

CHAPTER - III  
DEPOSIT MOBILISATION POLICY

Banking System is one of the many institutions that impinge on any economy, affect its performance for the better or the worse. In what measures a given banking system contributes to economic development depends upon the governing policy.<sup>1</sup> With the beginning of planning era, the banks have been called upon to act as an instrument of growth and development.

In the annals of Indian banking, nationalisation of the Imperial Bank of India, social control over banks and nationalisation of 20 major commercial banks are three very important events. The basic rationale that led to the adoption of these measures was to make banks instrumental in the translation of the envisaged national development objectives into realities.

Since social control failed to achieve the desired results, structural changes in the commercial banks was brought about by nationalisation of bank.

The basic objective of nationalisation of 14 major commercial banks in India was to accelerate economic development and thus make a significant impact on the problems of poverty and unemployment and to bring about progressive reduction of disparities between the rich and poor sections of our people and between the relatively advanced and backward areas of our country.<sup>2</sup>

The activity of deposit mobilisation by banks came into shape and rather attained credibility only after the 14 major commercial banks were nationalised. Significantly, there used to be hardly any urgency ~~only~~ in the pre-nationalisation era for deposit mobilisation, as the banks were like joint stock companies, mainly stewarded by big business houses who used to muster up resources required by them through their banks by routine operations only. The banks had no national goals to be fulfilled no social obligations to perform. The public in general were not aware of the facilities the banks could be made to provide and the government had no will to do that.<sup>3</sup>

In the pre-plan era deposit mobilisation was not a problem. Deposits accruing to the banks in the normal course were more than sufficient to meet the limited demand for credit made on them. Ability of a bank officer was judged on the advances he could make. The situation now is different. The biggest challenge facing the banking system to-day in the context of economic planning is the mobilisation of adequate resources.<sup>4</sup>

The banks are now responsible for fostering all round economic growth of the country. They are required to play the role of a catalytic agent and for that purpose they are supposed to provide a substantially large amount of credit facilities to the hitherto neglected sectors and the unbanked centres. Under the 'Service Area Approach', each bank branch have been given the responsibility of

surveying the socio-economic potentialities of the area and preparing annual action plans and bankable schemes for development. Commercial banks can successfully shoulder their new responsibility along side their traditional responsibility only when their resources position is strong.

Secondly, need for increased mobilisation of deposits by banks assumes further importance in view of the long-term objective of the Reserve Bank's Monetary Policy to induce banks to rely more on their own deposit resources, to satisfy increasing credit needs of the community rather than take recourse to the Reserve Bank. What is more, the monetary authority expects banks, which occupy a pivotal position in the economy to combat inflationary pressures by mobilising more and more savings of the people.<sup>5</sup>

Banks have nothing to do with the activity of saving, as it can not dictate the people to save, nor it can directly increase their income so that they may be able to set apart something out of their increased income. But they do help in stimulating savings by battery of incentives:

- 1) Interest on Deposits.
- 2) Cheap Remittances of Funds.
- 3) Safe Custody of Valuables.
- 4) Financial Consultation.

Banks by inspiring confidence in the people make them willing to keep their surplus with them who were otherwise chary of doing so. Banks break up the dualistic character

of economy by bringing within their fold the non-monetised sector. The savings of non-monetised sectors so far withheld from circulation become available by forming the part of monetised sector. The disintegration of demonetised sector which accounts for a significant segment of total economy where the high interest rates prevail is not a difficult task. It is perhaps a revolutionary endeavour, so far as it impinges upon the centuries old habits and taboos of the people.<sup>6</sup>

The rapid increase in the number of branches, between 1969 and 1985, played a vital role in the acceleration of the growth rate of deposits. However, with the emphasis on consolidation in the recent past, banks will have to increasingly depend on other factors for growth in deposits in future.

The importance of deposit mobilisation at the present juncture <sup>is</sup> examined below:

Firstly, Government presents substantial amount of bank resources, through the tools of CRR and SLR. These ratios are directly linked with the quantum of total deposits (CRR is 11 percent and SLR is 38 percent). Hence, growing quantum of deposits will mean increasing availability of funds to the State for development purposes.

Secondly, concentrated efforts for mobilisation of deposits is needed in view of the tough competition encountered by banks from other financial organisation like the Public sector units viz. UTI, Public Provident Fund, LIC, National Development Bonds, National Savings Certificates,

Post Office Bank Deposits, and the private sector's company deposits, shares, equity, debentures and chit funds.<sup>7</sup> The financial assets other than bank deposits have ~~gax~~ grown at compound growth rate of 16.5 percent between 1969-70 to 1986-87. This is a clear indication of an increasing preference of savers in favour of financial assets vis-a-vis real assets. This shift in preferences needs to be captured for accelerating the growth of bank deposits.

Thirdly, with 45 percent of credit diverted to the low yield, priority sector advances to keep their heads above water the banks need more and more funds by way of deposits. So that they can invest matching funds in the non-priority sector and are able to earn profits. Survival and development of banks, are as such mainly influenced by their ability to attract deposits from different segments of the community rather than by the volume of their capital resources. Banks purchase deposits, produce and sell loans. In other words, deposits are the main inputs for loan outputs.

### Interest Rate Policy

In the free world countries, rate of interest is an important determinant of bank deposits. However, in India, we have a rigidly administered interest rate structure, linked to the maturity pattern of term deposits. However, RBI does review, its interest rate policy, from time to time.

The evolution of the interest rate policy is discussed hereunder:

Immediately after bank nationalisation, the study group of the National Credit Council on deposit mobilisation examined the interest rate structure and argued that the level of deposits rates can not be far out of alignment with the rates of competing investment outlets such as non-banking deposits, chit funds, or other financial agencies.<sup>8</sup> The Committee also recommended a dual rate structure for deposits - a higher rate in rural areas and a lower rate in urban areas.

