# CHAPTER VII

## BRANCH EXPANSION

The branches are the main profit centres in the organisation of a bank. There has been an unprecedented growth in the number of bank offices during the post nationalisation period in India. The nationalised banks have implemented the branch licensing policy having its main thrust on opening of the branches in the un-banked and the under banked rural and semi-urban areas. This has resulted into a structural change in the branch-mix of these banks. The number of rural and semi-urban branches of these banks have recorded a significant rise in the total number of branches, during 1972-82. Therefore, an attempt has been made here to examine the effect of these structural changes on the profitability of these banks.

At the outset, we shall make an attempt to test the hypothesis that "rapid branch expansion adversely affects the profitability of banks." We propose to test the hypothesis and for the purpose analyse the data relating to the fourteen nationalised banks in India, in respect of,

(i) growth of branches and their impact on the profitability of these banks;

(ii) changes in the branch-mix of these banks and their impact on bank profitability; and

(iii) on the basis of the findings of (i) and (ii) above, examine the strong causative factors determining the relationship between 'rapid branch expansion' and the 'profitability of banks'.

## Branch Expansion and Profitability

During the pre-nationalisation period commercial banks in India confined themselves to financing mainly large operators in the field of commerce and industry and as such their geographical coverage in terms of branch location was restricted to metropolitan and urban areas only. These banks were not interested in expansion beyond these locations for a variety of historical and operational reasons; one important factor being their concern towards maximisation of profits which was possible more conveniently, if these banks confine themselves to large transactions in urban locations only.

This approach of the banks continued till 1968, when for the first time the government of India introduced 'social control' over commercial banks under the banking laws (Amendment )Act of 1968 with a view to ensure an effective and more involving participation of these banks in the task of achieving the identified socio-economic transformation of the Indian economy. Commercial banks were given directives in respect of branch expansion policy and programmes with a view to ensure a more balanced geographical coverage by these banks and also in respect of their advances to the identified sectors such as agriculture, small-scale industries exports and employment oriented lending programmes now called priority sectors.

Later on, the Government of India set up a National Credit Council with the Finance Minister as its chairman and the governor of the Reserve Bank of India as the Vice-Chairman to,

(i) assess the demand for bank credit for various sectors of the economy,

(ii) determine priorities for the grant of loans and advances,

(iii) co-ordinate lending and investment policies as between commercial and co-operative banks and specified agencies to ensure the optimum use of overall resources.

Again, immediately after nationalisation of the fourteen major commercial banks, the Reserve Bank of India appointed a committee of bankers under the chairmanship of Shri F.K.F. Nariman[1] for advising the government on branch expansion in the unbanked areas of the country. The committee emphasised the need for branch expansion in rural areas for increasing banking facilities in the semi-urban and rural areas for mobilising deposits resulting due to the application of the High Yielding Varieties[2] programme i.e. the New Agricultural Strategy, and also to fill-up the credit gaps in agricultural sector and to generate the possibilities and opportunities of self-employment by developing small-scale and cottage industries and to bring unbanked areas under banking system.[3] For the purpose, the committee suggested an 'area approach' to the problems of rural financing and recommended the introduction of the 'Lead Bank Scheme'. The Reserve Bank of India then adopted an intensive area development programme, lead bank scheme, and the rural oriented branch licensing policy. The nationalised banks embarked upon the 'Big Push Programme' for the massive branch expansion, especially in the unbanked

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[1]F.K.F. Nariman. Committee on Branch Expansion Programme, Reserve Bank of India, 1969, p.1.

[2]P.C.D. Nambiar. Financing for Agricultural Development, Commerce, August 30, 1980, pp.2-7.

[3]F.K.F. Nariman, op.cit.

semi-urban and rural areas for meeting the credit needs of rural families,[4] to reduce the importance of money lenders to help the co-operative institutions, marginal farmers, poor landless labourers etc. and to develop infrastructural facilities to create employment opportunities, improve the life of rural poor, collect the rural savings and thus ultimately accelerate the tempo of economic development.

This has resulted in an unprecedented expansion of bank offices during the post nationalisation period.[5] Table 1 shows the branch expansion in rural, semi-urban, urban and metropolitan areas by the nationalised banks during the post nationalisation period.

It is evident from the table that the rural branches have increased from 3026 in 1973 to 8229 in 1982 and the semi-urban branches from 2493 to 4152 respectively. The urban branches have also gone up from 1675 in 1973 to 2935 in 1982 and the branches in metropolitan areas from 1592 to 2577 respectively. The total number of branches have increased from 8786 in 1973 to 18263 in 1982.

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[4]L.K. Jha. Proceedings of the International Seminar on Banking and Development, Reserve Bank of India, February 9, 1970, p.70.

[5]P.C.D. Nambiar. Banking Policy which Direction, Commerce, September 20, 1980, p.548.

TABLE VII.1

Branch Expansion

Rural

| Banks | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central | 360 | 370 | 390 | 415 | 505 | 577 | 645 | 861 | 923 | 966 |
| India | 275 | 301 | 327 | 370 | 430 | 496 | 560 | 637 | 768 | 813 |
| Baroda | 278 | 290 | 308 | 359 | 475 | 520 | 597 | 665 | 758 | 797 |
| P NB | 329 | 375 | 433 | 465 | 517 | 560 | 635 | 756 | 865 | 931 |
| Canara | 223 | 350 | 375 | 288 | 333 | 363 | 733 | 425 | 475 | 496 |
| UCO | 252 | 279 | 329 | 377 | 418 | 439 | 492 | 614 | 706 | 779 |
| United | 139 | 150 | 175 | 285 | 343 | 362 | 372 | 388 | 406 | 146 |
| Syndicate | 227 | 256 | 286 | 312 | 384 | 414 | 422 | 499 | 565 | 577 |
| Union | 196 | 217 | 261 | 307 | 380 | 420 | 449 | 488 | 600 | 613 |
| Indian | 140 | 139 | 146 | 160 | 200 | 217 | 239 | 270 | 308 | 327 |
| Dena | 234 | 236 | 238 | 239 | 278 | 310 | 325 | 358 | 385 | 392 |
| IOB | 120 | 130 | 150 | 182 | 229 | 262 | 292 | 337 | 395 | 414 |
| Allahabad | 125 | 142 | 166 | 201 | 263 | 329 | 400 | 469 | 499 | 519 |
| MAHA | 128 | 122 | 128 | 139 | 181 | 211 | 422 | 312 | 375 | 459 |
| Total | 3026 | 3357 | 3711 | 4099 | 4936 | 5480 | 6583 | 7079 | 8028 | 8229 |

contd...

