Bank*	Total
				Government	Bank	Total	Government	Bank	Total			
1	2	3	4	5	6	7	8	9	10	11	12	13
1.	< 1	441	62	109	6883	6992	316	17480	17796	11317	166688	178005
2.	1 - 3	215	50	430	11219	11649	2131	11395	13526	30400	112527	142927
3.	3 - 10	542	80	3212	30026	33238	10564	33442	44006	83356	317972	401328
4.	10 - 25	344	41	4977	37110	42088	10064	30708	40773	69162	289561	358723
5.	25 - 100	347	51	18300	130004	148304	26796	56322	83118	50582	497392	647974
6.	100 - 200	92	15	13238	98900	112138	12814	37185	49998	96725	216604	313329
7.	> 200	62	13	25186	156146	181332	11066	25302	36368	80951	190726	271677
All Branches		2043	312	65452	470288	535741	73751	211834	285585	522493	1791470	

\* Adjusted for other costs.



## Statement 2

Estimates of cost measures of output for bank branches  
conducting Government Business (1984)

Sr. No.	Government Turnover Group (Rs. crores)	Total No. of branches	Cost per unit measure of output					
			TURNOVER (paise per Rs.100/- of turnover)			VOUCHERS (Rs.)		
			Government	Bank	Total Turnover	Government	Bank	Total Vouchers
1	2	3	4	5	6	7	8	9
1.	< 1	441	103.90	24.22	25.46	35.84	9.54	10.00
2.	1 - 3	215	70.70	10.03	12.27	14.27	9.87	10.57
3.	3 - 10	542	25.95	10.59	12.07	7.89	9.51	9.12
4.	10 - 25	344	13.90	7.80	8.52	6.87	9.43	8.80
5.	25 - 100	347	8.22	3.82	4.37	5.62	8.83	7.79
6.	100 - 200	92	7.31	2.19	2.79	7.55	5.83	6.27
7.	> 200	62	3.21	1.22	1.50	7.32	7.54	7.47
All Branches		2043	7.98	3.81	4.32	7.08	8.46	8.10

Statement 3

Set of Regression Equations utilised for apportionment of Total Establishment Cost

Cost : In thousand rupees.  
Output measures : In Rs.'000s

1. Turnover Group of Rs.200 crores and above

Sr. No.	Cost/Cost rate Dependent Variable	Constant (Other costs)	OUTPUT MEASURES		Multiple correlation R	SEE standard error of estimate	Mean of dependent variable	No. of obsn.
			Independent	Variable				
1.	2.	3.	4.	5.	6.	7.	8.	9.
1.1	C = (Total Estbt. Cost) 't' Statistics Elasticity (Apportionment of cost)	0.173	3.157 AG (Govt. Turnover) 1.73 0.275	+ 0.952 AB (Bank Turnover) 4.48 0.552	0.83	2867.60	4490.87	13

2. Turnover Group Rs.(100-200) crores

1.	2.	3.	4.	5.	6.	7.	8.	9.
2.1	(C/AT) = (Cost per unit turnover) 't' Statistics Elasticity (Apportionment of cost)	0.032	1.945 (NVG/AG) 5.02 0.805	+ 2.119 (NVG/AG) 19.15 0.663	0.98	1.39	6.29	15

## Statement 3 (Contd.)

3. Turnover Group  
Rs.(50-100) crores

1.	2.	3.	4.	5.	6.	7.	8.	9.
3.1	C = (Total Estbt. Cost)		243.619+5.670 NVG (Govt. vouchers)	+ 7.776 NVB (Bank vouchers)	0.88	736.79	2692.91	22
	't' Statistics	0.55	1.66	7.65				
	Elasticity (Apportionment of cost)	0.090	0.251	0.659				

4. Turnover Group  
Rs.(25-50) crores

1.	2.	3.	4.	5.	6.	7.	8.	9.
4.1	C = (Total Estbt. Cost)	41.778	+ 4.935 NVG	+ 8.671 NVB	0.88	342.34	1245.10	29
	't' Statistics	0.30	2.47	7.63				
	Elasticity (Apportionment of cost)	0.034	0.181	0.785				

