

Solvency Of State Bank Of India – An Analytical Study

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Abstract

A bank is a financial intermediary that accepts deposits and channels those deposits into lending activities. The essential role of a bank is to connect those who have capital such as investors or depositors, with those who seek capital such as individuals wanting a loan or businesses wanting to grow. Banks are the fundamental component of the financial system and also active players in financial markets and do many financial services. The short term creditors like suppliers of material are concerned with the firm's current debt-paying ability. On the other hand, long-term creditors like debenture holders, financial institutions, etc., are more concerned with the firm's long-term solvency. Financial strength is a prerequisite for any bank in order to run its operation successfully and smoothly and also to ensure its long-term existence. State Bank of India, being a service organization requires significant amount of capital to create a large portfolio of deposits and loans, has to invest little in fixed assets. Confidence and trust is essential to the banking business, which enables it to mobilize large amount of deposits for deploying in profitable operations. In this study an attempt has been made to analyse the solvency position of State bank of India and its associate banks.

The term solvency refers to the ability of a concern to meet its financial obligations. In finance or business it is the degree to which the current assets of an individual or entity exceeds the current liabilities of that individual or entity. The financial position may mean differently to different persons interested in the business concern. Management, banker, trade creditors, investor and auditor all have different views about the concept of the financial position. Solvency can also be described as the ability of a corporation to meet its long-term fixed expenses and to accomplish long-term expansion and growth. Generally, the examination of financial position involves the analysis of facts relating to proper and judicious use of funds, short-term and long-term solvency of the concern, safety of the interest of shareholders, etc.

Short term solvency: The short-term creditors of a company, like suppliers of goods on credit and commercial banks providing short-term loans, are primarily interested in knowing the company's ability to meet its current or short-term obligations as and when these become due. The short-term obligations of a firm can be met only when there are sufficient liquid assets. Therefore, a firm must ensure that it does not suffer from lack of liquidity or the capacity to pay current obligations. If a firm fails to meet such current obligations due to lack of good liquidity position, its goodwill in the market is likely to be affected beyond repair. It will result in a loss of creditor's confidence in the firm and may cause even closure of the firm. Even a very high degree of liquidity is not good for a firm because such a situation represents unnecessarily excessive funds of the firm being tied-up in current assets. Therefore, it is very important to have a proper balance in regard to the liquidity of the firm.

Short-term solvency is also called as liquidity. According to Herbert Mayo, "Liquidity is the ease with which assets may be converted into cash without loss". The short-term obligations are met by realizing amounts from current, floating or circulating assets. The current assets should either be liquid or near liquidity. These should be convertible into cash for paying obligations of short-term nature. The sufficiency or insufficiency of current assets should be assessed by comparing them with short-term liabilities. If current assets can pay off current liabilities, then liquidity position will be satisfactory. On the other hand, if current liabilities may not be easily met out of current assets then liquidity position will be bad. The bankers, suppliers of goods and other short-term creditors are interested in the liquidity of the concern. They will extend credit only if they are sure that current assets are enough to pay out the obligation.

Long-term Solvency: The long-term indebtedness of a firm includes debenture holders, financial institutions providing medium and long-term loans and other creditors selling goods on instalment basis. The long-term creditors of a firm are primarily interested in knowing the firm's ability to pay regularly interest on long-term borrowings, repayment of the principal amount at the maturity and the security of their loans. Accordingly, long-term solvency ratios indicate a firm's ability to meet the future interest and costs and repayment schedules associated with its long-term borrowings.

Following five solvency ratios have been calculated for the selected banks under study to analyse the solvency of State Bank of India and select two of its associate banks namely State Bank of Travancore (SBT) and State Bank of Bikaner & Jaipur (SBBJ): 1. Cash deposit ratio, 2.

Investment deposit ratio, 3. Credit deposit ratio, 4. Net interest margin and 5. Fixed assets to net worth. These ratios are exhibited in the Table.

