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   RESULTS & DISCUSSION

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ANALYSIS OF ASSET QUALITY OF PRIVATE SECTOR INDIAN BANKS

SULTAN SINGH
PROFESSOR & DEAN
DEPARTMENT OF BUSINESS ADMINISTRATION
CHAUDHARY DEVI LAL UNIVERSITY
SIRSA

MOHINA
RESEARCH SCHOLAR
DEPARTMENT OF BUSINESS ADMINISTRATION
CHAUDHARY DEVI LAL UNIVERSITY
SIRSA

SAHILA CHOUDHRY
ASST. PROFESSOR
INSTITUTE OF BUSINESS MANAGEMENT
JCD VIDYAPEETH
SIRSA

ABSTRACT

In the present study, an attempt is made to analyze the asset quality of selected private sector Indian banks. First section includes a brief review of some of the earlier studies. Second section covers the scope, objectives, hypothesis and research methodology. In third section, an attempt is made to analyze the asset quality of selected banks namely ICICI Banking Corporation Ltd (ICICI), Indusind Bank Ltd (Indusind), AXIS Bank Ltd (AXIS) and HDFC Bank Ltd (HDFC) in India by using CAMEL Model ratios for a period of eleven years i.e. from 2000-01 to 2010-11. Fourth section covers the conclusion and limitations of the study. To achieve the objectives of the study, the use is made of secondary data collected mainly from Report on Trends and Progress of Banking in India, Performance Highlights of Private Banks in India, various journals such RBI Bulletin, IBA Bulletin, etc. To test the statistical significance of the results, one-way ANOVA technique has been used. The results of the study reveal that there is a significant difference in the ratio of net NPAs to total assets, net NPAs to net advances and total investments to total assets in the selected banks; therefore, null hypothesis is rejected, which signifies the significant difference in the asset quality of the selected banks during the period under study.

KEYWORDS

Capital Adequacy, Net NPAs to Net Advances, Investment to Total Assets, Net NPAs to Total Assets.

INTRODUCTION

After the set back of early nineties when the Government of India had to pledge the gold to acquire foreign currency to meet the severe problem of balance of payment temporarily, the Government planned to liberalize the Indian economy and open its door to the foreigners to speed up the development process as a long-term solution for the ailing economy. The economic liberalization move, which was initiated in 1991 when the new government assumed office, has touched all the spheres of national activity. Perhaps one area where the deregulatory policies had the maximum impact was the banking sector. Until 1991, the banking in India was largely traditional. The bankers were prudent and cautious people who seldom took risks and were content with the normal banking activities i.e. accepting of deposits and lending against them. Labeled as "Agents of Social Change", their outlook was rigidly controlled by the policies of the Government, which were centered more on the alleviation of poverty and the upliftment of the downtrodden. The 1969 and 1980's nationalization of banks, bringing private banks under the state control, had the objective of realizing this government dream. Even as late as 1991-92, the profitability was a forbidden word in banking business. The banks were established to fulfill social objectives and their performance was evaluated on their 'task fulfillment' initiatives. Lending to the priority sectors, opening of rural branches, achievements in the implementation of Government sponsored schemes and adherence to the policies and programmes of the Government were the parameters considered for judging the performance of a bank. Indian banking system has made commendable progress in extending its geographical spread and functional reach. The nationalization of banks helped in increasing the number of branches, volume of deposits and ensured wider dispersal of the advances. Despite impressive quantitative achievements in resource mobilization and in extending the credit reach, some deficiencies have, over the years, crept into the system such as decline in the productivity and efficiency of the system, erosion of the profitability of the system, directed lending played a critical role in depressing the profits, the directed investments in the form of SLR and CRR hindered income earning capability and potentials, portfolio quality suffered due to political and administrative interference in credit decision-making, increase in cost structure due to technological backwardness, average ratio of capital funds to RWAs remained low which created problems in international operations and the system remained de-linked from sound international banking practices. Realizing all these ill effects, the efforts were made to bring reforms in the financial system of the country. The seed of the reforms in India were sown by the Narasimham Committee appointed by the RBI under the chairmanship of M. Narasimham, the former Governor of RBI, to examine the aspects relating to the structure, organization, functions and procedures of the financial system and suggest remedial measures. The Committee submitted its reports in November 1991 and thus, began a new chapter in Indian banking. The Reserve Bank of India acts as a centralized body monitoring any discrepancies and shortcoming in the system. It is the foremost monitoring body in the Indian financial sector. It is generally accepted that greater financial system depth, stability and soundness contribute to economic growth. But beyond that, for growth to be truly inclusive requires broadening and deepening the reach of banking by improving earning quality of banking sector. A wider distribution and access of financial services helps both consumers and producers raise their welfare and productivity. Such access is especially powerful for the poor as it provides them opportunities to build savings, make investments, avail credit, and more important, insure themselves against income shocks and emergencies. Though the Indian financial system has made impressive strides in resource mobilization, geographical and functional reach, financial viability, profitability and competitiveness, vast segments of the population, especially the underprivileged sections of the society, have still no access to formal banking services. The Reserve Bank is therefore considering the proposal for providing licenses to a limited number of new banks. A larger number of banks would foster greater competition, and thereby reduce costs, and improve the quality of service. More importantly, it would promote financial inclusion and ultimately support inclusive economic growth, which is a key focus of public policy. The success in the global scenario can be attained only if banks maintain competitive edged in their asset quality.

