AN INVESTMENT PATTERN OF SCHEDULED COMMERCIAL BANKS IN INDIA

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ABSTRACT

The words, the investment and investment problems will revolve around the concept of managing the surplus financial assets in such a way, that will lead to the wealth maximization and providing significant further source of income to the banks. Thus the investment is the management of the surplus resources in such a way that it will provide benefits to the supplier of the funds that is the banks. However, the investment is a procedural task. It must follow a definite process, to ensure the formulation of proper investment policy. Banks are disbursing their money as investment in trade business and industry. Therefore, banks should be following the principle of investment for profit. An investment policy should ensure maximum profit and minimum Risk. A huge collection and investment policy plays vital role for the economic development of whole economy. The main focus of this study will be towards the investment portfolio of the scheduled commercial banks.

Keywords: Investment; Scheduled Commercial Banks; Investment Pattern; RBI

INTRODUCTION

In 1991, much after China and other south Asian countries, waves of globalization touched Indian shores. Being a new player to globalization, many economic reforms were recommended by various economists. These reforms revolutionized the Indian economy in the era of globalization where India is performing pretty well and strong banking system of India has contributed a lot towards recovery of Indian economy from recession. Indian banking industry has direct impact on economy in terms of improved return on investment, decreasing non-performing assets, deregulation of interest rates, improved return on capital etc. Among all investment is one of the important factors to be studied. Banks must plan and keep aside some amount of money to meet uncertainty. Banks are disbursing their money as investment in traded business and industry. An investment should ensure maximum profit and minimum risk. By taking into account the importance of investment pattern of scheduled commercial bank, this paper studies the investment pattern of Schedule Commercial banks. Bank invest in gilt edged securities and stock exchange securities, as well as the shares and bonds of highly reputed companies.

Commercial Banks refer to both scheduled and non-scheduled commercial banks which are regulated under Banking Regulation Act, 1949

Scheduled Commercial Banks Are Grouped Under Following Categories:

1. State Bank of India and its Associates
2. Nationalized Banks
3. Foreign Banks
4. Regional Rural Banks
5. Other Scheduled Commercial Banks.

The scheduled commercial banks are those banks which are included in the second schedule of RBI Act 1934 and which carry out the normal business of banking such as accepting deposits, giving out loans and other banking services. The major difference between Scheduled Commercial Banks and Scheduled Cooperative Banks is their holding pattern, since cooperatives are registered under the Cooperative Societies Act as cooperative credit institutions.

Non-Scheduled Commercial Banks

Note: Banks in the groups (1) & (2) above are known as public sector banks whereas, other scheduled commercial banks mentioned at group (5) above are known as private sector banks.

Nature of Investment Account in a Schedule Commercial Banks

After meeting its liquidity requirements by keeping primary and secondary reserves and after satisfying the genuine credit needs of society, whatever is left is invested by a bank to acquire long term obligations of public and private enterprises in order to improve its own earnings. It include gilt edged securities and stock exchange securities, as well as the shares and bonds of highly reputed companies.

The principle objective of investment by a scheduled commercial bank is to maximize earnings and to keep the funds liquid and safe. As the matter of fact, security investment is suppose to act as third line of defence, and should replenish the secondary reserve to meet the unexpected withdrawals of deposits and unusual loan demand.

While secondary reserve account consists of securities of a very short period maturity, the investment account includes long period securities. Treasury bills due in 90 days are included in the secondary reserve whereas treasury bonds maturing in 15 years appear in the investment account.

Another redeeming feature of the investment account is that there is a constant movement of asset from the investment account to the secondary reserve. A government bond carrying a 10 year maturity forms part of the investment portfolio of a bank in the first 9 years; but, in the 10th year when the bond will mature, it moves to the secondary reserve accounts assuming that one year period is the dividing line at times, assets held in the secondary reserve move to the investment account.

The investment portfolio of Indian commercial banks, as indicated by their published accounts consists of government securities and domestic investments, including other trustee securities, the share and debentures of corporate bodies, real estate, bullion, units of UTI, and others.

