

STATE BANK OF INDIA

Rating: BUY

Price: Rs245

ASK-RAYMOND JAMES

& ASSOCIATES LIMITED

MEMBER, BOMBAY AND NATIONAL STOCK EXCHANGES

A Question of Leadership

India's Premier Bank has avoided many of the pitfalls which have tripped other state-controlled banks and the Development Financial Institutions. Its management depth and balance sheet strength have enabled it to weather the eccentricities of government policy, the occasional scam and a difficult legal and economic environment. This strength has been a major factor in our regular "buy" recommendation.

As the liberalisation of the economy continues and extends into financial services, and the internet and other developments transform commerce, State Bank of India (SBI) faces new challenges, which require visionary leadership.

For many years the government has appointed chairmen by seniority. This has resulted in short tenures and, in our opinion, prevented the emergence of chairmen with both visionary leadership qualities and a reasonable term in which to implement their vision. Since 1995, SBI has had four chairmen of very short duration. We believe the Indian government through the Reserve Bank of India (the largest shareholder) should reassess the existing policy, to maintain outside shareholder confidence in the new millennium.

- **SBI Act empowers the chairman with wide-ranging powers:** Section 27 (1) of the SBI Act, 1955 states, "The chairman shall preside at all meeting of the Central Board [board of directors] and, subject to such general or special directions as the Central Board may give, *exercise all such powers and do all such acts and things as may be exercised or done by the State Bank.* [emphasis ours]" The Act therefore provides the chairman with exemplary powers to manage the SBI and in the absence of the board the chairman can exercise all the powers of the board.
- **SBI chairmen are effectively CEOs:** In many organisations, the managing directors are day-to-day managers and the chairmen of the board discuss policy and long-term planning. In SBI, the chairman holds both responsibilities. The managing directors (MDs) and all the deputy managing directors (DMD) report directly to the chairman. The MDs, are only in charge of their respective areas – corporate banking and national banking and none of the DMDs report to the MDs. The managing directors apart from being executive board members (DMDs are invitees at board meeting) are merely senior-most among the DMDs.
- **Government playing safe going by seniority:** The short tenure of SBI chairmen stems from government following the seniority principle and appointing the senior-most SBI executive when the incumbent chairman retires (at the age of 60). As a result of this policy there are instances of SBI chairmen having a tenure of one and two months like Natarajan and Radhakrishnan.
- **Going by seniority,** successors to Vaidya will have a maximum tenure of less than a year: G.G. Vaidya, the existing chairman retires on 31st October 2000. Going by the seniority principle, SBI will have eight chairmen in the next four years. We are concerned that the organization may consequently suffer from a lack of long-term strategy, continuity and focus.

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Tenure of SBI Chairmen

Name	Date takes charge	Date Relinquishes	Number of years
Dr. John Mathai*	1 July 1955	30 September 1956	1.3
HVR Iengar*	1 October 1956	28 February 1957	0.4
PC Bhattacharyya*	1 March 1957	27 February 1962	5.0
B. Vekatappiah*	1 March 1962	28 February 1965	3.0
VT Dehejia*	1 March 1965	28 February 1969	4.0
RK Talwar	1 March 1969	3 August 1976	7.4
TR Varadachari	4 August 1976	30 April 1977	0.7
PCD Nambiar	23 May 1977	13 December 1982	5.6
VS Natarajan	20 December 1982	30 January 1983	0.1
RP Goyal	31 January 1983	30 November 1983	0.8
VV Nadkarni	1 December 1983	27 July 1984	0.7
DN Ghosh*	13 May 1985	12 May 1989	4.0
V Atal	15 January 1990	17 February 1990	0.1
MN Goiporia*	19 February 1990	31 July 1992	2.4
D Basu	25 February 1993	31 August 1995	2.5
MK Sinha#	1 September 1995	30 September 1995	0.1
PG Kakodkar\$	1 October 1995	31 March 1997	1.5
MS Verma	1 April 1997	30 November 1998	1.7
MP Radhakrishnan	1 December 1998	31 January 1999	0.2
GG Vaidya	1 February 1999	3 October 2000	1.7

