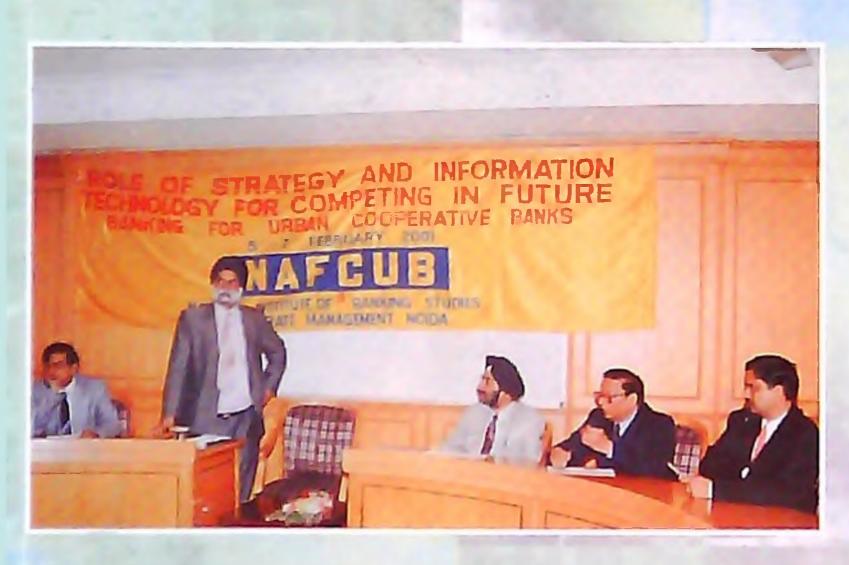
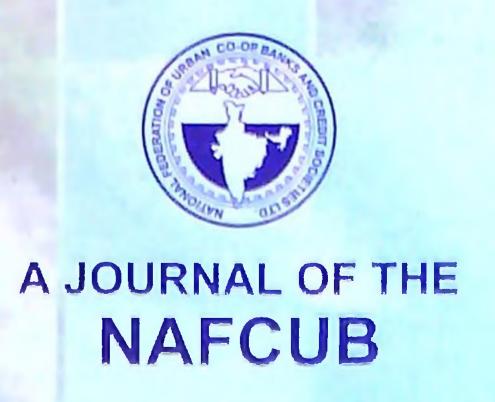


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Reserve Management in Urban Co-operative Banks: A Case Study

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Introduction

In the past, banks, in an urge to maximise profit, used to lend all their funds without keeping any reserves for liquidity. Later on banks realised the danger of this aggressive credit policy and started maintaining reserves based on their own wisdom. Still some banks disregarded reserve requirements and continued with aggressive credit practices overlooking liquidity. This tendency ultimately necessitated the need for imposing certain norms regarding reserves on the banking sector by the Central Bank. The instrument of statutory cash reserve requirement was first experimented by the Federal Reserve System of America in 1933. In India reserve requirements were first tested as a tool to safeguard the interest of the depositors but subsequently it was used as an instrument of credit control.

The Reserve Bank of India Act, 1934 introduced statutory provisions regarding reserve requirements for the first time. According to section 42(1) of the Act Scheduled Commercial Banks are required to keep minimum three per cent of their demand and time habilities as cash reserve. The Act also empowers the RBI to vary the ratio between three to 15 per cent depending upon the arcumstances Ason date the CRR of commercial banks is 8.5 per cent and co-operative banks 3 per cent. The cash reserve requirements of nonscheduled banks are governed by Section 18 of the Banking Regulation Act, 1949. According to Section 24 of

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the B.R. Act, 1949, banks are required to maintain not less than 25 per cent of their demand and time liabilities as liquid assets properly known as Statutory Liquidity Ratio (SLR).

According to the Banking Regulation Act, 1966 (as applicable to Co-operative Societies) a co-operative institution doing banking business with a share capital and reserves of Rs. one lakh and above is eligible to be treated as a co-operative bank. The Act which came into force on 1st March 1966 had empowered the RBI to have the same control over the banking business of the Co-operative banks as it has over the commercial banks coming under the Banking Regulation Act. According to the BR Act (as applicable to Co-operative Societies) a Co-operative bank is required to keep 25 per cent demand and time liabilities as statutory liquidity ratio over and above the cash reserve of three per cent since 1st March 1961.

Cash reserves constitute a zero return investment for the banks. Similarly the return on statutory liquidity reserves is below the mean cost of funds. Hence any reserves kept over and above the statutory requirements will impair the profitability of the banks.

Here an attempt has been made to examine the extent of excess reserves

maintained by the Palaghat Cooperative Urban Bank Ltd. and to estimate the opportunity cost of excess funds kept by the bank.

Excess Cash Reserves of Palaghat Cooperative Urban Bank (PCUB)

The excess cash reserve is estimated at three levels, namely, three per cent, four per cent and five per cent. The opportunity cost of excess cash reserves is calculated at minimum interest rate. The excess cash reserves of PCUB is given in Table 1.

From the table it is clear that the bank had kept excess cash reserves at 3 per cent level in all the years and at 5 per cent level in the initial year. The aggregate excess cash reserves kept by the bank at 3 per cent level was Rs.87.51 lakhs. However it is heartening to note that the excess reserves gradually declined over the years indicating improved reserve management efficiency.