The banking commission in 1972, in its report mentioned the result of a survey conducted by the National Council of Applied Economic Research, on its behalf. The Commission notes ".....84 percent of those who offered comments felt that the interest rates should be raised." "The same survey", writes the Commission, "also showed that 59 percent of the bank depositors who had deposits with companies as well as were attracted by the high rate of interest offered by companies."<sup>9</sup>

Chakravorty Committee on the Monetary System of India in 1985 discussed the issue of interest on bank deposits in detailed. The Committee favoured fixing of only one interest rate, that is on deposits with a maturity of 5 years or more. This interest rate was to be fixed on the maximum interest rate payable on bank deposits. It was to be atleast 2 percent higher than the expected long-term inflation rate. This will provide for a positive real rate of return of 2 percent. The banks would be free to fix the interest rates on deposits of other maturity patterns. Thus providing scope for inter bank comparison.

Considering the public's preference for term deposits with a maturity of 5 years or more, they recommended that all banks may be required to accept such deposits. As regards other maturities, the banks should be free to choose their maturity pattern of deposits, so long as a bank adheres to a uniform pattern of deposit maturities at all its branches at any given time. We, however, recognise that a bank should, similarly, be required to maintain an uniform interest rate structure at all its branches at any given time.

They also recommended that the interest on savings deposits with scheduled commercial banks may continue at the present level of 5 percent per annum. With the growth in the number of bank branches, the banking habit is spreading to hitherto unbanked areas and the interest on savings deposits represents an incentive to be offered to promote the banking habit, although these deposits are widely used for transactions purposes.

On the above basis, banks will have the opportunity to adjust the cost and maturity structure of their deposits to suit their lending operations and thereby improve their profitability.

Further, the Committee considered some aspects of the deposit rates related to the objective of social justice which the monetary system needs to pursue.

At present, interest rates on bank deposits are uniformly applicable to all depositors and no distinction is made between those who gain substantially by fiscal incentives and those whose low incomes prevent them from deriving any such benefit. The fiscal incentives made available to depositors appear to have been justified considering the phenomenal increase in the volume of fixed deposits over the years. These incentives need to be continued. There is, however, a strong justification, in our view, for providing the small saver a better deal than what he has got over the years for reasons we have mentioned earlier. We leave it to the imagination and innovative spirit of banks to devise suitable deposits schemes to achieve this objective.

To sum up, the level and structure of interest rates that we have recommended here explicitly takes into account the need to make a careful assessment of inflationary expectations in the economy while determining the nominal level of certain crucial interest rates. These interest rates are to be determined by the Reserve Bank in consultation with Government as may be necessary. Within the broad framework of administered interest rates which we have recommended, bank will have considerable flexibility to compete among themselves and with the non-bank financial sector by varying their deposit rates and lending rates.

The revision of interest rates suggested by us together with the implementation of our other recommendations in regard to the restructuring of the monetary system, is designed to have the effect of dampening inflationary



expectations in the economy and will hence permit a downward adjustment of all the administered nominal interest rates in succeeding period as inflation rates both actual and expected come down.<sup>10</sup>

### Structure of Interest Rate

V.V. Bhatt has examined the issue of the structure of interest rates in 1987.<sup>11</sup> He observed that, bank deposits being a traditional financial asset, is primarily dependent on the income level and its growth in a country. The existence of a positive real interest structure has been a significant explanatory factor for rising savings rate in practically all the countries experiencing rising rates of savings. Interest rate as such may or may not have much impact on total savings but they have substantial impact on the pattern of savings. The interest rate structure, then, should be such as to induce savers to keep their savings in the form of bank deposits, rather than in the form of investment in unproductive assets. Savers are likely to prefer a financial instrument that is simple, convenient and easily entangible i.e. involves minimal transaction costs, and can be easily and without loss converted into money. Interest bearing deposits of various maturities do provide such financial assets. The monetary yield on various types of deposits should be comparable to the yield exclusive of risk premium on private lending.

In 1984, G.S. Lall, provided important comments on the structure of interest rates.

The more important functions which the rate of interest is expected to perform in a developing economy are --

1. An appropriate structure of interest rates acts as a determining factor in the development of savings habits in a community. It is remunerative rates of interest that encourage savings and help in the mobilisation of resources of capital formation.
2. The structure of interest rates must be such so as to prompt the savings into organised financial institutions for channelisation into productive purposes.
3. In a poverty stricken under-developed economy like India the rate of the time preference is sufficiently high. Therefore, the structure of interest rates should take cognizance of this factor.

The structure of rate of interest therefore, is an important tool in the monetary and financial management of the economy. It is a major variant through which the central monetary banking authorities attempt to achieve their monetary objectives, the commercial banks manage their assets portfolio on the basis of interest yields obtainable on various kinds of assets; and in a market economy it is used amongst other measures as an allocational tool for sectoral resource deployment.

The structure of rates of interest as it operates in the organised money market in India, is not the outcome of free interplay of forces determining the demand for and supply of loanable funds, both short term and long term, rather the structure has been subjected to regulatory control of the RBI.

Further, G.S. Lall observed that the failure on the part of the authorities to conceive and develop an appropriate structure of interest rates had led to certain serious distortions in our financial structure.

1. It has led to a considerable diversion of community's savings into unproductive non-institutional channels with a consequential deprivation of growth investments in the matter of resources.
2. Certain savings instruments like LICs policies and units of UTI have not been as popular as they should have been. They are being taken up more because of Income-Tax concessions rather than the prospective rate of return on these investments.
3. In this country, Government securities have a 'captive' market and this had led to two significant developments :
  - a - The yield from government bonds has always been kept so low that they have seldom become attractive to private investors and,
  - b - This has not allowed development of a healthy bond market in this country.
4. It would have enabled the Government to mop up substantial resources out of the real savings of the economy. To that extent reliance on the finance of public sector outlays through commercial banks' and Reserve Bank's credit could have been reduced and the effects of inflationary finance mitigated.

5. In the context of the need for dispensation of social justice, adoption of an appropriate interest rate policy is inordinately overdue. Investment in unproductive channels have brought fabulous gains to certain sections of the society, whereas the contributory to the provident funds, small savings schemes, life insurance premiums, bank deposits etc. have suffered a serious inflationary erosion in their savings.

The structure of interest rates in this country, therefore, has seldom been assigned in legitimate role of a positive instrument of a growth policy. It is high time that this structure of interest rates is rationalised along the lines suggested.

There is indeed a strong case for raising the interest rates on bank deposits all along the line. The rate of interest must represent an element of hedge against inflation.