5. Turnover Group  
Rs.(10-25) crores

1.	2.	3.	4.	5.	6.	7.	8.	9.
5.1	C = (Total Estbt. Cost)	68.309	+ 6.608 NVG	+ 8.751 NVB	0.89	235.37	1042.80	41
	't' Statistics	0.71	2.35	11.04				
	Elasticity (Apportionment of cost)	0.066	0.185	0.749				

## Statement 3 (Contd.)

6. Turnover Group  
Rs.(5-10) crores

1.	2.	3.	4.	5.	6.	7.	8.	9.
6.1	C = (Total Estbt. Cost)	307.536	+ 8.153 NVG	+ 3.611 NVB	0.79	174.76	708.94	45
	't' Statistics	5.39	2.65	4.78				
	Elasticity (Apportionment of cost)	0.434	0.238	0.328				

7. Turnover Group  
Rs.(3-5) crores

1.	2.	3.	4.	5.	6.	7.	8.	9.
7.1	C =	336.341	+ 1.228 NVG	+ 7.503 NVB	0.82	194.72	789.90	25
	't' Statistics	3.45	0.26	8.57				
	Elasticity (Apportionment of cost)	0.426	0.027	0.547				
7.2	C =	352.469	+ 1.857 AT	+ 4.474 VT	0.88	165.98	789.90	35
	't' Statistics	5.32	3.78	4.43				
	Elasticity (Apportionment of cost)	0.447	0.128	0.425				
7.3	C =	377.342	+ 3.388 AB	+ 62.751 AG	0.80	208.13	789.90	35
	't' Statistics	1.49	7.79	0.96				
	Elasticity	0.447	0.218	0.305				

Statement 3 (Contd.)

8. Turnover Group  
Rs.(1-3) crores

1.	2.	3.	4.	5.	6.	7.	8.	9.
8.1	C =	372.627	+ 3.148 AB	+ 63.97 AG	0.84	211.69	664.83	50
	't' Statistics	3.38	10.77	1.27				
	Elasticity	0.561	0.247	0.192				

9. Turnover Group  
< Rs.1 crore

1.	2.	3.	4.	5.	6.	7.	8.	9.
9.1	C =	118.707	+ 33.448 NVG	+ 6.585 NVB	0.81	154.01	403.64	62
	't' Statistics	3.60	2.00	9.68				
	Elasticity	0.294	0.059	0.647				

**ANNEXURE IV**

**Cost rate based on analysis of branch-wise cost of conducting Government business as estimated by the State Bank of India**

A set of estimates of cost of conduct of Government business have become available for deliberation of the Committee. Various estimates and their sources are summarised below :

(Rs. in crores)

Cost component	Estimates of total cost of conduct of Government business			
	State Bank of India		Reserve Bank of India	
	MSD(1)	MSD(2)	DESACS(3)	DESACS(4)
Branch cost	51.03	66.57	52.25	51.10
Controlling offices cost	10.31	9.11	6.67	6.67
Total cost	61.34	75.68	58.92	57.77

- Notes:** (1) Received from State Bank of India to MSD, Reserve Bank of India, in August 86.
- (2) Received from State Bank of India, GM(O) No.CO/BOD/ dated 24th October 1986.
- (3) Received from DESACS, following Regression Method.
- (4) Received from DESACS using State Bank of India branch-wise estimates vide Table 1.0.

It would be seen that except the branch cost estimates in column (3) other estimates of branch costs are close and comparable. A close examination of the State Bank of India note furnishing the estimate of Rs.75.68 crores indicated that there were methodological problems responsible for higher estimate. The break-up of the branch cost of the activity of Government business and other expense allocation may be seen in the table below.

TABLE 2

(Rs. Crores)

Activity	Direct staff cost	Other expenses	Total
1. Government business	54.51	12.06	66.57
2. Bank business	437.74	41.10	478.84
3. Other expense of bank as a whole	-	53.16	-
Total*	492.25	53.16	545.41

\* The data on total establishment cost of State Bank of India branches in 1984 was Rs.492.25 crores and other expenses of the bank as a whole at Rs.53.16 crores. These were received from State Bank of India in their letter No.CO/BOD/38440 dated 6th August 1986.

