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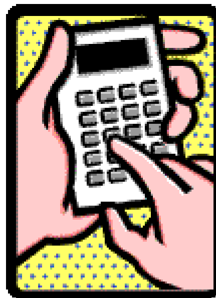
PROGRAMME ON

PROFIT PLANNING



Name:……………………………………………

Staff No:………………………………………...

Branch/Office:…………………………………..

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Profit Planning Terminology in a Nutshell

- "Interest Spread" & "Net Interest Income" are one and the same.
- The difference between 'non-interest expenditure' and non-interest income' is defined as "**Burden**".
- "Interest Spread' less 'Burden' determines " Operating Profit' "
- **Profit vs. Profitability**: While profit represents an absolute figure, profitability, measured by a ratio, represents the operational efficiency. As opposed to absolute profit volumes, profitability is a more meaningful yardstick of operational efficiency as it is size-neutral.
- **Return on Assets** (RoA) : RoA is the ratio of Net profit to total assets. This is a standard measure of profitability with 1% deemed as the international benchmark.
- **Net Interest Margin** (NIM) : NIM is the ratio of net interest income (Total Interest Income minus Total Interest Expenditure) to average earning assets.
- **Return on Capital** (ROC): ROC is the ratio of net profit to share capital. It indicates the return on paid up capital.
- Return on Net worth , also known as Return on Equity (ROE): Ratio of net profit to average net worth (share capital, plus reserves minus intangible assets). It indicates the return on equity capital.
- **Book Value**: Net worth divided by number of shares. Market price of share generally factors Book Value.
- **Earning Per Share** (EPS) & Price earning Ratio (P/E ratio) : EPS is the ratio of Net profit to number of shares.
- **Price – Earning** is the **ratio** of market price of a share to earning per share. EPS and P/E ratios indicate the ability of the bank to access to the capital market and the appetite of the bank's scrip in the market.
- **Capital to Risk-weight Assets Ratio** (CRAR): Total capital, consisting of Tier-I & Tier-II capital, as a ratio of risk-weighted assets. It indicates the soundness and risk bearing ability of a bank.
- **Yield on Advances**: Interest income on advances divided by average advances indicates average yield on advances.
- **Yield on Investments**: Interest & dividend income on investment divided by average investments indicate yield on investments..
- **Yield on Working Funds**: Total interest income divided by average working funds, consisting of interest earning and non-interest earning assets.
- **Cost of Deposits**: Interest paid on deposits divided by the average deposits, consisting of Current, Savings and Term deposits. This is the comparable benchmark for liabilities management.
- **Cost of Borrowings**: Interest paid on borrowings, including borrowing for Tier-II capital, divided by average borrowings.
- **Cost of Interest Bearing Liabilities**: Interest paid on deposits and borrowings divided by average interest bearing liabilities (deposits and borrowings, including Tier-II bonds).
- **Cost of Working Funds**: Total interest expenditure divided by average working funds, consisting of interest bearing and non-interest bearing liabilities (total of liability side of balance sheet).
- **Spread**: Difference between the Yield on Working Funds and Cost of Working Funds represents Spread.
- **Intermediation Ratio**: It measures the ratio of operating expenditure to total assets. As per international criterion, this ratio should be less than 1 per cent.

- **Cost- Income (Efficiency) Ratio**: Non-interest expenditure divided by net total income (total income minus interest expenses). It signifies movement in operating cost relative to income. Global benchmark is 40 per cent.
- **Burden Ratio**: Ratio of non-interest income to non-interest expenditure. As an efficiency criterion, non-interest income should be able to cover the non-interest expenditure.
- A recent cost benefit study on ATMs has revealed that a minimum of 150 transactions per day is required on an ATM to make it BREAK-EVEN.

- **Global Benchmarks in Profitability**:

Criterion	Parameter	International Standard
Solvency Ratio	Capital Adequacy	Minimum 8%
Efficiency of Assets Use	Return on Assets	1%
Net NPA Ratio	Net NPA Ratio to Net Advances	Less than 1%
Intermediation Efficiency	Operating Cost to Average Working Funds	Less than 1%
Burden Ratio	Other Income to Operating Expenses	Minimum 100%
Cost- Income Ratio	Operating Cost to Net Income	Less than 40%

- **Benchmark Prime Lending Rate:** RBI asked banks to declare their own Benchmark Prime Lending Rate (BPLR), i.e the minimum interest rate which the bank can charge for its zero risk customers.
- While deciding the BPLR, Banks should take into account following factors: Actual cost of Funds, Provision for NPAs, Other Regulatory provisions, Profit Margin.

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Profits And Profitability: Concepts & Relevance

Concept

- Profit is the surplus of income over expenditure. While operating profit is referred to as the difference between total income and total expenditure, net profit is arrived at after netting provisions (for NPAs, Tax, Standard Assets etc) and contingencies from the operating profit.
- The difference between interest income and interest expenditure is termed as "Interest Spread" or "Net Interest Income".
- The difference between 'non-interest expenditure' and non-interest income' is defined as "Burden".
- Thus, "Interest Spread' less 'Burden' determines " Operating Profit' "
- Efficiency of funds use, productivity and overhead efficiency determine profit margin.

Relevance

- To continue as viable organizations, banks have to generate adequate profits.
- Enlargement and diversification of balance sheet calls for augmentation of profits consistently.
- Profit is the index of efficient use of funds and is decisive to the premium that the Bank's stock commands in the market.
- Growing profit volumes enhance investors' confidence and improve credit ratings for further resources mobilization.
- Higher profits generate more retained earnings so as to augment the capital base and meet stringent capital standards under BASEL II.
- Profits only can augment economic capital (risk free capital) through higher retained earnings.

Profit vs. Profitability

While profit represents an absolute figure, profitability, measured by a ratio, represents the operational efficiency. As opposed to absolute profit volumes, profitability is a more meaningful yardstick of operational efficiency as it is size-neutral. Profitability ratios, in contrast to absolute profit levels, obviate difference in balance sheet size and places operational entities on a common footing. More often, it is such ratios, which are prudent measures of profitability and efficiency. More so, being a listed company, performance of the Bank is closely followed by the market and financial analysts, each quarter.

Profitability Ratios

- Return on Assets (RoA) : RoA is the ratio of Net profit to total assets. This is a standard measure of profitability with 1% deemed as the international benchmark.
- Net Interest Margin (NIM) : NIM is the ratio of net interest income (Total Interest Income minus Total Interest Expenditure) to average earning assets.
- Return on Capital (ROC): ROC is the ratio of net profit to share capital. It indicates the return on paid up capital.

- Return on Net worth , also known as Return on Equity (ROE): Ratio of net profit to average net worth (share capital, plus reserves minus intangible assets). It indicates the return on equity capital.
- Book Value: Net worth divided by number of shares. Market price of share generally factors Book Value.
- Earning Per Share (EPS) & Price earning Ratio (P/E ratio) : EPS is the ratio of Net profit to number of shares.
- Price – Earning is the ratio of market price of a share to earning per share. EPS and P/E ratios indicate the ability of the bank to access to the capital market and the appetite of the bank's scrip in the market.
- Capital to Risk-weight Assets Ratio (CRAR): Total capital, consisting of Tier-I & Tier-II capital, as a ratio of risk-weighted assets. It indicates the soundness and risk bearing ability of a bank.

Cost and Yield Ratios

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- Yield on Advances: Interest income on advances divided by average advances indicates average yield on advances. This ratio enables cost-benefit assessment from various advances related products. Progressive banking entities make extensive use of yield on even segment-wise advances (eg. retail, priority, consumer loan, etc.,) to realign the composition of advances portfolio.
- Yield on Investments : Interest & dividend income on investment divided by average investments indicate yield on investments..
- Yield on Working Funds: Total interest income divided by average working funds, consisting of interest earning and non-interest earning assets.
- Cost of Deposits: Interest paid on deposits divided by the average deposits, consisting of Current, Savings and Term deposits. This is the comparable benchmark for liabilities management.
- Cost of Borrowings: Interest paid on borrowings, including borrowing for Tier-II capital, divided by average borrowings.
- Cost of Interest Bearing Liabilities: Interest paid on deposits and borrowings divided by average interest bearing liabilities (deposits and borrowings, including Tier-II bonds).
- Cost of Working Funds: Total interest expenditure divided by average working funds, consisting of interest bearing and non-interest bearing liabilities (total of liability side of balance sheet).
- Spread: Difference between the Yield on Working Funds and Cost of Working Funds represents Spread.

Operational Efficiency Ratios

- Intermediation Ratio: It measures the ratio of operating expenditure to total assets. As per international criterion, this ratio should be less than 1 per cent.
- Cost- Income (Efficiency) Ratio: Non-interest expenditure divided by net total income (total income minus interest expenses). It signifies movement in operating cost relative to income. Global benchmark is 40 per cent.
- Burden Ratio: Ratio of non-interest income to non-interest expenditure. As an efficiency criterion, non-interest income should be able to cover the non-interest expenditure.

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Determinants Of Profits And Profitability

Global Benchmarks in Profitability:

Criterion	Parameter	International Standard	Canara Bank (at Mar 07)
Solvency Ratio	Capital Adequacy	Minimum 8%	13.50%
Efficiency of Assets Use	Return on Assets	1%	0.98%
Net NPA Ratio	Net NPA Ratio to Net Advances	Less than 1%	0.94%
Intermediation Efficiency	Operating Cost to Average Working Funds	Less than 1%	1.77%
Burden Ratio	Other Income to Operating Expenses	Minimum 100%	56.57%
Cost- Income Ratio	Operating Cost to Net Income	Less than 40%	46.83%

Profit Identity

Profit, in simple parlance, is the excess of income over expenditure, including provisions and contingencies. Total income comprises interest income and other income while interest expenditure and operating expenditure constitute total expenditure. The simple Profit Identity is as under:

Profit = Total Income – Total Expenditure

= {Int. Income + Other Income} – {Int. Expenses + Operating Expenses}

= { Int. Income – Int. Expenses} – {Other Expenses- Other Income}

= Net Interest Income (Spread) – Burden

Profit directly depends upon net interest income and is inversely related to burden. The margin between interest earned and interest paid, otherwise known as spread, is the primary source of income for banks. Banks' balance sheets comprise largely interest bearing liabilities and assets and consequently, net interest income is the most important driver of profitability of banks.

NII or Spread depends upon an array of factors like business volume, cost, yield, credit off-take, liquidity, burden, etc. Some such major factors are indeed decisive in the quantum and composition of banks' profit pool.

Cost of Funds

- Cost of funds is a function of demand, liquidity, inflation, and bank specific factors, such as, the operational and opportunity cost.
- Deposits constitute nearly 90% of banks' funds. Composition of deposits and movement in interest rates, thus, affect banks' cost of funds.
- Forces of disintermediation, government borrowings, interest rate movements and buoyancy in capital market are some of the factors that affect the cost of bank deposits.
- After a progressive decline, interest rate cycle has revived since later part of 2004-05, resulting in an uptrend in interest rates and consequently, in cost of funds.
- Volatile call money market, high cost of bulk deposits and active refinance market (housing and export refinance) do find a reflection in the liquidity crunch in the economy.

Yield on Funds

- In tune with the RBI guidelines, banks have been arriving at their Benchmark Prime Lending Rates (BPLR), considering the actual cost of funds, operating expenses, minimum margin to cover regulatory provisioning and profit margin.
- In recent years, it is observed in India that commercial banks' lending rates are relatively flexible downward while there is considerable rigidity in the upward movements.
- Since 1995, there had been continuous decline in interest rates. The average lending rates declined from 17% in 1995 to approximately 10% in 2004-05.
- Though, spread between the deposit and lending rates has widened considerably, voluminous sub PLR lending (mainly because of competitive forces), has affected banks' spreads.
- Focus should be on improving the high yielding advances such as retail, personal loans, SME, mid-cap and priority credit and we need to be selective as regards sub-PLR lending, particularly to corporate sector.
- With the opening up of the economy and liberalization of FII /FDI / ECB norms, blue chip Corporates are able to borrow from international markets at competitive rates, influencing thus, the domestic lending rates.

Credit Off take & Liquidity

- Cash in Hand, Deposits with RBI, Cash with Banks, very short-term investments, eligible export re-finance etc., determine the extent of liquidity available.
- Since October 2004, there has been an unprecedented growth in credit off-take. SCBs' advances have been growing, on an average, at 30% while the deposits have been growing at around 18%. Since later part of 2005, liquidity overhang has been considerably coming down with higher credit absorption in the economy.
- C-D ratio has been above 60% since October 2004 while incremental C-D ratio has been more than 100% during many fortnights since October 2004. Incremental advances have, thus, overshot incremental deposits in the banking system, giving rise to liquidity problems.
- To at least partially tide over the liquidity problem, commercial banks have been bringing down their excess SLR holdings. As a proportion of their NDTL, SLR holdings in the banking system have come down to below 30% from nearly 40% a year ago.
- High credit off-take and shortage of liquidity has increased cost of funds. This has an adverse bearing on banks' margins.

- Apart from deposits, additional capital requirements have also raised banks' borrowing cost in the face of interest rate reversal. Many of the banks have taken recourse to subordinated bonds at coupon rates that are significantly higher compared to the same in early FY06.

Burden Management

- Difference between non-interest expenditure and non-interest income is defined as the 'Burden'. It can be minimized by reducing the operating expenses and/or increasing the 'non-interest income'.
- Relatively high transaction cost, thanks to the sub-optimum leveraging of IT, contribute to be high burden for public sector banks compared to the private and foreign banks.
- However, of late, core banking implementation has had an impact on the operating expenses of the banks (both for capital expenditure and depreciation).
- As an efficiency benchmark, 'other income' should ideally cover 'operating expenditure'.
- Fee-based income is the core portion of 'other income' which needs to be boosted by broad basing fee-based services, foraying into new areas and rationalization of service charges.
- Operating expenses (non-interest non-salary expenses) can be controlled by
- increasing transaction volumes, leveraging computerization and capital expenditure planning etc.