Cash Deposit ratio: Cash Deposit ratio is the ratio of how much a bank keeps cash and bank balance out of the deposits it has mobilised. It indicates how much of a bank funds are being held as most liquid assets. This ratio is arrived at as total of cash in hand and bank balances divided by total deposits. A part of working funds has been kept as cash to meet day-to-day demand. Deposits are the major source of funds and here include all type of deposits mobilised by the bank.

The ratio of cash to deposits for SBI has been varying between 0.09 and 0.14 times and the average ratio for the study period is 0.11. Cash, being an idle asset, must be kept at a minimum level, i.e., a little more than the statutory requirement under Cash Reserve Ratio (CRR- which is normally around 5 percent of demand and time liabilities of the bank). The Cash to deposit ratio for SBI is around 11 per cent and therefore SBI must take steps to hold judicious level of cash, so as to minimise idle assets.

In case of SBT, the ratio of cash to deposits for the decade has been around the average 0.08 throughout the decade and it varied between 0.06 and 0.10 times. In case of SBBJ, the ratio of cash to deposits has been more than the average, 0.10, in the first half of the decade of study and has come down in the second half. The ratio has varied between 0.07 and 0.15 times.

The average ratio of cash to deposits is less in SBT (0.08) and is more in SBBJ (0.10) and SBI (0.11). In all the three sample banks, the ratio remained high in the first half of the decade. However, all the three banks have contained the ratio in the second half. Higher cash holdings reduce the revenue earning assets like loans and investments. SBBJ and SBI must take steps to reduce the ratio.

Investment Deposit ratio: Investments are made by banks essentially to meet certain statutory requirements, like Statutory Liquidity Ratio, as prescribed by RBI. SLR is prescribed by RBI as certain percentage of the Demand and Time Liabilities of the banks. The demand and time liabilities of the bank consists mainly deposits mobilized both under demand and time deposit schemes of the bank. The present SLR is 25 percent. Investments deposit ratio exhibits how much amount of deposits has been deployed towards investments. Investments are revenue earning assets for a bank next to loans and advances.

The ratio of investments to deposits for SBI has shown fluctuations little higher in the first five years than in the second five years of the decade of study. It is evident from the fact that the ratios of first half are more than the average (0.32 times) and they are less in the second half of the decade. The table shows that an average of 32 per cent of deposits have been deployed in investments by SBI. In general, the banks choose investments to comply with the requirements under Statutory Liquidity Ratio.

The average deployment of funds towards investments by SBI amounts to 32 per cent of its deposits and it is little more than the SLR requirements. Further there was a hike in the ratio to 0.36 times in 2015-16. The average ratio for the study period is the same for both SBI and SBI.

In case of SBI, the ratio of investment to deposits is comparatively less than that of SBI and SBI in all the years of the decade and it varied between 0.25 and 0.31times. Hence the average, 0.28 times, is also less than that of SBI and SBI.

In case of deployment of funds under investment portfolio, all the three sample banks have taken almost similar decisions. Therefore their average ratios for the decade are closely more than the SLR requirements. Further the ratio is greater than the required level which may reduce the earnings. So the select banks shall reduce investments and enhance loans and advances.

Credit deposit ratio: Credit to deposits ratio is a vital ratio that measures the bank's stability and profitability. Credit portfolio is very important as well as sensitive for a bank where the larger part of the working funds has been deployed in order to earn more interest income and deposits are the major source of funds for the banking operations.

Credit-deposit ratio, popularly CD ratio, is the ratio of how much a bank lends out of the deposits it has mobilized. RBI does not stipulate a minimum or maximum level for the ratio. But a very low ratio indicates that the banks are not making full use of their resources. Alternatively, a high ratio indicates that the banks rely mostly on deposits for lending. Since credit has an inbuilt risk, a very higher ratio may affect the liquidity of the bank.