While there is a strong case for raising the short-term interest rate, there is equally a strong case for establishing a proper relationship between short-term and long-term rates.

To sum up, the interest rate policy should be used to subserve twin objectives of promoting financial discipline on the one hand and stepping up the rates of savings and capital formation on the other.<sup>12</sup>

### Role of Interest Rate

In the task of mobilising deposits, the questions frequently raised is with regard to the role of interest rate. The importance of understanding the impact of interest rate is a policy variable that is subject to manipulation by the <sup>m</sup>onetary authorities. The role of interest rate in the economy, however, is more complex. The rates which banks and other financial institutions are allowed to pay on deposits from public will have a bearing on the rate at which they lend to their borrowers. Therefore, policy makers while deciding on the rates to be offered on deposits have to take into account the rates at which the banks have to lend. A higher interest rate offered on deposits, will in turn imply a higher interest rate on the loans. However, policy makers cannot completely ignore the depositors' preference pattern. A variety of econometric studies done in the past have shown that deposits do respond to changes in interest rates. However, the most important influence on deposit holding is of ~~income~~ <sup>income</sup>.

It would be incorrect to treat the interest rate offered on deposits by the banks as a kind of price that equates supply with demand of funds. The Central Banking Authority in most of the countries determines the interest rate offered on various types of deposits. Thus the level and the structure of the interest rates are very much the

consequence of the decisions of the policy makers.<sup>13</sup>

Traditionally, banks have been accepting three types of deposits from the public, namely current, savings and fixed deposits for specific periods. No interest is paid on current account, at the same time there are no restrictions on withdrawals from current accounts. The interest rate on savings deposits is the same as that offered by the post office savings bank, with the difference, however, that while the interest on the post office savings bank is free from income-tax, that on savings bank accounts with the commercial banks is included in the free limit of Rs.7,000/- for income from specified categories of financial assets. These savings deposits accounts in the commercial banks offer liberal withdrawal facilities and the commercial banks adopt standing instructions in regard to payment of bills and other remittances in respect of them. This means that the savings account holders get particularly all the advantages of liquidity of a current account and also a small income.<sup>14</sup>

The rates are tied to the bank rate, only in a loose way. For example, in March 1978, there was a downward readjustment of all the interest rates even though the bank rate remained at the old level. The Indian monetary authorities have operated more or less a low interest rate policy for a fairly long period. While interest rates have risen over a period of time, there have been no sharp increases, until very recently. For example, the interest rate on deposits upto one year stood at 2.45 percent in 1953 and 4 percent in 1963. Further, the range of interest rates among deposit of varying maturity was very narrow. In 1960, the interest rate offered

on savings deposits on which interest could also be drawn was 2.5 percent and the interest rate offered on term deposits of 7 years was 4.5 percent. A sharp rise in interest rate occurred in July 1974 when the rates of interest on longer term deposits were substantially increased. In April 1974, the interest rate offered on 5 year deposits was 8 percent and it was raised to 10 percent in July 1974. The difference between interest rates offered on savings deposits and on longer-term deposits was also widened to 5 percent. Thus, while some attempt has been made to raise the general level of interest rates offered on deposits after 1971, it is not in any way comparable to the kind of high interest policy followed by Taiwan and South Korea. There was no attempt to keep the real rates of interest at the nominal rate of interest, less the rate of change in the price level, as positive. In many years, the real rate of interest was negative. The changes made in 1978 have tried to lower the interest rate structure from the level to which it was raised in July 1974.<sup>15</sup>

Agarwal discussed the limitations of the interest rate policy.<sup>16</sup> "In fact the interest rate technique for deposit mobilisation cannot be utilised liberally. It is feared that it may, in the long run, defeat the very purpose for which it was devised. A high deposit rate will mean a high lending rate, it will in turn raise the cost of capital. Investment assuming its interest elasticity will be discouraged. Less income will be generated as a result and so less bank deposits as a consequence. However, there can be another angle of argument. High rate of interest - more deposits - more credit

generation possible even at lower lending rate - more investment as a result - more income and more deposits.

With respect to the influence of interest rate on savings, the views of Shri Chandravarker are quite relevant. "In respect of financial savings, the economic evidence while by no means conclusive, indicates that factors such as the level and the rate of growth of disposable income, wealth, price expectations and institutional facilities for savings are more influential in explaining observed variations in the volume of savings than changes in the rate of interest. All this reflects the complexity of the motives and incentives underlying savings decisions of persons and households."\*

#### Historical Review of the Interest Rate Policy

V.T. Dahajia vividly traces the changes in the interest rates on deposits during the decade 1955-65. The uptrend in prices started towards the end of 1955 and the rather sharp rise in industrial and agricultural production led to an unprecedently large credit expansion. Bank deposits did not rise adequately and therefore, the rates of interest on deposits were raised

Anand C. Chandravarker "Interest rate policies in Developing Countries" Training & Development March 1, 1970, PP 20.



as on adhoc measure. Interest rate on 3 month deposits, which was 3 percent at the beginning of the 1955-56 busy season, rose to 3.3/8 percent at the end of the season. The rates rose further towards the end of the 1956-57 busy season, partly because of the rise in the bank rate in May 1957. At about this time banks began accepting money at short notice of 3 days and inter-bank call money rates also rose sharply. Altogether a situation was thus created in which depositors could earn high rates of interest while retaining liquidity. To meet this situation some of the major commercial banks arrived at an agreement on maximum rates of interest on deposits towards the end of 1958. The agreement not only ~~revised downwards~~ the rates of interest but also prohibited payment of interest on call deposits from the public.

Interest rates on deposits were controlled by the banks themselves during October 1958, and with it started a healthy tradition. Banks stopped outbidding each other in the deposits markets. Thereafter the banks were directed by the RBI as to the maximum and the minimum rates the banks should pay for deposits of different maturities and with that started the era of administered interest rates.