Business Volume

- With continued pressure on margins, profit momentum can be maintained only by adopting a volume-led approach.
- Along with volume, composition of assets and liabilities with emphasis on low cost funds and high yield advances influence the spread of a bank.
- While focusing on volumes, we essentially need to be conscious of the returns from incremental business.

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" There is no finite end to improving the levels of efficiency and profitability. In fact, the situation is one where the system has to cope constantly with changes in the broader environment in which it functions and face new challenges that these developments impose on it."

Narasimham Committee II

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Topline And Bottomline Growth

A robust and sustainable Bottom-line is the very purpose of any going and growing enterprise. Improving the same assumes major importance in the planning exercise of any organization for all time horizons, viz., short, medium or long term. Banking is no exception.
Profits and Profitability, being the end-product of entire gamut of operations in the Bank, bears the reflection of efficiency of each individual segment / unit of the institution. A more holistic approach to the issue is very much imperative, more so when it comes to safeguarding the bottom-line in an increasingly competitive environment. While volume led Top line growth strategy is a standard policy prescription, need of the hour is focused action plans at all levels for sustaining our pre-eminent stature - not only in terms of Top line, but also in terms of various profits and profitability parameters, i.e., the quality of the Bottom-line. This paper attempts to weigh the various related aspects and explore possible trade-off between top line and bottom-line issues.
Banking and Financial sector is closely linked to the growth of the real sector. Thus, there is a need to put a perspective on the macroeconomic outlook as a starting block for the size vs. profitability debate.

Current Economic and Banking Landscape:

- The historically prominent rural India is likely to shrink and the agrarian economy overtaken by the services sector as reflected in the rapid growth of urban conglomerates.
- Globalization would see increased presence and competition from many international players while opportunities will be aplenty for Indian majors as well to expand overseas and capitalize on the increased trade flows in and out of India.
- New technologies would see emergence of new breed of financial players doing financial intermediation; increased inroads into a Banker's domain and shift in the conventional definition of banking are also distinct possibilities.
- Excessive dependence on Technology centric products and services to come to the fore like never before.

In this backdrop, the need of the hour is to have a re-look at the effect of various components that go into the two primary indicators of the profit of the Bank, namely, Net Interest Income and Burden of the Bank.

(Rs. in crore)

	2004-05	**2005-06**	**2006-07**
Net Interest Income	3150	3582	**4026**
Burden	565	970	**1114**
Gross Profit	2585	2612	**2912**
Total Business (Ave)	142452	169437	**209927**

As evident from the table above, as against the average business growth of 19% and 24% during FY 06 and FY07, Net Interest Income growth was 13.68% and 12.43% respectively. This implies that in the wake of declining margins, even to sustain the current pace of growth of Net Interest Income, the growth in business volumes should necessarily be pegged at a much higher level. Burden in FY07 has almost doubled compared to FY05, the increase being primarily on account of wage revision, outlay of funds for technology up gradation including rolling out of CBS and increase in various over head costs.

PROFIT TRIGGERS (%)	2004-05	2005-06	2006-07
NIM	3.41	3.36	**3.15**
Return on Avg Assets	1.07	1.13	**0.98**
Intermediation Cost	2.03	1.97	**1.77**
Cost to Income	44.93	47.93	**46.83**

While NIM is an indicator of the earning efficiency, RoAA is a pooled measure of the bank's profitability. In fact, NIM is well factored into the concept of RoAA through the 'Net Interest Income' route. However, NIM and RoAA need not necessarily exhibit similar movement. For NIM to be at an appropriate level relative to size of business, it requires a host of preconditions. Usually, increased volumes are associated with a NIM exhibiting downward bias. The strategic intent should therefore, be to at least safeguard NIM. Similarly for RoAA to exhibit direct co-movement with size, it is necessary that the various components under profits, including the pool of non-interest income, are also given the required push.
In the above backdrop, interplay of any thumb rule for size and margins will probably be an overstatement. A direct nexus between the two would in fact, pre-suppose several preconditions. These preconditions emanate primarily from the challenges related to banks' bottom-line and top line.

Challenges to Bank's Bottom-line warranting Strategic Planning Focus:

Sources of revenues as well as contribution pattern of various revenue streams are likely to witness a paradigm shift in the days to come.

- Liberalisation and globalization will see the spreads narrowing down to 1-1.5% from the current levels as in case of banks in developed countries.
- Growing disintermediation and competition to intensify pressure on core income of the Bank from both interest and fee based income.
- Increased focus on 'fee-based income' and exploring newer avenues of income is required to even sustain the current income level. Primary need to leverage higher core business from Non-Fund Based business.
- Post Basel II, lending activities may have to be priced in tune with risk perceived. Efforts and investments required for revamping procedures related to credit risk (measuring, controlling and monitoring).
- Infrastructure financing, which holds enormous opportunities are also prone to competitive pressures and impact on margins.
- Pressure on capital structure and essentiality of the balance sheet size to remain competitive for participation in such projects involving huge outlay, calls for a detailed planning exercise.
- Containing the cost of funds is one of the biggest challenge before the Bank, which could be tackled by an aggressive and long term resource mobilization plan coupled with improved customer service.
- Building up a strong base of CASA segment should be top priority. 'Project Core Deposits' aimed at improving the market share of the Bank has to be a continuous process. It will help in cost containment and effective Liability management system.
- To leverage technology and business process re-engineering, prolific product innovation and developing a customer-centric operation model assumes greater importance. Motivated and vibrant frontline staffs with a robust CRM and marketing back-up can certainly result in aggressive resource mobilization drive at the branches.
- **Cost / income ratio** of PSBs has been steadily increasing in recent years primarily due to higher wage bill and investment in technology. Trend is likely to continue post Basel II to set in place new risk management systems.

- Cost reduction measures (both funds and operating cost), capacity utilization of technology and improved intermediation efficiency level is required to mitigate the cost escalation.

Need for sustained Top line growth for improving the Bottom-line:

Based on the current trends, if the Bank has to improve upon its Bottom-line, the writing is clear on the wall that it has to put in place a comprehensive and well-directed Top line growth strategy due to the following reasons:

- Primarily top line growth is essential to protect and improve the market share of the Bank. True sign of any growing organization is its ability to continuously improve upon its position both in the Global / Domestic arena.
- The immediate fallout of the intense competition witnessed in the industry, is found in narrowing down of margins. In the era of shrinking margins, profits will be determined by quality and volume of business.
- Top line growth generates both implicit and explicit advantages through economies of scale and scope of operations. Size offers greater maneuverability in enhancing business volumes and product diversification.
- Higher turnover and lending to potential segments like infrastructure, would entail huge capital augmentation. Bigger size banks have a distinct advantage when it comes to meeting the capital adequacy requirements.
- Bank needs to possess matching financial muscle to compete with global players in an open market to have its share of credit expansion.
- While Mergers & Acquisitions route provides a quick step forward to enhance the Balance Sheet size, strategic alliances/ partnerships and collaborative approach provide an effective alternative when it comes to deciding the future market share of the Bank as well as the level of earnings. Robust organic growth will essentially facilitate cross selling of tech-supported products and thus improve alternative revenue streams.
- Leveraging technology to bring down the cost of transactions and offer competitive hi-tech / virtual banking services will certainly improve the bottom-line of the Bank.
- Justification for huge investment for continuous technology upgradation is possible only if higher business volumes are generated resulting in enhanced profits for the Bank.

Thus it can be seen that improvement of both, top line and bottom line is required in tandem and not in isolation to improve the profits and profitability position of the Bank. If top line growth is not properly balanced with bottom line growth, the size utility will be lost. At the same time if bottom line growth is achieved without top line growth it doesn't augur well for the Bank in the long run. **Thus, while top line growth is Cardinal, bottom line growth is an essentiality for the Bank to keep going and growing, more so from the stake holders point of view.**

Focus Areas for a Balanced Top line and Bottom-line Growth :

With the need to have both top line and bottom-line growth simultaneous and balanced, it is essential to put in place a more comprehensive and strategic planning exercise at all levels.

- The declining trend witnessed in net interest margin is likely to make a considerable dent in the profit and profitability position of the Bank. This calls for a more judicious **Spread Management** at branches for ensuring that the net interest income level and NIM are consciously improved.
- A robust top line growth with thrust on improving CASA ratio is required to maintain the current net interest income levels. Inherent strengths suggest that increased volumes are

more likely to be generated from Metro & Urban branches when compared to the Semi-Urban / Rural branches, the same need to be capitalized.

- There is a need to focus on generating higher volumes even if it means at a relatively lower NIM (due to intense competition). In such a scenario, the branches should necessarily plan for a judicious mix of business with a higher NIM too, to sustain its profits and profitability position.
- Branches need to increase their market share and market penetration by offering better services with the current product proliferation primarily aimed at increasing the business volume and clientele base.
- The net benefit from such market penetration can be felt with the increase in the clientele base for not only traditional products and services, but also for improving the insurance business and cross selling of mutual funds products to the captive customers.
- While technology costs are inevitable and imminent for the Bank, aggressive promotion of E-banking and Internet Banking will reduce transactions costs to a great extent.
- The ability of the branches to generate additional profits will primarily be determined by its cost efficiency, i.e., ability to reduce its Cost / Income ratio, while improved performance under conventional profit triggers like NIM and Intermediation Cost would continue to influence the branch level profits.
- The Cost / Income ratio throws light on the efficiency of the Bank / branch to mobilize incremental business at a lesser cost or in other words optimal utilization of the resources available at hand.
- The concept of 'Value for Money' to be stressed upon, any increase in the operating expenses should result in commensurate improvement in the productivity level.
- Pricing in Indian Banking system is more market driven rather being cost based. The tariff card of most of the Banks almost looks alike. Thus banks with a better cost control are able to post higher profits and realize higher returns in commensurate to its size and business level.
- A dedicated costing outfit to suitably price various products and services, review the tariffs at regular interval and have a watch over customer / product profitability is felt essential in this direction.
- There is also a need to monitor both top line and bottom-line growth of branches on a monthly basis in a structured fashion to ensure active participation from the field to reach the targets under both top line and bottom-line parameters by taking proactive decisions.

Thus it can be seen that there is an immediate need to drive home the point that robust top line growth and a more conscious planning to improve the bottom-line is the need of the hour. As there is a tremendous scope for the Bank to reduce the Cost / Income ratio from the current level, if the same is achieved in tandem with enhanced Net Interest Income level by generating higher business volumes, then the basic objective of the planning exercise to sustain top line growth without sacrificing bottom-line growth could be comfortably achieved.

Product Pricing: Cost Implications

Rationale: Deregulation of administered interest rates called for banks to price their own products. RBI has since allowed banks to declare their own benchmark prime lending rate. Competition in the market has forced banks to price their products properly so as to attract customers. However product pricing needs also to factor in the required, risk weightages and specific customer features, if need be.

Factors Affecting Pricing Policy:

- **Cost of Funds**
  - Average Deposits Cost
  - Average Borrowings Cost including Tier-II Borrowings
- **Operational / Transaction Cost**
  - Staff Cost
  - Other Operating Cost
- **Regulatory Cost**
  - Cost of Capital Adequacy
  - Standard Assets provisioning
  - NPA provisioning
  - Provisioning for Tax
- **Competition**
  - Competitive pressure force banks to offer quality services at competitive prices.
  - Innovation will only provide competitive advantage.
- **Profit Margin**
  - After covering Fund cost and operational costs profit margin should be factored into the price.
  - Profit margin, generally market driven; however, it should cover benchmark RoA of 1%.
- **Volume of Business**
  - Competitive pressure may not allow in pricing the product as per actual cost and cover a profit margin of 1%.
  - To reduce overall transaction cost, average fund cost and to increase absolute amount of total income, focus should be on enhancing the balance sheet size.

Benchmark Prime Lending Rate:
RBI asked banks to declare their own Benchmark Prime Lending Rate (BPLR), i.e the minimum interest rate which the bank can charge for its zero risk customers. While deciding the BPLR, Banks should take into account following factors:

- ♦ Actual cost of Funds
- ♦ Provision for NPAs
- ♦ Other Regulatory provisions
- ♦ Profit Margin

Cost of funds is estimated through weighted average cost of deposits, borrowings, tier-II bonds and equity capital. Other regulatory provisions include, provisions to maintain minimum capital adequacy, standard assets provisions and tax. However, for NPAs, actual provision is considered.

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Profit Planning & Monitoring

PROFIT PLANNING

Bottom Up Approach : Planning exercise in our Bank, as a part of the bottom-up approach, starts with the Performance Budgeting exercise at each branch, well before the financial year commences. The main aim of performance budgeting is to plan the business in keeping with the Corporate Objectives under sustained top line and bottom line growth within a prudent resource management framework. Efficiency, Innovation and Growth are the core objectives in planning the Business Strategies.

Profit Planning at Branches: Planning at branch level involves the following steps.

- Review of historical data (for last 2-3 years) relating to all major business and profitability indicators For this exercise, STR-11 (RBI Statement), PSR 1 (Flash Report), Monthly Profitability Report (MPR), Quarterly / Half Yearly P&L and Balance Sheet Returns, NPA Statements are the sources for data assimilation.
- Computation of various ratios related to profitability and analysis of their movement over time periods.
- Preparation of the profit plan for the ensuing year based on past trends, corporate objectives and potential in the command area.

Seriousness and precision in the branch level planning process holds the key to a successful profit planning exercise of the Bank. Profit budgeting at branch level essentially requires a strategic plan to generate higher levels of revenues while keeping the costs under check. Following are some issues that the branches need to keep in mind while framing their profit plan.