TABLE VII.1 (contd.)

Semi Urban

| Banks | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central | 388 | 404 | 431 | 463 | 466 | 477 | 487 | 511 | 525 | 536 |
| India | 183 | 208 | 241 | 269 | 280 | 296 | 299 | 309 | 320 | 324 |
| Baroda | 180 | 190 | 208 | 291 | 329 | 338 | 346 | 352 | 360 | 374 |
| PNB | 332 | 349 | 366 | 400 | 414 | 414 | 417 | 423 | 431 | 433 |
| Canara | 230 | 250 | 275 | 306 | 325 | 340 | N.A. | 378 | 386 | 392 |
| UCO | 180 | 191 | 204 | 220 | 229 | 243 | 247 | 259 | 268 | 279 |
| United | 118 | 125 | 130 | 162 | 159 | 174 | 178 | 178 | 180 | 184 |
| Syndicate | 208 | 227 | 238 | 237 | 231 | 247 | 250 | 256 | 264 | 264 |
| Union | 148 | 175 | 232 | 279 | 287 | 299 | 302 | 307 | 310 | 317 |
| Indian | 120 | 161 | 203 | 240 | 248 | 251 | 255 | 260 | 260 | 261 |
| Dena | 138 | 144 | 146 | 155 | 164 | 171 | 274 | 172 | 177 | 180 |
| IOB | 100 | 114 | 125 | 150 | 179 | 179 | 179 | 187 | 200 | 207 |
| Allahabad | 73 | 95 | 142 | 179 | 192 | 206 | N.A. | 219 | 223 | 230 |
| MAHA | 95 | 118 | 140 | 149 | 151 | 154 | N.A. | 164 | 166 | 171 |
| Total | 2493 | 2751 | 3080 | 3500 | 3654 | 3789 | 3134 | 3975 | 4070 | 4152 |

contd....

TABLE VII.1 (contd.)

Urban

| Banks | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central | 243 | 259 | 280 | 317 | 324 | 335 | 339 | 352 | 356 | 368 |
| India | 143 | 162 | 192 | 214 | 223 | 227 | 228 | 238 | 249 | 259 |
| Baroda | 159 | 169 | 176 | 205 | 219 | 231 | 237 | 258 | 269 | 280 |
| PNB | 210 | 220 | 239 | 266 | 279 | 287 | 290 | 296 | 307 | 215 |
| Canara | 227 | 100 | 125 | 179 | 195 | 195 | N.A. | 212 | 223 | 230 |
| UCO | 133 | 148 | 168 | 184 | 209 | 216 | 219 | 228 | 234 | 241 |
| United | 54 | 100 | 110 | 101 | 101 | 111 | 121 | 128 | 136 | 143 |
| Syndicate | 92 | 106 | 117 | 145 | 137 | 143 | 147 | 154 | 166 | 170 |
| Union | 124 | 134 | 152 | 175 | 184 | 196 | 200 | 209 | 225 | 231 |
| Indian | 80 | 86 | 108 | 141 | 136 | 140 | 142 | 153 | 158 | 163 |
| Dena | 75 | 80 | 90 | 106 | 115 | 125 | 130 | 137 | 141 | 147 |
| IOB | 75 | 88 | 100 | 110 | 118 | N.A. | N.A. | 138 | 143 | 151 |
| Allahabad | 80 | 90 | 111 | 137 | 147 | 147 | N.A. | 165 | 169 | 180 |
| MAHA | 80 | 95 | 110 | 115 | 122 | 129 | N.A. | 142 | 149 | 157 |
| Total | 1675 | 1837 | 2078 | 2395 | 2509 | 2482 | 2053 | 2810 | 2925 | 2935 |

contd....

TABLE VII.1 (contd.)

Metropolitan

| Banks | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central | 174 | 186 | 195 | 223 | 228 | 242 | 245 | 250 | 253 | 255 |
| India | 152 | 164 | 174 | 182 | 190 | 196 | 198 | 201 | 305 | 209 |
| Baroda | 142 | 149 | 160 | 180 | 189 | 223 | 225 | 217 | 224 | 224 |
| PNB | 144 | 157 | 164 | 172 | 185 | 197 | 202 | 205 | 209 | 211 |
| Canara | 159 | 113 | 131 | 242 | 259 | 264 | 468 | 269 | 271 | 275 |
| UCO | 105 | 115 | 124 | 131 | 149 | 159 | 161 | 166 | 176 | 171 |
| United | 98 | 79 | 87 | 136 | 142 | 149 | 150 | 151 | 153 | 154 |
| Syndicate | 111 | 122 | 137 | 166 | 191 | 201 | 205 | 208 | 211 | 213 |
| Union | 111 | 118 | 128 | 143 | 149 | 161 | 166 | 167 | 173 | 177 |
| Indian | 87 | 112 | 122 | 119 | 141 | 147 | 152 | 142 | 148 | 151 |
| Dena | 118 | 126 | 130 | 133 | 147 | 159 | 160 | 163 | 167 | 169 |
| IOB | 89 | 97 | 119 | 127 | 129 | 165 | 273 | 146 | 148 | 152 |
| Allahabad | 55 | 63 | 79 | 91 | 93 | 108 | N.A. | 105 | 108 | 112 |
| MAHA | 47 | 61 | 76 | 82 | 83 | 91 | 231 | 96 | 102 | 104 |
| Total | 1592 | 1662 | 1826 | 2127 | 2265 | 2557 | 2836 | 2486 | 2651 | 2577 |

contd....

TABLE VII.1 (contd.)

