



Investment Policy of Commercial Banks and It's Sources of Revenue

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Abstract: The commercial banks will perform all kinds of banking business like finance, trade and commerce. An efficient and well developed banking system is the backbone of the developing country like India. Thus bank have always played a vital role in a nation's economy for mobilize finance to various sectors. There are two leading functions of commercial bank is borrowing and lending, besides these two there are other functions are discussed in this paper. Commercial bank gain profit when the positive difference between bank's gross revenue and gross cost in a financial year. The present decisions of risk full investment will future gainful profit so a bank cannot gain drastic profit without any risk full investment. A sound and well mannered investment policy not only gainful for commercial bank but also it is much required to nation's economy for both economical and financial growth. The most important fact is that every investment is only possible when there is enough savings by commercial bank. If banks are consumed all of his incomes and savings in an unproductive way they will face hand-to-mouth problem. The main purpose of this study is that recommend the best investment policy to the commercial bank managers or policy makers.

Key Words - Commercial Bank, Investment Policy, Balance Sheet, Revenue

I. INTRODUCTION

A commercial bank is a financial institution that provides banking facilities and other financial services to its customer. Thus a bank is a financial intermediary which collects money from the individuals those have surplus money and lends this money to those who need them. In other words a bank acts as a mediator between the depositors on one hand and borrowers on the other hand. According to Crowther – "A bank is an institution which collects money from those who are saving out of their income and lends out those who require it."

II. LITERATURE REVIEW

R.R. Paul (1996) defines that a bank is a financial institution which deals with money and credit. It accepts deposits from the public, makes the fund available to those who need them and helps to transfer of money from one place to another within few second. Paul also discuss about both primary and secondary function of commercial banks. He argued that a commercial bank not only facilitates the borrowing and lending services but also it will helps to boost up country's economic development. **Jaydeb Sarkhel & Seikh Salim(2017)** point out commercial banks are the most important financial institutions in any country and can play an important role in the process of economic development. Researcher including **M.A.Akims(2022),Dr.M.K.Manish(2020) and Prof. K.Subbareddyast(2020)** has similar point of view too on commercial bank and economic development. The economic development is a dynamic and continuous process, the commercial bank have crucial role in economic development of a country because banks control a large part of supply of money in circulation. **Prof. Tagar Lal Khan&Shabnam Nishat(2019)** studies in his journal examines and compares of assets and liabilities of commercial banks and strategies adopted by the bank managers towards the management of two sides of balance sheet. They observed from the redundancy analysis and found that private banks are actively focusing on assets management but public sector banks give emphasis on accumulating funds from people and how increase deposits. **E.Gordon & K. Natarajan (2013)** will define that the basic aim of a commercial bank is to make profit. The capacity of a bank to earn profit depends upon its investment policy. Thus a better and well mannered investment policy will make profitable to commercial bank. **K.S.Thirumalai & U.Chandra(2014)** broadly explain the investment policy of a commercial bank and viewed that a better investment policy should determine the maximum profit of a commercial bank by minimizing the risk. **B.Kalpna & T.V.Rao(2017)** briefly explain the functions of commercial banks. It provides banking services to its customers through its branches. Commercial banks are all purpose banks that perform a wider

range of functions i.e. demand deposits, term deposits, issuing cheque, providing loans, purchasing and selling of foreign exchange.

III. OBJECTIVES OF THE STUDY

1. The main objective of the study is to provide empirical evidence of investment policy by a commercial bank.
2. To study the primary and secondary function of a commercial bank.
3. To study the main sources of revenue by commercial bank.
4. To study about the balance sheet of a commercial bank.
5. To study the role of commercial bank in economic development of a country.

IV. RESEARCH METHODOLOGY

This paper is based on the secondary data obtained from annual reports of RBI, annual reports of SBI, Narasimham Committee report on banking sector and from various journals, report, reference books and websites.

V. FUNCTIONS OF COMMERCIAL BANKS

Commercial banks will facilitate some principal functions are below:-

1) Primary functions

- I. Acceptance of deposits
 - Current deposits account
 - Saving deposits account
 - Recurring deposits account
 - Fixed deposits account
- II. Advancing loans
 - Interbank transfer
 - Over draft
 - Long term loans
 - Cash credit
 - Discounting bills of exchange

III. Creating of credit

IV. Encourage the cheque system for settle transactions

V. Provide remittance services

VI. Collections services

2) Secondary functions

- I. Agency services
 - Funds transfer
 - Act as an trustee
 - Collection and payment of credit instruments
 - Buying and selling of securities
 - Consultancy of income tax
 - Safe custody
 - Collections of dividends form shares
- II. General utility servicers
 - Letter of credit for foreign trade
 - Bank draft
 - Locker facility for safe custody
 - Traveller's cheques
 - Collections information related to financial matters
 - Act as a referee
 - Foreign exchange business
- III. Developmental functions
 - Helps to economic development
 - Helps to agriculture sector
 - Provide financial support to small scale industry
 - Provide loans to weaker sections
 - Facilitate poverty alleviation programme under bank scheme

VI. SOURCES OF REVENUE BY COMMERCIAL BANKS

The assets sides of balance sheet will generate revenue for commercial banks. The difference between borrowing and lending of funds will determine the profit or income level of commercial banks. A bank can generate revenue by borrowing money at a lower rate and lends these at a higher rate of interest. Banks will provide the intermediary services to savers and investors, not only freely but also bank will charge some commission or mediation fee.