- Element of challenge in setting business goals : Set ambitious business growth rates, even higher than the potential so that targets are not merely indicative of the minimum performance levels.
- Set monthly plans in alignment with the year end goals. For consistent growth, plan for evenly spread out increments each quarter/month. By doing so, the year-end inflation in business can be minimised.
- Plan for improvement in deposit mix and credit mix. Deposit mix should be in favour of a higher low cost deposit ratio to achieve reduction in cost of deposits. Credit mix need to be oriented towards higher yield on advances; focus on priority, SME, retail and other profitable mid-cap avenues of lending.
- Aim for a progressive increase in the effective CD Ratio (Average Credit to Average Deposit) of the branch.
- Plan for a drastic reduction in the non performing assets (NPA) thru' effective credit appraisal and monitoring besides one-time settlement of core NPAs in accordance with the recovery policy of the Bank.
- Deposit mix, Credit mix, CD Ratio and NPA ratio must be aimed to accomplish higher Net Interest Income (Interest Income minus Interest Expenditure). While improved CD Ratio is important, quality of Assets is paramount for boosting earning streams.
- Aim at reducing the 'Burden' (Non Interest Expenditure minus Non Interest Income) by augmenting non-interest income and containing the non-salary non-interest expenses.

- Project and achieve higher levels of business volumes so that Average Business per Rupee of General Charges is improved.

Profit Planning at Regions / Circles : Planning at Regional/Circle level involves a more scientific and forward looking approach, in tune with the 'Corporate Business Guidance Policy' for the ensuing year. While basis for the planning process is the aggregate of branch budgets under various financial parameters, due weightage has to be accorded on market share, market penetration and Corporate vision. Circle level "Business Plan Conference" involving all executives from branches and controlling units is provided with the requisite direction by the Head Office with a view to integrate the corporate perception and the ground level opportunities.

Profit Planning at Head Office: The corporate planning process involves more intricate exercise of integrating the performance budget of Circles, International Division, Treasury and other Wings of Head Office. Same is also effectively interwoven into the long range plan of the Bank. It involves a comprehensive exercise involving all functional wings and culminates in the 'Corporate Business Plan conference' wherein strategic plans are drawn up to achieve the planned goals.

Top down Approach: Based on the Bank's Business and Profit Plan deliberated upon and finalized in the Corporate Business Plan Conference, annual/ quarterly/ monthly business and profit targets for the Circles are finalized in the 'Budget Settlement Meet' involving the Circle Heads and Top Management of Head Office. Circles, in turn, allocate their settled budget in terms of quarterly/ monthly targets to all branches in the Circles and strategies to achieve the set targets are firmed up in the Branch Managers' Conference held at each Circle level involving all Branch Heads and Circle Management. This is how, under the 'Top Down' approach, disintegration of the Corporate Plan, under each functional parameter, into branch wise targets takes place so that the Corporate Plan essentially remains a sum total of the individual Branch Plans. Achievement of branch plan, thus, assumes further significance since under-performance at any branch/ unit level affects the overall performance of the Bank.

NET PROFIT BUDGETING

Profit planning and profit budgeting at branches / Circles, so far, was confined to the operating profit/ book profit level. Most of the branches being deposit intensive, thus end up in a net operating loss in their balance sheets while the few credit intensive branches post net operating profits. For all profit related reviews, the operating profit level after HO Interest (transfer price) was the parameter and the transfer price mechanism was linked to the operating profit as the distributable surplus for transfer pricing for being transferred to / charged on lending / borrowing branches.

With profits and profitability related issues taking centre stage of strategy formulation, several profit centric initiatives at corporate level have been undertaken leading to significant policy shifts, including the following:

- Shift from gross profit linked TPM to Net Profit linked TPM for assessing branch profitability
- Allocation of Net Profit targets to COs/Branches instead of Operating Profit allocated hitherto.

Need for Net Profit Planning: The dire need to go for a net profit planning approach can best be summed up by an observation made by our C&MD :

'When the Bank earned an operating profit of Rs.2612 crore in FY06, who stole away the 50% that I'm left with Rs.1343 crore (net profit). Provisions, particularly the NPA provisions which are entirely branch creations and eat away a sizeable portion of the hard earned profit remains the most unplanned and unmanaged.'

PROFIT MONITORING

Success of any plan depends on the frequency and quality of review of actual performance vis-à-vis the set plan. The extant profit monitoring mechanism in our Bank entails review of actual performance under profit and profitability parameters at monthly/quarterly/Half Yearly periodicity basing on the Monthly Profitability Report (MPR), Quarterly Balance Sheet and Profit and Loss Account, Half Yearly/Yearly Balance Sheet and Profit & Loss Account.

Monthly Profitability Report (MPR) :

The Monthly Profitability Report Format is designed to capture business, income, cost and efficiency related data from branches.

EXPENDITURE	INCOME
***I.* Interest Expended:** a) Current Deposits b) SB Deposits c) Term Deposits d) RBI Borrowings e) Call Borrowings f) Other Borrowings (IDBI/SIDBI/NABARD) g) Others	**III. Interest Earned:** a) Agricultural Advances b) Other than Agricultural Advances c) Bills Purchased d) Others
***II.* Operating Expenses:** 1. Establishment Expenses a) Salary to Staff ** b) Other Allowances 2. Other Operating Expenses a) Rent, Taxes, Lighting b) Postage, Telegram & Telephone c) Law Charges d) Stationery Expenses i) Computer Stationery ii) Other Statement e) Repairs & Maintenance f) Computer Expenses g) Other Expenditure	**IV. Other Income:** 1. Commission, Exchange & Brokerage a) Cheques & Bills purchased/discounted b) Cheques & Bills for Collection c) DDs/TTs, etc. d) LCs/Guarantees e) Others 2. Other Receipts a) Safe Deposit Lockers b) ECGC Guarantee fee recovered c) Service Charges d) Miscellaneous Receipts 3. Profit / Loss on Exchange Transactions
V. PROFIT	**VI. LOSS**
TOTAL	**TOTAL**

Efficiency Parameters

A. Profit / Loss Before HO Int.	Profitability Related
B. Net HO Interest Receivable / Payable HO Interest Receivable HO Interest Payable	1. Cost of Deposits (%) 2. Yield on Advances (%) 3. Interest Spread (%) 4. Average Business per Employee (Rs. in lakhs) 5. Average Business per Rupee of General Charges 6. Other Income to Establishment Expenses (%) 7. Other Income to Operating Expenses (%)

Quarterly Balance Sheet and Profit and Loss Account:

The Quarterly Balance Sheet and Profit and Loss Account is relatively comprehensive as compared to the Monthly Profit and Loss Account. The Balance Sheet and other related Returns submitted along with the Profit and Loss Account facilitates detailed analysis of the various heads of income and expenditure, profitability ratios, NPA levels, Provisioning requirements and the Net profit position.

Half Yearly Balance Sheet and Profit and Loss Account:

In view of the comprehensive nature of data captured in various returns along with the Balance Sheet and Profit and Loss Account, a thorough analysis of each component /sub-component of income and expenditure is possible. Due diligence in compiling the various returns and the financial statement ensures more accuracy and reliability of the data.
Though the Bank has in place the system of Monthly Profitability Reports (MPR) as a tool for monthly tracking of profit and profitability movements and each branch submits the same to its Circle Office every month, there is no system of an organized review at branch/ Circle level, thus, impacting its effectiveness. For a better monitoring at branches/operation unit level, a structured format is furnished here which may be made use of. The format also carries a systematic flow of crucial aspects of profit & profitability such as, Net Interest Income, Burden, Operating Profit, Provisions to Net Profit. This will certainly provide valuable MIS for the Branch as well as Circle management in monitoring the profit movements on a regular basis.

Format For Monthly Monitoring Of Profit And Profitability Postion Of Branches / Circles

Monthly monitoring of actual performance of branches/Circles vis-a-vis set targets under profitability parameters, essentially involves the following three aspects.

A. Net Interest Income Management
B. Burden Management
C. Provisions and Profit Management

The actual performance under various income and expenditure heads can be extracted from the Monthly Profitability Report and Quarterly/Half Yearly/ Yearly Balance Sheet & Profit and Loss Account. Additional information required on some of the business parameters can be extracted from RBI Statement (STR-11), Flash Report (PSR –1) and NPA s Statements.

TEN POINT PROFIT PERFORMANCE MATRIX:

For a comprehensive evaluation of performance of branches in profitability front, achievement of set targets under the following 10 key profitability matrices may be studied.

Average Deposits	Cost	Non Interest Income	Book Profit
Average Advances	Yield	Other Operating Expenses	Addl. Provision on NPA
	Spread		Net Profit before TPM

"Spread being our lifeline, operations would need to put at least spread retention on top of their agenda".
Shri M B N Rao - Chairman & Managing Director.

One more avenue for the branches to shore up the profits of the Bank.
Remit excess cash to the Currency Chest immediately.
Review Bankers' balance regularly.
Prudent cash management is the need of the hour.

Madurai Circle Limit	Actual Holdings 30.8.07	Excess Holdings	Loss incurred by the circle due to Excess Cash perday
1150 lacs	2057 lacs	907 lacs	3.30 lacs

* * *

Key Points in Profit Planning & Profit Monitoring

1. **Net Interest Income** is a function of Interest Cost, Interest Yield and effective Volume of Business (average deposit and average advances). The interest expenditure will increase with growth in deposits, except under declining interest rate trends; same in case of interest income. The focus should therefore, be on the cost of deposits and yield on advances, as opposed to amount incurred in absolute terms. The right mix of deposit and advances, thus, assumes greater significance.
   With competition between Banks intensifying for resource mobilization and lending, margins are narrowing day by day; for sustaining the net interest income levels, it is the volume of effective business and the mix which are crucial. While the liability planning should focus on increasing the share of low cost deposit, on credit front, the mix should be in favour of high yielding advances; focus should be on SME, priority, retail and other mid-cap segments with better yields. NPA ratio is another important factor, which decides the size of earning assets and yield.
   The impact of cost and yield on net profit of the Bank can be well understood from the fact that, at the average deposit/credit levels of our Bank estimated for Mar'07.

   Every 10 bps change in cost will impact the profits by Rs.120 Crs while every 10 bps change in yield will impact the profits by Rs.83 Crs.

   Similar working/assessment should be done at Circle level.
2. **Burden** is the difference between Non Interest Expenses and the Non Interest Income and an efficient burden management strategy essentially calls for drastic measures to contain the non-interest cost and augment the non-interest income/ other income.
   Various measures for Cost Cutting and Non-interest Income augmentation are dealt in detail separately in the booklet.
3. **Provision**, particularly the provision in respect of NPAs, is the biggest unplanned expenditure in our Profit & Loss account which warrants serious attention of each branch/controlling office. Ensuring better asset quality through proper appraisal and monitoring and swift recovery mechanism are the only ways to keep provisions under check.

* * *

Monthly Profitability Statement

COST OF DEPOSITS

Kindly verify the interest paid on the MPR.
Kindly verify the reversal of interest provision made for the previous quarter / half year / year end.
Kindly verify the running of the appropriate program for the interest provision to be made for the particular month / quarter and its accounting.
Kindly verify the reduction in LCD ratio, for the corresponding increase in Cost of Deposits and decrease in profits.

YIELD ON ADVANCES.

Kindly verify the movement of increase or decrease, corresponds to the revision in interest rates.
Kindly verify the accounting of interest for the month / quarter is by running appropriate programme before drawing the profit and loss account.
Kindly verify the reduction, if any, is in commensurate with the reduction in the outstanding levels of High Yielding advances like retail lending / mid cap accounts.

INDIVIDUAL ITMES OF OTHER INCOME AND EXPENDITURE

Kindly verify the correctness of the cumulative figures that are being reported, as there cannot be a reduction in the expenditure and / or income columns.

Cost Containment

Cost Cutting

Cost cutting is not merely about reducing the incremental expenditure or the growth of expenditure. Growth in expenditure is concomitant to business expansion on most occasions. Expenditure, however, assumes significance when seen in the light of underlying liability and /or the matching revenues. Hence, cost minimization has been occupying the centre stage in on profitability strategies. As oft quoted, world class companies' stature owes a lot to their prudence in cost management.

Cost reduction applies basically to two components viz., Interest Cost and Non-interest Cost.

Interest Cost, which arises from the resources mobilized in the form of deposits, can be managed with proper planning of the deposits mix. Besides planning the low cost deposit share in the total deposits of the branch, the term deposits composition, including bulk deposits, has to be planned and managed to achieve reduction in cost of deposits. The Branch has to assess the potential of its command area and plan the resource mobilization duly keeping in mind the implications on cost of deposits.

Non-interest cost, also called the Operating Cost, comprises **Establishment Cost** and **Non-salary Non-interest Cost** like rent, taxes, lighting, telephone, stationery, advertisements, insurance, law charges etc. Besides minimizing these costs in terms of growth, it is also equally important to measure these costs in ratio terms like 'Cost Income Ratio', 'Burden Ratio' (Non-Interest Income to Non-Interest Expenditure), 'General Charges per Employee', 'General Charges to Business' etc. By popularizing the hi-tech and e-based products and services like AWB, ATM, IMB, RTGS, NEFT, ECS etc., the cost of transaction can be brought down, with attendant improvement in intermediation efficiency.

Opportunity Cost:

Apart from Cost reduction and Yield improvement which are clearly reflected in the Branch Profit and Loss Account, branches also have to pay attention to Opportunity Cost in the form of idle assets carried like cash balances, balances with other banks, excess premises space, un-hired lockers, surplus stationery etc., These idle assets not only involve carrying cost like rent, taxes, insurance, lighting etc., but also may mean opportunity income forgone. A close watch and control of these will ultimately help in improving the Cost and Yield ratios of the branch directly or otherwise. Some of these can not be totally eliminated but those are to be maintained to the minimum level depending upon the requirements of the branch.

Some of the measures of relevance to branches, to contain non-salary non-interest expenditure, are listed below.

Save Rental Outgo : Rent, Taxes and lighting accounts for nearly 80% of our Revenue expenditure budget. Hence, there is need for closely monitoring these expenses

- Ensure effective negotiation of rent /option period increase within permissible limits.
- Ensure prompt renewal of lease and avoid claims for payment of rental arrears with retrospective effect.

- Area norms to be adhered – branches/Circles to work within the area norms prescribed and avoid taking larger areas especially due to CBS/Revised SWS.
- Identification and surrender of surplus area in existing premises. In cases where surrender /part surrender is not possible, alternate use of excess space be explored.
- Ensure surrender of space wherever already permitted. At the same time, explore possibilities of shifting to alternate premises.
- Optimum utilisation of Bank owned premises.

