# Chapter 4 : Commercial Banks & Development Banks

By

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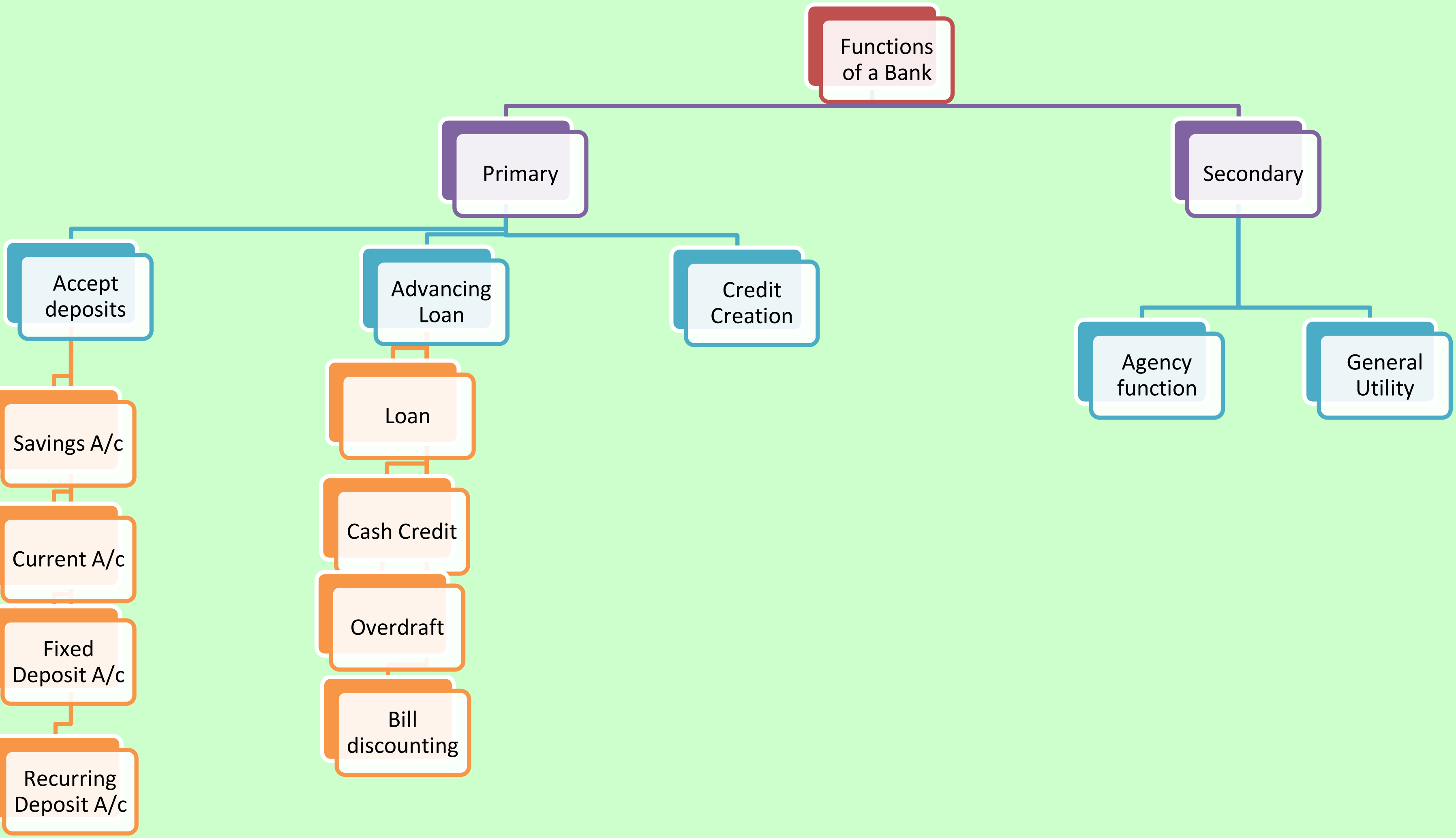
# Commercial Banks



