

## CHAPTER I

### INTRODUCTION

#### RATIONALE OF STUDY :

The subject of management accounting is expanding its horizon day-by-day. It is a subject of recent origin and it is a combination of two words i. Management and ii. Accounting.

A better management is a key to success, hence any organisation will be interested in its better management. When accounting is used for the purpose of management, it does not remain only debit and credit of transaction which is well known as book keeping. The subject of accounting when used for management, becomes a multi facet subject, and in its wider perspective it includes political science, sociology, psychology management, economics statistics, law etc.

The application of subject of management accounting is not restricted to only manufacturing organisations. It has a wider area of application. The techniques are also applicable to the service organisations and lending institutions are no exception to it.

The function of management basically involves the better organisational management and hence better staff management, resource management and the time management can be considered crucial for an ideal management.

It would not be over emphasising, if one says that a fund is the important resource and hence the funds management is very crucial for any management. As banks deal with funds mainly, the funds management can be considered to be of top most importance. This calls for liability management and the asset management. Liability management may not become a matter of much concern, so far as deposits are concerned. On account of the confidence of the public which the bank governs, however the deployment of funds and utilisation thereof in the best possible manner is of vital importance. Here Edgar Morsman states that, "commercial lending is a fascinating, profitable and productive means of employing bank funds."<sup>1</sup> Here it may be noted that, "an ideal advance is that which is granted to a reliable customer for an approved purpose, in which the customer has adequate experience, safe in the knowledge that the money will be used to advantage and repayment will be made within a reasonable period from trading receipts or known maturities due on or about given dates."<sup>2</sup>

This calls for the best asset management. Amongst the assets, the advance portfolio is the income generating asset. Hence the best management of this advance portfolio is the sine qua non for bank's success. In India, in old days i.e. prior to nationalisation

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1. Morsman Edgar M. Jr., Commercial Loan Structuring, Journal of Commercial Bank Lending, November, 1991, pp. 38-42.
  2. Mather L.C. as quoted by Govadhan Rao B.V., ABC of Credit Management, The Banker, November, 1987, p. 37.

the approach to lending decision was security oriented; however with the remarks of National Credit Council there has been a little diversion in the approach and even though the security is not neglected the purpose is given importance.

Here the use of financial information will not be over-emphasised along with the use of non-financial information. As a R. Chandran states, "a careful and thorough scrutiny of the financial factors is a pre-requisite in arriving at credit decision."<sup>3</sup>

About the introduction of management accounting techniques to bank lending portfolio C. Jeevanandam states that "the need for applying management accounting principles to bank lending arose because of the shortcomings of the traditional methods of credit appraisal in coping with the changing business environment. The role of banker has changed over years from just being an intermediary between lender and borrower to something more important and more participative. An accompaniment of this phenomenon is the change in the expectations of the customers from the banks which has become more demanding."<sup>4</sup>

L.S. Dyer mentions in this connection that "as management accounting systems are introduced, bankers will have available with the customer's cooperation, a tool which can be used to

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3. Chandran R., Financial Statements - Approach of a Banker, IBA Bulletin, December, 1985, Vol. VII, No. 17, pp. 384.

4. Jeevanandam C., Management Accounting, A Handbook for Bankers, pp. 201.

look ahead to the probable trend of the bank balance and to monitor the performance of the company."<sup>5</sup>

"Management Accounting comes handy as a supplement to traditional credit appraisal by overcoming some of the limitations and refining certain techniques of traditional methods."<sup>6</sup>

For the present scenario of advance portfolio there has been a gradual deterioration in the quality of advances as a result of some pressure points and this has resulted in mounting over-dues, non-performing advances (NPA) and declining trends in the profitability of the banks.<sup>7</sup>

Under the above circumstances a tool is required which will improve the efficiency of the advance portfolio for which C. Jeevanandam states that, "management accounting techniques when used alongwith traditional methods improve the overall, efficiency of credit appraisal by the banks as well as their efforts at post disbursement supervision and follow-up."<sup>8</sup>

The application of management accounting techniques to lending decision by commercial banks in India stands in need of a detailed study which can throw light on various aspects as far as lending decisions by commercial banks are concerned.

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- 6. Jeevanandam C., Management Accounting: A Handbook, for Bankers, p. 211.
  - 7. Vide Karunasagar and Kaveri V.S., Health Code System : A Critique, Prajnan, Vol. XXI, No. 2, 1992, p. 219.
  - 8. Jeevanandam C. Management Accounting : A Handbook for Bankers, p. 211.
  - 5. Dyer L.S., A Practical Approach to Bank Lending, p. 56.