Reduce Expenditure under Electricity and Lighting

- Use of energy saving lamps, judicious usage of power to curtail expenditure on Electricity & Lighting. Minimizing electrical works while doing upgradation/furnishing of branches.
- Review of electricity bills to be done by Branch/Office in charge at irregular intervals to monitor the consumption.

Economy in Other Expenditure

- Telephone Expenditure: Availing of Centrix facility, Group billing, India One announced by BSNL/ MTNL on telephone connection to avail discount on tariffs. Wherever Internet connection is provided judicious usage / prompt logout to be ensured.
- Postage & Telegrams : Extensive usage of Corporate e-mail in containing Postage and Telephone expenditure-Economize on number of covers / clubbing of Tappal.
  Recovery of P&T expenses incurred on account of Customers as per norms
- Repairs & Maintenance : Ensure proper / timely up keep/preventive maintenance of high value office equipments like Electrical systems, AC Equipment, Generators, photocopier machines, batteries computers etc so that huge repairs /replacement costs are avoided / minimized.
- Printing & Stationery : Computer Stationery (paper) and Consumables put together takes nearly 50% of our P&S Annual budget. The following steps are suggested to control expenditure under this head.
  - Judicious use of Computer Stationery and avoidance of wastage. Use right type of stationery for letters/office notes.
  - Regulate supply of Stationery from P&S Sections, Circle Office to branches/Offices.
  - Go for printing of reports/statements, only to the extent required.
  - Extensive Recycling / Re-use of computer consumables (Printer Ribbons, Floppies, CDs, Cartridges) as per schedule given by DIT Wing.

* * *

Non Interest Income

Given the fierce competitive pressures, a robust and growing earnings profile continues to be the avowed goal of progressive banks. Within the earnings profile, the core income (interest on advances) streams are largely market determined and are, thus devoid of substantial headroom. In case of Canara Bank, core income accounts for about 66% of total income. However, from the viewpoint of stable margins, core income movements are often offset by expenses on account of repriced liabilities. It is well recognized that the frequency in asset repricing, as opposed to liabilities involves a larger lead time, affecting thereby, the margins adversely,

It is in this backdrop that the significance of a robust and sustained non-interest income pool comes to the fore. Fee based income does provide the elbowroom for banks to counter the margin pressures and shore up profitability levels. Such income streams are also relatively less volatile and more resilient to the risks. Of late, fee income deserves a concerted focus, especially in view of continued slackness in treasury profits and continued pressure on margins.

For Canara Bank, though total non-interest income growth remains subdued, fee based earnings which accrues from operations has seen a perceptible increase during the recently concluded financial compared to the previous four years; a definite positive sign. This is the core non-interest revenue source and constitutes near half of the total non interest income of the Bank. Thus, there is a compelling need to analyze the trends in fee income avenues and chart out clear cut strategies for the future. A detailed account of non-interest income portfolio of the Bank is given in Annexure I.

Components of Non-Interest income:

Trading Profits: Trading income is by nature very volatile and is prone to the vicissitudes of market forces. Banks' profitability from trading activities is being dented by the upswings in the interest rate. As evident from the data furnished, contribution of trading profit has remained reduced to single digit against near half of the Other Income coming from this segment till 2003-04. There is, of course, a positive growth in the currently concluded financial, though to a limited extent.

Commission, Exchange & Brokerage: This is one segment which has been growing steadily and has contributed to one third of Bank's total non-interest income in the recent years. However, as seen from the Table, share of this segment has remained stagnant during the currently concluded fiscal despite newer and potential business like Bancassurance (included under the head) growing faster.

It is recognized that such income emanating from the traditional remittances and collection businesses is under pressure. While a substantial part of commission earnings used to accrue from Demand Drafts and Telegraphic Transfers for customers, these forms of money transfers are fast disappearing with the arrival of Real Time Gross Settlement (RTGS) of funds across banks and across locations, powered by technology. With cheques encashable at any location and the facility of instant transfer of funds through telebanking and ATMs, there is a sea change happening in the remittance business. Similarly, though bills culture is expected to assume significance, bills collection business, as practiced over the years, is fading due to basic changes taking place in the trade financing operations.

Commission income on guarantees issued by banks, the other traditional fee earner, is facing serious pressure on rates. Scope for issue of guarantees on behalf of customers for long periods, such as, deferred payment guarantees to support buyer's credit for purchase of machinery and other assets, has become rare, since clients are able to get more cost effective alternate financing arrangements. Apart from the traditional sources of services generating commission, a new breed of IT enabled services has been added to the arena of banking services. Branches need to leverage the IT/ITES to popularize such services to compensate for the loss of revenues from traditional sources of fee based income. Investments in providing these ITES being very high, it is prudent to leverage commensurate returns from such investments.

Service charges: Service charges contribute a higher percentage to our fee based income next only to 'Commission, exchange and brokerage' and the same has steadily improved during last 4 years. This segment encompasses a variety of charges/fees and is a potential area for higher growth of revenues. Service charges competitively priced can garner higher business as well as income. To boost collections under this segment, emphasis is to be laid on retail lending. Timely collection of service charges and plugging of income leakages can further add to this segment of revenues.

P&L on exchange transactions: Profit from exchange transactions mainly emanates from the operations of Foreign Departments/ designated branches/ International Division, Mumbai. It contributes a good share to the coffers of non-interest income. Though the revenues from the segment are affected by the volatility in forex market, apart from influences from global markets, the decline/stagnant growth in recent years in exchange earnings at ID is a result of offering finest rates and concessions to Corporate clients. Despite the stiff competitive and compelling situations, Circles will appreciate, that little more prudence may help in minimizing its impact on our bottomline.

Bancassurance and insurance products: Distribution of financial products is clearly a fast emerging segment. By engaging in distribution of third party products, banks would stand to draw additional value from millions of customers and offer them a useful range of services within their available contingent of manpower and infrastructure. Insurance and mutual funds stand apart in this respect as two important products that provide a ready opportunity for banks in India.

MEASURES TO AUGMENT FEE BASED EARNINGS:

- Earnings from traditional sources, with increased application of IT/ITES, is certain to come down in days to come. The only way out to compensate for the shortfall seems to be a higher turnover. High turnover coupled with a larger customer base will aid in augmentation of revenues.
- LCs/Guarantees is a segment, which contributes 44% of the total commission earnings and holds a large potential for further augmentation. However, as evident from the figures furnished earlier, growth rate of earnings from this stream has reduced to 2.6% in 2006-07 compare to 10% growth in 2003-04. Reasons may be attributed to the rising demand from customers for concessions in tariff, as also the possibility of non fund business of our corporate clients being routed through other Banks. Circles need to analyse/ review the Balance sheets of corporate clients to ascertain the quantum of business passed on to the Bank, so as to capture our due share of Non-fund business.
- Emerging avenues of fee based income warranting focus are selling of bancassurance and mutual fund products. For most customers buying insurance products, convenience in buying and ease of payment of premiums are the key motivating factors.

- More concentration on life insurance and pension plans, as the same offers higher commission. All the captive business in Non Life segment should be covered under our arrangement only.
- Bank has already tied up with other banks for sharing of ATM network/NFS. Bank is providing value added services like E-ticketing, mobile top up through ATM and SMS/mobile banking facility, Visa money transfer etc. All these services will aid in generation of fee based income.
- We can leverage the facilities created, only when our card base is stronger; only if our customers are educated as well as encouraged to use these new products/ services.
- Branches to popularize usage of credit/Debit card, as the many add on benefits are introduced for the card holder.
- Thrust on retail lending will mop up higher service charges.
- Judicious recourse to concessional facilities and periodical review of concessional facilities to ensure adequate compensation for the sacrifice.
- A step forward to competitive pricing, Service charges pertaining to non-priority–inland credit related services have already been revised. Tariffs pertaining to other basic Services are under review and being revised in line with market trend.
- Branches need to ensure timely recovery of service charges and plug income leakages.

Another promising avenue, where many of our peers are already in, is Bullion Trading. While the continuous uptrend in bullion price is likely to take care of the funds cost, even at a margin of Rs.40 per gram, it generates a revenue of Rs. 4 crore per ton of gold sold across the counters. We may have to diversify into such activities more and more to widen the fee based earning streams.

Further migration of branches to CBS framework will free the surplus staff to facilitate entry into more productive ventures that may add to further income under non interest income. Branches, therefore, need to draw up clear plans to engage the staff to perform more productive roles, by entrusting them with functions that yield interface with customers more actively, and selling/offering customers a new range of services beyond the conventional bouquet of banking products.

We need to leverage our branch network and Information Technology towards improving value-added services such as On-Line Broking, Utility Bills Payment etc., to our clientele base. This, coupled with effective Customer-Relation Management, will ensure a sustained growth in non-interest income.

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Branch Profitability

To strike a balance between various operational units in terms of contribution to total profits of the Bank, there is a need to continuously evaluate the profitability of the branches. The branch Profit & Loss account per se doesn't reflect the true profit position of the branch in the absence of a mechanism to evaluate diverse business units on a common performance-evaluating platform. Thus the Bank uses Transfer Price Mechanism rates (discussed at length elsewhere in the book) and the performance of the branch after application of HO interest has been a common approach adopted by the Bank to determine the viability of the branch.

LOSS MAKING BRANCH - DEFINITION : A loss-making branch is one, which incurs loss after application of HO interest for the period of review and has completed a gestation period of three years. Similarly a continuous loss-making branch is defined as a branch, which has been in existence for over 5 years and incurs losses continuously for three years. Thus it is very much imperative that the branch posts a profit figure after application of HO interest irrespective of the profit position before application of HO interest.

MAJOR CAUSE OF INCURRING LOSS: The ongoing study of loss incurring branches reveals that the loss making branches generally feature the following:

- High level of core NPAs
- Low or negative interest spread. High cost of deposits
- Low level of Business per Rupee of General Charges
- Low level of business
- Higher Burden

These factors impact the profit position of the branch even before application of HO interest since they have a direct bearing on the branch's Profit & Loss account.

ACTION PLAN FOR TURNAROUND OF LOSS MAKING BRANCHES

Branch specific turnaround strategies need to be worked out by the branches in consultation with the controlling offices. Any turnaround strategy will need to factor business composition and potential of the command area in tandem with the manpower and other operating expenditure of the branch. Branches and controlling offices alike are in a position to monitor the profit position before and after application of HO interest on a monthly basis with the aid of the Monthly Profitability Report and the monthly vouching of HO interest accounted at branch books of accounts.

From the corporate viewpoint, the following general strategies could provide cues for working out branch specific turn around strategies.

1. **NPA Management**: Reduction in Gross NPA and Gross NPA ratio by increasing the Gross Advance level of the branch coupled with decrease in Gross NPA level through recovery efforts. Prompt transfer of NPAs to the ARM branches for reducing the Gross NPA and improving the yield on advances.
2. **Productivity and Profitability**: Improvement in branch profitability by way of either increasing the business level and / or by right sizing of staff. Increase Business per Rupee of General Charges, either by improving the business level or by reducing the operating expense of the branch.
3. **Spread Management**: Work towards improvement in interest spread / net interest income. Reduction in cost of deposits and increase in yield on advances by augmenting low cost deposits and high yielding advances respectively.
4. **Burden Management**: Bring down the gap between General Charges and Non-interest income.
5. **Merger / closure / relocation** of the branch could also be resorted.

Based on the above and in consultation with the respective controlling offices, time bound turnaround strategies need to be put in place by branches.

* * *

Transfer Price Mechanism (TPM)

TPM CONCEPT: Profit is the most commonly acceptable measure for evaluation of Branch performance. Though branches are independent units in terms of accepting deposits, lending funds and extending ancillary services, they are not truly independent commercial units. The branches operate in diverse locations, typifying specific features, such as, predominance of household accounts, commercial entities, export finance and other functions aligning the rural / metro / urban locations. As the branches are functioning under varied environment, the business mix, income streams, cost and yield factors are not uniform. Therefore, the profit as per the books of accounts of the branches will not be truly reflective of the profitability of branches. The primary objective of Transfer Price Mechanism (TPM) is to enable the bank to work out a close approximation of profit/ loss of the branches on realistic and rational basis. TPM aims at placing units of diverse functions on a common platform and assess their contribution to bank's profits individually. TPM is also being increasingly used in setting the business mix on a sound footing so as to be in tune with corporate goals.

RATIONALE: All branches are engaged in raising resources by way of deposits and in deployment of resources by way of advances. After meeting the branch requirements, the surplus funds are transferred to Head Office or the deficit funds are borrowed from Head Office. Depending upon the type of branch i.e., Surplus or Deficit, Head Office compensates the branches for transferring surplus funds or charges deficit branches at a notional rate. These notional rates / prices are known as Transfer Price and the system by which these prices are determined is known as Transfer Price Mechanism. Besides the TPM rates, subsidies are also extended to those branches for activities which are in tune with the corporate goals, like priority sector lending, export finance, Govt. Sponsored schemes etc., that may impinge on the profit of the branches.

METHODOLOGY: Broadly, the methodology adopted by different banks can be classified into three categories.

1. Unitary Transfer Price System **(UTPS)** – A single rate applied to Head Office balance, whether in debit or credit.
2. Dual Transfer Price System **(DTPS)** – Two separate rates – one for lending to and the other for borrowing from Head Office.
3. Multiple Transfer Price System **(MTPS)**– Different weights assigned to nominal interest rates of various assets and liabilities.

The Bank, till 2000-01, followed MTPS wherein, irrespective of the net business or net HO balance position, TPM rates covering certain average business parameters were considered for all the branches. Since the entire exercise was done at the apex level after the finalization of the Bank's balance sheet, the branches were not in a position to take proactive decisions with regard to augmenting their profit position after application of HO interest on an ongoing basis.