Following are the major source of revenue of a commercial bank:-

1. Interest received on loans
2. Advances to corporate, industries and individuals
3. Intermediation commission
4. Brokerage
5. Interest from reverse repo rate
6. Money at call
7. Bills discounted

VII. COMMERCIAL BANKS AND ECONOMIC DEVELOPMENT

The actual meaning of economic development is whereby an economy's real national income and per capita income will increase simultaneously over a long period of time. Thus a well developed banking system is an essential condition for economic development in a modern economy. Besides borrowing and lending function commercial banks also play a crucial role in the economic development of both underdeveloped and developing countries. They will provide concessional lending money to the priority sectors which include agricultural sector, large scale industries, small scale industries, and exporter. They also provide loans to weaker sections of society at a lower rate of interest under different poverty alleviation programme of government under the banking scheme.

The important role of commercial banks in the development of underdeveloped countries in the following ways:-

1. Deal in foreign exchange
2. Mobilization of savings
3. Promote capital formation
4. Promoting people's saving habits
5. Creating of credit
6. Help financially to entrepreneurial innovations
7. Monetization of economy
8. Channelizing the funds into productive investment
9. Provide direction for fully utilization of resources
10. Financially help to government
11. Implementation of monetary policy
12. Provide financial support to the right type of industries
13. Balanced development
14. Development of small scale industries and agricultural sector
15. Smoothing of trade
16. Generate employment opportunity
17. Development of both money market and capital market

VIII. BALANCE SHEET OF A COMMERCIAL BANK

The balance sheet of bank is a financial statement which containing its assets and liabilities at a particular time period, whether a bank make profit or bear loses, it will be reflected in its balance sheet. Thus balance sheet contains two sides, one is assets side which will refers to all profits or credit items representing the banks claim and hopes to get an income. Another is liability side which refers to all debit items representing the liable to pay by bank. If assets or credit exceeds than liabilities at that time a bank will be profitable and vice versa.

Balance sheet of a commercial bank will contain such below:-

LIABILITIES	ASSETS
Borrowing from other banks	Cash
Borrowing from RBI	Reserves
Share capital	Investment
Reserve funds	Advances and loans given to public
Deposits	Money at call and short notice
Saving deposit	Securities
Current deposit	Deposits at central bank
Fixed deposit	Fixed assets
Other terms deposits	Bill discounted
Other liabilities and	Investment in govt. securities

IX. INVESTMENT POLICY OF COMMERCIAL BANKS

Before discuss about the investment policy by a commercial bank we have to distinguish between loans and investment. As all knows that higher risk gives higher returns and lower risk gives lower returns. The banks will provide loans for making short term profit, it will gives lower amount of profit to the bank. Bank loans otherwise known as bank credit .Commercial banks keeps a certain portion of its total deposit as a minimum reserve for meeting the demand of the depositors and lends out the remaining excess reserve to earn profit. On the other hand banks will invest his money for making long term profit, it will gives higher amount of profit to the bank. Thus a commercial bank will invest his money in real-estate, mutual fund, stocks, gilt edged securities, bonds, large scale industries etc.

The capacity of a bank is to earn more profit will determined by its well investment policy. The improved investment policy of commercial bank in turn, depends on the manner in which it manages its investment portfolio. The investment portfolio means to manage its assets and liability in such a manner that will maximize the profit of commercial bank without losing any liquidity .Thus the main objective of portfolio management are profit, safety and liquidity. In the above discussion shows a bank should behave rationally and make their investment policy in such a way, so that bank will gain more and more profit from their investment safely and without losing any liquidity of money.

In order to secure and maintain the balance among liquidity, profitability and securing a bank should follow to certain principles as below.

- Liquidity
- Safety
- Profitability
- Diversity
- Stability
- Marketability

As instructed by Reserve Bank of India, the investment policies of commercial banks are discussed below:-

• **Mandatory Investment**

The mandatory investment of commercial bank will be made compulsory by RBI for controlling the money flow or credit control.

In terms of mandatory requirement of banking regulation act, Bank is compulsory to invest minimum 3% as cash reserve fund (CRR) and 25% as statutory liquidity reserve (SLR)

CRR- Commercial banks are required to hold certain portion of their total deposits in the term of cash. Banks don't hold these cash with themselves but they have to keep it reserved with central bank account. The cash reserve ratio is decided by the central bank and there is no interest pay by central bank to any commercial bank. The current cash reserve ratio is 4.5 percent (As on April 06, 2023). **SLR-** Statutory liquidity ratio refers amount that the commercial banks require to maintain in the form of gold on government approved securities before providing credit to its customers. The statutory liquidity ratio is determined by the central bank to control the money supply in market on bank credit. The current statutory liquidity ratio is 18% (As on April 06, 2023) may be change depends up on the market situation and inflation.