Between October 1958 and November 1960 the revisions of inter-bank agreements made further downward adjustments of interest rates on bank deposits. Notwithstanding this, deposits increased rapidly, particularly in 1959. The reason for this trend is not far to seek. Industrial production

and investment received a set-back in 1957 on account of the foreign exchange crisis and this position continued upto the end of 1959. During these years of restricted industrial production business firms and also individuals invested in bank their excess cash which could not be used directly in business. When the industrial situation began to peak up in 1960, there was a reverse trend in bank deposits. Towards the end of that year there was a sharp decline in the accretion of new deposits. In contrast, boom conditions prevailed in the stock markets and even men of small means began to invest in shares. The fall in the rate of deposit accretion was felt to be sharp perhaps because of the rather high rate of growth of deposits in the previous year and the shift in that year of a larger proportion of liquid funds into stock markets. In september, 1960, the RBI directed the scheduled commercial banks to fix the minimum lending rates. This, together with the normal tendency in influencing conditions to raise lending rates widened the gap between the deposit and lending rates inducing industrial and commercial concerns to accept deposits from the public at rates higher than those offered by banks. There was, thus, a further diversion of potential bank deposits. The upward revisions of the interest rates after 1960 were essentially designed to cope with this situation. In September, 1964 the RBI intervened directly to raise the rates on longer term deposits and to lower the rates on shorter term deposits. With a view to widening the spread between very short-term and long term deposits, the banks imposed ceiling of 2.5 percent and 1.25 percent on interest rates payable on deposits for 46 to 90 and 15 to 45 days respectively.

The ~~maximum~~ rate payable on deposits for periods upto 14 days was pegged at the rate payable on a current accounts. Banks were also advised to pay a minimum of 4 percent per annum on deposits of 91 days with adequate spread for deposits of longer periods, with a view to encouraging further deposits mobilisation. In February 1965, there was a further upward revision of these rates by the RBI. To adjust deposit rates suitably to the other charges, maximum interest payable on deposits for 15 to 45 days and 46 to 90 days were raised by a quarter percent and half percent respectively, and minimum rates were prescribed for deposits for 91 days, 6 months and 1 year and for savings bank deposits at 5, 5.1/2, 6 and 4 percent respectively.

Interest rates on deposits declined in 1959 and remained almost unchanged in 1962, 1963 and 1964. The growth of deposits in all these four years, however, was not only quite large but larger than in the year 1958 and 1961, when interest rates rose. To treat these 6 years as exceptional when the influence of interest rates on deposits was not evident and to regard the rather large growth of deposits in 1965 as mainly due to the influence of interest rates would not be correct. It cannot be denied that interest rates do influence deposit accretion but the importance of other factors should not be underestimated. Deposit accretion depends to some extent upon opportunities or the want of them for profitable use of liquid funds in business. As has been indicated earlier, funds flow into bank; when business is slack and industrial and agricultural production is on the downswing. This is

particularly so in respect of fixed deposits. In the past year and a half, the notable rise in fixed deposit and also the slow rise in current accounts - which are used to a lesser degree when business transaction contract - cou'd be traced to the recession in the Indian economy.<sup>17</sup>

V.T. Dahajia attributed the spur in deposits in 1965, mainly to the favourable movement in the rate of interest. "During 1965, the aggregate deposits of commercial banks increased by the sizeable amount of Rs.398 crores, as compared with Rs.316 crores in 1964 and Rs.246 in 1963. In the first half of the current year (1965) also, deposits increased further by Rs.251 crores. This welcome trend has given rise to speculative thought and ~~misleads~~ understandably so in the absence of proper investigation - on the relative importance of the contributing factors. Some of these factors are plainly visible. Among the visible factors one is inclined to accept and readily so, the contribution of higher interest rates, as the response pattern of interest rates is easier to interpret and understand than the rather abstruse effects of other factors. Nevertheless, the possible impact on deposit accretion of factors like the growth of national income, the increase in money supply as also spread of banking habit and branch expansion programme can not be ignored."

In 1968-69, some banks expressed their unhappiness over the deposit rates agreement. There was a sort of confusion in the deposit market. The RBI appointed a Committee of bankers to examine the issue on the basis of the recommendation of this committee, the RBI issued a directive

on September 1, 1969, stipulating deposit rates payable by commercial banks and thus all the controversy and confusion come to an end.

From September 1, 1969, interest rates for various categories of deposits have been prescribed by the RBI though the policy regarding the structure of rates remain the same. The main features of the present structure of deposit rates are as follows :

- A) interest rate on deposits of less than 90 days tenor is quite low.
- B) the rate for 1 year deposits equals the bank rate.
- C) The rate of interest for deposits for 2 to 3 years was 6.1/2 percent, for 3 to 5 years 7 percent and above 5 years 7.1/4 percent.

Smaller banks are allowed to pay slightly higher rates of interest on various categories of fixed deposits.<sup>18</sup>

A study of the directives make it clear that there was no material difference between deposits rates structure prevailing under the deposit rates agreement and the provisions of this directives rates of interest remained unchanged.

But after the directive, interest rates on deposits have been revised upward several times. The upward revisions in interest rate has taken place mainly for mobilising greater savings. In fact the RBI was revising upward its bank rate and commercial banks lending rate in order to curb inflation. Therefore, the deposit rates of commercial banks too were pushed upwards. Some sort of alignment between commercial banks' lending rates and deposit rates is essential.

Keeping one constant may cause adverse effect on commercial banks' profitability or efficiency.<sup>19</sup>

On February 18, 1970 the Chairman/Chief Executives of the Banks and the Governor of the R.B.I. reviewed credit and deposit trends during the first three months of 1969-70 bus. season. As credit expansion continued to grow in the 1969-70 busy season the Governor asked the Bankers to exercise the utmost caution in extending credit and exercise greater vigilance in the matter of end-use of credit. The Governor also urged the banks to rely more on the resources, which they could mobilise by way of deposits than on resource to the R.B.I.

R.B.I. also took certain additional measures to curb credit expansion and to encourage deposit mobilisation by banks.