Total of Rural, Semi-Urban, Urban and Metropolitan Branches

| Banks | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central | 1165 | 1219 | 1296 | 1418 | 1523 | 1631 | 1716 | 1974 | 2057 | 2125 |
| India | 753 | 835 | 934 | 1035 | 1123 | 1215 | 1285 | 1385 | 1542 | 1605 |
| Baroda | 759 | 798 | 852 | 1035 | 1212 | 1312 | 1405 | 1492 | 1611 | 1675 |
| PNB | 1015 | 1101 | 1202 | 1303 | 1395 | 1458 | 1544 | 1680 | 1812 | 1890 |
| Canara | 739 | 813 | 906 | 1015 | 1102 | 1162 | 1201 | 1284 | 1355 | 1393 |
| UCO | 670 | 733 | 824 | 912 | 1005 | 1057 | 1109 | 1267 | 1375 | 1470 |
| United | 409 | 454 | 502 | 684 | 745 | 796 | 821 | 845 | 875 | 897 |
| Syndicate | 638 | 711 | 778 | 850 | 943 | 1005 | 1024 | 1117 | 1206 | 1224 |
| Union | 579 | 644 | 773 | 904 | 1000 | 1076 | 1117 | 1171 | 1308 | 1338 |
| Indian | 427 | 498 | 578 | 660 | 725 | 755 | 788 | 825 | 874 | 902 |
| Dena | 565 | 586 | 604 | 633 | 704 | 768 | 789 | 838 | 870 | 888 |
| IOB | 384 | 429 | 494 | 569 | 655 | 706 | 744 | 808 | 886 | 924 |
| Allahabad | 333 | 390 | 498 | 608 | 695 | 785 | 876 | 958 | 999 | 1041 |
| MAHA | 350 | 396 | 454 | 485 | 537 | 585 | 653 | 714 | 792 | 891 |
| Total | 8786 | 9607 | 10695 | 12121 | 13364 | 14308 | 15082 | 16358 | 17562 | 18263 |

Source: Financial Analysis of Banks 1972-82, Indian Banks' Association, Bombay.

Further in order to understand the changes in the branch mix of nationalised banks during the period covered by the study, we have analysed the data into the share of rural branches, semi-urban branches, urban branches and metropolitan branches in the total number of branches. Table 2 reveals the percentage change in the share of rural, semi-urban and metropolitan branches.

The analysis relating to the branch expansion by nationalised banks has revealed that the percentage share of rural branches has gone up from 34.44 per cent in 1973 to 46.54 per cent in 1982. During the period the percentage share of urban and metropolitan branches has declined. In the following part of this exercise, an attempt has been made to examine the effect of increase in the share of rural branches on the profitability of the nationalised banks. For this purpose, the following determinants of bank profitability have been identified:

Profit Margin expressed as,

$$PM = \frac{NP}{\text{Total Income}} \times 100 \quad \text{and}$$

Profit Expenditure Ratio expressed as,

$$PER = \frac{NP}{\text{Total Expenses}} \times 100$$

## TABLE VII.2

### Branch Expansion

Rural Branches as % to Total Branches

| Banks | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central | 30.90 | 30.35 | 30.09 | 29.27 | 33.16 | 35.38 | 37.58 | 43.61 | 44.87 | 45.45 |
| India | 36.52 | 36.05 | 35.01 | 35.75 | 38.29 | 40.82 | 43.57 | 45.99 | 49.80 | 50.65 |
| Baroda | 36.63 | 36.34 | 36.15 | 34.69 | 39.19 | 39.63 | 42.49 | 44.57 | 47.05 | 47.58 |
| PNB | 32.41 | 34.06 | 36.02 | 35.69 | 37.06 | 38.41 | 41.12 | 45.00 | 47.73 | 49.25 |
| Canara | 30.18 | 43.05 | 41.39 | 28.37 | 30.22 | 31.24 | 61.03 | 33.09 | 35.05 | 35.60 |
| UCO | 37.61 | 38.06 | 39.93 | 41.34 | 41.59 | 41.53 | 43.96 | 48.46 | 51.34 | 52.99 |
| United | 33.99 | 33.04 | 34.86 | 41.67 | 46.04 | 45.48 | 45.31 | 45.91 | 46.40 | 46.37 |
| Syndicate | 33.58 | 36.01 | 36.76 | 36.71 | 40.72 | 41.19 | 41.21 | 44.67 | 46.84 | 47.14 |
| Union | 33.85 | 33.70 | 33.76 | 33.96 | 38.00 | 39.03 | 40.19 | 41.67 | 45.87 | 45.81 |
| Indian | 32.79 | 27.91 | 25.26 | 24.24 | 27.59 | 28.74 | 30.32 | 32.72 | 35.24 | 36.25 |
| Dena | 41.42 | 40.27 | 39.40 | 37.76 | 39.49 | 40.52 | 41.19 | 43.13 | 44.25 | 44.14 |
| IOB | 31.25 | 30.30 | 30.36 | 31.99 | 34.96 | 37.11 | 39.24 | 41.70 | 44.58 | 44.80 |
| Allahabad | 37.54 | 36.41 | 33.33 | 33.06 | 37.84 | 41.91 | 45.66 | 48.95 | 49.94 | 49.85 |
| MAHA | 36.57 | 30.81 | 28.19 | 28.66 | 33.71 | 36.07 | 64.62 | 43.69 | 47.34 | 46.78 |
| Total | 34.44 | 34.94 | 34.70 | 33.82 | 36.94 | 38.30 | 43.64 | 43.29 | 45.76 | 46.54 |

contd....

TABLE VII.2 (contd.)

Semi-Urban Branches as % to Total Branches

| Banks | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central | 33.30 | 33.14 | 33.26 | 32.65 | 30.60 | 29.25 | 28.38 | 25.88 | 25.52 | 25.22 |
| India | 24.30 | 24.91 | 25.80 | 25.99 | 24.93 | 24.36 | 23.26 | 22.31 | 20.75 | 20.18 |
| Baroda | 23.72 | 23.81 | 24.41 | 28.12 | 27.15 | 25.76 | 24.62 | 23.59 | 22.34 | 22.32 |
| PNB | 32.71 | 31.70 | 30.45 | 30.70 | 29.68 | 28.40 | 27.00 | 25.17 | 23.78 | 22.91 |
| Canara | 31.12 | 30.75 | 30.35 | 30.15 | 29.49 | 29.26 | N.A. | 29.43 | 28.48 | 28.14 |
| UCO | 26.87 | 26.06 | 24.76 | 24.12 | 22.79 | 22.99 | 22.07 | 20.44 | 19.49 | 18.97 |
| United | 28.85 | 27.53 | 25.90 | 23.68 | 21.34 | 21.86 | 21.68 | 21.06 | 20.57 | 20.51 |
| Syndicate | 32.60 | 31.93 | 30.59 | 27.88 | 24.50 | 24.58 | 24.41 | 22.91 | 21.89 | 21.56 |
| Union | 25.56 | 27.17 | 30.01 | 30.86 | 28.70 | 27.79 | 27.03 | 26.21 | 23.70 | 23.69 |
| Indian | 28.10 | 32.33 | 35.12 | 36.36 | 34.21 | 33.25 | 32.36 | 31.51 | 29.74 | 28.93 |
| Dena | 24.42 | 24.57 | 24.17 | 24.49 | 23.30 | 22.35 | 22.05 | 20.72 | 20.34 | 20.27 |
| IOB | 26.04 | 26.57 | 25.30 | 26.36 | 27.33 | 25.35 | 24.04 | 23.14 | 22.57 | 22.40 |
| Allahabad | 21.92 | 24.36 | 28.51 | 29.44 | 27.63 | 26.24 | N.A. | 22.86 | 22.32 | 22.09 |
| MAHA | 27.14 | 29.80 | 30.84 | 30.72 | 28.12 | 26.32 | N.A. | 22.90 | 20.95 | 19.19 |
| Total | 28.37 | 28.64 | 28.80 | 28.88 | 27.34 | 26.48 | 20.77 | 24.31 | 23.17 | 22.73 |

contd.....