POLICY SHIFT IN 2001-02: With a view to simplify and enable effective monitoring of the profit position of branches on a more frequent basis, a simplified DUAL TPM was introduced based on **Net Head Office balance** of branches. The accounting of HO Interest at branches and fixation of Profit before and after HO interest were introduced. Under DUAL TPM methodology, two separate rates are arrived at, one for branches lending funds to HO and the

other for branches borrowing from HO. TPM rate is applied to branches based on their net funds position, arrived at considering five major heads of the RBI statement of the branch as listed below:

- Head Office Account
- Demand Draft Account
- Branch Adjustment Account
- Local Cheques & Cash Remittances (LCCR) account
- ATM Settlement Account

This enabled branches to derive full benefit of the funds managed by it and the TPM effect is seen only on the net funds position which may be surplus or deficit as the case may be. The TPM rates are being aligned from time to time with the overall cost and yield factors of the business parameters. Taking into the consideration the location / business wise variations, separate rates are applied for the two groups, viz., Metro & Urban branches and Semi-Urban & Rural branches.

Element of subsidy: Growing diversity in branch functions, priority sector obligations, participation in Govt. sponsored programmes, segmented business approach, low yielding / international bench marked lending portfolio etc. have prompted banks to subsidize branches, predominantly undertaking such business. Rural and semi-urban branches wherein both the productivity and profitability performance are comparatively low when compared to that of metro and urban branches, a nominal subsidy is provided on their average priority advances portfolio. Subsidy on priority advances encourages the rural and semi-urban branches to fully tap the potential of their command area and it also helps the Bank accomplish the national priorities and comply with the mandated norms. However, an ideal TPM warrants that the extent of subsidy to branches is kept at minimum.

REVISITING THE METHODOLOGY 2006-07: Hitherto the HO interest transferred to branches was based on the net distributable surplus arrived at after adopting TPM rates linked to operating profit of the Bank. However, a more scientific approach necessitates linking of TPM to the net profit position by which branch profitability can be assessed with more precision and realism. Such a method is also stated to obviate the shortcomings related to undue cross-subsidization among branches and compensation for business indiscretion.Thus from the year 2006-07, the Bank is adopting TPM rates linked to the targeted net profit position of the bank. As a result, the net surplus available for distribution comes down drastically.

The following presumptions were made before adopting the TPM rates, based on net profit position of the Bank:

- Efficient allocation of resources is best left to the discretion of the branches, i.e., the TPM HO interest is provided or charged only on the net funds surplus / deficit position of the branch. This minimizes the need for branches to depend on HO interest for shoring up their profits and profitability position.
- The benefit of effective burden management rests on the branch itself, i.e., if the branch is in a position to reduce its burden (non-interest expenditure less non-interest income), then the full benefit is reflected in the profit position of branches even before application of HO interest.

- The combination of the above referred assumptions challenges the branches to effectively manage credit - deposit ratio, quality of credit, improve interest spread, enhance productivity, augment non-interest income and effect cost reduction. Any improvement in the profit position of branches before application of HO interest is retained at the branch level itself and any HO Interest based on TPM rates only further augments the profits and profitability position of the branches.

CONCLUSION

Even though banks have the freedom to adopt any TPM methodology and rates, there is a thorough scrutiny of the profit position of the operational units after application of HO interest by RBI during their annual financial inspection.

There is a need to clearly reorient the policies regarding TPM and communicate the same to the branches / controlling offices for effective monitoring of their profits and profitability position. In the long run the new TPM policy will result in increasing profit awareness at branches / controlling offices and the natural corollary of improved profits and profitability position of the Bank.

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Introduction of Maturity Matched Multiple Transfer Price Mechanism & TPM Rates for FY10.

Cir.12/2010 // Other Ref: Cir 125/2002

- Hitherto, to evaluate the profit position of branches after application of HO interest, the Bank was following a **simplified dual TPM**, i.e., separate rates - for branches lending funds to H.O. and for branches borrowing funds from H.O., applied on the average net HO Funds of branches.
- HO interest was calculated at Circle Offices and conveyed to branches by sending memorandum of HO Interest.
- Vouching / Accounting of HO interest, debit or credit, in the books of accounts of the branches was dispensed with effect from 01-03-2009.
- Calculation and communication of H.O. interest to branches by sending memorandum of H.O. interest is continued at Circle level.
- Now, it is permitted by the Board to adopt 'Maturity Matched Multiple TPM' for FY10 to determine profit position of branches after HO interest.
- Under this concept, TP rates are computed for different products of assets and liabilities as this concept lays emphasis on product profitability and highlights areas for improvement.
- The concept works on the premise that deposit products are a source of funds, while advances products are for deployment of funds.
- The income from deposit products is the transfer price less the interest payout. The income from advances products is the interest received less the transfer price.
- **Methodology:** The new concept will be in force from the month of April 2009 onwards.
- To begin with, it has been decided that the HO interest would be calculated for following products: **Liability Products:** CA/c; SB; Term Deposits & **Asset Products:** Priority Advances ; Non Priority Advances.
- **The Transfer Price rates for the financial year 2009-10**: CA/c :**5.87%** /// SB : **7.24%** /// Term Deposits : **8.17%** /// Priority Advances: **5.85%** /// Non Priority Advances: **7.85%**
- CASA share in total deposit of the Bank is at lower level and its growth is essential to reduce the cost and therefore incentive is factored in TP rates to promote CASA deposits.
- Further, basing on average cost of mobilizing term deposits, incentive is factored in TP rate of term deposits.
- Similarly, risk premium is added to Priority and Non Priority sector advances.
- Risk premium is kept low for priority sector advances, keeping in view the need to accelerate lending to this sector.
- **Calculation of H.O. Interest:** After validating Flash reports by MIP Section, H.O., HO interest would be calculated at Profit Planning Section, H.O. based on the monthly average of each product which is culled out from the FLASH report (PSR1) through the package modified/developed by the Department of Information Technology.
- **'Maturity Matched Multiple TPM'** takes into account the profitability of each product and hence branches would benefit depending upon their performance under each product.
- Branches to strive for judicious mix of business in their portfolio for improving profits and profitability.

Illustration:

- Average Current Deposits 100000* (5.87%) = +5870
- Average Savings Bank Deposits 150000 *(7.24%)= +10860
- Average Term Deposits 350000*(8.17%) = +28595
- Average Priority Advances 100000* (5.85%) = -5850
- Average Non Priority Advances 150000*(7.85%) = -11775
- (+5870+10860+28595-5850-11775) =
- Total H.O. interest +27680

(+) denotes HO Interest receivable by the branch and (-) denotes HO Interest payable by the branch.

Government Business – A Source To Augment Profit

Intense competition in the Banking Industry has put tremendous pressure on Net Interest Margin (NIM). Therefore, Banks are compelled to scout for non-conventional sources of income, such as insurance, credit card, sale of gold, Government Business etc. Handling of Government Business is one of the major sources of income. Apart from the commission we earn for handling the business, the Bank gets benefit of float funds. Further, handling of Ministerial accounts and affiliated Institutions and Trusts, will improve our low cost deposits. The pensioners' accounts will also be a source of improving our core deposits.The Government business consists of Direct & Indirect tax collections, payment of pension of various departments, handling Ministerial accounts, Postal & Treasury accounts, collection of Senior Citizen's Deposit, PPF and sale of Reserve Bank of India & Government Bonds etc.

RATE OF AGENCY COMMISSION PAID BY THE GOVERNMENT: Till 30th June 2005, the Banks were getting commission at 0.12 paise percent. However w.e.f. 1st July 2005, the Government has revised the rate of commission as under:

- **Direct / Indirect tax collections - Rs. 45 per challan**
- **Pension payment - Rs. 60 per payment**
- **All payment except pension - 0.09 paise percent (Rs.9000/ crore)**

PERFORMANCE OF OUR BANK: We were in forefront when OLTAS was launched and we have received lot of appreciation from RBI / Ministry in the beginning. However, in the past one year our performance is not upto the mark. Following are the common errors noticed:

- All branches are not participating under On-Line Tax Accounting System (OLTAS)/ Electronic Accounting System in Excise & Service Tax (EASIEST) on all working days.
- Errors are noticed while keying in challan data, resulting in higher percentage of invalid PAN / TAN.
- Delay in remitting funds collected is noticed occasionally under Direct taxes and on many occasions under CBEC, resulting in levying of penal interest by the authorities.
- In case of PPF and Senior Citizen deposits also, branches are not strictly adhering to the guidelines and while auditing such branches, RBI officials have passed strictures against some of our branches.
- In case of pension payments, revision in DA, refixation of pension, acceptance of nomination, opening of joint accounts are some of the areas where lot of complaints are received. Guidelines / Circulars issued from time to time are not properly implemented, resulting in dissatisfaction among the pensioners.

In nutshell, we may summarize that Government Business is conducted as a matter of routine, out of compulsion, without any zeal / enthusiasm to improve it further. At circle level also adequate attention / importance is not being given for improving the performance.

We may add here that in centres like Allahabad, Meerut, Ahmedabad, Kolkata, Chennai, New Delhi, Mumbai, Pune etc., where there are huge tax collections, our share in these centres is less than 3 to 4% only. Some of the private sector Banks like HDFC, UTI, ICICI are topping the collection list along with SBI and performance of some of the smaller Nationalized Banks like Corporation Bank, Union Bank of India, BOI, BOB is also better than our performance.

Most of the authorized branches conducting Government business will be brought under Core Banking Solution (CBS) and Government business module in the CBS branches will make their job very easy for conducting Government business. **We need to change our attitude towards conducting of Government business. we have to accept it as an opportunity to increase our income.**

We suggest that Circles / branches may implement the following strategies:

1. Each Circle should nominate one executive in-charge of Government business and depending upon the potentials of the branches, the branch-wise targets should be fixed. The same should be periodically monitored. While analyzing the performance of branches, Government business should be made as one of the parameters.
2. TMS and BS&IC Sections should go hand-in-hand and extend necessary technological support to the branches for improving the quality of the data.
3. Training should be imparted to the staff atleast once in six months at local RSTC and awareness should be brought among the staff that Government business is one of avenues for income generation and branches should attend the work as a part of their normal branch function and not as an additional work.
4. Circle should aim at improving their share in the total tax collection of the commissionerate upto 10% so that quantum of total collections would substantially improve and apart from the commission, the Bank will get the benefit of float funds.
5. Our Bank is accredited banker for HRD Ministry, which is implementing Sarva Shiksha Abhiyan (SSA) scheme in almost all the States. The total fund outlay for implementation of the project is around Rs.32000 crores for this year. The Circle should aim at securing the accounts of SSA Scheme upto district level, because the funds allocated for implementation of the project are ultimately lying in the District Level Savings Bank Account of the SSA. Hyderabad and Bangalore Circles have successfully implemented the 'web portal' package and the branches of these circles have received substantial amount of low cost deposits support under the scheme. All Circles should aim at securing the account.
6. With the implementation of CBS, e-payment of Direct and Indirect tax will also be implemented. The Circles should impress upon the branches to enroll more Large Tax payer Units into their fold for e-payment of taxes. It will help in improving Current Account deposits.
7. **Taxes collected are remitted to Government account in T+3 and T+5 days depending upon the location of the branch. Hence, on an average the Bank gets the benefit of float funds of almost 3 to 4 days' collections. Therefore, it is imperative for all of us to improve our collections and maximise the benefit of float funds.**
8. The branches should scout for more pension accounts. This not only generates income by way of commission, but also helps the branches to improve their core deposits from the terminal benefits of the pensioner. After payment of pension, scrolls to be submitted and reimbursement should be claimed expeditiously.
9. At branch level, all authorized branches for collection of taxes have to improve the collections as well as the quality of data so that our performance under tax collections maybe improved and it will help the Bank in getting authorisation for additional branches for conducting Government business.
10. Branches should contact their own clients, Current Account holders and ensure that they pay their taxes only through us.

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Improvement of Government Business under Tax collections.

Cir.282/2009

- Government Business is a good source of non-interest income
- Bank has 466 authorised branches under On-Line Tax Accounting System (OLTAS) and 154 authorised branches for collection of Indirect Taxes under Electronic Accounting System in Excise & Service Tax (EASIEST), besides 79 branches handle Postal transactions at present.
- Our total Direct tax collections for the year 2008-09 was Rs.6031 crores as against collection of Rs.6997 crores during 2007-08 showing a decrease of 13.80% .
- The total collection of Direct taxes for the country for the year 2008-09 was Rs.338000 crores and our Bank's share was a mere 1.78 % of the country's Direct Tax revenue.
- There is negative growth in the tax collection of our Bank.
- More than 50% of the total tax collection has come from two centres.
- Performance of the remaining centres is far from satisfactory.
- It may be noted that after introduction of e-payment of taxes, not only our authorised branches but also all our Core Banking Solution (CBS) branches can remit taxes directly through internet.
- Central Board of Excise & Customs has made e-payment of Service Tax and Excise Duty mandatory with effect from 01.10.2006 for those assessees who have paid Service Tax / Excise Duty of above Rs.50 lakhs in the preceding year or during the current financial year.
- In our Bank, e-payment mode for Service Tax / Excise Duty has been introduced with effect from 01.10.2006.
- Central Board of Direct Taxes (CBDT) has made e-payment of Direct Taxes mandatory with effect from 01.04.2008 in respect of following category of tax payers. (a) All companies; (b) All tax payers covered under provisions of Section 44AB, i.e., turnover or gross receipt from business exceeds Rs.40 lakhs in the previous year or whose gross receipts from profession exceed Rs.10 lakhs in the previous year.
- All our branches handling tax collections to display a keen and active interest in enrolling new tax payers, educate them and show improved performance under tax collection.

Strategies To Improve CASA And Retail Term Deposits

Protecting and improving our market share of business is of paramount importance. Keeping the said aspect, our sharp focus continues to be in favour of “Resource Mobilisation” and “Resource Mobilisation” alone which should also be cost effective. Given the unabated credit demand, the Bank must find ways for aggressive deposit growth, a key factor for resource mobilisation, to match its credit expansion programme. Volumes apart, the crucial approach should be to grow under CASA/Retail segment keeping in focus cost factor which will ultimately augment our profits.

The bygone year witnessed continued buoyancy in credit demand thus necessitating the need for faster augmentation of resource base.