On January 21, 1970, R.B.I. removed the ceiling rate of interest on advances, which was fixed at 9.1/2 percent on March 2, 1968 and which was applicable to the larger Indian Scheduled Commercial Banks and Foreign Banks operating in India. The removal of the ceiling rate of 9.1/2 percent on advances and the upward revision of the rates of interest on certain categories of postal deposits, the R.B.I. raised on March 28, 1970 by 1/4 to 1/2 percent the rate payable by banks on deposits for periods of two years and above. While retaining the rates of interest on savings deposits and the rates on fixed deposits for period of less than two years at the previous levels. The new rates came into effect from April 1, 1970.<sup>20</sup>

The rates of interest on various types of deposits (except current deposits, which are interest free) were revised in 1971 and again in April 1973 with effect April 1, 1974, the rates of interest on deposit with banks were revised upwards by 0.25 percent to 1.0 percent for various categories of deposits. The most important revision was the increase by full (one) percent in the case of savings deposits which was intended to promote savings in this form. The interest payable by the R.B.I. on additional deposits maintained by Commercial Banks under Section-42(1) of the R.B.I. Act was revised from 4.75 percent to 5.25 percent.<sup>21</sup> Simultaneously, in order to assist deposit mobilisation and encourage savings interest rates on various categories of commercial banks deposits were increased. The maximum rate payable on deposits of over 5 years was raised from 8 percent to 10 percent per annum, while the rate on savings deposits remained unaltered at 5 percent, upward adjustments in the rates on fixed deposits were made with relatively large increases in respect of longer term deposits.

Connected with the need to check the growth in money and credit, the RBI announced on July 22, 1974 a general hike in the structure of interest rates, covering both lending and deposit rates.

The revision of deposit rates had the principal objective of encouraging savings. Hence, while the rate on savings deposits (which was raised by one percentage point in April 1974) was retained at 5 percent. The rates on various categories of fixed deposits were increased. The increased was 0.5 percent in respect of short-term deposits but as much as 2 percentage points for deposits

of above 5 years and 1.25 percent for deposits in the categories of 3 to 5 years.<sup>22</sup>

The rationale of these directives on interest rates is that the periods for term deposits are categorised. No interest is payable on current account and deposits upto 14 days, the rate of interest to be paid on savings bank accounts is also stipulated. Banks are permitted to pay interest on deposits accepted by them or renewed by them in accordance with such terms and conditions as may be laid down from time to time.

R.B.I. directed that all scheduled commercial banks shall with effect from July 23, 1974 pay interest on deposits maintained in savings accounts at the following rates :

- 1) Banks having aggregate demand and time liabilities of less than Rs.10 crores at the rate of 5.5 percent per annum.
- 2) Banks having aggregate demand and time liabilities of Rs.10 crores and over at the rate of 5 percent per annum.

Thereafter, a need was felt for rationalising the cost structure of banks by changing the interest rates on certain types of deposits and advances.

First of all the deposit rates were revised to encourage mobilisation of savings of a term character. The spread between the short-term and long-term deposit rates was widened, and changed was effected in the types of savings accounts, with effect from June 1, 1977. The rates for fixed deposits



in the range of 91 days to five years were lowered while the rate on fixed deposits of over five years was kept unchanged. A significant change was the two way classification of savings deposits to distinguish between transaction money kept as saving deposits and deposits which partake of genuine savings. With effect from July 1, 1977 the rate on savings deposits with cheque facilities was lowered to three percent while that on savings deposits without cheque facilities continued at 5 percent. Simultaneously the rate of interest paid to banks by the RBI on deposits impounded through the enhancement in the statutory cash ratios (average as well as incremental) was raised from 5.1/2 percent to 6 percent with effect from June 1, 1977. Banks were asked to pass on the additional impounded deposits to their borrowers particularly those in the priority sectors.<sup>23</sup>

Again, the interest rate on bank deposits were revised on September 13, 1979 when the rates on savings deposits and on fixed deposits with a maturity of 9 months to 1 year was raised by half a percentage point and that on fixed deposits of 1 year and over by 1 percentage point.

Simultaneously, with the presentation of the Central Budget for the fiscal year 1981-82, several changes were made in the deposit and lending rate structure. These changes were considered necessary, firstly, because of the persistence of inflationary pressures. Secondly, the various adjustments in lending rates applicable to different categories of borrowers made from time to time combined with the incidence of the interest tax, had resulted in a plethora of rates and certain anomalies which called for rationalisation.

The changes made with effect from March 2, 1981, retained the maximum rate at 10 percent. The rates on fixed deposits of 1 year and above were restructured to make the returns on this categories more comparable with those offered on company deposits of like maturities. The category of deposits with maturity of 1 year and above and upto and inclusive of 3 years (on which interest was paid at 7 percent) was abolished and in its stead two new categories viz. 1 year and above but less than two years was given 7.5 percent and 2 years and above but less than 3 years was given 8.5 percent. While deposits of 3 years and above were allowed the maximum of 10 percent. The category of 5 years and above was dropped; this was done with a view to discouraging banks from taking on fixed interest commitments for excessively long maturities as this creates problem in making shorter term alteration in deposit interest rates.

The new deposit rates were not allowed to be retrospective in effect. However, in the case of reinvestment of old deposits, the penalty payable on premature withdrawal of deposits was not applicable provided the deposits were invested for a longer period than the balance period of the old deposits. As on earlier occasions smaller scheduled commercial banks and regional rural banks were given the discretion to offer  $1/4 - 1/2$  percent higher on deposits of maturities upto 3 years but no such discretion was allowed on the maximum of 10 percent payable on deposits of 3 years and above.<sup>24</sup>

The rates of interest payable by scheduled commercial banks on term deposits of less than 3 years have been stepped up by RBI with effect from March 1, 1982. The actual rise is 1.1/2 percent for deposits of 6 months to less than 9 months and 9 months to less than 1 year. 1 percent for deposits of 46 to 90 days and 91 days to less than 6 months and 1/2 percent for deposits of 15 to 45 days, 1 year to less than 3 years the rate of interest payable on deposits of 3 years and above, however, remains unchanged at 10 percent as also that on savings deposits at 5 percent. By rising the shorter term deposit rates, the RBI has sought to align these rates with the rates on deposits of longer maturities thereby <sup>elongating</sup> ~~smoothening~~ the ~~market~~ maturity pattern. It will be recalled that when the deposit rates of banks were increased in September 1979 and March 1981, the rates for maturities of below 1 year had been left untouched. The revised interest rates however, apply only to fresh deposits and on renewals of maturity deposits.