• **Advancing loans**

Advancing loans is a function or a non mandatory investment by commercial bank. The loans-to-deposit ratio (LDR) is a simple measurement used to know the bank liquidity by comparing its total loans with its total deposits for the same periods of time. After keeping certain cash reserves on mandatory investment a bank can invest up to 70% of its deposits in advancing loans. There are various types of loans gives by commercial bank viz- money at call, cash credit, over draft, discounting of bills of exchange, term loans.

• **Investment in other banks**

If a bank facing deficit of money at that time another commercial bank may invest its surplus funds in any banks viz- commercial bank, public sector bank, private sector bank, co-operative banks. In recent trends it may be called call money or interbank transaction. Such investments are very short period loans say one day to fourteen days.

• **Investment in government securities**

Government securities are otherwise known as gild edged securities will issued by either central government or state government and purchased by commercial banks. Due to most reliable and bear least risk a commercial always prefer to invest on these securities.

• **Investment in private companies**

Investment in private companies is a risk full investment for commercial bank, but higher risk gives higher returns to the commercial banks.

- **Investment in other institutions, corporations and companies**
Despite higher interest rate given by other institutions, corporations & companies, commercial bank will not invest its excess or surplus funds fund in any of these.
- **Investment in share money of co-operations institutions**
Bank may invest 2% of its funds in the co-operative institutions.
- **Investment in non-SLR securities**
A commercial bank will invest 10% of its total deposits in non-SLR securities include debentures or bonds, preference share, equity shares, mutual fund unit, commercial paper and investment in securities issued by a reconstruction company.
- **Cash Management**
Unfortunately if a commercial bank will keep excess money, it will badly affect the profit of the commercial bank. So commercial banks have to manage his money rationally.

X. BEST SUGGESTIONS FOR BETTER INVESTMENT POLICY

In modern banking a better investment policy is not only make profitability to commercial bank but also it will help to developing country for their growth and development. Thus to achieve maximum profits goal the bank will follow below principles:-

1) Liquidity

The actual meaning of liquidity is the ability of a bank to give cash on its customer demand .The most liquid assets of a bank is cash. A bank should choose such securities for investment which contain more liquidity. Such highly liquid securities are government bonds, government securities or gilt edge securities etc. The main objective to choose highly liquid securities is to easily saleable and bank will repay money to its customers. If a commercial bank does not have sufficient liquidity, it will lose public confidence and destroys its own business and profit.

2) Safety or security

When an individual deposits their money in a bank they think about is their money or deposit safe or not. So commercial bank will assure to his customer about the deposits. Thus a commercial bank is a trustee of its customer. Therefore, it must be the greatest care by commercial bank in the matter of investing its customer's funds in the form of deposits. If the bank follows always the safety principle strictly by holding only the safest assets and will not take too much risk, it may not be to earn higher income. As we know that "higher risk will gives higher returns and lower risk will gives lower returns" to satisfy this sentence, a bank must estimate the amount to invest in risk factors to gain higher returns.

3) Profitability

The most important objective of a commercial bank is to earn maximum profit to satisfy its all expenses and to make payments to its customers as interest. Therefore a commercial bank will invest its funds in such a manner to extract sufficient income with minimum cost. Thus a commercial bank should prefer to invest in such securing which will give maximum profit.

4) Stability

Floating interest rate is not secure and will not give a fixed rate of profit to the bank. So, a commercial bank should invest in those securities which give a fixed interest rate and possess a high degree of stability in their price. Such securities are viz- government securities or gilt edge securities, government bonds, government debentures and reputed companies.

5) Diversity

The commercial bank should invest its funds in different types securities or different industries for minimizing the risk. If a commercial bank choose only a single sector to invest funds it will not make profitable. So a commercial bank has to diversity its fund or surplus money in different types of sector.

6) Marketability

Meaning of marketability is the ability and attractiveness of a security to be sold easily. Thus a commercial bank should adopt the principle of marketability in investment policy. It helps to bank for easily saleable the securities and recovered profit with in short period of time.

XI. CONCLUSION

The above discussion concludes that commercial banks always an essential institution for a developing country. A well mannered and sound investment policy by commercial bank is a very powerful condition in developing economy for both economical and financial growth of a country. In the developing country not only banking facility are limited to a few developed in urban areas but also the banking activity provide finance to industry, trade, business and agriculture. According to my point of view and study commercial bank not only choose always riskless investment for investing money but also they have to choose somehow risk plus investment by

following above discussed investment policy to gain drastic profit within short period of time. When a country financially stable it will help to increase its standard of living and decrease of inflation.

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