# Balance sheet of a Commercial Bank

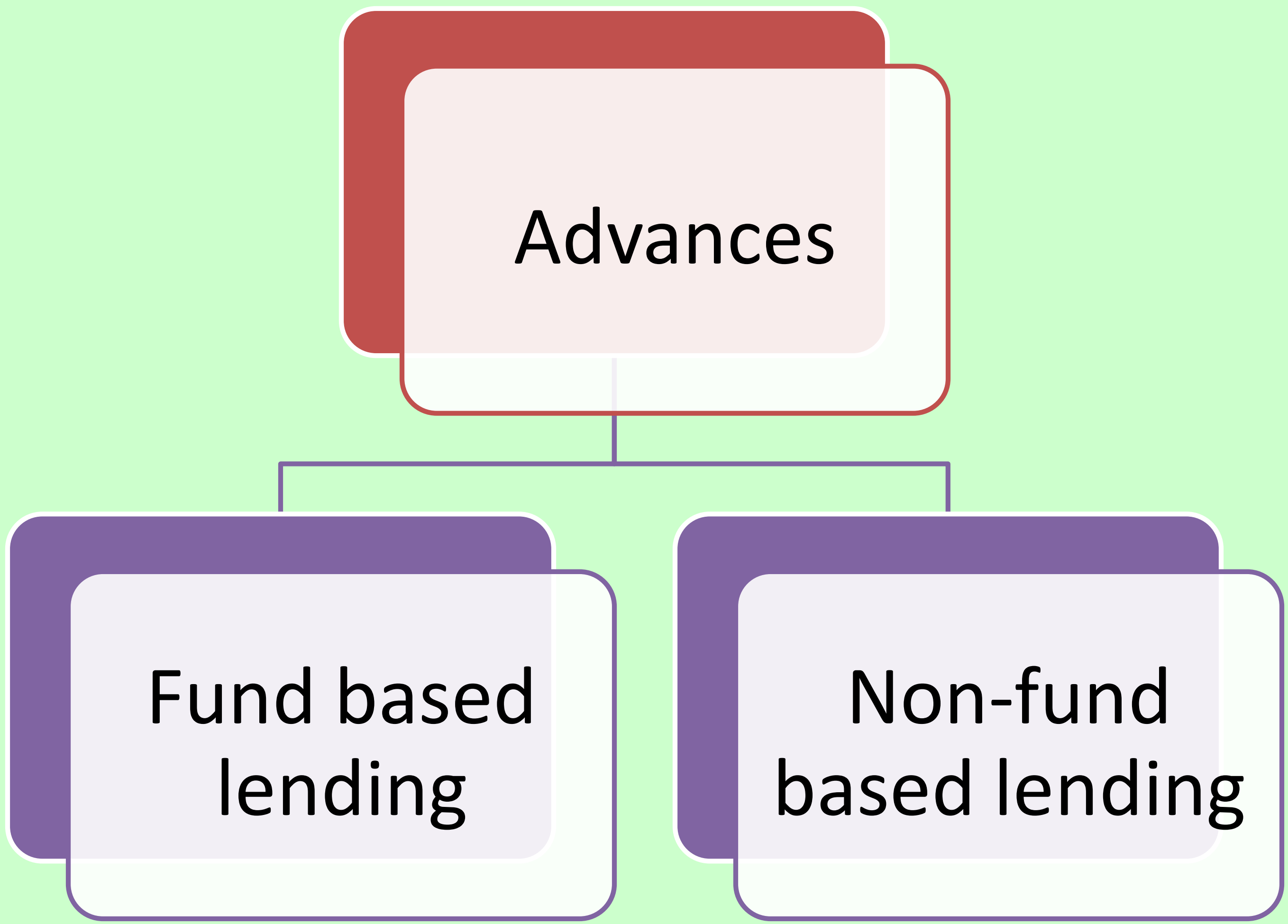
| | Sch No | L.Y. Rupees | C.Y. Rupees |
|---|---|---|---|
| Capital & Liabilities: | | | |
| 1. Share Capital | 1 | | Xxx |
| 2. Reserves and Surplus | 2 | | Xxx |
| 3. Deposits | 3 | | Xx |
| 4. Borrowings | 4 | | Xx |
| 5. Other liabilities and provisions | 5 | | xx |
| Total Funds Employed | | | Xxx |
| Assets : | | | |
| 1. Cash in hand and Balance with RBI | 6 | | Xx |
| 2. Balance with other banks and Money at call & Short notice | 7 | | Xx |
| 3. Investments | 8 | | Xx |
| 4. Advances | 9 | | Xx |
| 5. Fixed Assets | 10 | | Xx |
| 6. Other Assets | 11 | | xx |
| Total Funds Employed | | | xxx |
| Contingent Liabilities | 12 | | Xx |
| Bills for Collection | | | xx |