TABLE VII.2(contd.)

Urban Branches as % to Total Branches

| Banks | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central | 20.86 | 21.25 | 21.60 | 22.36 | 21.27 | 20.54 | 19.75 | 17.83 | 17.30 | 17.31 |
| India | 18.99 | 19.40 | 20.56 | 20.68 | 19.86 | 18.68 | 17.74 | 17.18 | 16.14 | 16.13 |
| Baroda | 20.95 | 21.18 | 20.66 | 19.81 | 18.07 | 17.61 | 16.86 | 17.29 | 16.69 | 16.71 |
| PNB | 20.69 | 19.98 | 19.88 | 20.41 | 20.00 | 19.68 | 18.77 | 17.61 | 16.94 | 16.66 |
| Canara | 17.19 | 12.30 | 13.80 | 17.64 | 17.70 | 16.78 | N.A. | 16.51 | 16.45 | 16.51 |
| UCO | 19.85 | 20.19 | 20.39 | 20.18 | 20.80 | 20.44 | 19.57 | 17.99 | 17.01 | 16.39 |
| United | 13.20 | 22.03 | 21.91 | 14.77 | 13.56 | 13.94 | 14.73 | 15.14 | 15.54 | 15.94 |
| Syndicate | 14.42 | 14.19 | 15.04 | 17.06 | 14.53 | 14.23 | 14.35 | 13.78 | 13.76 | 13.88 |
| Union | 21.42 | 20.81 | 19.66 | 19.36 | 18.40 | 18.22 | 17.90 | 17.84 | 17.20 | 17.26 |
| Indian | 18.74 | 17.27 | 18.69 | 21.36 | 18.76 | 18.54 | 18.02 | 18.54 | 18.07 | 18.07 |
| Dena | 13.27 | 13.65 | 14.90 | 16.75 | 16.34 | 16.34 | 16.47 | 16.50 | 16.20 | 16.68 |
| IOB | 19.53 | 20.51 | 20.24 | 19.33 | 18.02 | N.A. | N.A. | 17.07 | 16.14 | 16.34 |
| Allahabad | 24.02 | 23.08 | 22.29 | 22.53 | 21.15 | 18.73 | N.A. | 17.22 | 16.91 | 17.29 |
| MAHA | 22.86 | 23.99 | 24.23 | 23.71 | 22.72 | 22.05 | N.A. | 19.88 | 18.81 | 17.62 |
| Total | 19.06 | 19.12 | 19.43 | 19.76 | 18.77 | 17.35 | 13.61 | 17.18 | 16.65 | 16.62 |

contd...

TABLE VII.2 (contd.)

Metropolitan Branches as % to Total Branches

| Banks | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central | 14.94 | 15.26 | 15.05 | 15.73 | 14.97 | 14.84 | 14.27 | 12.66 | 12.29 | 12.00 |
| India | 20.19 | 19.64 | 18.63 | 17.58 | 16.92 | 16.13 | 15.40 | 14.51 | 13.29 | 13.02 |
| Baroda | 18.71 | 18.67 | 18.78 | 17.39 | 15.58 | 17.00 | 16.01 | 14.54 | 13.90 | 13.37 |
| PNB | 14.19 | 14.26 | 13.64 | 13.20 | 13.26 | 13.51 | 13.07 | 12.20 | 11.53 | 11.16 |
| Canara | 21.52 | 13.90 | 14.46 | 23.84 | 22.60 | 22.72 | 18.96 | 20.95 | 20.00 | 19.74 |
| UCO | 15.67 | 15.69 | 15.05 | 14.36 | 14.83 | 15.04 | 14.38 | 13.10 | 12.14 | 18.43 |
| United | 23.96 | 17.40 | 17.33 | 19.88 | 19.06 | 18.72 | 18.27 | 17.86 | 17.48 | 17.16 |
| Syndicate | 17.40 | 17.16 | 17.61 | 19.53 | 20.25 | 20.00 | 20.01 | 18.62 | 17.49 | 17.40 |
| Union | 19.17 | 18.32 | 16.56 | 15.82 | 14.90 | 14.96 | 14.86 | 14.26 | 13.22 | 13.22 |
| Indian | 20.37 | 22.49 | 21.11 | 18.03 | 19.45 | 19.47 | 19.28 | 17.21 | 16.93 | 16.74 |
| Dena | 20.88 | 21.50 | 21.52 | 21.01 | 20.88 | 20.78 | 20.27 | 19.63 | 19.19 | 19.18 |
| IOB | 23.18 | 22.61 | 24.09 | 22.32 | 19.69 | 23.37 | 36.69 | 18.06 | 16.70 | 16.45 |
| Allahabad | 16.52 | 16.15 | 15.86 | 14.97 | 13.38 | 13.12 | N.A. | 10.96 | 10.81 | 10.75 |
| MAHA | 13.43 | 15.40 | 16.74 | 16.91 | 15.46 | 15.56 | 35.37 | 13.44 | 12.87 | 11.67 |
| Total | 18.12 | 17.30 | 17.07 | 17.55 | 16.95 | 17.87 | 18.80 | 15.20 | 14.45 | 14.66 |

Source: Financial Analysis of Banks 1972-82, Indian Banks' Association, Bombay.

Rural Branch Expansion and Profit Margin

Profit Margin (PM) is extremely low or even negative in the rural branches. Especially during the first few years of their existence with the change in the branch licensing policy of the Reserve Bank of India and the thrust of nationalised banks in the rural areas, the growth of rural branches has been unprecedented. As most of the rural branches are loss making branches, an increase in their share in the total number of branches of banks is bound to adversely affect the profitability of the nationalised banks through a decline in their Profit Margin (PM). Table 3 clearly depicts the decline in the profit margin (PM) of the nationalised banks during the period when these banks increased the share of rural branches from about 34 per cent to 46 per cent of the total number of branches. It is evident from the table that except in the year 1975 when average profit margin (PM) of all the nationalised banks taken together increased, the average profit margin (PM) of the nationalised banks during the period 1972 to 1982 has declined from 1.95 per cent in 1972 to 1.57 per cent in 1982.