*Not from SBI

#Acting Chairman

\$Acting Chairman from 1 October 1995 till 12 December 1995

Prospective chairmen and their tenures going by the Seniority Rule

Name	Present Designation	Tenure Ends	No. of mth as Chairman
S.K. Mukerjee	Managing Director, State Bank of Bikaner and Jaipur	30 November 2000	1 month
Vepa Kamesan	Managing Director, State Bank of Travancore	30 September 2001	10 months
Y. Radhakrishnan	Deputy Managing Director, Corporate Development Officer	30 June 2002	9 months
S. Govindrajan	Deputy Managing Director, Chief Financial Officer	31 July 2002	1 month
R. Sundarman	Managing Director, State Bank European Bank	30 September 2002	2 months
Janki Ballabh	Deputy Managing Director, International Banking	31 October 2002	1 month
A.K. Batra	Managing Director, State Bank of Patiala	31 August 2003	10 months
Krishnamachari	Managing Director, State Bank of Mysore	31 July 2004	11 months

- **Immediate successors to Vaidya are presently posted in SBI subsidiaries:** Mukerjee and Kamesan, the senior-most after Vaidya, are currently posted as managing directors of SBI's bank subsidiaries and are therefore outside the decision-making in SBI. Only Radhakrishnan is presently within SBI. We believe that at least the senior most officers who will succeed the incumbent chairman must be given sufficient exposure to high-level decision-making in SBI prior to taking charge, otherwise the transition will be more difficult for the new chairmen. Recent press reports indicate that Mukerjee and Kamesan have been cleared by the Ministry of Finance to succeed the existing managing directors.
- **Past examples of dynamic SBI chairman:** In the years since nationalisation, SBI benefited from the leadership of several long-serving and visionary chairmen. But even then, many of the key issues raised have taken decades to resolve e.g. Mathai's comment to shareholders at SBI's 1st AGM (1956) to strengthen SBI's international

operations took nearly 10 years to materialise and Dehejia's comment to shareholders in 1968 for disclosing SBI's secret reserves has yet to be implemented. SBI needs Chairmen that will confront major issues and can resolve them at the speed now demanded by an integrated global economy. R.K. Talwar and D.N. Ghosh stand out as examples of strong past chairman (see attached appendix).

- **Breaching the seniority principle has worked before:** R.K. Talwar was promoted out of turn and D.N. Ghosh was recruited from outside. And D. Basu's elevation was expedited after the 1992 Securities Scam.
- **Long tenure chairman with visionary leadership required:** As SBI enters the new millennium it urgently requires visionary leadership combined with a reasonable tenure. The chairman's role in SBI is that of a long-term planner as well as a chief executive officer and the post is therefore of crucial importance to the organisation. We believe that the government should appoint chairmen with a minimum tenure of three years and preferably a tenure of six years to provide sound leadership and vision to the bank.
- **Review of human resources (HR) policy:** Further, we believe SBI should review its HR strategy at the higher levels. Otherwise, the entire senior management cadre will be approaching retirement. The average age of the current DMDs is 57. SBI should ensure the most able candidates reach the executive board by the age of 50 to develop a pool of experienced prospective future chairmen of reasonable tenure.
- **SBI believes its internal systems can withstand high turnover of chairmen:** SBI believes that its systems are so strong that they will deliver the right results, irrespective of the individuals holding top positions. In the past, this may have been so. But liberalisation, mass communications and the internet require rapid responses. And SBI concedes that its greatest weakness is in its speed of response to new challenges.
- If the policy of appointing the senior-most individual as chairman continues, we will review our existing BUY recommendation since we believe that the seniority rule will impose on SBI short tenure chairman whose horizon will be confined to a few months.

Tenure of SBI Senior Management by Seniority

	Name	Tenure Ends	Designation
1	G.G. Vaidya	31 October 2000	Chairman
2	V. Janakiraman	28 February 2000	Managing Director, Corporate Banking
3	S.R. Iyer	31 May 2000	Managing Director, National Banking
4	S.K. Mukerjee	30 November 2000	Managing Director, State Bank of Bikaner and Jaipur
5	Vepa Kamesan	30 September 2001	Managing Director, State Bank of Travancore
6	D.P. Roy	30 September 2001	Deputy Managing Director, Associates and Subsidiaries
7	Y. Radhakrishnan	30 June 2002	Deputy Managing Director, Corporate Development Officer
8	Birendra Kumar	30 April 2002	Managing Director, SBI Capital Markets
9	S. Govindrajan	31 July 2002	Deputy Managing Director, Chief Financial Officer
10	R. Sundaraman	30 September 2002	Managing Director, State Bank European Bank
11	Janki Ballabh	31 October 2002	Deputy Managing Director, International Banking
12	A.K. Batra	31 August 2003	Managing Director, State Bank of Patiala
13	Krishnamachari	31 July 2004	Managing Director, State Bank of Mysore
14	P.N. Venkatachalam	31 July 2004	Deputy Managing Director, Chief Credit Officer
15	Madhukar	28 February 2004	Deputy Managing Director