# Investment policy of a Bank

The following principles must be taken seriously while deciding the nature and amount of Investments done by a bank:

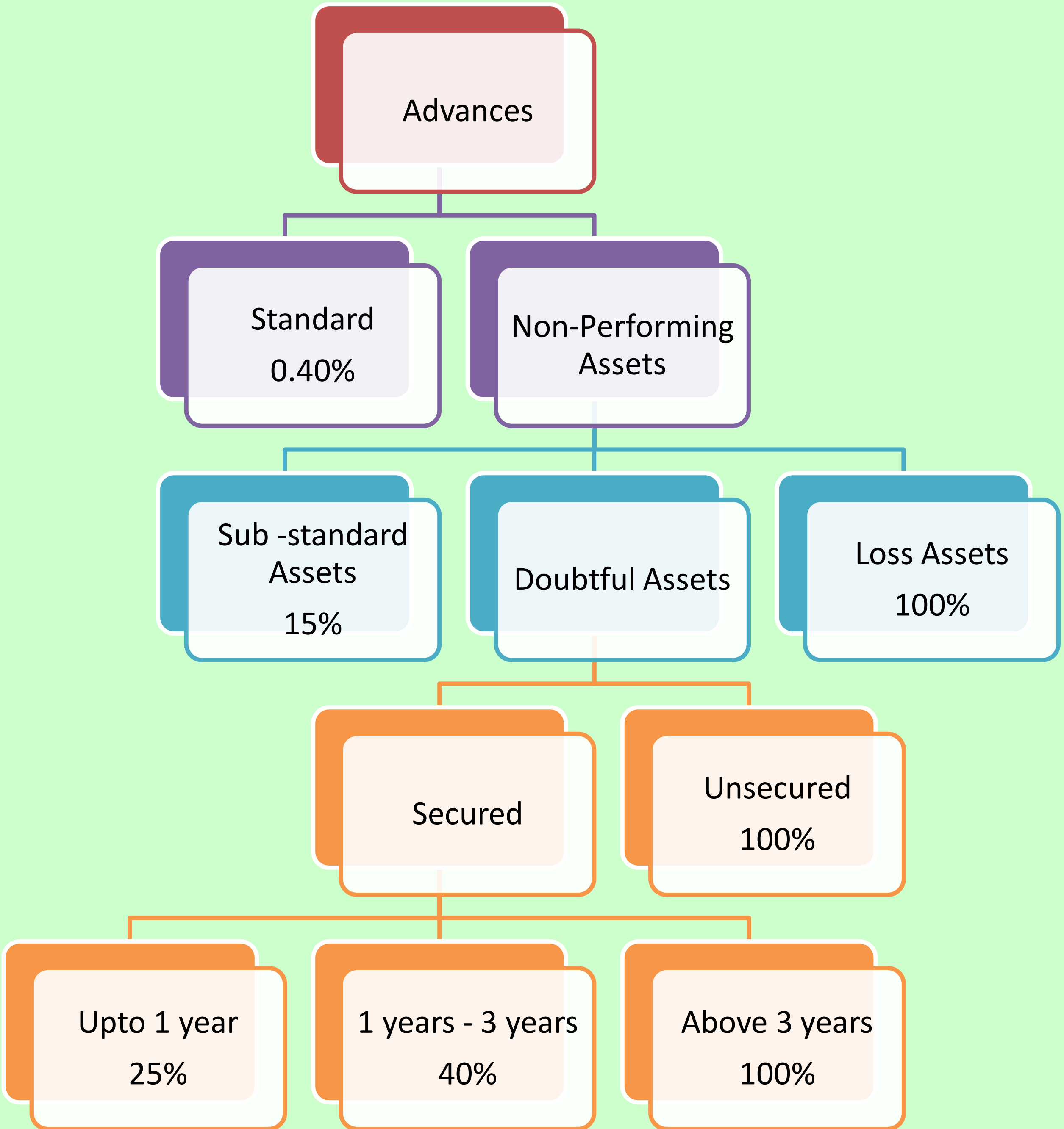
- Liquidity
- Profitability
- Safety and security
- Diversify
- Saleability of securities
- Stability in the value of investments
- Principle of Tax exemption of investments

