Funds Management: A Key to Success for New Private Sector Banks

Vijay Vrat Arya* & Sudhir Kumar Gupta**

Abstract

Efficient management of funds is the key to success of any financial institution. Banking sector is not an exception to it. The success of private sector banks specifically new private sector banks in comparison to other banks except foreign banks is surely accomplished by the efficient funds management policies. Funds management requires balancing between sources of funds and their uses. A tendency of availing cheaper sources of funds and maximum return on their uses creates the higher profits. New sources of earnings by efficient and economical use of funds and at the same time cheaper fund sources are always considered by the funds managers. This paper is an attempt to focus on important aspects of funds management, specifically with reference to new private sector banks. Among new private sector banks ICICI bank, HDFC bank, AXIS bank and IndusInd bank were selected for the current study along with the justification for their selection.

Key Words: Private sector banks, sources of funds, uses of funds, funds management.

Introduction

For any industry input and output products are of prime importance. The relative cost of input product to output product determines the profit of the industry. This profit itself can be elevated by efficient and judicious management of available resources as well as acquiring of input products and selling of output product at the same time. Funds contribute as the input as well as output product for the banking industry, therefore, it implied that success of banking industry is running around efficient management of acquiring the funds from all available sources at cheapest possible rate and employing the funds in economically beneficial and profitable, least risky uses of funds at the highest possible return rate. To all this process the concept of competition among various banks and relative recognition and standing among the available customers makes a difference.

The concept of bank and banking is not new in Indian context. Pre-independence banking appears not to be very much organized and sophisticated. Even post independence banking has seen vast developmental activities from regulation to nationalisation and liberalisation. The constant acquiring of modern tools of banking and related operations has been a feature of appreciation in the banking industry from the point of view of managers as well as to the customers. Competition among public and private sector banks further ignited the field of banking in particular especially in post-liberalisation era. The ultimate gainer appears to be customers in the form of getting quality service.

New private sector banks evolved in post-liberalisation era are responsible for changing the face of banking in India. They have come up with vast variety of services on offer to their customers qualitatively as well as quantitatively. This entry of new private sector banks with the state-of-the-art technology and lean structures has forced the old private sector banks and public sector banks to respond to the new challenges with aggressive restructuring measures. The banking industry is rapidly introducing new products and services, computerizing and networking key branches, rationalizing manpower and launching number of initiatives to improve operating efficiencies. This way a bank has to flexibly manage the balance between its assets and liabilities in order to enhance of the existing capacities and to increase the business setup.

Research Methodology

Present study was conducted and concentrated mainly on the ICICI bank, HDFC bank, AXIS bank and IndusInd bank's fund management practices. Banks history and annual reports were studied as a secondary source. Respective authorities were consulted and interacted telephonically and

* Centre for Corporate Education, Training and Consultancy (CCETC), Indira Gandhi National Open University (IGNOU), New Delhi.
** Faculty of Commerce & Business Administration, D.N.P.G. College, Meerut.

by email as and when required in order to obtain thorough information on the present study.

Growth of New Private Sector Banks

The liberalisation and de-regulation process has completely changed the face of the Indian banking industry. Following the Narasimham Committee's[1] recommendations, the guidelines to facilitate the entry of private sector banks were issued in 1993 to foster greater competition with a view to achieve higher productivity and efficiency of the banking system. To overcome with the situation of monopoly and hidden regulations new private sector were born after liberalisation policy with a view to make a competitive environment, better services to customers and a transparent system. Those banks which have started sanctioning after liberalisation policy are termed as new private sector banks(new - which came into existence after liberalisation of nineties and old - which were in existence from before)[2]. They are as similar to other private sector banks but with only difference of having more autonomy, much competitive, highly financially viable, rich in technological backup and last but not the least progressive.

The deregulating entry requirements and setting up new bank operations has benefited the Indian banking system from improved technology, specialized skills, better risk management practices and greater portfolio diversification. Further, various prudential measures that conformed to the global best practices were also implemented. One of the major objectives of banking sector reforms has been to enhance efficiency and productivity through enhanced competition. Entry of new private sector banks with the state-of-the-art technology and lean structures has forced the old private sector and public-sector banks to respond to the new challenges with aggressive restructuring measures. The banking industry rapidly introducing new products and services, computerizing and networking key branches, rationalizing manpower and launch a number of initiatives to improve operating efficiencies.

The genesis of these new private sector banks is given in table-I. These new private sector banks have different potential areas of business like forex exchange, retail segment, agriculture segment, international banking segment. They are much focused and intelligently giving tough competition to both public and foreign banks.