While resource mobilisation is the key for increasing the business volume, the mix of deposit accretion is vital for increasing net interest income. This brings into fore the importance of mobilizing low cost deposits and retail/core deposits. Again, in the term deposit segment, the relative share of retail deposits and bulk deposits has its own effect on the cost of funds.

The important developments that are arising on account of market competition such as relatively less pace of deposit accretion; gradual dissipation of the liquidity overhang; gradual increase in cost of funds and attendant impact on bottom line and excessive recourse to whole sale deposits were a matter of concern for us.

The maturity wise composition of deposits is showing a disturbing trend. As per the trend and progress of Banking in India, the share of short term deposits in the total time deposits increased sharply from 43.80% as at March 2000 to 58.20% as at March 2006. In comparison, our Bank’s share of short term deposits in the total time deposits is 71.22% as at March 2006.

It was seen that a substantial portion of resource allocation emanates in the bulk component, that too, for the shorter durations. The lackluster growth under low cost deposit coupled with lackadaisical growth under bulk deposits is vividly telling on the cost of funds of the Bank.

The excessive competition to garner bulk deposits is vitiating the markets and the adverse effects are:

- Existing deposits are getting repriced at avoidable higher rates. The assets are not getting repriced simultaneously.
- Cost of funds is going up at a very rapid pace.
- The entire focus is shifted on satisfying a few customers rather than serving the core clientele. Ultimately the image of the Bank as a ‘retail bank’ is suffering due to retail customer’s dissatisfaction.
- The phenomenon of bulk deposits which was hitherto confined to metro centres and PSUs/Large Corporates have now proliferated to smaller cities, institutions and individuals.
- In the process, the core deposits are not growing as much as they used to be, in the past.
- Most of the bulk deposits are for shorter periods exposing bank to repricing risks and maturity mismatches.

The structural shift witnessed in the deposit pattern with the share of long term deposits shrinking, costs dearly to the Bank's lendable resources for a longer tenor. In order to mitigate the mismatches, new products like Cansaral, Can Champ, Can Tax Saver, Can Relax, Canara Centenary Scheme etc., should be effectively used as marketing tools. Bank has embarked upon several contest schemes like, Savings Bank Campaign and contest, Recurring Deposit campaign and contest for opening of new accounts as motivational tool. This would come as a shot in the arm for the branches to vigorously canvass low cost and retail deposits.

The hike in the interest rates towards the end of the last fiscal for medium and long term deposits provided more than adequate ammunition to be in the market for deposit hunt.

To reaffirm our traditional status as a retail bank, the operational units, with the guidance and support from the administrative units, should increasingly strive for mobilizing low cost and retail deposits of longer durations. The need of the hour, therefore, is to be innovative and resort to out of the box methods to garner a higher market share of deposits, a share which is justifiably ours, given our over a century old legacy, size and reach.

The competition has certainly intensified, but with concerted efforts coupled with excellent customer service, there is certainly scope for us to improve our share of low cost deposits and retail/core deposits. The success of recent road shows held at various centres is an eye opener for us to steadfastly continue the process as an effective marketing strategy. Our strength in Rural and Semi Urban centres is being put to test by the new generation private banks on account of the recent regulatory relaxation, change in ownership pattern and market orientation.

Some of the time tested strategies for improving CASA and retail deposits are:

- Savings Bank accounts, the mother of all deposit schemes, should be encouraged by offering courteous service at the counters and reviving our conventional method and traditional culture of "asking for deposits" and remain as a 'retail bank'. The best of the staff should occupy the front office and man the counters.
- "Catch them young" should be our slogan to target younger age group with higher incomes.
- Every staff member both individually and in groups to reach out to larger section of society and "ask for deposits".
- Extend the coverage of the area by combing the respective hinterland by organizing door-to-door campaigns covering institutions employing large number of people like Govt. departments; IT Companies; Colleges; Corporate offices and the like.
- Visit residential complexes; flats and colonies; mandis/shandi and business districts.
- Increasing the share of Current Account by organizing meeting of traders and business houses and bringing them to our fold.
- Securing the accounts of parents/students during the fee collection process for admission to professional courses.
- Getting the mandate from the Institutions/PSUs/IT Companies etc., who are our customers for their employees' salary credit. These employees should be given Debit Cards on priority.
- Technology is to be made a business enabler. Marketing and publicizing of technology products and creating awareness among staff and possible users by making available all tech-products like Internet Banking; Mobile Banking; RTGS; NEFT etc., to the customers. Thereafter, monitor the usage and cost, which would improve efficiency.
- Last but not the least, better service will enable improvement in CASA**.**
- The task though difficult is not impossible. We shall all resolve and work together for substantial improvement of share of low cost deposits in total deposits and thus augment our profits

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Non-Resident Deposits:
A source of stable and cost effective deposits

1. **Prompt dispatch of cheque book/Pass book:** Prompt dispatch of cheque books/ pass book to Non-Residents should be ensured. Especially when branches of the exchange companies are sending the application forms along with the remittances, cheque book/pass book has to be dispatched to such of those branches within a reasonable period of time.
2. **Prompt renewal of deposits and dispatch of renewed Deposit Receipts:** It is observed that in many instances, the renewed receipts are either retained at the branch level or sent to the customer directly instead of sending to exchange company branches, from where the renewal request has been forwarded. In UAE, there is no system of door delivery of Post like in India and if the addressee fails to collect the mail within some days, the mail will be returned to sender or may get lost forever.
3. **Prompt crediting of MT/DD proceeds:** It is observed that many branches are not crediting the amount immediately upon receipt of MT/DD drawn on them. Delay upto two weeks after receipt of MT/DD are noticed. Whenever DDs/MTs are paid, branches are expected to provide the branches of exchange companies, the date of payment instead of ignoring their letters on the pretext that MT/DD is already paid. In respect of remittances sent for investment in NRE KDRs, value date benefit (from the date of MT) has to be extended.
4. **Prompt responding to stop payment requests:** The Stop Payment instructions are to be promptly attended and acknowledgement sent.
5. **Prompt crediting of high value MTs i.e., above Rs.2 lakhs:** Branches of exchange companies are sending “Drawing Advise” only for DD above Rs.2 lakhs and not for MTs. No separate drawing advise is required for MTs issued by the exchange companies, irrespective of the amount. Such high value MTs/DDs are to be credited to the accounts of Non-Resident Indians and acknowledgements to be sent.
6. **Prompt in acknowledging the remittances:** Branches do fail to send acknowledgements for having received and credited the remittances to beneficiaries accounts. In many cases, details like date of credit and balance in the accounts are not furnished in the acknowledgements.
7. **Prompt by E-mails:** It is common complaint by our NRI customers that e-mails sent by them are not replied. Prompt reply by e-mails to the queries made by Non-Resident Indians would serve as testimony to our courteous services.
8. **Canbank EFT:** Electronic Funds Transfer (EFT) was launched on 16/10/2004 to act as an effective tool to combat competition. AS per the agreement, EFT proceeds are to be credited to the respective accounts with designated branches on the very same day of transmission. Here again, the following deficiencies are noticed:
   - **a.** Some branches express their ignorance about existence of the facility in their branches.
   - **b.** Some branches express technical problems and not able to download the data. They may require the assistance of BC Section.
   - **c.** In case of technical problem, even if the branches receive branch advice, they will not be in a position to act, since the branch advice does not contain beneficiary details.
   - **d.** Many branches are not opening e-mail and looking for messages.
9. **Ambience:** Apart from the above, maintenance of the good ambience of our branches/offices also plays a major role in attracting non resident customers**.**
10. **Relationship:** Though strategies can be many, maintaining good relationship with their local contact/relatives and catering to their non banking requests whenever possible would help develop a relationship beyond banking, which would be well appreciated by the NRIs who stay away from the dear and near.

Provisions

In August 1991, a high level committee, headed by Sri M Narasimham was appointed to examine various aspects of our financial system. One of the important recommendations of Narasimham committee was that balance sheets of the banks should be transparent and comply with international accounting standards. The committee recommended that banks should adopt uniform accounting practices in regard to income recognition and bad debts provisioning. In particular, income recognition of non performing assets should not be on accrual basis but on record of recovery. The committee also suggested that provisioning should depend upon a proper classification of assets, which in turn should be based on objective criteria. Following these, the RBI issued guidelines/instructions to banks in April 1992 for classification of assets. Initially an advance was treated as non performing if interest / installment remained past due for a period of 4 quarters. Gradually this period was reduced over the last 12 years. Now an account is considered as non performing one if the interest / installment remains unpaid for 90 days.Narasimham committee also recommended that the assets should be classified into the following 4 categories: Standard, Sub Standard, Doubtful and Loss assets and provisioning should be done based on the classification of assets.

Banks derive their major source of income by way of interest on advances and investment. Interest is charged to the asset and then recovered from the party / borrower concerned. Thus income is booked initially on accrual basis. However, if the bank is not able to get / recover interest from the counterparty within reasonable time, then the interest income should not be accounted for or recognized, till it is actually received. Thus, accounting for interest is changed to mercantile one. The asset in this situation becomes a non performing one. A non performing asset causes two fold impact on the profitability of a bank. On one hand the bank ceases to earn interest on this aspect and thus is deprived of its legitimate income from the asset.

On the other hand, the bank is required to make provisions for this asset, depending on the classification / category of the asset and the value of security if any. This makes further dent in the profitability of the bank. The Reserve Bank of India introduced the system of asset classification and provisioning in line with international practices for the first time in 1993. These norms have undergone several changes during the past 14 years.Depending upon the age of NPA, the classification of the asset changes. Thus with the passage of time , probability of recovery diminished and hence the requirement of provisioning goes up. Thus the provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained nonperforming and the availability of security and the realisable value thereof. Banks are urged to ensure that while granting loans and advances, realistic repayment schedules may be fixed on the basis of cash flows with borrowers. This would go a long way to facilitate prompt repayment by the borrowers and thus improve the record of recovery in advances.

The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors.As per the guidelines of Reserve Bank of India, provisions are to be made based on Asset Classification as under:

STANDARD ASSETS: As per the guidelines of Reserve Bank of India, a general provision ranging from 0.25% to 1% is required to be made as detailed hereunder:

Category of Standard Advances	**Provision %**
Direct Advances to Agriculture and MSE Sectors	0.25%
Loans to Commercial Real Estate Sector	1.00%
All other Loans and Advances (Including Medium Enterprises)	0.40%

In respect of NPAs i.e., Sub-Standard, Doubtful and Loss Assets provision is required to be made based on the Asset Classification, securities available and ECGC/CGTSI Cover available.

SUB-STANDARD ASSETS:

- A general provision of 10% on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities available. The 'unsecured exposures' which are identified as 'sub-standard' would attract additional provision of 10%, i.e., a total of 20% on the outstanding balance.
- Unsecured exposure is defined as an exposure where the realisable value of security, as assessed by the Bank / approved valuers / Reserve Bank's Inspecting Officers, is not more than 10%, ab-initio, of the outstanding exposure. 'Exposure' should include all funded and non-funded exposures (including underwriting and similar commitments). Security will mean tangible security properly discharged to the Bank and will not include intangible securities like guarantees, comfort letters etc.
- While reporting the value of securities in the supporting sheets meant for sub-standard assets, total value of securities (for both fund and non fund based limits) should be reported. While calculating the provision, the value of securities should be compared with total of fund and non fund based liability and –

- If the value of security is more than 10% of the total liability (i.e., fund and non fund based), provisioning at 10% is to be made.
- If the value of security is less than 10% of the total liability and as on the date of sanction also, it was less than 10%, provisioning at 20% is to be made.

DOUBTFUL ASSETS: Provisioning at 100% is to be made for the deficit portion i.e., to the extent to which advance is not covered by the realizable value of the security / ECGC / CGTSI cover to which the Bank has a valid recourse and the realizable value is estimated on a realistic basis.
In regard to the secured portion, provision is to be made on the following basis, at the rates ranging from 20% to 100% of the secured portion depending upon the Year of Doubtful.

Period for which the advance has remained in 'doubtful' category	Provision Requirement (%)
Upto one year	20%
One to three years	30%
More than three years	100%

Whenever collateral security of our own term deposits is available, Branches need not calculate 20% / 30% / 100% of its value for arriving at the provisioning requirement.
LOSS ASSETS: Provision at 100% of net liability would be made at Head Office / Circle Office.