Appendix – Past Visionary Chairmen

- **R.K. Talwar (1st March 1969 till 3rd August 1976).** Talwar was notable for his vigorous defence of SBI interests, robustly criticizing government policy, for example when UTI and LIC were given access to the interbank market in the early 1970's. Talwar also managed to push the bank into agrarian and other priority lending and yet maintain the bank's capital strength in the face of higher non-performing loans (NPLs) generated by the introduction of socio-economic considerations in the bank's lending policy. At SBI's 20th AGM on 31st March 1975, Talwar pointed out the declining capital funds ratio (published capital funds to deposit liabilities) of the Indian banking system and the threat of NPLs from the banking systems' focus on priority lending. He argued that, "public participation in the equity capital of banks is decidedly one way" and stressed the need to increase the capital funds ratio of banks. Nearly 19 years later, in December 1993, SBI finally had its IPO to meet internationally established capital adequacy norms.
- **Resisting political pressure:** Talwar also resisted attempts at Government interference in the operation of SBI. One such instance was when a Minister of State instructed Talwar to act in a particular way in an industrial relations dispute. Talwar declined to obey and the Minister then remarked, "Are you refusing to carry out the orders of the Government?" Talwar replied, "Mr. Minister, you are not running SBI. I am. It is for me to decide what is in the best interest of the Bank. You have a right to decide whether I should continue to be the chairman, but you have no right to tell me how to administer the Bank." The minister did not pursue the matter. (quoted in N. Vaghul, *R.K. Talwar: Tributes*. page 11. private publication.) Such instances of rare courage are few and far between.
- **Stupendous growth in Talwar's tenure:** Talwar managed unprecedented growth in SBI focusing on the government's directive of branch expansion, agrarian and small-scale credit growth. During his tenure, SBI increased its branches from 1,557 in 1968 to 3,831 in 1975 i.e. almost a branch a day for seven years. Employees increased from 55,000 to 106,000 during this period. Kudos to Talwar, that SBI did not succumb to this unprecedented growth since he was instrumental in building up adequate systems to monitor and manage this tremendous growth. SBI is today credited with having the best internal system amongst the government banks because of Talwar's initiative.
- **D.N. Ghosh (13th May 1985 till 12th May 1989):** Surprisingly for a former civil servant, Ghosh was instrumental and extremely conscious of improving SBI's profitability. The credit goes to Ghosh for activating SBI's dormant treasury division and under his stewardship SBI began trading in government securities in a significant manner. Although there were no disclosures in the accounts in that period, SBI is reported to have made huge profits from trading securities. Ghosh was also extremely concerned about the impact of disintermediation on SBI and was instrumental in transferring SBI's merchant banking division into a separate company, SBI Capital Markets which also started mutual funds. Ghosh was also the first SBI chairman to allow international credit rating agencies to evaluate and rate SBI.
- **Long tenure provides continuity of focus:** In analyzing the chairmen's speeches to shareholders - especially those of Talwar, Nambiar and Ghosh we discern areas where the chairman identified and monitored areas of concern for SBI. With Talwar there was the emphasis on agrarian and priority sector finance, with P.C.D. Nambiar, SBI's focus was on international operations and under D.N. Ghosh SBI embarked on a policy of diversification to counter disintermediation. In all their speeches one clearly sees the significance the chairmen gave to issues which they perceived to be important and which they publicly identified with.