The Investment Account Differs From the Loan Account In Many Respects

1. It carries with it the concept of the use of funds for a short term period (frequently, but not regularly) on condition of repayment.
2. An investment, on the other hand, implies the outlay of funds for a relatively long period.
3. In bank lending the borrower usually initiates the transactions.
4. But in investing, the bank takes the initiative by entering the market to make purchases or to sell.
5. In lending, the bank, in most instances, is the major creditor.
6. While, in investing, the bank is usually one of the many creditors.
7. Advances may involve the creation of temporary source of fund.
8. While in case of investment it may not be so in each situation.
9. In bank lending there exist a personal relationship between the bank and the customer.
10. But investment is an impersonal matter.

**Fundamental Principle of Security Investment By Commercial Bank**

**Safety of Funds** - Whatever securities are to be bought, bankers must ensure that the money invested therein will not be lost. In respect of government securities, the condition of the economy which support the obligation, profitability performance of state units, and the tax and borrowing powers of the governments determine the latters ability to issue the securities. Political stability is essential for debt repayment by the different parties. In evaluating securities, the state of the economy should also be taken into account because the government derives for it the funds necessary for the payment of principle and interest. The borrowing ability of the government should, there for, be looked into. Where it is limited in its borrowing activities the credit risk of its securities increases the banker should refrain from holding securities of such a government.

From the view point of credit risk, the bonds of Central Government are consider to be very safe because such bonds are backed up by the tax-paying capacity of the whole nation and great borrowing powers of the government. The security of the State Government or Local Government cannot be rated as high as those of Central Government because there taxing and borrowing powers are not comparables. In the case of foreign securities as well, there is no inconsiderable credit risk at times, when foreign exchange can be manipulated by government causing loss to the bankers through adverse fluctuations in the rates of exchange. The bonds of corporate enterprises are relatively more risky because the repayment of debt is tied to the earnings of the companies, which may fluctuate from time to time.

**Stability of Prices** - Commercial banks need a high degree of stability of the principle in there investment portfolio. Because of their thin equity cushion, they cannot afford any loss or shrinkage in the value of securities. As stated earlier, security investment is subject to money rate risk, besides the credit risk. The money rate risk involves the movement in market values and change in interest rate. The amplitude of fluctuations in the prices of shares is much higher than those of bonds, particularly because shares do not carry a fix dividend rate and there prices are depend on myriad of factors. The fluctuation in the value of securities is of great significance to a banker. Each investor accepts the current yield of market at the time he buys. If there is a change in the interest rate, the yield which the investor received when he bought the securities may be below or above the current rate. In the event the securities are sold, the holder would stand to lose or gain.

**Liquidity** - While choosing securities for bank investment, liquidity principle should be adequately provided for. A liquid security is one which can be dispose of insubstantial quantities, at short notice, with a negligible capital loss. Therefore, the term liquidity, when applied to a security, immediately implies a high degree of marketability. For the investment account, the liquidity standards are not supposed to as stringent as those applicable to the secondary reserve. The asset of the secondary reserve must be of near-cash quality and so highly saleable.

In extreme cases, the banker may resort to the reserve bank for funds. This does not mean, however, that the liquidity principle should be ignored. Some amount of liquidity in the investment account asset is necessary because they act as the third line of defence. If, at any time, the banker requires a large amount of cash to meet the extra ordinary demand of his customers, he is obliged to liquidate a portion of his security investment. Securities of reputed business concern are, however, marketable even in big lots without an appreciable scaling down of their prices.

**Return** - The forth cardinal principle that should engage the attention of the banker while acquiring obligation for his funds is the return on the portfolio. The investment portfolio should comprise such securities as may assure the bank affair and stable return on the capital outlay. In calculating the income, it is necessary to take in to account the rate of interest, or the dividend rate, which the securities carry, the tax exemption benefit, and the loss or gain, if any, at the time of redemption. Though there is great temptation to place this consideration first, it rightfully, comes forth, after the
considerations of safety, stability and liquidity. An effective evaluation of risk may permit one to pay attention to the higher yield elements in the portfolio through a diversification and judicious weighing of other risk factors.

**Size of Investment Portfolio** - The volume of investment portfolio should be designed in light of liquidity requirements the credit needs of the economy the fluctuations in deposit and the size of capital account. After meeting these liquidity requirements the left-over funds are used to meet credit needs and to acquire obligation of public as well as private sector enterprise. If the credit needs are heavy and the bank experiences wide fluctuations in the level of its deposits, the size of the investment portfolio will have to be kept low. The revision enable banks to avail of the opportunities of investing in priority placed shares and debentures of large and profitable corporate bodies.