* * *

Return on Assets (RoA)
RoA is the ratio of Net profit to total assets. This is a standard measure of profitability with 1% deemed as the international benchmark.

$$ROA = \frac{\text{Net Profit}}{\text{Total Assets}}$$

Net Interest Margin (NIM)
NIM is the ratio of net interest income (Total Interest Income minus Total Interest Expenditure) to average earning assets.

$$NIM = \frac{\text{Net Interest Income}}{\text{Avg. Earning Assets}} = \frac{\text{Int. Income} - \text{Int. Exp}}{\text{Avg. Earning Assets}}$$

Return on Capital (ROC)
ROC is the ratio of net profit to share capital. It indicates the return on paid up capital.

$$ROC = \frac{\text{Net Profit}}{\text{Share Capital}}$$

Return on Networth , also known as Return on Equity (ROE)

Ratio of net profit to average networth (share capital, plus reserves minus intangible assets). It indicates the return on equity capital.

$$ROE = \frac{\text{Net Profit}}{\text{Average Networth}}$$

Book Value
Networth divided by number of shares. Market price of share generally factors Book Value.

$$\text{Book Value} = \frac{\text{Net Worth}}{\text{No. of Shares}}$$

Earning Per Share (EPS) & Price earning Ratio (P/E ratio)

EPS is the ratio of Net profit to number of shareholders.

$$EPS = \frac{\text{Net Profit}}{\text{No of Shares}}$$

Price - Earning is the ratio of market price of a share to earning per share. EPS and P/E ratios indicate the ability of the bank to access to the capital market and the appetite of the bank's scrip in the market.

$$P / E \text{ Ratio} = \frac{\text{Market Price}}{\text{EPS}}$$

Capital Adequacy Ratio (CRAR)

Total capital, consisting of Tier-I & Tier-II capital, as a ratio of risk-weighted assets. It indicates the soundness and risk bearing ability of a bank.

$$CRAR = \frac{\text{Tier I Capital + Tier II Capital}}{\text{Risk Weighted Assets}}$$

Cost and Yield Ratios

Yield on Advances

Interest income on advances divided by average advances indicates average yield on advances. This ratio enables cost-benefit assessment from various advances related products. Progressive banking entities make extensive use of yield on even segment-wise advances (eg. retail, priority, consumer loan, etc.,) to realign the composition of advances portfolio.

$$\text{Yield on Advances} = \frac{\text{Interest Income on Advances}}{\text{Average Advances}}$$

Yield on Investments

Interest & dividend income on investment divided by average investments indicated yield on investments..

$$\text{Yield on Investments} = \frac{\text{Int. Income on Invest.+ Dividend Income}}{\text{Average Investments}}$$

Yield on Working Funds

Total interest income divided average working funds, consisting of interest earning and non-interest earning assets.

$$\text{Yield on AWF} = \frac{\text{Total Interest Income}}{\text{Average Working Funds}}$$

Cost of Deposits
Interest paid on deposits divided by the average deposits, consisting of Current, Savings and Term deposits. This is the comparable benchmark for liabilities management.

$$\text{Cost of Deposits} = \frac{\text{Interest Expenditure on Deposits}}{\text{Average Deposits}}$$

Cost of Borrowings
Interest paid on borrowings, including borrowing for Tier-II capital, divided by average borrowings.

$$\text{Cost of Borrowings} = \frac{\text{Interest Expenditure on Borrowings}}{\text{Average Borrowings}}$$

Cost of Interest Bearing Liabilities
Interest paid on deposits and borrowings divided by average interest bearing liabilities (deposits and borrowings, including Tier-II bonds).

$$\text{Cost of Int. Bearing Liabilities} = \frac{\text{Total Interest Expenditure}}{\text{Average Deposits + Average Borrowings}}$$

Cost of Working Funds
Total interest expenditure divided average working funds, consisting of interest bearing and non-interest bearing liabilities (total of liability side of balance sheet). This ratio has significant bearing on the spreads earned by banks.

$$\text{Cost of AWF} = \frac{\text{Total Interest Expenditure}}{\text{Average Working Funds}}$$

Spread
The difference between Yield on Working Funds and Cost of Working Funds represents Spread.

Spread = Yield on Working Funds – Cost of Working Funds =

Operational Efficiency Ratios

Intermediation Ratio
It measures the ratio of operating expenditure to total assets. As per international criterion, this ratio should be less than 1 per cent.

$$\text{Intermediation Ratio} = \frac{\text{Operating Expenditure}}{\text{Average Working Funds}}$$

Cost- Income (Efficiency) Ratio
Non-interest expenditure divided by net total income (total income minus interest expenses). It signifies movement in operating cost relative to income. Global benchmark is 40 per cent.

$$\text{Cost-Income Ratio} = \frac{\text{Operating Expenditure}}{\text{Net Total Income}}$$

Burden Ratio
Ratio of non-interest income to non-interest expenditure. As an efficiency criterion, non-interest income should be able to cover the non-interest expenditure.

$$\text{Burden Ratio} = \frac{\text{Non-interest Income}}{\text{Non-interest Expenditure}}$$

Branch Management Planner
A Source of Reference For Performance Budgeting

- Attention of the Branch-in-charge is drawn to the “Branch Management Planner” Booklet (previously referred to as “Work Book and Performance Record”) which provides historical, statistical and qualitative information pertaining to the Branch.
- The information available in this booklet, is very relevant and provides inputs for decision making. The data available in this book, will be very useful for making business projections and drawing up Performance Budget of the branch.
- Hence, the branches are requested to keep the planner updated and make best use of the information available in it.
- The present “Branch Management Planner” supplied to all branches is for the period 2004 – 2007.
- The new book for the period April 2007- March 2010 duly revised/ updated by our O&M Section, Inspection Wing will be going for print shortly and will be sent to all the branches well in advance.
- The Branch Managers should note to update and use this important record for planning and monitoring business growth and make it available to the visiting executives during their branch visits, to enable them to make their comments.

Base Rate

RBI Guidelines dated April 9, 2010 & Clarification dt.14.05.2010

- RBI constituted a Working Group on BPLR (Chairman : Shri Deepak Mohanty) to review the present benchmark prime lending rate (BPLR) system and suggest changes to make credit pricing more transparent.
- The Working Group its report submitted in October 2009.
- Draft guidelines on Base Rate were placed on the Reserve Bank's website in February 2010.
- RBI has decided that banks should switch over to the system of Base Rate.
- The BPLR system, introduced in 2003, fell short of its original objective of bringing transparency to lending rates.
- This was mainly because under the BPLR system, banks could lend below BPLR.
- For the same reason, it was also difficult to assess the transmission of policy rates of the Reserve Bank to lending rates of banks.
- The Base Rate system is aimed at enhancing transparency in lending rates of banks and enabling better assessment of transmission of monetary policy.

Base Rate

- The Base Rate system will replace the BPLR system with effect from July 1, 2010.
- Base Rate shall include all those elements of the lending rates that are common across all categories of borrowers.
- **Base Rate = Cost of Deposit or Funds** + **Negative Carry on SLR/CRR*** + **Unallocatable Overhead Cost*** + **Average Return on Net Worth*** (*Formula has been suggested by RBI for calculating each of these elements of BR)
- **Negative carry on CRR and SLR** balances arises because the return on CRR balances is nil, while the return on SLR balances (proxied using the 364-day Treasury Bill rate) is lower than the cost of deposits.
- **Unallocatable Overhead Cost** is calculated by taking the ratio (expressed as a percentage) of unallocated overhead cost and deployable deposit.
- **Average Return on Net Worth** is computed as the product of net profit to net worth ratio and net worth to total liabilities ratio expressed as a percentage.
- Actual lending rates on loans will include such other customer specific charges as considered appropriate.
- Banks may choose any benchmark / methodology to arrive at the Base Rate for a specific tenor that may be disclosed transparently. (It should be consistent and be made available for supervisory review).
- The actual lending rates charged may be transparent and consistent and be made available for supervisory review.
- The Base Rate could also serve as the reference benchmark rate for floating rate loan products, apart from external market benchmark rates. The floating interest rate based on external benchmarks should, however, be equal to or above the Base Rate at the time of sanction or renewal.

Base rate not applicable to:

The following categories of loans could be priced without reference to the Base Rate: (a) DRI advances; (b) Loans to banks' own employees; (c) Loans to banks' depositors against their own deposits.

Applicability of Base Rate

- All categories of loans should henceforth be priced only with reference to the Base Rate.
- The Base Rate system would be applicable for all new loans and for those old loans that come up for renewal.
- Existing loans based on the BPLR system may run till their maturity.
- In case existing borrowers want to switch to the new system, before expiry of the existing contracts, an option may be given to them, on mutually agreed terms. Banks, however, should not charge any fee for such switch-over.
- Changes in the Base Rate shall be applicable in respect of all existing loans linked to the Base Rate, in a transparent and non-discriminatory manner.
- Since the Base Rate will be the minimum rate for all loans, banks are not permitted to resort to any lending below the Base Rate. Accordingly, the current stipulation of BPLR as the ceiling rate for loans up to Rs.2 lakh stands withdrawn. It will increase the credit flow to small borrowers at reasonable rate and direct bank finance.
- RBI will separately announce the stipulation for export credit.
- **Clarification on Fixed rate Loans:** Even after introduction of the Base Rate system, banks would have the freedom to offer all categories of loans on fixed or floating rates. Where loans are offered on fixed rate basis, notwithstanding the quarterly review of the Base Rate, the rate of interest on fixed rate loans will continue to remain the same. However, the only condition is that such fixed rate should not be below the Base Rate.

Review of Base Rate

- Banks should review the Base Rate at least once in a quarter with the approval of the Board or the ALCOs.
- Since transparency in the pricing of lending products has been a key objective, banks to display their Base Rate at all branches / websites.
- Changes in the Base Rate should also be conveyed to the general public from time to time through appropriate channels.
- Banks to provide information on the actual minimum and maximum lending rates to the RBI on a quarterly basis.

Implications of Base Rate:

- **First**, the introduction of the base rate system brings to end of two decades of efforts to deregulate the lending rates of banks. This is expected to enhance the allocative efficiency of the financial intermediation process by banks.
- **Second**, deregulation of lending rates will promote financial inclusion with greater credit flow to agriculture and small business. This, together with other specific measures taken by the Reserve Bank for financial inclusion, will draw borrowers away from the informal financial sector to the formal financial sector and thus, facilitate credit penetration.
- **Third**, the base rate system that comes into effect from 1st July 2010 gives complete freedom to banks in their loan pricing decisions while ensuring transparency. Banks have

unlimited access to public deposits and privileged access to the liquidity facility of the Reserve Bank. Hence there is a greater need for transparency and responsible lending practices for public purposes.

- **Fourth**, the base rates of banks will mirror their relative efficiency and cost structure. While lending rates tend to be sticky, it is expected that the base rate system will show greater flexibility and strengthen both the interest rate and credit channels of monetary transmission.
- **Fifth**, the new system gives the freedom to banks to choose other market related benchmarks besides their base rates for pricing floating rate products. This could promote development of market benchmarks. It could also deepen the money market to facilitate short-term liquidity management by banks.
- **Sixth**, there is some apprehension that the base rate system may raise the effective cost of borrowings. This is unlikely because corporates have access to multiple sources of funds and hence the effective borrowing rates will be determined by market competition.
- **Seventh**, the nominal effective lending rate of the banking system which remained higher in the 1990s have declined significantly in the 2000s. This can largely be attributed to moderation in overall inflation, reduction in inflation risk premia, interest rate deregulation and increasing efficiency of the banking system.
- **Eighth**, the computation of real lending rate becomes challenging without a comprehensive measure of consumer price inflation and difficulties in measuring inflation expectations. Nevertheless, ex post measures of real lending rates over the last two decades show a clear pattern. The real lending rates rose in the 1990s and then declined in the 2000s. The real weighted average lending rate was higher than the real GDP growth rate, particularly during the period 1997-98 to 2002-03. Thereafter, the real weighted average lending rate has declined concurrent with the high growth phase of the Indian economy.
- **Finally**, credit and industrial output cycles show inverse relationship with real interest rate. However, there is a need for further research to better understand the relationship between credit and interest rate cycles and its implications for sustainable growth.

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Reorganization / Formation Of Sections/Functional Wings At Head Office

Memo: 70 / 2007

The Bank has been restructuring its administrative structure by either changing the administrative control of functional sections or by formation of new sections from time to time according to the business challenges taking place in the Banking Industry. Having regard to the thrust areas and for bringing in better administrative control, we have re-organized certain Sections/Divisions and formed new sections in certain wings in relation to the functions handled by them.

Costing Cell within Profit Planning Section, Planning & Development Wing:

In order to suitably price various products and services, review the tariffs at regular intervals and to have a watch over customer/product profitability on a continual basis, a Costing Cell within Profit Planning Section, Planning & Development Wing, Head Office is formed. The brief Objectives and Functions/Roles and Responsibilities of the newly introduced sections/departments are enumerated below:

Costing Cell -Objectives:

- Proper pricing of various products/services in the Bank.
- Prudent cost control and continuous track on customer and product profitability.
- Transaction costing at regular intervals.
- Costing strategy for effective spread and burden management.
- Countering the impact of narrowing margins and increasing cost of overheads including technology.

Costing Cell -Functions:

- Pricing of various products and services.
- Review of service charges/tariffs at regular intervals and monitoring of market trends.
- Monitoring of customer/product profitability on a continuous basis.
- Various costing related studies, Cost Benefit/Breakeven Analysis.
- Transaction Costing: Activity based costing of various transactions and advising the reference rates to various Departments/Circles for Cost Benefit Study.
- Review of 'Delegation of Powers for Concessions in Service Charges/at par facilities'.
- Studies related to EMI/Annuity, BPLR calculations, etc.
- Measuring the impact of revisions in rate of interest on deposits and BPLR.
- Correspondent Banking Arrangements/DD Drawing Arrangements.
- Issue of various Educative Series/Newsletters on Cost Control/Costing related issues for larger awareness at operational level.

Further, Costing Cell, apart from its basic costing / pricing function, shall provide need based support to other Sections of the Wing as well as other Wings.

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Cost of Funds For The Bank And Profitability

Cir. 211 / 2006

NEED TO BE SELECTIVE IN RECOMMENDING PROPOSALS FOR REDUCED RATE OF INTEREST: IT is observed that interest concession proposals are recommended by the branches without sufficient justification. While it is understandable that to compete in the market we have to offer competitive rates, it is also imperative that such proposals are to be considered based on the dealings of the party, value of the account and spin off benefits from the party which may compensate the loss on account of offering concessions on a selective basis and not as a matter of routine at the cost of profitability.

In the context of prevailing hardening interest rate scenario, it is all the more important to be selective in considering such proposals, even in cases where the loan is against our own Term Deposits. Due to the hardening of interest rates the cost of funds for the bank has gone up considerably in the recent months in view of the following:

- The Reserve Bank of India (RBI) has revised provisioning requirement from 0.25 % to 1 % on certain types of loans which has direct impact on our profits.
- Similarly RBI has revised the Risk Weight on certain advances to 150 % necessitating banks to provide additional capital.
- The RBI has revised their lending rate to Banks by 1.00 % during the last one year period.
- The 10 year yield on Government of India securities has gone up by almost 130 basis points.
- The rates of interest on deposits have also gone up by more than 1 % for various maturities.

The above factors have resulted in increased cost of funds for the banks including our Bank. All the banks have increased their rates of interest as a result of the above. However our rates are still competitive compared to many other banks.

Some branches are recommending even small proposals for interest concession. Against deposits, normally 90 % is given as a loan, whereas the funds available due to maintenance of CRR and SLR is only 70 % of the deposits. So extending facilities against deposits @ 90 % level with 2 % above the interest rate on deposit is itself a fine rate.