With a view to enabling banks to attract remittances from abroad a special incentives has been provided for non-resident deposits, with effect from March 1. The term deposits of 1 year and above under the Foreign Currency Non-Resident Accounts Scheme (F C N R) and the Non-Resident External Rupee Accounts Scheme (N R E ) carry interest at rates and percent above the rates permissible on domestic deposits of comparable maturities. Since the additional 2 percent is payable over and above the revised rates, the actual increase in the interest rate (as compared to the earlier rates prior to March 1, 1982) works out to 2.1/2

percent for deposits of 1 year to less than 3 years whereas the increase in respect of deposits of 3 years and above is 2 percent. As in the case of domestic deposits the revised rates would be applicable to fresh deposits and on renewals of maturing deposits. The RBI has however, made it clear that premature renewals of existing deposits under both the non-resident deposits scheme: should not be allowed except on the terms and conditions stipulated in the D B O D circular of January 14, 1975 in respect of domestic deposits.

The Smaller scheduled commercial banks that is those having aggregate demand and time liabilities of less than Rs.25 crores may at their discretion continue to allow an —additional interest of  $\frac{1}{4}$  percent on all term deposits of less than three years and savings deposits.

The revisions in interest rates are expected to assist deposit mobilisation and help the banks in mobilising more savings both from within the country and abroad. They would also enable the banks to bring about a better balance in the maturity pattern of their short-term liabilities and assets.<sup>25</sup>

With effect from May 27, 1985, the RBI restored the interest rates for deposits of schedule commercial banks upto 90 days to the levels prevailing prior to April 8, 1985 and has fixed the rate for maturities of 91 days to less than 6 months at 6.5 percent and the rate for 6 months to less than 1 year at 8 percent.

Out lining the development which led RBI to review the situation and announce the aforesaid changes. Shri R.M. Malhotra, Governor in a communication to the scheduled

commercial banks said that the banks were given the discretion to fix interest rates on deposits of maturities of less than one year within a ceiling of 8 percent with effect from April 8, 1985. It was then expected that with reasonable rates of interest on such maturities the banks would be able to mobilise hitherto untapped resources and thereby widen their deposit base as also achieve a better distribution of term deposits instead of the present highly skewed distribution with concentration ground the longer maturities at relatively higher costs.

Individual banks were expected to so fix the rates as to safeguard their current and savings accounts and simultaneously bring about better portfolio management. However, the approach of banks did not come upto those expectations. The major initially fixed uniform rates for five maturities below 1 year at a level of one percentage point above the rates prevailing prior to April 8, 1985. Subsequently, when a few banks started offering a rate of 8 percent even for a maturity of 15 days, all banks simply followed suit and without regard to the consideration of profitability set a single rate of 8 percent for maturities starting from 15 days and up to one year.

Some of the banks began to manage their 15 days deposits almost like current accounts. Moreover, resort to maturities above 15 days but below one year was greatly diminished. The consequence was a shift of deposits from current account and to a lesser extent from savings accounts to 15 days deposits. Therefore, in respect of maturities of 15 days to 45 days and 46 days to 90 days the interest rates have been restored to

3 and 4 percent respectively.<sup>26</sup>

### Deposit Schemes

Immediately after bank nationalisation in 1969 some studies pointed out the importance of non-interest characteristics of deposit schemes in mobilising bank deposits.

Workshop held at NIBM in 1969 for 'Deposit Mobilisation' indicates the successful techniques as given here under :

The various schemes devised by commercial banks for the purpose of Deposit Mobilisation can be looked at broadly from the following points of view.

1. Schemes which help the commercial banks to go out into the interior parts of the area served by their offices and to reach out new segments of customers hitherto inaccessible to them. In this can be mentioned -
  - a) Mobile Van Scheme
  - b) Mobile Bank Scheme
  - c) Itinerant Agent Scheme
  - d) Small Deposit Scheme
  - e) One-man Office
2. Schemes which are meant to reduce the cash drain from the commercial banks. Presently, in the absence of certain facilities customers are obliged to draw out from the banks their requirements of cash for a longer period of time than would be necessary if certain devices could be found for replacing cash by other acceptable instruments which could be passed on from hand to hand in lieu of cash. In this comes -

- a) Travellers' Cheques
- b) The Credit Card System
- c) Guaranteed Cheques.

3. Schemes which are meant to generate deposits automatically by linking up with certain sources of generation of incomes. In this falls the In-Plant System of some of the banks.
4. Schemes which are specially designed to suit the convenience of the customers which include, apart from convenient location, fixing of convenient hours of business, as for example, morning and evening branches or branches at the shopping centres in the evening hours when people generally take to shopping or branches specially manned by female staff. Night depository service could also be included in this head.

Schemes under which special inducements are offered to prospective customers to open accounts with banks so that the relationship thus built up could grow and result in sizeable deposits for the banks in future. Under this would come schemes such (a) Savings Promotion Campaign (b) Savings weeks.<sup>27</sup>

V.T. Dehajia, V.V. Bhatt, Gopal Karkal and other emphasis on incorporation of the following elements on deposit schemes which were expected to increase bank deposits.

Investments in bank deposits have some advantages which investments in other forms - physical or financial - do not have. These are frequent renewability, overdraft in case of need, an absence of any cost of investment, absence

of the risk of capital depreciation etc. The rate on bank deposits should be lower than yield on other form of investment for these reasons.

The cost and risk of investing funds in assets other than bank deposits, as also, the minimum size of investment required, make bank deposits the natural and perhaps the only form of investment open to majority of individuals.

Despite these considerations, banks in India have relied only upon interest rate to attract deposits. The net effect of deposit accretion of the rise in rates since mid-fifties is a matter of guess. Interest bearing deposits have risen and to that extent the high rates had perceptible effect. But the cost of deposits has also gone up.

Interest rate can not be made the main plank of deposit mobilisation efforts except at the risk of harming the orderly growth of banking in our country.

For the reasons mentioned above, the main emphasis should be in attracting cash intended for current transactions into bank deposits. Here the quality and the variety of services rendered by the banks in the matter of making payments and transferring funds is the decisive factor. In terms of quality of service nothing is more important than reducing the time taken to put through a transaction.