The credit deposits ratio of SBI has improved in the second half of the decade when compared to its performance in the first half. This is evidenced by the fact that the ratios are less than the average, 0.81times, during the first five years and they are above the average in the

second five years of the decade of study. The average ratio 0.81 indicates clearly that around 81 percent of the deposits has been deployed towards loans and advances by SBI.

In case of SBT, the credit deposits ratio has shown more fluctuations between 0.80 to 0.78 times during the decade of study from 2006-07 to 2013-14, leaving the last two years, 2014-15 and 2015-16. The ratio has come down sharply below the level of the average, 0.77, in the last two years of the study period.

The CD ratio of SBBJ during the years of first half are less than the average 0.78 times, and the ratios are more than the average during the four years of the second half of the decade of study. Further the ratio declined to 0.78 in 2015-16.

Among the three sample banks, the average CD ratio of SBI (0.81times) indicates that a comfortable portion of deposits has been deployed in loans and advances. The average CD ratio of SBT (0.77) and that of SBBJ (0.78) indicate that these two banks can improve their CD ratio by deploying more funds in loans and advances thereby the interest income can be increased. The performance of SBT in 2014-15 and 2015-16 is dismal as it has reduced its loans and advances and thereby the CD ratio has come down to 0.65 in 2015-16. SBT must improve its CD ratio.

Spread to total assets ratio: The spread is the difference between the interest income generated by banks from investments and loans portfolio and the amount of interest paid by them for the deposits and borrowings. The spread, which is the surplus of income through interest over the interest expenditure, plays an important role in the profitability of the bank. Higher the spread ensures a comfortable position for the bank to make profit and vice versa. Thus the ratio of spread to total assets is considered to be an important ratio for the analysis of the performance of the bank towards profitability, which in turn spells out the long term solvency of the bank. Spread must be positive always.

The ratio of spread to total assets for SBI is almost constant around the average ratio of 0.03 times for the study period. Similarly, the ratio of SBBJ also is constant around 0.03, its average ratio for the decade. In case of SBT also, the ratio of spread to total assets is almost constant at 0.02, its average ratio for the decade.

The ratios of spread to total assets of SBI and SBBJ show that the spread of these two banks is only around 3 per cent of their total assets respectively. The performance of SBT is still

less as its spread is 2 per cent of its total assets. Spread level has to be improved in all the three sample banks to ensure profits.

Net worth to fixed assets: Net worth is a part of working funds and it consists of share capital, reserves and surplus, higher net worth helps the bank to have better solvency status. Low net worth would exhibit the banks weakness. In case of fixed assets, the funds are locked and are not easily convertible into liquid funds. A higher net worth and low level of fixed assets would help for sound financial position. Thus a higher ratio ensures better solvency position.

The ratio of net worth to fixed assets for SBI has shown fluctuations throughout the decade of study. The ratios varied between 11.10 and 15.10 times, whereas the average is 14.12 times. In six out of ten years, the ratios have been less than the average. The reduction in the ratio during the last two years, 2014-15 and 2015-16, causes concern as the net worth of SBI has come down with reference to its fixed assets.

Similar to that of SBI, the ratio of SBT also has shown fluctuations throughout the decade between 9.97 times in 2006-07 and 13.54 times in 2015-16. However, the ratios are less than the average, 13.57 in five out of ten years. Here also, the ratios of the last two years, 2014-15 and 2015-16 are less than the average, which denotes that the net worth of SBT is deteriorating with reference to its fixed assets in 2014-15 and 2015-16.

In case of SBBJ, the ratio of net worth to fixed assets has improved in the second half, i.e., from 2011-12. The ratios of first five years are less than the average 15.37 times. Here also, in 2014-15 and 2015-16, the ratios have come down when compared to the preceding three years. This denotes that the net worth of SBBJ is declining with reference to its fixed assets in the end years of the decade of study.

The ratios of net worth to fixed assets of the sample banks are almost the same as they are around 14 or 15. This indicates that select banks have net worth equal to 14 to 15 times of their respective fixed assets. Further, the reduction in ratio during 2014-15 and 2015-16 causes concern.