The excess cash reserves naturally would have undermined the profitability of the bank. Hence an attempt was made to estimate the opportunity cost of excess reserves kept at all the three levels. The opportunity cost was calculated at three alternative interest rates namely, minimum lending rate, mean lending rate, and maximum lending rate. The opportunity cost

Table 1. Excess Cash Reserves of PCUB (From 1994-95 to 1998-99)

(Rs. in lakhs) DIL. CRR 3% of 5% of Year 4% of Excess Excess Excess at DIL. DTL DTL at 3% at 4% nt 5% 1994-95 89174 4994 2684 3178 44.73 23 10 15 16 5 21 1995-96 1177 46 55 20 35 32 47 10 58 87 19.88 8 10 148664 6508 4554 89 38 74 23 1990-97 20 54 5 70 1849 03 65 11 55 17 73.90 92 45 1997-98 9.87 104 95 131.19 1998-99 202184 9283 7871 14 12 Total 28.96 5.21 87.51



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Year	Excess	Excess	Excess	Minimum	Mean	Max Int.	10	_		(0====			(Amou	THE III	IUKI
164	CRR at	CRR at	CRR at	The second secon	Interest	(Gold loan) Rate (%)	Excess	CRR at 3	<u> </u>		tunity C CRR at		Excess	CRR at	5%
	1010						At Mi	n At Mea	nAt Max	At Min	At Mean	At Max	At Min	AtMear	LAt M
							Int	Int.	Int	Int	Int	Int	Int	Int	In
	(2)	(7)	-(0)				(8)	(9)	(10)	(11)	(12)	.(13)	(14)	(15)	_(1)
.,	(2)	(3)	(4)	(5)	(6)	(7)	(2x5)	(2×6)	(2 x 7)	(3x5)	(3x6)	(3×7)	(4×5) (4x6)	(4x'
994-95	23 10	15.16	5.21	14.0	16.16	17.0	3.23	3.73	3.93	2.12	2.45	2.58	0.73	0.84	0.
995-96	19.88	8.10		14.0	16.79	18.0	2.78	3.34	3.58	1.13	1.36	1.46			
996-97	20.54	5 70		17.5	18.51	19.0	3.59	3.80	3.90	1.00	1.05	1.08			
997-98	9.87			16.5	18.04	19 0	1.63	1.78	1.87	500					
998-99	14.12	-		16.0	16.76	17.5	2.26	2 37	2.47					-	
TAL	87.51	28.96	5 21				13.49	15.02	15.75	4.25	4.8G	5.12	0.73	0.84	0.

of the excess reserves at the three alternative lending rates is shown in Table 2.

The table indicates that if the bank had lent the excess reserves at 3 per cent level at the maximum, mean and minimum lending rates it would have made an additional aggregate income of Rs.15.75 lakhs, Rs.15.02 lakhs and Rs.13.49 lakhs during the reference period. The marginal difference in the opportunity cost of excess funds was due to the narrow difference in the minimum, mean and maximum lending rates. The aggregate

estimated revenue loss was Rs.5.12 lakhs, Rs.4.86 lakhs and Rs.4.25 lakhs at 4 per cent cash reserve for maximum, mean and minimum lending rates respectively.

Excess Statutory Liquidity Reserves
The PCUB is legally bound to
maintain 25 per cent of its demand
and time liabilities as statutory
liquidity ratio (SLR). The bank used
to invest the statutory liquidity
reserves in the Palakkad District
Co-operative Bank, Kerala State Cooperative Bank and in
unencumbered eligible securities.
For the purpose of this study any

Table 3. Excess Statutory Liquidity Reserves of PCUB

(Amount in lakhs)

Year	DTL	SLR Actually kept	SLR computed	25% of DTL	Excess of SLR
(1)	(2)	(3)	(4)	(5)	(6) = (4-5)
1994-95	894.74	268 93	245.83	223 68	22.15
1995-99	1177 46	416.86	390.08	294.36	102.62
1996-97	1484 64	575.12	554.88	371.16	183 72
1997-98	1849 01	734 54	724 67	462 25	262 42
1998-99	2623 84	135189	1399.77	655.96	683.81
			Total		1254.72

Table 4. Opportunity cost of excess SLR kept by PCUB

(Amount in lakha)

Year	Excess SLR kept	Maximum Interest rate (%)	Mean Interest rate (%)	Differential Interest rate (%)	Opportunits cost of excess SLR	
(1)	(2)	(8)	(4)	(5)=(3-4) (5)	(6)=(2x5) (6)	
1991-95	22 15	17.0	16 16	0.84	0.19	
1995-99		18.0	16.79	1 21	1.24	
1990 97		19.0	18.51	0.49	0.90	
1997-98		19.0	18.01	0.98	2.52	
1998-99		17.5	16.76	0.71	5 06	
			Total		9.91	

investment made over and above the statutory requirement of 25 per cent is treated as excess SLR. It was observed that the excess cash reserves was transferred to statutory liquidity ratio. So for computing the opportunity cost of excess SLR, the excess CRR was deducted from the actual SLR kept by the bank. The excess reserves under SLR is indicated in Table 3.

From the table it can be seen that the bank was keeping huge excess statutory liquidity reserves. The excess of SLR steadily increased from Rs.22.15 lakhs in 1994-95 to Rs.683.81 lakhs in 1998-99. The aggregate excess statutory liquidity reserves amounted to Rs.1254.72 lakhs during the reference period. Eventhough the bank fetched some return on the investment of SLR, the yield would have been more if the excess reserves were converted into high yielding loans. Hence the opportunity cost of excess SLR was estimated at differential interest rate and given in Table 4.

Opportunity cost of excess SLR

Table 4 reveals that the estimated aggregate loss due to excess SLR kept by the bank for the entire period of the study was Rs.9.91 lakhs. The opportunity cost of excess SLR kept by the bank steadily increased from Rs.0.19 lakhs in 1994-95 to Rs.4.06 lakhs in 1998-99. (Contd. on p.33)

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