As the cost of funds are showing an increasing trend our spreads are already under pressure and offering concessional rates will further put pressure on the profitability if proper restraint is not exercised.

The non interest income has been showing a declining trend due to waiver/reduction of processing charges etc. Further, with the ever advancing technology traditional sources of non interest income like DD/OSC commission etc. is on the decline.

In the above background, it is necessary to maintain the existing spread as far as interest income is concerned.

In view of the foregoing, branches/offices are advised as under:

1. To explain and convince the borrowers seeking interest concessions by highlighting the advantageous/positive features of our loan schemes and the difficulties in considering their request.

2. To recommend such proposals very selectively considering the following:
value of the account
a. desirability of the connection
b. spin off benefits accrued and expected
c. ticket size of the loan
d. threat of losing the account wherever documentary evidence in support of other bank's offer is available.
e. possibility of cross selling of the bank's other products.

3. Wherever considering such proposals are inevitable sufficient justification for the same to be informed to the higher authorities.

Branches/offices are requested to take note of the above and advised to be very selective in recommending the proposals for ROI concession including for loans against term deposits.

* * *

Why CASA?

Hon'ble Finance Minister Shri. P Chidambaram, in the recently held meeting with the Chiefs of the Bank has directed the Banks to aim at achieving the target of 40% under CASA.

Remember it is going to be a collective, enterprise wide effort
We all must make it Happen

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Burden Efficiency Ratio:

- Operational efficiency of an organization is measured by various profitability ratios. Amongst key profitability ratios, burden efficiency ratio measures the level by which noninterest income covers noninterest expenditure.
- Burden efficiency ratio has gained prominence in the wake of several factors affecting spread (difference between interest income and interest expenditure).
- The ability of an organization in enhancing profits lies in its coverage of non interest expenditure (establishment and other operating expenses) by non interest income (commission and other income).
- As an efficiency criterion non interest income should be equalto non interest expenditure. (i.e.100%)
- The burden efficiency ratio of our bank has steadily improved from 56% in 2006 to 82% in March 2010.
- The ratio for circles as a group has improved from 39% to 56% in the same period.
- An analysis of income and expenditure pattern reveals that for every 1% reduction in non interest expenses or increase in non interest income the ratio improves by around 80 basis points.
- Keeping in view the significance of this ratio, Bank has included it, this year, as one of the 12 profitability parameters for evaluating Circle's performance.
- Operational units can contribute their mite by curtailing controllable expenditure and enhancing fee based income.

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Performance Budget

Circular:39/2007 dated: 08.02.2007

INTRODUCTION: The Performance Budgeting exercise is in vogue in our Bank for the past several years. It has become an integral part of the planning process of the Bank. The exercise has been subjected to periodical revisions and reviews to suit the changing needs. The Performance Budget format introduced in 2002-03 covered various aspects of the planning requirement. However, to meet the changing requirements, the format has been fine-tuned over the years. The Performance Budget format for the year 2007-08, is on similar lines with that of previous year format with a few parameters added during the year.

OBJECTIVE OF PERFORMANCE BUDGETING: The main objective of Performance Budgeting is to plan the business keeping in view the Corporate Objectives and **generate maximum profits by ensuring optimum utilisation of the resources at our command**. Efficiency, Innovation and Growth should be the objective in planning our Business Strategies.

FORMAT DETAILS: The Performance Budget format has been fine tuned to facilitate easy compilation and contains only 2 parts, i.e., Performance Budget on Business Parameters & Performance Budget on Profitability Parameters
Profit Budget: Profit Budget format has been re-designed to have an easy flow of data.

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PRESS RELEASE dated October 20, 2010

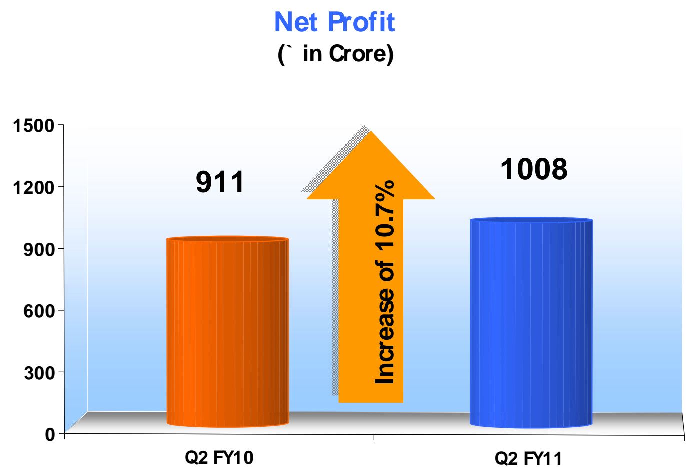
Net Profit for Q2 at ` 1008 crore, up by 10.7%
Aggregate Business crosses ` 4.25lakh crore

Buoyed by a 21% growth in total business, Canara Bank's Net Profit for Q2 moves up to `1008 Cr.

Major Highlights – Q2 (FY 11)

- **Total business crossed `4.25 lakh crore, up by 21%**
- **Net Profit at `1008 crore, up by 10.7%**
- **Over `1000 crore Net Profit for Two Consecutive Quarters**
- **Robust Net Interest Income Growth at 52.5%**
- **Further improvement in NIM to 3.16%**
- **Return on Assets at 1.52%**
- **Capital Adequacy Ratio at 13.88%, Tier I ratio at 8.82%**
- **Gross NPA ratio at 1.49% and Net NPA ratio at 1.06%, both down y.o.y**
- **100% Coverage of Branches under CBS**

Net Profit for the second quarter of FY11 rose to `1008 crore, with a y.o.y growth of 10.7% compared to `911 crore recorded in the corresponding Q2 of the previous financial. The Bank has posted over `1000 crore in net profit for two consecutive quarters.



Notwithstanding the muted treasury gains during the quarter, **operating profit** rose by 6.5% to `1416 crore.

A total provision of `408 crore, including a provision of `199 crore towards NPA, has been made. **Provision Coverage Ratio** is 77.06% as at September 2010.

Return on average assets (RoAA) for the Q2 was at 1.52%. **Earnings per Share** (EPS) rose to `24.58 as against `22.21 a year ago. **Book Value** increased to `355.25 compared to `280.38 as at September 2009.

Capital Adequacy

Capital Adequacy Ratio stood at 13.88%, well above the regulatory minimum of 9%. Tier I capital ratio improved to 8.82%. The Bank has raised `750 crore under Innovative Perpetual Debt Instrument and `1000 crore under Upper Tier II bonds during the second quarter. With 73.17% Government of India holding, the Bank has adequate headroom available under both Tier I and Tier II options to raise capital and support business growth momentum.

Income and Expenses-Q2

Net Interest Income for the second quarter **rose by a significant 52.5%** to `2003 crore compared to `1314 crore in the same quarter a year ago.

Recording a growth of 17%, **interest income from loans/advances** rose to `4110 crore.

While growth in **total expenditure** was 9.1%, the growth in **interest expenses** during Q2 was contained at 5.3%.

First Half (H1) Performance

Net Profit for the first half (H1) recorded a 38% growth to reach `2021 crore compared to `1466 crore in the corresponding period last year. **Operating profit** grew by 28.8% to `2899 crore over `2250 crore recorded in the period a year ago.

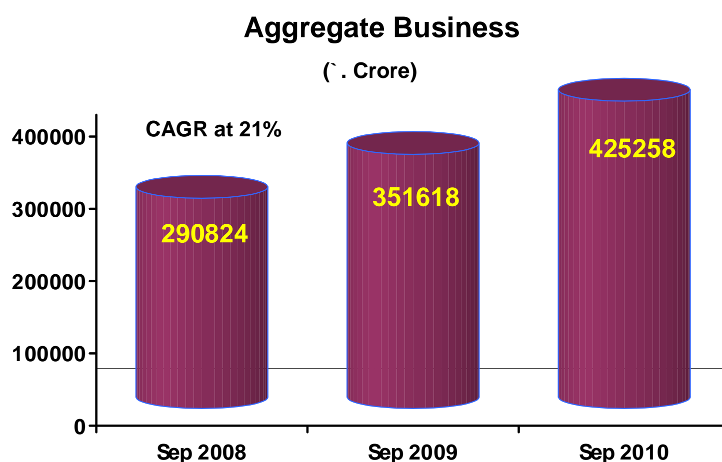
Net Interest Income for H1 grew by a significant 43% to `3731 crore compared to `2605 crore a year ago.

Net Interest Margin (NIM) further improved to 3.16%, up from 2.66% at September 2009 and 3.01% at June 2010.

Total income for the first half rose by 12.6% to `11972 crore, driven by a 14% growth in income from loans/advances. The Bank's non-interest income upto September 2010 was `1234 crore.

While **total expenses** grew moderately at 8.2% to `9073 crore, growth in interest expenses was contained at 5.2%.

Business Growth and Productivity



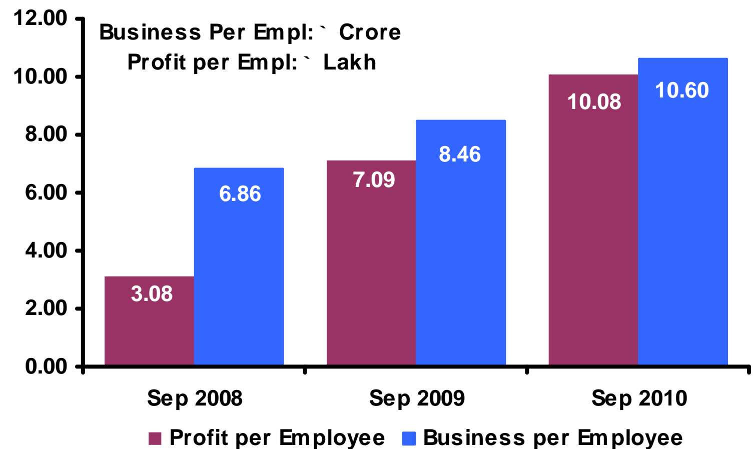
Total business of the Bank rose to a level of `425258 crore as at September 2010, **recording a y-o-y growth of 21%**. Total deposits increased to `249187 crore, with a growth of 21.5%.

Advances (net) grew by 20.2% to reach `176071 crore, up from `146456 crore as at September 2009.

The Bank's **domestic business** constituted 96% of the total business with `241740 crore under deposits and `167535 crore under advances.

Driven by an intensive thrust, **CASA deposits** crossed `72000 crore as at September 2010. Both CASA deposits and savings deposits in particular recorded a growth of 23%. Share of CASA deposit in domestic deposits improved further to 30.10% compared to 29.19% a year ago. Notably, the Bank has added `10,000 crore in SB deposit and over 17 lakhs SB Deposit clientele during the period. The Bank has launched a nationwide **'Savings Mahotsav'** campaign across all branches to shore up SB deposit level.

Steady improvement in business is well reflected in rising productivity of the Bank. While **Business per Employee** increased to `10.60 crore, **Business per Branch** improved to `138.70 crore as at September 2010 compared to ` 125 crore a year ago. The Bank's **clientele base** reached 37.46 million, comprising 33.33 million under deposit accounts and 4.13 million under borrowal accounts.



Asset Quality

With relentless thrust on asset quality and intensive monitoring of credit, the Bank's **gross NPA ratio** came down to 1.49% (`2636 crore) and **net NPA ratio** to 1.06% (`1860 crore) as at September 2010 compared to the gross NPA ratio of 1.60% and Net NPA ratio of 1.16% as at September 2009. **Cash recovery** during the first half at `742 crore was much higher than `530 crore in the same period a year ago.

Credit Segments

The Bank's credit growth at 20% during the period compares well with the industry's growth and is broadbased across segments- retail, priority sectors, industrial and infrastructure.

Driven by higher retail credit demand, the Bank's **retail lending portfolio** grew by 26.3% to `26029 crore. The growth under direct housing loan was robust at 41.8% with an outstanding portfolio at `11669 crore. Housing loan constituted 45% of the retail lending portfolio, of which a majority comes under the priority ambit. The Bank is currently celebrating a **retail loan festival**, offering attractive rates on Home and Vehicle loans to enhance further retail loan portfolio.

The Bank's credit to **Micro, Small and Medium Enterprises** (MSME) recorded a 21.4% growth to reach `32801 crore compared to a level of `27030 crore as at September 2009.

Outstanding **advances to the priority segments** grew by 14.4% to reach `60658 crore, with an outstanding agricultural advances level of `23882 crore.

Continuing its lead among nationalized banks, the Bank's **education loan portfolio** rose to `3259 crore, covering 1.77 lakh students.

Pursuing its commitment to the financial inclusion, the Bank has achieved total financial inclusion in all the 26 lead districts spread over five States. The Bank has opened 1.8 lakhs No Frill Accounts during H1, taking the total tally of **No-frill accounts** to 23.59 lakhs since

inception. The Bank formed 3.34 lakhs **Self Help Groups** as at September 2010, with credit linking of 2.85 lakhs SHGs.

InfoTech Advancement

All branches of the Bank are now under Core Banking Solution (CBS), accounting for 100% of the Bank's business. With 100% CBS, the Bank offers technology banking, such as, Internet & Mobile Banking and Funds Transfer through NEFT and RTGS across all branches. With over 2000 ATMs, the Bank's debit card base rose further to 52 lakhs.

Delivery Channels

During the first half, the Bank added 19 domestic branches and one overseas branch at Leicester, UK and a Representative Office at Sharjah, UAE, taking the total tally under the branch network to **3066 branches**. The Bank plans to open 200 branches in the identified centres during the current financial year, with majority of branches slated for opening during the third quarter itself.

Goals for FY11

- The Bank aims to reach an **aggregate business** figure of **`5 lakh crore**, comprising total deposits of `285000 crore and advances of `215000 crore.
- The Bank will continue to focus on **core business**, with the objective of augmenting profits and profitability.
- Expanding global footprints, the Bank has plans to open branches in **Manama and QFC-Qatar** .
- The Bank has plans to open **over 200 new branches** during H2.

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