

## IMPACT OF BANK'S REVENUE DIVERSIFICATION ON RISK: A CASE STUDY OF STATE BANK OF INDIA

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### ABSTRACT

*The purpose of this paper is to assess the impact of diversification of income generating activities of State Bank on three different types of risks namely Asset risk, Market risk and Insolvency risk during the period 2005-06 to 2014-15. Our analysis of the impact of income diversification activities of bank on three different measures of risks has clearly highlighted the fact that all three measures of risk have worsened after 2009-10. One way to overcome this concern is that in the short run government must recapitalize the public sector banks while in the long run banks must considerably improve its recovery performance to enhance non-interest income and provide lending for viable projects only.*

**KEYWORDS:** *Income Diversification, Asset Risk, Market Risk, Insolvency Risk, Non-Interest Income.*

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### Introduction

Banking sector in India has witnessed dynamic changes since 1991 along the lines of the recommendations by the Narasimham committee on financial sector reforms. The introduction of Information Technology in the banking activities has widened the scope of banking sector operations from fund based to non fund based functions. In this context State bank of India in 1998 entered into payment card business through an exclusive agreement with visa international. In 1999, State bank of India and central depository services agreed to make arrangements for trading State bank of India shares in demat form. In the year 2000, State bank of India further expanded its non-fund based activities by forming 'State bank of India Gold and Precious Metals Private Limited' with a 50% equity participation. In 2001 State bank of India launched 'Magnum Gilt Fund Scheme' which is exclusively meant for investing in government securities. In the same year it also launched a subsidiary called 'State bank of India Life Insurance Company Limited' for doing Life Insurance Business in the country. In 2004 it joined hands with visa to issue travel cards to the people to ease transaction process. In 2007 it established a branch in the Israel's Diamond Exchange market and in 2015 it launched Rupay Platinum Debit Card in association with the National Payment Corporation of India. Thus, State bank of India has been expanding its non-fund based activities in the country and abroad, since the last two decades however, gradual diversification also involves various types of risk challenges for the bank. The purpose of this paper is to analyze the impact of bank's income diversification on the three types of risk during the period from 2005-06 to 2014-15.

### Review of Literature

Many papers that have studied the impact of revenue diversification of banking sector operations on three different types of risks normally faced by commercial banks. In reference to this, **Aplado and Kolari (1996)** investigated the risk structure of U.S. bank holding companies and the effect of mutual fund activities on bank's risk and profitability over the period 1987-1994. The findings of their study showed that mutual fund activities reduce the exposure of banks to systematic industry risk but have no significant impact on bank market risk.

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