#### OBJECTIVE OF THE STUDY :

In the light of the importance of the management accounting techniques in various decisions the study attempts to examine the following :

1. Evolution of the subject of management accounting and development of various techniques used by the management for the function of planning and control is examined. Here are discussed the various techniques of management accounting like business plan, budgeting, fundsflow, cashflow, break-even-analysis, method of costing, ratio analysis etc.
2. The present study surveys also the reports of various committees appointed by Reserve Bank of India, particularly for introducing discipline in the advance portfolios. Here the important recommendations of Tandon Committee, Chore Committee, Marathe Committee, Chakravarthy Committee and Narsimham Committee are discussed.
3. In the light of the importance of management accounting techniques in general and in particular for bank lending decisions, the present study proposes to examine various aspects of the application of various techniques in bank lending on the basis of the various branches of commercial banks in Baroda City in the Gujarat State. The examination of the management accounting techniques from different angles throw light not only on the professional expertise of the branch but it also reflects the size of the branch, sometimes location etc. The

application of these techniques is also expected to affect the recovery of loan, problem credit etc.

The application of the management accounting techniques and the extent of the application of technique is required to be studied at the branch level rather than for the bank as a whole. The study at the branch level also requires some information regarding advances, deposits, profits sectoral advances, facilitywise advances.

This type of the information at branch level is not available readily; hence the study of various branches and variations among them is essential before we analyse the application of the techniques in lending decisions. Thus the present study proposes to examine structural variations in credit portfolio of commercial bank branches under study and changes therein over a period of time.

Here the share of advance to deposit for each respondent branch is worked out for period understudy. Over and above this the profit as a proportion to advance and profit as a proportion to volume of business is also worked out for each respondent branch. An attempt is also made in the present study to estimate the dependence of profit on advance, deposit, volume of business and credit-deposit ratio by running separate regression by  $y = a + bx$ , where  $y$  represents profit and  $x$  represents advance, deposit, volume of business and credit deposit ratio.

Over and above this, the share of priority sector to total advance, for each branch and variations among the branches are examined. Moreover, within the priority segment the share of each subsegment is found out for each respondent branch and variations there in are also examined. Also the advances are provided by various facilities by banks. The share of each facility of advance to total advance is also found out for each respondent branch and variations between the branches are also examined.

4. After analysing thus, the profile of respondent branches, an attempt is made to examine the relative importance given to various factors, taken into consideration while taking lending decisions. There are some traditional factors for example, character, capability etc. which play an important role in lending decisions by commercial banks. The relative importance of these factors not only varies with different segments but it varies also from bank to bank and from branch to branch. Considering this aspect, it is attempted to examine variations in relative importance of these factors, while taking lending decisions. The study will reveal whether the relative importance of factors remains more or less the same across various branches of commercial banks or not.

To estimate this relationship between the segments and between the banks the tool of Rank Correlation Coefficient is used. Here Rank Correlation Coefficient (RCC) is measured by

$$RCC = 1 - \frac{6 \sum d_i^2}{n^3 - n}$$

Where 'd' refers to difference in ranking of factors, between segments and between banks respectively and 'n' refers to the number of factors under study. Moreover, it is also interesting to find out whether branches of one bank form one group or they are scattered over various groups as far as the use of traditional factors is concerned. To examine this aspect the method of linkage analysis is used.

5. Over and above the use of traditional factors, various management accounting techniques have been applied by commercial banks while taking lending decisions.

There are certain norms prescribed by RBI suggesting application of certain management accounting techniques for lending decisions. But the use of various management accounting techniques is not necessarily identical for all branch of commercial banks under study and for different segments. An attempt is also, therefore, made to examine the application of management accounting techniques to various segments in broad sense.

An attempt is made to estimate the relationship between the techniques within the segment i.e. the chances of application of one technique when another is being applied. This is estimated with the use of Phi-Coefficient, here



$$r_{\theta} = \frac{(x_1 y_1) (x_0 y_0) - (x_0 y_1) (x_1 y_0)}{\sqrt{(x_0 y_1 + x_0 y_0) (x_1 y_1 + x_1 y_0) (x_1 y_1 + x_0 y_1) (x_1 y_0 + x_0 y_0)}}$$

Where x and y represent the two techniques the relationship between which are being examined and '1' and '0' suffix to x and y represent the 'yes' or 'no' i.e. application or otherwise of the techniques, respectively.

From this the branches applying the techniques the most is also found out with the use of composite index. This composite Index is the method of deriving one single value for different variables. It is the first principal Component which is derived on the basis of the method of Principal Component Analysis.

Of much more importance is the testing of existence or otherwise of relationship between the specialisation of branch to advances to particular segment and the extent of application of techniques. To study this, RCC is used where ranks are assigned, based on the proportion of particular segment's advance to total advance, to determine specialisation and based on composite index to determine the extent of application of management accounting techniques.

Generally with the increase in the size of the branch, the indepth application of management accounting techniques increases due to a number of factors. An attempt is made here to examine the role of the size of the branch in determining the extent of indepth application of management accounting techniques.