TABLE VII.3

**Profit Margin**

| Banks | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Central | 0.67 | 0.99 | 1.06 | 1.07 | 0.96 | 0.92 | 0.78 | 0.68 | 1.46 | 1.26 | 1.14 |
| India | 2.96 | 2.63 | 2.23 | 2.99 | 2.46 | 2.20 | 1.98 | 1.91 | 1.55 | 1.52 | 1.27 |
| Baroda | 2.27 | 1.76 | 1.55 | 3.14 | 2.78 | 2.58 | 1.89 | 1.97 | 2.06 | 1.77 | 1.98 |
| PNB | 2.44 | 1.89 | 1.94 | 3.70 | 3.15 | 2.76 | 2.49 | 2.08 | 1.85 | 1.60 | 2.16 |
| Canara | 1.25 | 1.50 | 1.35 | 2.85 | 2.54 | 2.46 | 2.65 | 2.49 | 2.31 | 1.99 | 1.70 |
| UCO | 3.10 | 2.30 | 1.77 | 3.36 | 2.94 | 2.20 | 2.04 | 1.78 | 1.44 | 1.14 | 1.49 |
| United | 1.72 | 0.27 | 2.02 | 2.54 | 1.85 | 1.30 | 1.31 | 1.33 | 1.03 | 1.01 | 0.86 |
| Syndicate | 2.25 | 1.75 | 1.74 | 2.86 | 2.65 | 2.44 | 2.25 | 2.13 | 0.95 | 1.76 | 1.64 |
| Union | 1.98 | 1.49 | 1.49 | 2.74 | 2.23 | 2.01 | 1.98 | 1.79 | 1.86 | 1.55 | 1.53 |
| Indian | 1.84 | 1.57 | 1.79 | 3.76 | 5.18 | 2.31 | 2.41 | 1.94 | 1.45 | 0.91 | 0.87 |
| Dena | 1.81 | 0.57 | 0.62 | 1.58 | 1.53 | 1.36 | 1.19 | 1.04 | 1.00 | 0.78 | 0.93 |
| IOB | 0.72 | 1.48 | 4.61 | 5.07 | 6.89 | 6.21 | 5.07 | 3.91 | 3.10 | 2.33 | 2.04 |
| Allahabad | 1.16 | 0.61 | 0.91 | 2.72 | 2.51 | 1.62 | 1.87 | 2.45 | 2.00 | 1.57 | 1.46 |
| MAHA | 0.53 | 1.21 | 0.83 | 0.66 | 0.65 | 0.50 | 0.47 | 0.95 | 1.47 | 1.38 | 2.03 |
| Total | 1.95 | 1.56 | 1.67 | 2.73 | 2.56 | 2.19 | 2.00 | 1.87 | 1.66 | 1.53 | 1.57 |

Source: Financial Analysis of Banks 1972-82, Indian Banks' Association, Bombay.

<u>Profit Expenditure Ratio</u>

The other indicator that has been identified to explain the declining profitability of the banks due to rapid branch expansion and more than proportionate growth in the number of rural branches is profit/expenditure ratio. The justification for idenfitying this indicator lies in the fact that new branches and especially those in the rural and semi-urban areas have a gestation period ranging from three to five years to break-even mainly because the establishment and other fixed costs are irreduceable, whereas increase in business and the resultant revenue takes its own time to grow inspite of serious efforts. This is evident from table 4 which shows profit as a ratio of expenditure of nationalised banks during the period 1972 to 1982. Table 4 shows an adverse effect of rural branch expansion on profitability of the nationalised banks. The rapid rural branch expansion has resulted imto more than proportionate increase in the expenditure of the nationalised banks. Due to this the profit as percentage to total expenditure has declined from 1.99 per cent in 1972 to 1.59 per cent in 1982.

The two indicators, Profit Margin (PM) and Profit Expenditure Ratio (PER) have proved that rapid rural branch expansion has increased the expenditures of these

TABLE VII.4

Profit Expenditure Ratio

(Percentage)

| Banks | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Central | 0.67 | 1.00 | 1.07 | 1.08 | 0.96 | 0.92 | 0.78 | 0.69 | 1.48 | 1.28 | 1.15 |
| India | 3.05 | 2.70 | 2.28 | 3.08 | 2.51 | 2.24 | 2.22 | 1.95 | 1.57 | 1.54 | 1.29 |
| Baroda | 2.33 | 1.78 | 1.57 | 3.24 | 2.85 | 2.15 | 1.93 | 2.01 | 2.10 | 1.80 | 2.02 |
| PNB | 2.50 | 1.92 | 1.98 | 3.85 | 3.24 | 2.84 | 2.55 | 2.12 | 1.88 | 1.62 | 2.20 |
| Canara | 2.10 | 1.52 | 1.38 | 2.92 | 2.60 | 2.52 | 2.72 | 2.56 | 2.36 | 2.03 | 1.73 |
| UCO | 3.20 | 2.35 | 1.80 | 3.48 | 3.02 | 2.24 | 2.09 | 1.81 | 1.46 | 1.16 | 1.51 |
| United | 1.75 | 0.27 | 2.06 | 2.60 | 1.88 | 1.31 | 1.33 | 1.35 | 1.04 | 1.02 | 0.86 |
| Syndicate | 2.30 | 1.78 | 1.78 | 2.94 | 2.71 | 2.50 | 2.30 | 2.18 | 0.96 | 1.79 | 1.67 |
| Union | 2.02 | 1.51 | 1.53 | 2.82 | 2.27 | 2.05 | 2.02 | 1.82 | 1.90 | 1.57 | 1.56 |
| Indian | 1.87 | 1.60 | 1.83 | 3.90 | 5.46 | 2.35 | 0.21 | 1.98 | 1.47 | 0.92 | 0.87 |
| Dena | 1.85 | 0.59 | 0.62 | 1.61 | 1.54 | 1.37 | 0.11 | 1.05 | 1.01 | 0.79 | 0.93 |
| IOB | 0.72 | 1.15 | 4.83 | 5.34 | 7.39 | 6.62 | 0.42 | 4.07 | 3.20 | 2.39 | 2.09 |
| Allahabad | 1.88 | 0.62 | 0.94 | 2.80 | 2.57 | 1.64 | 0.16 | 2.52 | 2.04 | 1.60 | 1.48 |
| MAHA | 0.53 | 1.20 | 0.84 | 0.66 | 0.65 | 0.50 | 0.05 | 0.96 | 1.49 | 1.40 | 2.08 |
| Total | 1.99 | 1.58 | 1.70 | 2.81 | 2.62 | 2.23 | 0.17 | 1.90 | 1.75 | 1.55 | 1.59 |

Source: Data analysed is based on the published Annual Financial Statements of the nationalised banks.

banks more than proportionately to their incomes. Therefore, it can be inferred that the rural branch expansion has adversely affected the profitability of the nationalised banks.