As per RBI directive issued in October 1996 bank’s total exposure to company by way of investment in share and debenture in the primary or secondary market as well as advances, should not exceed 25% of the net owned funds of the bank and 30% of companies paid up capital. The exposure ceiling in the case of group has been fixed at 50%. Indian banking industry exposure to capital market is likely to go up over four times following the recommendation of the RBI-SEBI Committee that banks investment in share, debentures and mutual funds should be linked to the outstanding advances and not the incremental deposit of the previous year.

**Pattern of Investment Portfolio** - The policy statement should spell out the make-up of the investment portfolio that is the types of securities in which funds will be invested and there relative proportion to the portfolio. This has to be determining by taking in to account the objective of investment and the portfolio needs of the bank. If the objective of the investment policy of the bank is to make higher earnings, it may invest largely in high yielding corporate securities. But where a greater stress is laid on liquidity, the management will have to restrict its investment to high grade bonds and highly marketable securities.

The risk position of bank will shape the policy on the composition of the investment portfolio. Banks taking considerable lending risk (in relation to their capital position), and banks lacking managerial expertise or effort, should restrict their investment to Central Government securities, State Government and Municipal securities and corporate blue chips. Such a policy (in conjunction with reasonable securities/ maturity policies) should limit the risk in the investment portfolio, and may be implemented with limited managerial talent. But the banks which have the necessary managerial talent and are in position to take additional risk in their investment portfolio should be less restrictive in their quality limits. Such banks are in position to invest in high yielding low quality securities.

The tax position of the bank is an essential element in determine whether its policy should encourage concentration in State and Local securities with tax-exempt interest payments, or in other investment instruments which pay taxable interest. The quality that the management would like in the portfolio must be defined for the guidance of the investment officer, who must have some standards to guide him in the selection of securities. It would not been sufficient to mention in the policy statement that a certain percentage of bank’s investment must consist of securities that are of high qualities unless certain norms of determine this high quality are laid down. The standard of acceptability of different kind of securities should be mention in the statement of policy.

**LITERATURE REVIEW**

Bose S & Dipankor C (2003) made an attempt to understand the nature and extent of imperfection of the Indian market for corporate bonds. The paper examined that Imperfections in the secondary market for corporate bonds are manifest in infrequent trading, high liquidity risk, a high degree of dispersion of price/ YTM over time, and a lack of strong and unidirectional relationship between bond’s credit rating (risk) and its’ market price/ YTM. The need to have mandatory credit ratings, irrespective of whether the debt is publicly issued or privately placed, has been stressed in recent times.

Ghosh Chinmoy, Harding John & Phani B. V. (2006) examined that the gains by private sector banks...
Were almost double those of nationalized banks and analyze the firm specific abnormal returns crosssectional regressions and find a significant relation between firm-specific abnormal returns and factors typically associated with a bank’s potential for takeover. These results provide the first empirical support for Stulz’s hypothesis that one cause of the valuation gains associated with liberalization is the expected gain from a reduction of agency costs.

Lakshmi K analyzed the differences in the level of foreign portfolio investment in public sector banks and private sector banks. The study finds that the foreign portfolio investment in private sector banks is higher than the public sector banks when FIIs investment is considered as a percentage of total shareholding however, the difference disappears when FIIs shareholding is measured as a percentage of free float shares. The results suggest that strong, stable and efficient banking system is a prerequisite for economic growth of any country.

OBJECTIVES OF THE STUDY

This Paper studies Investment Pattern of the Scheduled Commercial Banks. The main objective is to analyze the investment pattern / portfolio of Scheduled Commercial Banks.

SCOPE OF STUDY

This study was undertaken to examine investment portfolio of Scheduled Commercial Banks from 2003-2015. Different types of securities in which banks invest its funds is also considered and the same is presented on pie chart. The revised investment policy of the banks is also determined. The secondary data has been collected from RBI website and other sources.