# Advances by Banks



- Fund based lending:
  - Working Capital Finance
  - Project Finance
  - Loans to Small and medium enterprises (MSMEs)
  - Rural and Agricultural Loans
  - Directed Lending
  - Priority sector Lending
  - Export Credit
  - Retail Loan
  - International Loans

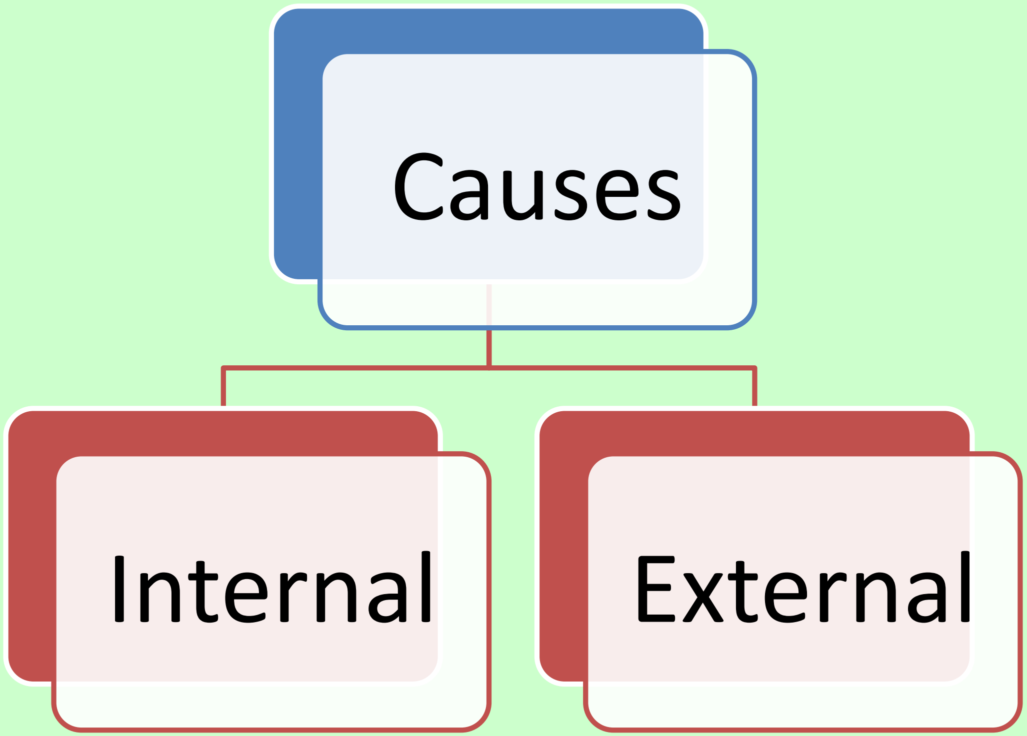
# Non – Performing Assets (NPA)



- <u>Non-Performing Assets:</u>

  An asset is classified as non-performing asset if any amount of interest or principal installment remains overdue for more than 90 days, in respect of term loans.