Conclusion

The performance of SBI with reference to the solvency ratios is satisfactory. SBI has comfortable solvency position as its ratios, investment to deposits and credit deposit, are around 0.32 times and 0.81 times as respective averages for the decade. The ratio of net worth to fixed assets is also comfortable as SBI has an average of 14.12 times of its fixed assets as its net worth.

But, the ratio of cash to deposit is more, as it is around the average of 0.11 times and it has to be reduced to minimise the idle assets. The ratio of spread to total assets is only around the average of 0.03, which means, SBI could have only 3 per cent of its total assets as spread. The low level of spread will affect profit. The solvency ratios of SBT indicate that SBT has comfortable solvency with reference to four out of five ratios leaving the ratio of spread to total assets. The performance of SBT in this ratio is not satisfactory as it could have only 2 per cent of its total assets as spread. Similar to SBI, SBBJ exhibits comfortable solvency through the results of the ratios of I/D, C/D and NW/FA. In case of the ratios CS/D and S/TA, the performance of SBBJ is not satisfactory. The average ratio of CS/D is 0.10 times, which is to be reduced and the average ratio of S/TA is 0.03 times, which has to be improved.

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SOLVENCY RATIOS

(In times)

Year	SBI					SBT					SBBJ				
	CS/D	I/D	C/D	S/TA	NW/FA	CS/D	I/D	C/D	S/TA	NW/FA	CS/D	I/D	C/D	S/TA	NW/FA
2006-07	0.12	0.34	0.77	0.03	11.10	0.09	0.31	0.80	0.03	9.97	0.15	0.30	0.72	0.03	11.62
2007-08	0.13	0.35	0.78	0.02	14.53	0.10	0.32	0.80	0.02	10.34	0.13	0.31	0.74	0.02	10.66
2008-09	0.14	0.37	0.73	0.02	15.10	0.06	0.31	0.78	0.03	13.11	0.11	0.28	0.76	0.02	11.94
2009-10	0.12	0.36	0.79	0.02	14.94	0.08	0.31	0.76	0.02	14.01	0.09	0.30	0.76	0.02	12.12
2010-11	0.13	0.32	0.81	0.03	13.64	0.08	0.31	0.79	0.02	15.65	0.11	0.25	0.77	0.03	13.61
2011-12	0.09	0.30	0.83	0.03	15.36	0.08	0.31	0.77	0.02	15.89	0.07	0.27	0.80	0.03	20.61
2012-13	0.10	0.29	0.87	0.03	14.12	0.06	0.32	0.80	0.02	15.25	0.09	0.28	0.80	0.03	20.60
2013-14	0.10	0.29	0.87	0.03	14.78	0.06	0.31	0.78	0.02	14.63	0.09	0.24	0.87	0.03	20.27
2014-15	0.11	0.31	0.82	0.03	13.77	0.07	0.29	0.75	0.02	13.26	0.09	0.27	0.83	0.03	15.31
2015-16	0.10	0.28	0.85	0.03	13.89	0.08	0.36	0.65	0.02	13.54	0.10	0.26	0.78	0.03	16.92
Average	0.11	0.32	0.81	0.03	14.12	0.08	0.32	0.77	0.02	13.57	0.10	0.28	0.78	0.03	15.37
CV	14.44	10.01	5.59	17.89	8.61	17.76	5.65	5.85	19.17	15.06	22.44	8.23	5.62	17.89	25.93
ACGR	-2.01	-2.13	1.10	0.00	2.52	-1.30	1.68	-2.28	-4.41	3.46	-4.41	-1.58	0.89	0.00	4.26

Source: Compiled from the annual reports of selected banks.

*CS-Cash, D- Deposits, I-Investment, C-Credit, S-Spread, TA-Total Assets, NW-Net Worth, FA-Fixed Assets.