1. Narasimham, M. (1991) & Narasimham, M. (1998).
2. See Saggar (2005). Commercial Banks in India. Deep & Deep Publications Pvt. Ltd. New Delhi.

Table - I: Growth of New Private Sector Banks in India

Bank	Started	F/ NF	Remarks
Axis Bank Ltd.	Dec.3, 1993	F	Renamed Axis Bank Ltd. in Middle 2007.
Global Trust Bank Ltd.	1993	NF	GTB amalgamated with Oriental Bank of Commerce on August 14, 2004.
ICICI Bank Ltd.	Jan.5, 1994	F	-
IndusInd Bank Ltd.	Apr.11, 1994	F	-
Centurian Bank	Jun.30, 1994	NF	Merged with Bank of Punjab Ltd. and formed Centurian Bank of Punjab Ltd.
HDFC Bank Ltd.	Aug.30, 1994	F	-
IDBI Bank Ltd.	Sep.15, 1994	F	The bank merged with IDBI on April 2, 2005 & formed as public sector bank
Bank of Punjab Ltd.	Apr. 1995	NF	Merged with Centurian Bank Ltd. forming Centurian Bank of Punjab Ltd.
Times Bank Ltd.	Jun.6, 1995	NF	Merged with HDFC BANK Ltd., on 26 Feb., 2000
Kotak Mahindra Bank Ltd.	Mar. 2003	F	-
Yes Bank	Nov. 2004	F	-
Centurian Bank of Punjab Ltd.	Oct.1,2005	F	-

F = Functioning; **NF** = Not Functioning; **Source:** Arya (2007)

Funds Management in Selected New Private Sector Banks

The term 'funds' refers to three things namely 'Cash', 'Working Capital' and 'Total Financial Resources'. In business terminology, irrespective of the volume of business, it is believed that success and failure depends upon the efficient use of the available funds. In the case of banks, the chief executive of business manages funds efficiently, direct them into profitable base, and control their use & investment. He also keeps a constant watch to make sure not only that they are used to the best advantage, but also that no financial difficulty arises in due course. The problem of funds management in a bank becomes more acute and complex due to the day-to-day fluctuation and frequent movement of funds.

Even though funds management in banks is not new, it is only recently that the systematic and scientific funds management policies have come to be recognized as an important aid to efficient management of growth. It would be a good precaution for a bank to review once in a month the amount of funds in each category of its assets and liabilities. In the case of banking company, this quantitative distribution of assets and liabilities into their component parts is not only of primary importance from the point of view of theory of banking, but is also of practical significance to the banker in his everyday activities. In fact, if the balance sheet is properly drawn up and items therein are wisely and systematically arranged, it provides some significant and valuable information, such as where the banking funds have come from and where those have AXISlised. It is well understood that the balance sheet approach popularly followed in India to analyse and examine the funds requirements. Thus, it is not only useful but also needful for banks management to keep track of flexible funds management in the bank. The fund management process in the new private sector banks can be understood with the help of Figure-I. The concept of funds is build around two main components viz, sources of funds and uses of funds. The efficient use and well maintained balance among these two is the key towards success in banking.