2. The estimates of direct staff cost for the activity bank business is obtained as residual. This is at variance with one given in the State Bank of India note. Direct staff cost as proportion of total staff cost as estimated by them is only 0.1107. The allocation of other expenses to Government business is, however, at a higher proportion of 0.2268 which needs to be corrected. Besides, analysis of direct staff cost data of the branches as given in CGB return XI, made by DESACS, indicated that staff cost in the returns were higher by about 15 per cent on account of arrear payments made during the year 1984 to some of the branches. Method of estimation of total cost, using only six classes of Government turnover as against ten classes vide Table 1.0 has further introduced error of over estimation in the cost estimate by about 5 to 6 per cent. Thus, the estimate of direct staff cost of conduct of government business as obtained by the State Bank of India needs to be corrected atleast to the tune of 20 per cent. All other establishment costs of the banks are required to be corrected by atleast 15 per cent for arrear payments. When the data are adjusted for these discrepancies, the resulting estimates give closer look. These are given in the table below.

TABLE 3

Corrected estimate of Branch Cost of Government business  
by State Bank of India

Activity	Direct staff cost	Other expenses	Total branch cost
1. Government business	45.43 (0.1061)	5.64	51.07
2. Bank business	382.61 (0.8939)	47.52	430.13
3. Other expenses of bank	-	53.16	
Total	428.04 (1.000)	53.16	481.20

It would be seen that the corrected estimate of total branch cost of Rs.51.07 is close to one furnished earlier by the State Bank of India. The estimate of corrected direct staff cost of bank business is now close to one given by in the State Bank of India note, thereby indicating that this component of cost was arrived at after excluding the amount of arrears paid to the staff during 1984.

3. The estimates of branch cost in regression method combines the apportionment of other expense cost of branches. The method of excluding outlier cost or output branches used by DESACS minimises the effect of cost inflation on account of extraneous sources such as arrears payment to branches or where output and cost do not show any relationship shown by other branches of specific group of government turnover. Hence the estimates have not been corrected again for arrears payment effect or estimation bias as in case of State Bank of India estimates. The bias has arisen because of pooling of higher than Rs.50 crores group of government turnover and that in the group of Rs.one crore or less.



4. As regards the differences in the estimates of controlling office cost, as obtained by the Reserve Bank of India and the DESACS, it needs to be stated that State Bank of India method of computation of overhead expense is not recommended by the Thakur Committee. On the contrary it observed "The present method of computation of Head Office control cost is not rational" (page 97 section 2.5 of the Thakur Committee Report). One important short-coming in the State Bank of India approach is that it does not adjust for the Local Head Office and Central Office cost for their own maintenance, a basic principle utilised in all cost-output matrix showing flow of output of one sector to other output generating sectors. The cost apportionment of the Local Head Office and Central Office costs to operating branches (Sector) has to be made after subtracting its own maintenance cost which would be in proportion to (199/691) or 0.288 of their total cost. Total cost of Local Head Office and Central Office is Rs.199.37 crores and that of all branches Rs.492.65 crores and these add up to Rs.691.62 crores say Rs.692 crores as total establishment cost excluding other expenses. Thus, the estimate of overhead expenses when corrected for this, gives an estimate overhead expense of Rs.(0.712) x 9.11 crores (estimated by State Bank of India) or Rs.6.49 crores. The estimate of total cost of conducting Government business accordingly works out to Rs.51.07 crores + Rs.6.49 crores or Rs.57.56 crores. This is almost same as obtained by the DESACS.

5. Bonus payment constitutes an element of profit and has been excluded from consideration of payment of compensation even by the Thakur Committee Report. As such, this could not be accepted for inclusion as cost element in the exercise.

6. Since cost of government business bears a direct relationship with the total establishment cost of the bank which grows in time at a rate of about 16 per cent annually, the estimated cost of conduct of government business for the quinquennium may be of the order as below.

Year	Turnover	Estimated cost of Government business (Rs. crores)
1984	69022	57.77
1985	80480	67.01
1986	93839	77.73
1987	109416	90.17
1988	127580	104.60

These could be subject to adjustment with (0.135) of actual normal establishment costs of all the State Bank of India branch offices, over the years. This is so because with slackening rate of licensing of new bank branches, the growth rates in establishment costs may be less than 16 per cent annually as observed for past years. Reserve Bank may, however, give an average rate of commission of Rs.67.53 crores + a relief amount of Rs.2.5 crores or say Rs.70 crores for the three years 1984, 1985 and 1986, a little higher than the estimated cost rates. The relief amount may take care of other factors not considered in the exercise.