Income Statement

Year to 31st March (Rs mn)	1997	1998	1999	2000E	2001E
Net Interest Income	53,593	54,057	60,631	60,294	65,551
Other Income	26,431	28,202	32,847	37,502	41,182
Total Income	80,024	82,259	93,478	97,796	106,733
Salaries	(33,229)	(35,577)	(41,474)	(45,937)	(50,530)
RIB Expenses	0	0	(3,059)	0	0
Other expenses	(12,819)	(11,632)	(14,433)	(15,614)	(17,748)
Total Overheads	(46,048)	(47,209)	(58,966)	(61,551)	(68,278)
Bad Debt Provisions	(8,333)	(11,514)	(14,227)	(11,550)	(10,952)
Prudential Provision	0	(1,490)	(140)	(255)	(371)
Investment Provisions	(39)	9,505	(153)	0	0
Others	(816)	(661)	(1,333)	(1,758)	(2,285)
Provision for SBI Mutual Fund	0	0	0	(1,250)	0
Provision for salary revision	0	(1,000)	(3,153)	0	0
Tax	(11,495)	(11,279)	(5,228)	(6,815)	(7,914)
Total Provisions	(20,683)	(16,439)	(24,234)	(21,629)	(21,523)
Net Profit	13,293	18,611	10,278	14,616	16,932
Dividend	(1,995)	(2,105)	(2,105)	(2,367)	(2,635)
DPS (Rs)	4.00	4.00	4.00	4.50	5.00
EPS (Rs)	26.6	35.4	19.5	27.8	32.1
EPS Growth	51.5%	33.1%	-44.8%	42.2%	15.6%
Net Interest Margin	4.05%	3.62%	3.29%	2.71%	2.57%
Cost-to-Income	57.5%	57.4%	63.1%	62.9%	64.0%
Average Tax Rate	36.1%	32.8%	22.7%	20.0%	20.0%
Gross NPL	16.0%	14.1%	15.6%	13.8%	12.0%
Net NPL	7.3%	6.1%	7.2%	6.3%	5.4%
Provisions/Gross NPL	58.7%	60.8%	58.0%	58.2%	58.3%

Return on Assets

Year to 31st March (Rs mn)	1997	1998	1999	2000E	2001E
Net Interest Income	3.56	3.22	3.02	2.52	2.39
Other Income	1.76	1.68	1.63	1.57	1.50
Less Overheads	(3.06)	(2.81)	(2.93)	(2.58)	(2.49)
Less Provisions	(1.37)	(0.98)	(1.21)	(0.91)	(0.79)
ROA	0.88	1.11	0.51	0.61	0.62
ROE	19.78	21.17	10.27	13.28	13.76

Ratios

Year to 31st March (x)	1997	1998	1999	2000E	2001E
Price Earnings	10.3	8.0	10.9	8.8	7.6
Price to Book Value	1.8	1.5	1.1	1.1	1.0
Price to Adjusted BV	2.6	2.0	1.7	1.7	1.4
Dividend Yield (%)	1.5	1.4	1.9	1.8	2.0