A. Sources of Funds

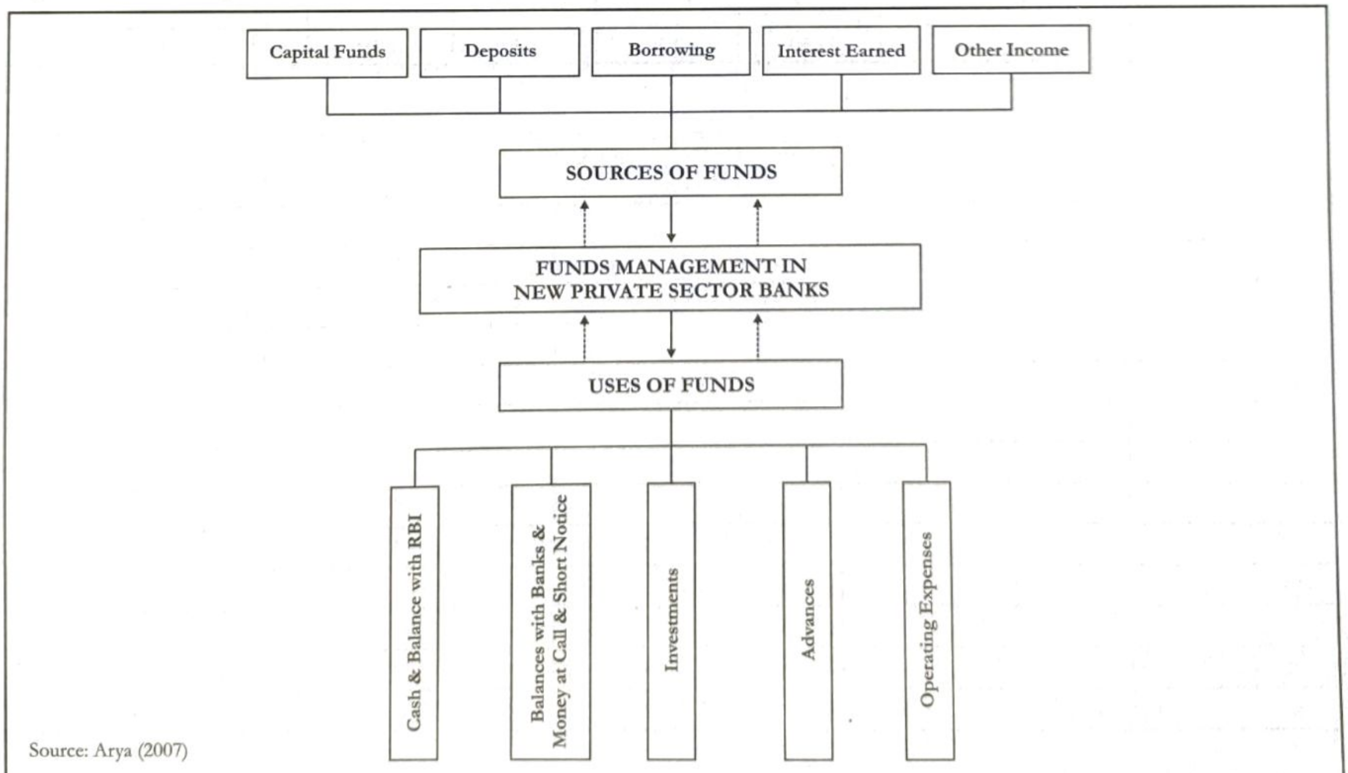
Funds have proven their importance in fulfilling the financial needs of a business. In order to manage such funds requirement at the short and long run, a smart financial management is the ultimate remedy. There are different sources of funds which have been flexibly taken into consideration by the new private sector banks to meet the challenge of funds requirements. According to the nature of the funds, bank raises funds through –

1. Capital funds (selling its shares)
2. Accepting deposits
3. Earning interest
4. Borrowing money from market
5. Other sources

These are the broadly classified sources of funds. Each of these sources has their own role and significance in the bank. It is interesting that major share of funds comes from first three sources of funds i.e., capital funds, deposits and interest earned. Banks acquire funds from various available sources and which facilitates new private sector banks to acquire assets that may further be granted as loans & advances and to make investments in open market. From the principal sources of earning the bank meets the operating expenses involved in attracting and servicing deposit accounts, managing its loans and investments. The different sources of funds are discussed below.

(i). Capital Funds: Capital funds are the owned funds of a bank, and consist of the capital subscribed by the

Fig. 1: Funds Management in New Private Sector Banks



Source: Arya (2007)

Shareholders and the reserves it has been able to buildup from the profits earned. Capital fund gives the basic criterion of the soundness of a bank. Bank's capital provide funds for infrastructural investments such as, building, furniture, machinery, equipment and the supplies necessary to establish a bank. After operational need is fulfilled, the ground is ready for the various functions of the capital to come into force. The new private sector banks have to follow the statutory limit of maintaining the capital adequacy ratio (CAR) at 9% and above which has been fixed by the RBI. Although, the new private sector banks maintain a much higher CAR (See Table-II & III).

(ii). Deposits: It is the most important source of bank's liquidity and treated as a barometer of banks financial strength. It is an important index of the growth of banking business, essential for the mobilization of resources. Deposits growth depends upon various factors such as, money supply, credit extension, the saving habits of the public, the monetary policy of the government and the Reserve Bank of India, and the general economic conditions of the country. Further there are also derivative deposits, i.e., the deposits accruing from the advancement of loans and the investment of funds. Deposits can further classified as 'demand' and 'time' deposits.