## Factors Determining Relationship between 'Branch Expansion' and 'Declining Bank Profitability'

The analysis given above clearly indicates that the profitability of nationalised banks in India has declined as a result of their rapid expansion mainly in the rural and semi-urban areas. In order to further explain this as well as to find out the strong operational factors responsible for the negative correlation between growth of branches (in numbers) and profitability of banks, an analysis of bank profitability at the branch level has been done by stratifying the sample bank offices on the basis of their location, age and profitability. The rationale for this analysis lies on the premise that the profitability of a bank (as a whole) depends ultimately on the profitability of its branches (profit centres).

For the sake of analysis, at the outset, the branches have been classified into profit making branches and loss making branches. The loss making branches show losses after giving effect to the imputed interest cost on the transferred funds with the application of the transfer prices.

As the data pertaining to the loss making branches in terms of branch mix, age-wise, and quantum of loss are not available, we have conducted a survey of the fourteen nationalised banks. On the basis of our survey regarding loss making branches, we have identified three banks whose identity is not to be disclosed, hence we shall call them bank 'x', bank 'y' and bank 'z'. The analysis of these banks has been made on the basis of the following:

(i) Total number of branches as on 31st December 1982,

(ii) The number of 'loss making branches' have been identified, area-wise, from the total number of branches,

(iii) The branches have been classified, age-wise, on the basis of their date of opening in different areas,

(iv) Actual loss made by a branch has been calculated with the help of branch accounting procedure after taking into account the transfer price rate, etc.

Table 5 relating to bank 'x' shows the area-wise loss making branches. This table reveals that 61 per cent of the total loss making branches are in rural areas and 20.98 per cent are in the semi-urban areas.

TABLE VII.5

BANK 'x'

Distribution of Loss-making Branches - Area-wise

| Area | No. of branches as on 31st December 1982 | No. of Loss-making branches as on December 1982 | Percentage of loss-making branches to total No. of branches as on December 1982 |
|---|---|---|---|
| Metropolitan | 211 | 36 ( 4.60) | 17.1 |
| Urban | 315 | 105 (13.42) | 33.3 |
| Semi-urban | 433 | 164 (20.98) | 37.9 |
| Rural | 931 | 477 (61.00) | 51.2 |
| Total | 1890 | 782 (100.00) | 41.38 |

Note: Figures in brackets indicate percentage to total.

Table 6 relating to bank 'y' reveals that 60.27 per cent of the total loss making branches are in rural areas and 20.70 per cent are in semi-urban areas.

TABLE VII.6

BANK 'y'

Distribution of Loss-making Branches - Area-wise

| Area | No. of branches as on 31st December 1982 | No. of loss-making branches as on December 1982 | Percentage of loss-making branches to total No. of branches as on December 1982 |
|---|---|---|---|
| Metropolitan | 215 | 36 ( 5.48) | 16.7 |
| Urban | 268 | 89 ( 13.55) | 33.2 |
| Semi-urban | 358 | 136 ( 20.70) | 38.0 |
| Rural | 764 | 396 ( 60.27) | 51.8 |
| Total | 1605 | 657 (100.00) | 40.9 |

Note: Figures in brackets indicate percentage to total.

Table 7 relating to bank 'z' shows that out of total loss making branches 59.65 per cent are in rural areas and 21.04 per cent are in semi-urban areas.

TABLE VII.7

BANK 'z'

Distribution of Loss-making Branches - Area-wise

| Area | No.of branches as on 31st December 1982 | No.of loss-making branches as on December 1982 | Percentage of loss-making branches to total No.of branches as on December 1982 |
|---|---|---|---|
| Metropolitan | 284 | 48 ( 5.55) | 16.90 |
| Urban | 355 | 119 ( 13.76) | 33.52 |
| Semi-urban | 475 | 182 ( 21.04) | 38.32 |
| Rural | 1011 | 516 ( 59.65) | 51.04 |
| Total | 2125 | 865 (100.00) | 40.70 |

Note: Figures in brackets indicate percentage to total.

The branches of these banks have been further classified age-wise. The age-wise analysis of loss making branches shows the gestation period in metropolitan area, urban area, semi-urban area and rural area. The classification of age-wise loss making branches of the banks is given as under:

(i) Branches less than three years of age,

(ii) More than three years of age but less than five years old branches,

(iii) More than five years of age but less than ten years old branches,

(iv) Branches above ten years age.

Tables 8, 9, and 10 of the banks 'x', 'y' and 'z' reveal that the number of loss making branches belonging to the age group, above five years but less than ten years are relatively greater in number.

The loss making branches above ten years of age are also relatively large in number in rural and semi-urban areas.

In order to understand the adverse implications of increasing number of loss making branches on profitability, we will examine them in terms of the quantum of their loss.