- <u>Causes of NPA:</u>



- Standard Assets:
  - Those advances who repay their principal and interest amount regularly on time and rarely default are called as Standard Assets. They are also called as Performing Assets.

- Sub-Standard Assets:
  - Sub-standard assets are those assets whose current net worth or guarantor or current market value of securities mortgage is not enough to ensure the recovery of dues to the bank in full and the asset has well defined credit weaknesses that endanger the liquidation of the debt and are characterized by the distinct possibility that the banks will incur some losses, if the deficiencies are not corrected.

- <u>Doubtful Assets:</u>
  - An asset becomes doubtful if it remains sub-standard for a period of 12 months and recovery of bank dues is doubtful.
  - As per RBI norms, Doubtful Assets are further classified as:
    - Secured Assets
    - Unsecured Assets
  - Secured Assets are further classified based on the age of security and proportionate RDD is created.

- <u>Loss Assets:</u>
  - Loss assets are those assets where loss has been identified by the bank or RBI. These are generally uncollectable.

# Different Ways to manage NPAs

- Debt Recovery Tribunal (DRT) – was as per the recommendation of The Narasimham committee.
- Asset Reconstruction Companies
- The Securitization Act – The Securitization and Reconstruction of Financial Assets and Enforcement Act
- Corporate Debt Restructuring (CDR)
- <u>Prompt Corrective Action:</u>
  - a) Mandatory Actions
  - b) Discretionary Actions

# Capital Adequacy Ratio (CAR)

- Capital adequacy is used to describe adequacy of capital resources of a bank in relation to the risk associated with its operations.
- This concept of CAR was introduced by the International BASEL committee recommendation.

$$\text{CAR} = \frac{\text{Capital Fund*}}{\text{Risk weighted Assets + Off Balance Sheet items}}$$

- * Capital Fund consists of Tier I and Tier II capital

- All commercial banks (except RRBs) including Nationalized Banks, Public Sector Banks and Foreign banks have to maintain a **Capital Adequacy ratio of 9%**

## **Tier I Capital:**

- Paid up capital
- Non-Cumulative Preference Share Capital
- Perpetual Debt instruments
- Capital Reserve
- Deducted by Intangible Assets and Accumulated Losses

## **Tier II Capital:**

- Undisclosed Reserves
- Cumulative preference share capital
- Revaluation Reserve (considered at 45% of book value for calculation purpose)
- General provision and loss reserves
- Investment Reserve Account
- The quantum of Tier II capital is limited to a maximum of **100% of Tier I Capital**

# Development Banks

- Development banks are specialized financial institutions which provide long term credit for the expansion or creation of agricultural, industrial and commercial enterprises in a developing country.
- <u>Features of a Development Bank</u>:
  - It is a specialized financial institution
  - It provides long term credit
  - It does not accept deposits from customers
  - It provides financial assistance to public and private sector of economy for the development purpose
  - The rate of interest is comparatively low
  - The motive of such banks is service to the public rather than making profits.(Social project)

- Role of Development Banks (Need):
  - As the Development Banks provide assistance for long term projects, they tend to create long term assets for the economic development of the country.
  - Development Banks provide finance for those projects which are commercially not viable and not financed by commercial banks.
  - Development banks acts as an catalyst to promote speedy industrial expansion.
  - Development banks are organized to achieve the preparation, appraisal, financing, implementation and evolution of investments projects and programs.
  - These banks provide technical assistance to improve the quality of the projects and reduce the risk.

# Evolution of Development Banks

- 1948 -IFCI
- 1951 - SFC
- 1955 - ICICI
- 1964 - UTI
- 1964 - IDBI
- 1976 – UTI delinked from RBI
- 1982 - EXIM
- 1990 - SIDBI