Induced by the forgoing revelations, an attempt is made to analyze the asset quality of selected private Indian sector banks, which is divided into four sections. First section includes a brief review of some of the earlier studies. Second section covers the scope, objectives, hypotheses and research methodology. In third section, an attempt is made to analyze the asset quality of selected private sector Indian banks. Fourth section covers the conclusion and limitations of the study.

LITERATURE REVIEW

The articles published on different facets of Indian banking reforms are restrictive in nature and have been found wanting in terms of the assessment of the impact of the reforms on the banking sector. Reddy and Yuvaraja (2001) were of the view that the adoption of international capital adequacy standards, deregulation of interest rates and entry of private and foreign banks underlined that the speed and sequencing of the financial sector reforms should be as per the requirements of the Indian economy. Rao (2002) concluded that the international regulations are forcing the Indian banks to adopt better operational strategies and upgrade the skills. The system requires new technologies, well-guarded risk and credit appraisal system, treasury management, product diversification, internal control, external regulation as well as skilled human resources to achieve the international excellence and to face the global challenges. Muniappan (2003) focused on two areas - firstly, challenges faced by the Indian banks and secondly, the management of these challenges. Every aspect of the banking industry, be it profitability, NPA management, customer service, risk management, HRD etc., has to undergo the process of transformation of aligning with the international best practices. He concluded that the future of Indian banking system needs a long-term strategy, which should cover areas like structural aspects, business strategies, prudential control systems, integration of markets, technology issues, credit delivery mechanism and information sharing, etc. Ghosh and Das (2005) highlighted the ways how market forces may motivate banks to select high capital adequacy ratios as a means of lowering their borrowing costs. If the effect of competition among banks is strong, then it may overcome the tendency for bank capitalization. If systemic effects are strong, regulation is required. Empirical tests for the Indian public sector banks during the 1990s demonstrated that better capitalized banks experienced lower borrowing costs**.** Sharma and Nikadio (2007) presented an analytical review of the capital adequacy regime of the banking sector in India and concluded that in the regime of Basel I, Indian banking system performed reasonably well, with an average CRAR of about 12 per cent, which was higher than the internationally accepted level of 8 per cent as well as India's own minimum regulatory requirement of 9 per cent. Ghosh and Ghosh (2011) emphasized on management of non-performing assets in the perspective of the public sector banks in India under strict asset classification norms, use of latest technological platform, recovery procedures and other bank specific indicators in the context of stringent regulatory framework of the Reserve Bank of India and concluded that the reduction of non-performing assets is necessary for improving the profitability of banks and to comply with the capital adequacy norms as per the Basel Accord(s). Thiagarajan, Ayyappan and Ramachandran (2011) analyzed the role of market discipline on the behaviour of commercial banks with respect to their capital adequacy and concluded that the commercial banks are well capitalized and the ratio is well over the regulatory minimum requirement. The private sector banks show a higher percentage of Tier-I capital over the public sector banks. However the public sector banks show a higher level of Tier-II capital. The study also indicated that the Non-Performing Assets influenced the cost of deposits for both public and private sector banks in a significant manner. The return on equity had a significant positive influence on the cost of deposits for private sector banks. The public sector banks can reduce the cost of deposits by increasing their Tier-I capital.