METHODOLOGY OF STUDY

This paper studies Investment Pattern of the Scheduled Commercial Banks for 2003-2015. The Methodology of study includes

Population- Investment portfolio of the Scheduled Commercial Banks is taken in to consideration.

Data Collection- The relevant secondary data has been collected mainly from website of Reserve Bank of India (RBI), various reports and other studies. Journals such as the Banker and the Journal of Indian Institute of Bankers have also been referred to.

Time- Period of The Paper - The period considered in this paper is from 2003 to 2015 of Scheduled Commercial Banks.

ANALYSIS AND INTERPRETATION

Investment Pattern of Scheduled Commercial Banks

![Table](source: www.rbi.org.in)
As per the above table, Scheduled Commercial Banks invest its majority of funds in SLR Securities. These may be due to low risk and tax exemption benefit. Scheduled Commercial Banks after investing in SLR Securities invest its remaining funds in Private corporate sector bonds / debentures then after in PSUs bonds / debentures. These may be due to fix return. Remaining funds in instruments issued by financial institutions, mutual funds and others bonds / debentures. Then after it invest in private corporate sector shares and commercial paper. Fewer amounts of funds are invested in shares issued by PSUs and others. If it is analyzed yearly then there is constant increase in amount of investment made by Scheduled Commercial Banks except in March 31, 2006. In March 31, 2006 there is minor decrease in the amount of investment (Difference of 327.3).

**Investment Policy of Scheduled Commercial Banks**

The revised Investment Policy of the Scheduled Commercial Banks will be as under:-

**Mandatory Investment** - In terms of mandatory requirement of Banking Regulation Act, it is compulsory to invest minimum 3% as Cash Reserve Fund (CRR) & 25% as Statutory Liquid Reserve

**Loans & Advances** - Bank can invest up to 75% of own funds and up to 70% of total deposits in loans & advances, out of which, after observing the prescribed norms for priority sector & weaker section of the society, remaining portion can be advanced as per Loan Policy of the Bank keeping in view the ceiling of maximum amount of advance to a single person, similar type of business & on similar type of securities to minimize the risk involved.

**Investment With Other Citizen Cooperative Banks** - Bank will not make any investment with these Banks except undertaking normal transactions in the accounts opened for clearing and transfer of funds purpose.

**Investment In Other Banks** - Bank may invest its surplus funds in any commercial, private & cooperative Banks but if any such bank provides considerably higher rate of interest then its financial position has to be analyzed.

**Investment In Non-SLR Debt Securities** - In compliance of the instructions issued by the Reserve Bank of India from time to time and also keeping in view the additional income on investment and safety of surplus funds, investment may be made in Liquid Funds enjoying good market credit rating and also trading in Government Securities. In this connection Board of Directors keeping in view the circumstances prevailing at that time may fix a limit for the purpose, take a decision in the matter of investment and delegate powers to the Managing Director for investment to a certain extent.
at one time. Investment will be made with the institutions which are enjoying AAA credit rating. Such investment will not exceed 10% of the total deposits of the Bank.

**Investment in Other Institutions, Corporations & Companies** - Bank will not invest its surplus funds in any other institution, company, corporation etc whatsoever be the attractive rate of interest.

**Investment In Share Money Of Cooperative Institutions** - Bank may invest 2% of its personal funds in the share money of the Cooperative Institutions but it will be in accordance of the directives of the Reserve Bank of India.

**Investment In Private Companies** - Bank will not make any investment in private companies or in Shares/ Debentures of other institutions other than Cooperative Institutions.

**Investment In Government Securities** - “Government Securities” will mean securities issued by the Central & State Governments.

**Cash Management** - Except in abnormal conditions, cash balance in the Bank will be kept within the fixed limit as excess cash will affect the profitability of the bank.

**CONCLUSION**

Thus, Scheduled Commercial Banks should be very much careful while investing its funds. An investment should ensure maximum profit and minimum risk. Banks are more concentrating on advances as compare to investment out of their total deposits. With this, there is also a downfall in income of banks, because return on investment is lesser as compare to interest income. Thus, banks must be motivated to invest outside India to earn maximum foreign exchange. For this RBI may limit some portion of investment as mandatory in foreign securities. Thus, Portfolio of investments may be upgraded to earn maximum returns on investments.

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