TABLE VII.8

BANK 'x'

Distribution of Loss-making Branches

as on 31st December 1982

(Area x Age Group)

| Area/Age | Less than 3 years | 3 years and above but less than 5 years | 5 years and above but less than 10 years | Over 10 years | Total |
|---|---|---|---|---|---|
| Metropolitan | 9 | 5 | 13 | 9 | 36 |
| Urban | 24 | 12 | 37 | 32 | 105 |
| Semi-urban | 23 | 10 | 77 | 54 | 164 |
| Rural | 200 | 103 | 113 | 61 | 477 |
| Total | 256 | 130 | 240 | 156 | 782 |

TABLE VII.9

BANK 'y'

Distribution of Loss-making Branches

as on 31st December 1982

(Area x Age Group)

| Area/Age | Less than 3 years | 3 years and above but less than 5 years | 5 years and above but less than 10 years | Over 10 years | Total |
|---|---|---|---|---|---|
| Metropolitan | 8 | 5 | 13 | 10 | 36 |
| Urban | 21 | 12 | 32 | 24 | 89 |
| Semi-urban | 19 | 9 | 64 | 44 | 136 |
| Rural | 167 | 83 | 93 | 53 | 396 |
| Total | 215 | 109 | 202 | 131 | 657 |

TABLE VII.10

BANK 'z'

Distribution of Loss-making Branches

as on 31st December 1982

(Area x Age Group)

| Area/Age | Less than 3 years | 3 years and above but less than 5 years | 5 years and above but less than 10 years | Over 10 years | Total |
|---|---|---|---|---|---|
| Metropolitan | 11 | 6 | 18 | 13 | 48 |
| Urban | 28 | 14 | 42 | 35 | 119 |
| Semi-urban | 26 | 12 | 86 | 58 | 182 |
| Rural | 218 | 111 | 119 | 68 | 516 |
| Total | 283 | 143 | 265 | 174 | 865 |

Tables 11, 12 and 13 of the banks show that the loss making branches belonging to the age group above five years but less than ten years between the range of the quantum of loss from Rs.50,000 to Rs. 1 lakh are relatively greater in number.

TABLE VII.11

BANK 'x'

Distribution of Loss-making Branches as on 31st December 1982

(Age Group x Quantum of Loss)

| Quantum of Loss/Age Group | Less than 3 years | 3 years and above but less than 5 years | 5 years and above but less than 10 years | Over 10 years | Total |
|---|---|---|---|---|---|
| Less than Rs 10,000 | 39 | 12 | 19 | 7 | 77 |
| Rs.10,000 to Rs.25,000 | 17 | 31 | 45 | 17 | 110 |
| Rs.25,000 to Rs.50,000 | 72 | 38 | 44 | 33 | 187 |
| Rs.50,000 to Rs. 1 Lakh | 88 | 34 | 56 | 36 | 214 |
| Over Rs. 1 Lakh | 40 | 15 | 76 | 63 | 194 |
| Total | 256 | 130 | 240 | 156 | 782 |

# TABLE VII.12

## BANK 'y'

## Distribution of Loss-making Branches as on 31st December 1982

(Age Group x Quantum of Loss)

| Quantum of Loss/Age Group | Less than 3 years | 3 years and above but less than 5 years | 5 years and above but less than 10 years | Over 10 years | Total |
|---|---|---|---|---|---|
| Less than Rs.10,000 | 33 | 10 | 16 | 6 | 65 |
| Rs.10,000 to Rs.25,000 | 14 | 26 | 38 | 14 | 92 |
| Rs.25,000 to Rs.50,000 | 61 | 33 | 37 | 28 | 159 |
| Rs.50,000 to Rs. 1 Lakh | 74 | 29 | 47 | 30 | 180 |
| Over Rs. 1 Lakh | 33 | 11 | 64 | 53 | 161 |
| Total | 215 | 109 | 202 | 131 | 657 |

TABLE VII.13

BANK 'z'

Distribution of Loss-making Branches

as on 31st December 1982

(Age Group x Quantum of Loss)

| Quantum of Loss/Age Group | Less than 3 years | 3 years and above but less than 5 years | 5 years and above but less than 10 years | Over 10 years | Total |
|---|---|---|---|---|---|
| Less than Rs.10,000 | 43 | 13 | 22 | 8 | 86 |
| Rs.10,000 to Rs.25,000 | 19 | 34 | 49 | 19 | 121 |
| Rs.25,000 to Rs.50,000 | 80 | 42 | 48 | 37 | 207 |
| Rs.50,000 to Rs. 1 Lakh | 98 | 38 | 62 | 40 | 238 |
| Over Rs. 1 Lakh | 43 | 16 | 84 | 70 | 213 |
| Total | 283 | 143 | 265 | 174 | 865 |

The loss making branches above ten years of age are making quantum of loss above Rs.1 lakh. Their number is also high.

The major findings of our analysis of loss making branches are summarised as follow:

(i) Approximately 80 per cent of the total loss making branches are in the rural and semi-urban areas.

(ii) Relatively large number of loss making branches are above five years of age but less than ten years of age and above ten years of age also.

(iii) A large number of loss making branches referred above are having quantum of loss above Rs.1 lakh.

The above findings prove that the increasing number of loss making branches, particularly in rural and semi-urban areas have adversely affected the profitability of the nationalised banks. Therefore, an attempt has been made to analyse the factors adversely affecting the profitability of rural and semi-urban branches.

## Factors Adversely Affecting the Profitability of Rural Branches

These factors have been broadly classified into two groups; (Exhibit VII.1)

I. High Cost Factors, and

II. Other Factors.

We will first narrate the High Cost Factors affecting the profitability at the branch level.

### I. High Cost Factors

#### (1) High Cost of Transactions in Rural Branches

The analysis of cost reveals that the cost of transactions in rural branches is relatively higher. The service cost of deposits and advances is higher in rural branches, particularly service cost of advances is much higher in rural branches. The cost of service of all advances expressed as percentage to total outstanding credit is 1.17 in metropolitan and urban centres and 2.36 in semi-urban centres as against 3.24 in rural areas.[6] Hence rural branches are more expensive in their operations compared to the urban branches.

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[6] PEP Committee unpublished Report, Reserve Bank of India, Bombay, 1977.

(2) Establishment Expenditure

The rapid increase in the number of rural and semi-urban branches have increased their establishment expenditure. This mounting increase in the establishment expenditure has affected the profitability of the banks.[7]

(3) High Level of Cash Balances

The cash in a branch is an inventory. The rural branches are spread over a very large territory. This problem of long distances makes it difficult for the rural branches to transfer their excess cash to head office promptly. As a result of this, the rural branches have to bear the carrying cost of funds/inventory. This factor reduces their earnings and increases the interest costs on idle cash balances. This ultimately adversely affects the profitability of rural branches.[8]

(4) Transfer Price

Transfer price is another factor affecting the profitability of a branch. Different banks follow

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[7] Ibid.
Economic Times, 8th February 1979.

[8] S.G. Shah. Branch Profitability Consideration, Business India, July 21 to August 3, 1980, pp.48-49.

PEP Committee's Report, Reserve Bank of India, Bombay, 1977, PX9, Unpublished Report.

different transfer prices. As in wellknown, the branch profitability depend on the factors such as

(i) the total interest paid and establishment costs incurred at the branch level,

(ii) the net income directly earned by the branch on its advances, investments and services, and

(iii) the interest received by the branch on surplus funds transferred by it to the head office or interest charged to the branch for funds made available by the head office to it.