SCOPE, OBJECTIVES, HYPOTHESES AND METHODOLOGY

SCOPE OF THE STUDY

This study covers four private sector Indian banks namely ICICI Banking Corporation Ltd (ICICI), Indusind Bank Ltd (Indusind), AXIS Bank Ltd (AXIS) and HDFC Bank Ltd (HDFC).

OBJECTIVES OF THE STUDY

The present study aims to analyze the present position of asset quality of selected private sector Indian banks.

RESEARCH HYPOTHESIS

H01: There is no significant difference in the net NPAs to total assets ratio of the selected private sector Indian banks.
H02: There is no significant difference in the net NPAs to net advances ratio of the selected private sector Indian banks.
H03: There is no significant difference in the total investments to total assets ratio of the selected private sector Indian banks.

RESEARCH METHODOLOGY

To achieve the objectives of the study, the use is made of secondary data for a period of eleven years i.e. from 2000-01 to 2010-11, collected mainly from various sources like Report on Trends and Progress of Banking in India, Performance Highlights of Private Sector Indian Banks, various journals such as RBI Bulletin, IBA Bulletin, ICFAI Journal of Bank Management. To test the statistical significance of the results, one-way ANOVA technique has been used to arrive at the conclusions.

ANALYSIS OF ASSET QUALITY

The quality of assets is an important parameter to gauge the strength of bank. The prime motto behind measuring the assets quality is to ascertain the component of net NPAs as percentage to total assets/net advances. This indicates what types of advances the bank has made to generate interest income. Thus, assets quality indicates the type of the debtors the bank is having.

3.1 NET NPAs TO TOTAL ASSETS

This ratio indicates the efficiency of the bank in assessing credit risk and, to an extent, recovering the debts. This ratio is arrived at by dividing the net NPAs by total assets. Total assets are considered net of revaluation reserves. Lower the ratio better is the performance of the bank.

TABLE 1: NET NPAs TO TOTAL ASSETS

Years	ICICI	Indusind	AXIS	HDFC
2000-2001	0.00	2.39	1.59	0.12
2001-2002	0.00	3.39	1.23	0.14
2002-2003	0.00	2.30	0.83	0.14
2003-2004	1.14	1.41	0.46	0.07
2004-2005	0.90	1.56	0.57	0.12
2005-2006	0.42	1.11	0.44	0.21
2006-2007	0.58	1.31	0.36	0.22
2007-2008	1.04	0.32	0.98	1.19
2008-2009	1.20	0.65	0.22	0.34
2009-2010	1.06	0.29	0.23	0.18
2010-2011	0.59	0.16	0.17	0.11
ANOVA Value	F-5.86	P-value-0.002		df-3

Source: Performance Highlights of Private Sector Banks, IBA, Mumbai.

As is evident from the Table-1, the ratio of net NPAs to total assets ranges from 0.00 to 1.20 in case of ICICI, from 0.16 to 3.39 in case of Indusind, from 0.17 to 1.59 in case of AXIS and from 0.07 to 1.19 in case of HDFC during the period under study. The results of one-way ANOVA reveal that there is a significant difference in the ratio of net NPAs to total assets in the selected banks; therefore, null hypothesis is rejected.