In recent years, banks have been offering in a spirit of competition, a large number of free services, like free issue of travellers cheques, courtesy cards, free transfers of money and collection of cheques. These services have



their uses in making bank deposits attractive as means of payments. There is not doubt that this will increase the advantages of bank deposits over currency and thus lead to a greater proportion of money supply being held in the form of demand deposits. But the real question is whether from long-term point of view, it is in the interest of banking to render these services free of cost.<sup>28</sup>

Commenting on the importance of innovative deposit schemes, V.V. Bhatt stated that 'it is the purpose to suggest certain deposit schemes which can serve the purpose of raising the saving rate in general and the rate of deposit expansion in particular.

The objective of new deposit schemes should be to induce a higher rate of saving generally and saving in the form of bank deposits in particular. This implies that the schemes should be attuned to the basic motives to save. This by itself is not enough. The savers should feel that the instrument of deposits is a simple, convenient and intelligible instrument for saving. They should have enough confidence in the banks so as to induce them to trust the bankers. And the bankers' attitude and approach must be such as to inspire trust and confidence and their services must be such as to offer maximum convenience to the savers.

Apart from the link of deposits with saving motives, some deposit schemes should also be linked with certain services. If the banks can offer these services, the savers would be inclined to keep a part of their saving in the form of deposits.<sup>29</sup>

Earlier importance of deposit mobilisation and use of currency substitutes, if economic development larger deposits and lesser use of currency are necessary to finance increased economic activity. Deposit mobilisation requires high skills - skills of marshalling resources to provide strength and liquidity to the banks. There are various schemes or techniques developed by the banks not only to attract fresh deposits both in urban and rural areas, but also to reduce the cash drain from the banks. Whether the banks operate in suburb or in commercial or industrial centres or in urban residential or rural areas, no two branches are like in their nature of business; in their composition of customer and in local conditions. In other words, the very outlook and method of business differ from place to place and from bank to bank. This means that methods and techniques to be employed to attract deposits and to lend would have to be different to suit the areas, types of clientele and other factors.<sup>30</sup>

The various strategies devised by commercial banks for deposit mobilisation revolve round the fundamental principles of mobility, flexibility, convenience to customers, automatic facility, reduction of cash drain and special inducements to depositors.<sup>31</sup>

The only systematic study of deposit schemes was by C. Rangrajan, has divided the deposits schemes in the following categories.

As part of the effort to mobilize deposits on a larger scale, banks in India have been introducing a variety of new

deposits schemes to suit the needs of different types of customers. Indian banks attract three type of deposits current, savings and fixed. It is in relation to fixed deposits that a number of variations has been introduced to satisfy the requirements of different classes of savers.

In the standard, fixed deposit schemes a customer makes a deposit for a fixed period, the period ranging from 15 days to 5 years and beyond. In such a scheme, interest is paid periodically and the interest rate varies with the term for which the amount is deposited. The essential characteristic of a fixed deposits scheme is a commitment on the part of the depositors to keep the money with the bank for period fixed in advance. From the point of view, portfolio of management such fixed deposits are a great help to banks even though the interest cost can be some sizeable starting from the essential characteristic that the amount is set aside for a fixed period, banks have introduced a variety of modifications to cater to the needs of different classes of customers while the schemes introduced by individual banks may vary in detail the different schemes introduced by the banks fall under the following four categories :

- 1) Reinvestment Schemes
- 2) Recurring Deposit Schemes
- 3) Pension Plan
- 4) Small Deposit Scheme

In the case of all the schemes, described an element of liquidity is imparted into them by providing for loan facilities against securities of deposit receipts or in some cases allowing even withdrawals before maturity. When such

withdrawals are allowed the rates of interest are drastically reduced to act as a deterrent.<sup>32</sup>

The sluggish growth of bank deposits in the recent past has been a cause of concern, especially because of the paramount importance of bank deposits as a monetary variable of the economy. Both Ravi Kumar Bhola and S.G. Shah have attributed this sluggish trend to the following facts.

Deposit growth is a continuous process, much more so in a developing economy, where resource mobilisation acts as a prime mover of the vehicle of development. The valuerability of a complex economy like that of India to the interaction of various heterogenous economic and social factors is more often than not a chain of emerging aberration which becomes difficult to explain.

The pattern of deposit growth in the banking system for quite sometime in the recent past is one such instance. It is in this context that an urgent solution ought to be found to the knotty problem of sluggish deposit growth.

There are several factors those had contributed to the sluggish growth of deposits. Some major factors are as follows :

#### 1) Interest Rate Structure

The interest rate structure governs the deposits with banks, the maximum rate of interest on time deposits with commercial banks is only 11 percent per annum for fixed

deposits with maturity period of 5 years or over, while similar deposits with the corporate sector fetch upto 15 percent per annum - a margin of 4 percent on deposits with the corporate sector is a definite attraction for small investors. This has resulted in the outflow of household savings from the banking system to the corporate sector.

The experience of some other developing countries also confirms that a substantial increase in the interest rates on savings and fixed deposits can bring about substantial increase in the bank deposits. The inflation conditions in these countries reduced the level of real interest rates. Hence, a very high rate of interest was needed to attract deposits. Experiments in Korea, Taiwan, Malaysia and Singapore have also confirmed the effectiveness of ensuring a positive real returns to savers for the mobilisation of deposits. In India, the impact of inflationing conditions has not fully disappeared. Therefore, the rate of interest charged by commercial banks should be raised.

## 2) Inadequate Mobilisation of Rural Savings

The growing prosperity of rural area still remains inadequately exploited by commercial banks for purpose of deposit mobilisation. The saving income ratio of rural households is still low. Rural household income is still invested in an unproductive manner. This shows that there is adequate scopes for mobilising savings in rural areas.

It is essential that banks should post only such team of well trained staff in their rural branches as have an

aptitude for serving in rural areas.

### 3) Poor Customer Service

Commercial banks can not long survive in a competitive environment, if they fail to provide the kinds of services that fulfil the needs and satisfy the wants of their customers. Therefore, whether commercial banks are going to succeed or fail in their trade area is determined to a large extent by how well the needs of their customers have been understood and satisfied.

The attitude of bank's staff towards the customers is very important. The building of an effective customers oriented service involves much ~~more than mere~~ good intensions, it requires human approach, imaginative leadership and innovative outlook.