The interest computed on funds flowing to and from branches influence the branch profitability.

The transfer prices fixed by the bank management at head office level should be so worked out that the profit figures of branches constitute an accurate reflection of the branch management's performance and the contribution of the branch towards the overall performance of the bank.[9]

(5) Security

The rural branches are generally located in the remote rural areas where the security of public funds

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[9]Banking Commission - Analysis of Profitability of Banks, 1972, pp. 12-53.

is a problem. For this every branch has to employ one guard. It also increases the overhead administrative expenses.[10]

## II. Other Factors

### (1) Lack of Perspective Planning of Branch Expansion and Command Area.

Every programme of expansion has definite planning and objective. The branch expansion policy has a definite set of objectives and the banks followed the Big Push Programme of Branch Expansion without any systematic planning.[11] The banks followed the target approach without considering the following:

(i) Banking needs in the area,

(a) Deposit potentiality of the command area, and

(b) Credit absorption capacity of the command area.

(ii) Infrastructure facilities,

(iii) Existing of other financial institutions and bank offices.

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[10] R.K. Talwar. Problems in Expansion of Banking in Rural Areas: Proceedings of International Seminar on Banking and Development, RBI, Bombay, February 9, 1970 p.53.

[11] K.Y. Natarajan. Future Structure of the Indian Banking System, Technical Studies prepared for the Banking Commission, 1972.

(iv) Co-ordination of existing financial agencies.

(v) Existence of suitable communication and delegation of authority systems.

(vi) The availability of suitable and well trained personnel for the new type of jobs and environment prevailing in rural areas.

Banks have achieved growth in their capacity but not in sales.[12] The increased number of branches have reduced their profits. Thus, the post nationalisation era of growth in terms of an increment in the number of branches created the problems of profitability at the rural branch level.

(2) <u>Absence of Management Information System (MIS)</u>

The large scale branch expansion programme exerted severe pressure on manpower resources of banks. The absence of MIS, decentralisation of powers and delegation of authority have their adverse impact on the profitability of rural branches.

The management institutions and organisations have developed some suitable management techniques and skills for the centralised firms. The banks to a great extent apply the same management techniques and skills to their decentralised net work of branches. The applications of

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[12] R. Raghupathy. Profit Planning in Commercial banks, Reasons for declining profitability, Indian Banks' Association Bulletin, May 1980, p.1.

techniques and skills of centralised undertakings to decentralised branch network have failed to produce expected results and have not been able to achieve the target of increasing operational efficiency.

(3) <u>The Number and Staff Mix at the Branch</u>.

The number of personnel in a branch is larger than the business available to it. This results in idle manpower in a rural branch. Approximately 50 per cent of manpower remains idle in rural areas. Thus, there is an under utilisation of manpower in the rural branch. The staff mix[13] with a high percentage of senior employees drawing high salaries constitute a drag on the rural branch profitability.[14] A rural branch is too weak to bear the burden of the salaries of such senior staff.

(4) <u>Urban Oriented City-Bred Bankers</u>.

The bank employees working in rural branches are generally transferred from cities to villages. They find it difficult to stay there. They lack interest and initiative in day-to-day operations of a branch.

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[13] Report of the PEP Committee, RBI, Bombay, 1977, px 5-6.

[14] R.K. Talwar., <u>op.cit</u>.

The banker is a public servant and it is his responsibility to develop the business of a branch. The bankers in villages have no idea about their command area and they simply remain the sleeping bankers at the branch. These bankers should go out of the branches and mix with the target groups, like agricultirists, artisans, landless labourers, fishermen, etc. But most of the bank personnel who are city-bred and city accustomed, have been found unsuitable for rural banking.[15]

(5) Capacity Utilisation at the Branch Level.

During the years 1972 to 1982 the nationalised banks made a record in rural branch expansion.[16] The branches opened in rural and semi-urban areas did not remain economically viable. The economic viability of a branch alongwith other variables depends upon the business potential in the area. Most of the loss incurring branches are in rural areas.[17] The business potentialities of such areas are very low. The

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[15] R.K.S. Rao. Personnel Policies in the eighties, Commerce, August 30, 1980, pp.15-16.

[16] Indian Banks' Association Bulletin, May 1980.

[17] Report of the PEP Committee, RBI, Bombay, 1977.

infrastructural facilities are poor.[18] For example if a bank opens two offices, one in metropolitan area and the other in a rural area on the same date with the same inbuilt capacity or with identical office organisation or the same input cost, the branch in metropolitan area will soon reach the break-even point, while the branch in rural area will suffer losses for a long period of time.[19]

Excess capacity or idle capacity in a branch results in low output[20] and higher cost per unit of output. The economies of scale explains the effects of changes in the levels of production on the cost per unit.[21]

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[18] J.C. Sandesara. Economies of Scale - Some Notes, Artha Vikas, Vol. XII, No.2, July-December 1976.

[19] R. Raghupathy. Profit Planning in Commercial Banks reasons for declining profitability, Indian Banks Association Bulletin, May, 1980, p.1.

[20] R. Raghupathy. Economic Viability of Commercial Banking, Commerce, August 30, 1980, p.12.

[21] J.C. Sandesara, op.cit.

Lyle E. Gramely. A study of scale economies in commercial banking.

George J. Benston. Economics of Scale of Financing Institution, U.S.A.,1970, pp.8-9,43.

Committee on Money and Credit, Private Financial Institutions, U.S.A.,1963.

Report of Banking Commission 1972, 'Restructuring of the Banking System, pp.372-394.

In manufacturing there tends to be a reduction in cost per unit of production as volume increases. This is due to the economies frequently realised in purchasing larger quantities of raw material and the more efficient use of labour and manufacturing facilities. In banking on the other hand, although interest cost is a substantial part of the cost of sales the number of loans made does not directly affect the interest cost per rupee on funds obtained. Reduction in unit cost therefore, must come from better utilisation of resources.

(6) Deposit Surplus and Low Credit Deposit Ratio

The loss incurring branches are deposit surplus branches. In recent years the deposit mix in a branch has changed in favour of term deposits with longer maturities carrying higher costs. The interest costs of resources have gone up with increasing proportion of low yielding assets in rural areas.

The low credit deposit ratio at the rural branches has also adversely affected the profitability of rural branches.

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EXHIBIT - VII.1

**FACTORS AFFECTING THE BRANCH PROFITABILITY**