Historic at year-end prices
Balance Sheet

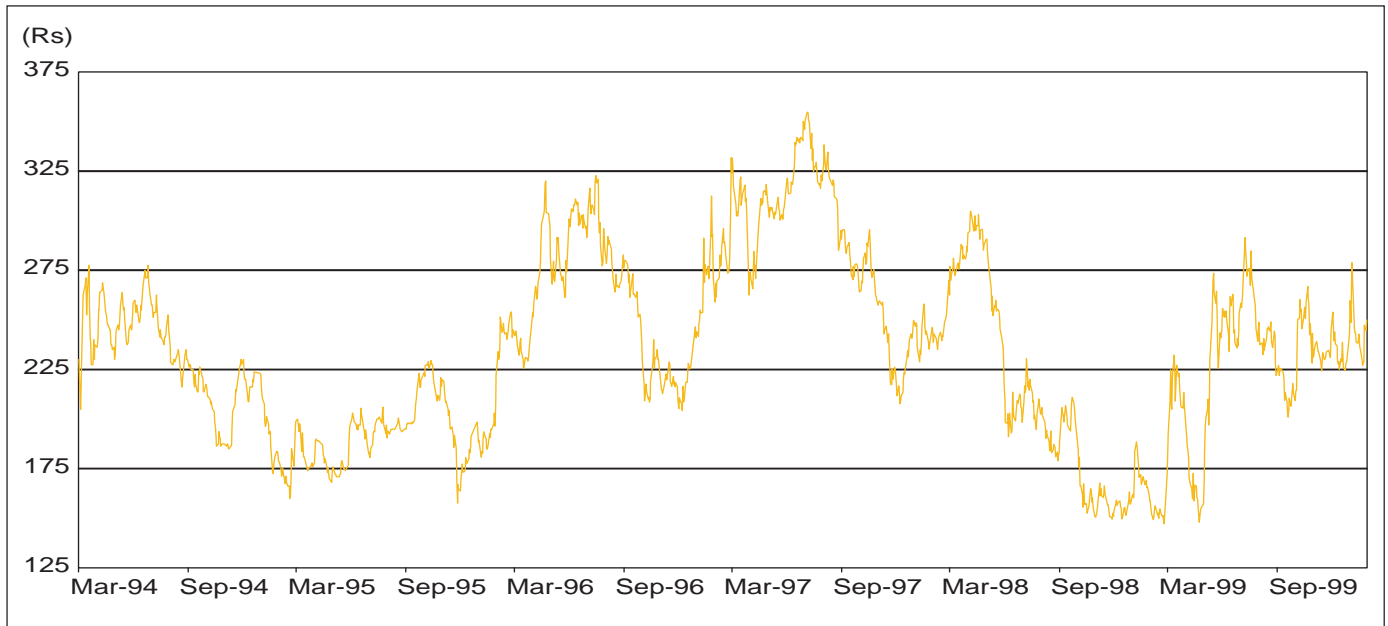
As at 31st March (Rs mn)	1997	1998	1999	2000E	2001E
Cash with RBI	108,472	134,146	173,923	184,355	212,009
Cash at call	169,056	192,313	358,203	411,933	473,723
Total Cash	277,528	326,459	532,126	596,289	685,732
Investments	468,276	549,822	712,865	825,010	901,377
Advances	622,332	742,373	823,598	952,551	1,140,145
Net Block	11,709	15,063	21,937	26,105	31,065
Other assets	184,888	163,010	134,564	152,057	171,825
Assets	1,564,733	1,796,727	2,225,090	2,552,012	2,930,144
Demand Deposits	256,464	278,137	306,920	388,796	424,760
Savings Deposits	240,281	292,078	343,213	388,796	447,116
Term Deposits	610,265	740,698	1,040,286	1,166,389	1,363,703
Total Deposits	1,107,010	1,310,913	1,690,419	1,943,982	2,235,579
Other Borrowing	69,605	80,934	90,791	104,410	120,071
Subordinate Debt	9,921	9,874	9,841	8,066	8,026
Total Borrowing	79,526	90,808	100,632	112,476	128,098
Other liabilities	298,425	298,926	330,016	379,518	436,446
Equity	5,263	5,263	5,263	5,263	5,263
Reserves	74,509	90,817	98,760	110,773	124,758
Total Equity	79,772	96,080	104,023	116,036	130,021
Total Liab & Equity	1,564,733	1,796,727	2,225,090	2,552,012	2,930,144

Capital Adequacy

Year to 31st March (Rs mn)	1997	1998	1999	2000E	2001E
Tier I Capital	67,784	81,836	87,430	90,177	109,090
Tier II Capital	29,841	29,664	29,423	29,383	29,343
Total Capital	97,625	111,500	116,853	119,561	138,433
Risk-Weighted Assets	802,178	764,746	934,078	1,110,391	1,300,947
Tier I Capital	8.5%	10.7%	9.4%	8.1%	8.4%
Tier II Capital	3.7%	3.9%	3.2%	2.6%	2.3%
Capital Adequacy	12.2%	14.6%	12.5%	10.8%	10.6%

Adjusted Book Value

Year to 31st March (Rs mn)	1997	1998	1999	2000E	2001E
Book Value (Rs)	151.6	182.6	197.6	220.5	247.0
Equity	79,772	96,080	104,023	116,036	130,021
Net NPLs	(45,430)	(44,960)	(59,060)	(59,996)	(61,546)
Secret Reserves	19,920	20,126	20,126	20,126	20,126
Prudential Provisions	0	1,490	1,630	1,885	2,256
Adjusted Equity	54,262	72,736	66,719	78,051	90,857
Adjusted BV (Rs)	103.1	138.2	126.8	148.3	172.6

Price Movement


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