### 4) Absence of New Schemes

The deposit schemes of various banks are so stereotyped that there is very little room for innovativeness. The straitjacket growth of deposit schemes has slowly removed the attractiveness of bank deposits, to the interest conscious savers.

It is high time therefore that commercial banks attempted to introduce innovative deposit schemes to mean away the depositors from the non-banking financial intermediaries who are able to introduce more deposit schemes. At this juncture, new schemes of deposits, incentives for depositors and attraction should be considered for attracting customers.

4        The increased economic activity is generally higher demand for bank credit in the various sectors of the economy and mainly in the priority sectors. Under the circumstances, commercial banks will have to depend largely on their efforts regarding mobilisation of deposits. The banking facilities should cover as large as number of depositors as possible. Hence, as planned effort for mobilising deposits from a large number of depositors in India is very much needed for the growth of banks' funds, which will increase their capacity to lend more amount of the different sectors of our economy for promoting economic development.<sup>33</sup>

Banks believe in two very simple explanations of the decline in growth rate of their deposits.

One is that high and increasing cost of living has affected the capacity of the people to save. Another is that non-banking corporate sector offers stiff competition to banks by offering higher interest rates. These factors are not adequate to explain the decline in the growth rate of deposits.

The fear that company deposits are depriving banks of their rightful deposits assume that deposits are interest sensitive, while savings or fixed deposits may to some extent be in competition with company deposits, current deposits of banks are complementary to company deposits. Individual banks or individual savings and fixed deposits accounting lose deposits to companies in response to their higher rates, although to some extent,

better facilities and tax benefits and liquidity for transaction needs of customers may hold bank money from going into company deposits.

The position would have been different or difficult if banks did not have money lending opportunities. But in times of credit squeeze and shortage, banks can lend to any one and they maintain both their advances portfolio at a high level upto the permissible limits and maintain also their deposits growth rate.

There is a different relationship between deposits and rates of interest and bank credit. All these years, company deposits rates have been substantially higher than bank deposits rates. Yet the annual rate of growth of bank deposits has always been higher than the growth rate of company deposits at 10 percent per annum, except in 1974, when company deposits rose by 35 percent. The explanation for the extra ordinary growth in that year did not lie in the interest rates structure of that year but in the credit squeeze enforced during that year. It is a severe credit squeeze that drives the borrower depositors away into company deposits and not the attraction of higher interest rates on company deposits. This year again, if company deposits have become more attractive, it is <sup>because</sup> ~~became~~ of high lending rates and severe credit squeeze and not because of lower deposit rates.

Finally, there is a new dimension to the problem of deposit mobilisation. Rate of deposit growth depends more on the income level than on deposit rates. A more cogent



explanation of this year's deposit performance is low rate of growth in GNP rather than lower deposit rates.

Within these overall parameters, each individual bank is capture of improving its own deposit performance. Even if where the overall deposit growth of the banking system would be less than or around 20 percent per annum. Some banks can individually show a growth of 35 to 40 percent and even faster. They are able to do this with a four elements of new strategy. These elements are :

- 1) a problem solving approach towards customers
- 2) development of financial management expertise of a much higher calibre than is quitable in the market
- 3) emphasis on mobilising a captive market of staff deposits and
- 4) greater emphasis on reinvestment plans, recurring deposits, cash certificates and other forms of deposits, where interest is not paid but but accumulated.<sup>34</sup>

On the other hand, the example of one of the nationalised bank is, which has successfully introduced an innovative deposit scheme is cited by V.V. Bhatt. The bank has exemplary achievement in terms of deposit mobilisation.

The Pigny Deposit Scheme introduced on October, 1928 was one scheme which distinguishes syndicate bank from all other banks, even though the limitations of this scheme are many. This scheme was conceived as a supplementary source of resource mobilisation specially from the small savers besides the other

regular saving schemes. As it has remained so during the last five decades of its operation.

The savings of the lower income groups are not generally tapped by any banking company\* because of the huge organisational task and the modicum of business prospects. As the savings would be in dribblets, the cost of collection has to be kept down to render the saving scheme financially viable. It is therefore, necessary to adopt a new strategy to subserve these twin objectives.

Under the Pigmy Deposit Scheme, the bank arranges to collect small sums of money on a daily basis from the door steps of the prospective customers. The minimum amount of savings collected from the depositors under this deposit scheme is Rs.0.25 per day. The accredited agent of the Bank would make his daily rounds to collect the deposit from the customers. He would also issue a receipt to the depositor indicating the balance as on that day. The period of maturity for the deposit is 7 years. The attractiveness of the scheme is not the rate of interest, but the convenience of operations. The lower interest rate offered is justified on the ground that for the dribblets of savings, there is no other avenues of investment available and the opportunity cost is zero.

Loans are also arranged on the outstanding balance of the Pigmy Deposit at the time of need.

\* The non-banking financial intermediaries which are not subjected to any monetary control, attract the savings of these groups by offering fabulous gift schemes, see, "Report of the study Group on Non-Banking Companies", RBI, Bombay 1975.

To make the scheme more attractive after a few other banks started similar scheme. The bank has introduced a new variant called Adarsh Deposit Scheme in 1971.

This had been employed to tap the savings of a particular group of customers. This scheme could be adopted as a means for inculcating banking habits <sup>ing</sup> ~~amongst~~ those classes of the society which normally remain beyond the ambit of modern banking. <sup>35</sup>

### Conclusion

A review of the schemes during the study period reveals that banks compete among themselves for deposit mobilisation by offering special services or imparting special characteristics in various deposit schemes. Given the administered interest rates which are uniform for all the banks, this is the only possibility where in lies the scope for inter-bank competition. Yet, very few banks have introduced innovative schemes with special characteristics tempted to attribute this complacency of the banks to the easy flow of bank deposits, which is a monetary characteristics of most of the developing countries. However, as soon as, the ~~initial~~ initial phase of deposit mobilisation - continuous rise in deposits - is over the banks will have to increasingly depend upon improvisation of the bank deposits as a financial assets for increasing their deposits. The growing competition from NBFIs and Government Securities will make it all the more necessity for the banks to be innovative in formulation of deposit schemes.

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