(iii). Borrowing: As the main sources of funds for banks are capital funds and deposits, but very often during allocation of these funds, banks find themselves temporarily short of funds. Then, they strive to increase their resources by resorting to borrowings from market. These borrowings may be either from public or the RBI or other banks or from the financial institutions set up for this purpose. Although, borrowing has its own importance as it is the gap between 'required funds' and 'arranged funds' for the proper functioning of a bank. Here 'required funds' is the sum of a bank's total requirement of funds that is to be Analyzed by way of its commercial operations. On the other hand, 'arranged funds' consist of the sum of funds available with bank such as capital plus deposits plus other

Table-2: Capital Adequacy Ratio (CAR) for Scheduled Commercial Banks

Type of the Bank	1999	2001	2002	2003	2004	2005	2006
Scheduled Comm. Banks	11.3	11.40	12.00	12.70	12.90	12.80	12.40
Public Sector Banks	11.3	11.20	11.80	12.60	13.20	12.90	12.20
Nationalised Banks	10.6	10.20	10.90	12.20	13.10	13.20	12.40
Foreign Banks in India	10.8	12.60	12.90	15.20	15.00	14.00	13.00
Old Pvt. Sector Banks	12.1	11.90	12.50	12.80	13.70	12.50	11.70
New Pvt. Sector Banks	11.8	11.50	12.30	11.30	10.20	12.10	12.60

Source: RBI (2006). pp. 305-307

Table-3: The Capital Adequacy Ratio (CAR) for Selected Banks (in %)

Year	ICICI Bank	AXIS Bank	HDFC Bank	IndusInd Bank
94-95	36.09	-	-	33.11
95-96	17.52	16.22	25.53	18.19
96-97	13.04	14.43	13.00	12.90
97-98	13.48	09.72	13.92	17.91
98-99	11.06	11.64	11.86	15.16
99-00	19.64	11.37	12.19	13.24
00-01	11.57	09.00	11.10	15.00
01-02	11.44	10.65	13.93	12.51
02-03	11.10	10.90	11.12	12.13
03-04	10.36	11.21	11.66	12.75
04-05	11.78	12.66	12.16	11.62
05-06	13.35	11.08	11.41	10.54
Avg.	**15.04**	**11.72**	**13.44**	**15.42**

income plus interest earned.

(iv). Interest earned: It relates to funds based income and represents the return on pure banking business. The major components of interest earned consist of interest on investment and discount received on bills. The ratio of interest as percentage of working funds is an indicator of the rate at which a bank earns income by lending funds[3]. In a broader perspective, interest earned has four sources i.e. interest on balance with the RBI and inter bank funds, interest on advances, discount on bills, income on investments and other interest earned.

(v). Other income: The other income of a new private sector bank mainly depends upon the volume and type of assets held, the return on these assets, and charges made for various services. These other income is made in the form of interest, dividend, commission and exchange received on (i) loans and advances, (ii) bills discounted and purchased, (iii) Investments, and (iv) Other sources comprising of commission on letters of credit, bills for collection and other service charges etc. Given below are some of the major sources of other income which contribute valuable share in the total other income of the new private sector banks.

1. Income earned by way of dividend.
2. Commission, exchange and brokerage
3. Profit on sale of investment
4. Profit on sale of land, building and other assets
5. Profit on revaluation of investments
6. Profit on foreign exchange transaction
7. Miscellaneous income

B. Uses of Funds

Once a bank make a strategy on sources of funds, it is very important then to make proper planning to utilize the collected fund in best possible way. Here comes the concept of quality fund management, which means the proper coordination between the available funds in hand and the proposed utilization of funds. More specifically, it is expected and advised to banks that the available total resources must be used in such a manner as would permit the bank to attain its objective of portfolio management. Because, once the bank has sufficient fund, the responsibility of senior management is to evolve an efficient mechanism and proper plan of utilizing the available fund. They devise such system which gives answers to the following questions like – where to deploy and how to invest the available funds so that the appropriate return on invested fund can be obtained? There are six ways that a bank chooses to utilize the available funds.

- Maintaining of Cash & Balances with the RBI
- Balance with Other Banks and Money at Call & Short Notice
- Investments
- Loans and Advances
- Interest Extended
- Operating Expenses

(i). Cash and Balance with the RBI: This is one of the regulatory compulsion for new private sector banks to maintain some amount of their funds with the Reserve Bank of India. As some share of their funds are to be kept with the RBI in the form of cash, on which banks receives some interest money from the RBI. Although, cash and balance with the RBI is a block fund as a bank can not utilize such money for its business activities, however, new private sector banks prefer to deposits with the RBI as compare to other banks. This is due to security of deposits with the RBI.