To examine this, the extent of indepth application of management accounting techniques is regressed on size of the branch. A similar exercise is carried out taking advances of the branch as an explanatory variable. The extent of indepth application of management accounting techniques is a qualitative variable, therefore, the use of Logit model is made. Here

$$y_1 = \frac{1}{1 + e^{-(B_1 + B_2 x_1)}}$$

Where  $y_1$  is the probability of application of management accounting techniques and  $x_1$  is advances of the branch or the volume of business of the branch.

b. Over and above the examination of management accounting techniques in broad terms, the analysis of the indepth application of management accounting techniques is also essential.

The depth of application of techniques is examined with two weapons :

- a. the detailed questions for each method and
- b. presentation of hypothetical cases requesting judgement thereon from respondents.

For (a) detailed questions were raised on techniques business plan, break-even analysis, method of costing, fundsflow statements, cashflow statements and ratio analysis. For example, for break-even analysis the factors which are of importance, the

utility of margin of safety, use of break-even analysis in multi-product situation, use of probability in break-even-analysis etc. were the questions put. The detailed questionnaire appears as Appendix - 1.

For (b) the cases which are developed are also forming part of questionnaire.

7. The application of management accounting techniques is also examined to review and follow-up aspect.
8. To examine the effect of application of management accounting techniques on the quality of loan portfolio, based on available data, an attempt is made to estimate the impact of application or otherwise of management accounting techniques on problem credit. For this purpose the proportion of problem credit to total advance(y) is regressed on average probability of application of techniques(x). This aspect of problem credit is considered important in the light of increasing overdues and emphasis being given to transparency affecting to the image of banks.

#### SOURCES OF DATA :

Looking to the nature of the subject, the primary data collection was considered to be best suited method for the purpose. The sample selected is that of Baroda City Region. Within the Baroda City Region also the scope is limited to SBI, its associates and nationalised banks considering the fact that these 28 banks at a national level cover majority of the advance

portfolio. The identity of data is not to be revealed in any respect and hence the name of bank or branch is not given, however they are assigned the numbers which remains uniform for a particular branch throughout the study.

Here it would be of importance to note the following comment by A.F. Langrana : "although the art of lending is practical with a wide range of responsibilities ranging from that of a Branch Manager right upto the Board of Directors, it is reasonable to assume that there exists some general body of principles which guide all lending decisions. It would be nice to think that the principles are embodied in doctrine set out clearly for all those who lend."<sup>9</sup>

The author here, emphasises that the basic principles for those who lend remains the same.

It may be observed that such studies are generally limited to locational area etc. and in this context Karunasagar aptly observes that, "it was therefore, decided to confine the study to five commercial banks located in Bombay, Pune or in the vicinity thereof."<sup>10</sup>

In the light of this, the present study examines various aspects considering scheduled commercial Banks located in Baroda City.

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9. Langrana A.F., Management of Lending, Thesis submitted to NIBM, Pune for Post Graduate Diploma in Bank Management, 1979, p. 15.
  10. Karunasagar, Credit Monitoring System : A Review of Health Code Classification of Borrowal Accounts By Commercial Banks - A Thesis submitted to NIBM, Pune for Post Graduate Diploma in Bank Management, 1990-91, p. 7.

For the purpose of data collection to make it more systematic a detailed questionnaire covering various aspects of management accounting <sup>technique</sup> touching to the lending decision is prepared and it is attached as Appendix - 1, for ready reference. Over and above this questionnaire prior to finalisation of the same informal discussions were also held with lending officers at some of the branches. Over and above the informal discussions with the lending officers and data collection through questionnaire, discussions were also held with the appraising officers at the regional offices of some of the public sector banks. On account of the secrecy of data/responses assured to them the name of bank for which regional offices were contacted is not declared here.

The data collection from secondary sources is mainly based on :

- Report on currency and finance
- R.B.I. Bulletin
- R.B.I. Annual Report
- Banking Statistics

Reference has been made at the appropriate places in the thesis.

#### PLAN OF THE STUDY :

The study, analysis and results are presented in the following manner.

Chapter I is an introductory chapter.

Chapter II discusses the evolution of subject of management accounting, various management accounting techniques and development in the discipline aspect of advance portfolio of the banking system in India.

Chapter III discusses in detail the purpose behind each question in the questionnaire and the importance of each particular question with reference to banking system and to present study.

Chapter IV discusses the analytical profile of commercial bank branches under study. Here the profile of each bank branch (subject to availability of data) is created in terms of ratio of advance to deposit, profit to advance, profit to volume of business, share of priority sector advance and share of each subsegment of priority advance to priority advance.

Chapter V presents the relationship in relative importance of factors between the segments, within bank branch and between the branches. It further, discusses, the most important aspect of the study, the application of various techniques to various segments and also with reference to total advances of the branch and with reference to volume of business of respective branch.

Chapter VI presents the extent of indepth application of techniques. Utility of techniques for monitoring and follow-up and the impact of application of management accounting techniques on quality of loan portfolio. i.e. the problem credit is discussed.

Chapter VII is the concluding chapter, summarising main results of the study.