3.2 NET NPAs TO NET ADVANCES

It is the most standard measure of assets quality. In this ratio, net NPAs are measured as a percentage of net advances. Net NPAs are gross NPAs net of provisions on NPAs.

TABLE 2 - NET NPAs TO NET ADVANCES

Years	ICICI	Indusind	AXIS	HDFC
2000-2001	2.19	5.25	3.43	0.45
2001-2002	5.48	6.59	2.74	0.5
2002-2003	5.21	4.25	2.30	0.37
2003-2004	2.21	2.72	1.29	0.16
2004-2005	1.65	2.71	1.39	0.24
2005-2006	0.72	2.09	0.98	0.44
2006-2007	1.02	2.47	0.72	0.43
2007-2008	1.55	2.27	0.42	0.47
2008-2009	2.09	1.14	0.40	0.63
2009-2010	2.12	0.50	0.40	0.31
2010-2011	1.11	0.28	0.29	0.19
ANOVA Value	F- 6.61	P-value- 0.001		df-3

Source: Performance Highlights of Private Sector Banks, IBA, Mumbai.

As is evident from the Table-2, the ratio of net NPAs to net advances ranges from 0.72 to 5.48 in case of ICICI, from 0.28 to 6.59 in case of Indusind, from 0.29 to 3.43 in case AXIS and from 0.16 to 0.63 in case of HDFC during the period under study. The results of one-way ANOVA reveal that there is a significant difference in the ratio of net NPAs to net advances in the selected banks; therefore, null hypothesis is rejected.

3.3 TOTAL INVESTMENTS TO TOTAL ASSETS RATIO

It indicates the extent of deployment of assets in investment as against advances. This ratio is used as a tool to measure the percentage of total assets locked up in investments, which by conventional definition, does not form a part of the core income of a bank. A higher level of investment means lack of credit off-take in the economy. This ratio is calculated by dividing the total investments by total assets of a bank. A higher ratio means that the bank has conservatively kept a high cushion of investments to guard against NPAs. However, this affects its profitability adversely.

TABLE 3: TOTAL INVESTMENTS TO TOTAL ASSETS

Years	ICICI	Indusind	AXIS	HDFC
2000-2001	39.05	26.73	36.80	42.57
2001-2002	34.04	22.94	44.04	48.36
2002-2003	33.20	25.60	39.98	44.00
2003-2004	34.13	26.33	32.27	45.52
2004-2005	30.11	26.05	37.82	37.62
2005-2006	28.43	30.70	43.29	38.63
2006-2007	26.48	28.15	36.72	33.50
2007-2008	27.88	28.50	30.76	37.09
2008-2009	27.17	29.27	31.36	32.09
2009-2010	33.27	29.41	30.99	26.35
2010-2011	33.15	29.69	29.66	25.57
ANOVA Value	F-8.35	P-value-0.00		df-3

Source: Performance Highlights of Private Sector Banks, IBA, Mumbai.

As is evident from the Table-3, the ratio of total investments to total assets ranges from 26.48 to 39.05 in case of ICICI, from 22.94 to 30.70 in case of Indusind, from 29.66 to 44.04 in case of AXIS and from 25.57 to 48.36 in case of HDFC during the period under study. The results of one-way ANOVA reveal that there is a significant difference in the ratio of total investments to total assets in the selected banks; therefore, null hypothesis is rejected.

CONCLUSON AND LIMITATIONS

To sum up, there is significant difference in the ratio of net NPAs to total assets, net NPAs to net advances and total investments to total assets in the selected banks; therefore, null hypothesis is rejected, which signifies the significant difference in the asset quality of the selected banks. The results obtained from the present study will be helpful to the policy makers, depositors, investors and other stakeholders to take decisions about the asset quality of the selected private sector banks in India. As the present study covers the analysis of four private sector banks for a period of eleven years only, therefore the results drawn cannot be applied to the banking sector as whole.

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