(ii). Balance with Other Banks and Money at Call & Short Notice: Banks, in addition to maintaining cash reserve requirements, need to keep funds in a short term asset generally known as 'money at call and short notice'. This asset refers to the money lent by banks to other banks and brokers in the call money markets, and is not subject to any statutory requirement against deposit liabilities. It is also very sensitive to the variations in the availability of funds for investment purposes, and to market conditions, such as seasonalties. Sometimes the financial institutions and banks require funds in a bigger volume; this fund requirement can be met by the new private sector banks through their big deposit base with such banks and financial institutions. The important comparison between 'Cash and Balance with the RBI' and 'Balance with Other Banks and Money at Call & Short Notice' is that in the case of earlier option it is mandatory for banks to maintain some share of their funds with the RBI while in the second case it is advised to maintain good volume of their funds with other banks and financial institutions, as it can be taken back whenever required in short term and other important thing is that the bank get a good interest income on such balance from other banks.

(iii). Investments: In order to gain the benefit of funds acquired by the banks by way of borrowing, capital and deposits; a certain percentage of fund is put in some business ventures, shares, debentures and bonds etc. from

3 Amandeep (1993). Profits and Profitability in Commercial Banks. Deep & Deep Publications Pvt. Ltd. New Delhi

where the bank can get a handsome return amount, which is in addition to the principal amount after a certain period of time. This is basically called as investment. Investment can be done in India as well as outside India. Although, those funds which are placed in the credit instruments of enterprises, both public and private, for relatively long period of time have an objective to earn income and high liquidity from investment. The investment portfolio of banks consists of government securities and other domestic investments. Government securities include both domestic and foreign ones, while domestic government securities are issued by the Central or State Governments. Other domestic investments include treasury saving deposit certificates, other trustee securities, fixed deposits with other bank, shares and debentures of corporate bodies, real estate, etc. It is the qualitative and quantitative composition of investment portfolio which is governed by variety of factors like the RBI liquidity requirements, the individual bank's investment policy, the credit pressure, the general level of funds available in the bank, etc. The factors may be individually or collectively detrimental for the pattern of investment during any time.

(iv). Loans and Advances: Banks are such financial institutions which fill the financial gap of demand and supply of funds. They provide loans and advances to agriculture, trade, commerce and industry of the country for their smooth functioning and growth. Banking business is primarily based on taking funds at lower interest rate and lending the fund at higher interest rate. This devises a handsome amount of profit. In this way lending is one of the most important functions of the banks. Loans and advances are also the greatest source of profit of the bank. The banks should organise their lending function in such a way that it guarantees safety of deposits and proper circulation of credit to the advantage of growth of economy on the one hand and profitability to the bank on the other[4] . The new private sector banks have different modes for facilitating loans and advances, such as –

- Bills purchased and discounted
- Cash credits, overdrafts and loans repayable on demand
- Term loans
- Securitisation, finance lease and hire purchase receivables
- Advances secured by tangible assets
- Advances covered by bank/government guarantees
- Unsecured advances
- Advances to priority sector
- Advances to public sector
- Advances to banks

(v). Interest Extended: Interest expenditure relates to funds based expenditure and represents the cost of funds for the banks. The major components of interest expenditure consist of interest paid on deposits and interest paid on borrowings. The ratio of interest paid as percentage of working funds is an indicator of the rate at which a bank incurs expenditure by borrowing funds . In the case of new private sector banks, they have a model of paying interest on deposits made by customers, interest on borrowing from RBI and interest on inter bank borrowing and other interests. Although, this constitute a very small share to the total funds utilized by the bank.

(vi). Operating Expenses: Every business house has to incur some regular expenses to strengthen and maintain business services properly. In the case of new private sector banks operating expenses consists of the following expenses on regular basis-

- Advertisement and publicity
- Auditor's fees and expenses (including branch auditors)
- Depreciation on banks property
- Depreciation on leased assets
- Director's fees, allowances and expenses
- Insurance
- Law charges
- Other expenditures
- Payments to and provisions for employees
- Postages, telegrams, telephones, etc.
- Printing and stationery
- Rent, taxes and lighting
- Repairs and maintenance

Although, these operating expenses necessarily occur, but by applying the right approach and proper expenses management, the reduction in operating expenses is very much possible. However, this hardly affects a small part of funds management.

Conclusion

The prime objective of liberalization policy in the Indian context was to prepare a level playing field and a competitive environment among the public, private and foreign banks. It was observed that although the new private sector banks are running their business of somewhat narrow margins but at the same time the quality and quantity of services offered by them raised their profits towards higher levels.

4 Abrol (1987). Commercial Banks. Anmol Publications, Delhi

New private sector banks have claimed huge profits by lowering their operating expenses. In the beginning the kind of infrastructure they raised appeared to be too expensive. But at later stages public sector banks have to switch to these changes to stay in the competition in market. Finally all this returned in the form of better profits as well which happens to be a treat after a long wait.

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