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PERFORMANCE OF NEW GENERATION BANKS IN INDIA: A COMPARATIVE STUDY

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ABSTRACT

Evaluating Indian Banks' performance is not an easy task, as it seems. There are so many factors, which need to be taken care while differentiating good banks from the bad ones. Just by using some standard ratio for banks' financial analyses, one can reach at conclusions some time or the other, and still could be away from actuality. However, there has to be some mechanism through which these banks can be compared and evaluated from time to time. The traditional analysis largely focused on parameters like Credit –Deposit ratio, commonly referred to as CD ratio, level of nonperforming assets, Capital Adequacy ratio and the other usual earnings ratio. Now, the things have changed; by just having high CD ratio it doesn't mean that the bank is sound. The basic definition of banking business has changed, largely due to the entry of private banks as well foreign banks in the banking industry which has given a totally new dimension to the banking business, which was never thought of a decade ago. This paper tries to analyse the economic performance of commercial banks on the basis of some modern techniques popularly used for this purpose.

KEYWORD

Commercial banks, performance analysis, modern techniques.

INTRODUCTION

In the backdrop of global financial crisis and its repercussions on the Indian economy, the year 2008-09 has been a testing year for the Indian banking sector. The Indian banking sector, however, withstood this test and the resilience of this sector was more than evident. Also, no one will ignore the fact that the sector is currently in a transition phase. It has been passing through a transformation phase and has the influences of a number of forces that are operating in the domestic economy as well as in the international financial system. While public sector banks are in the process of restructuring, private sector are busy in consolidating through mergers and acquisitions. The entry of foreign banks leaves influential impact over the whole sector. The financial sector is likely to witness a significant structural change in the coming year. Nowadays, there are many new entrants which are about to come into the banking sector from both domestic and international sector. Entry of private and foreign banks in the segment has provided healthy competition and is likely to bring more operational efficiency into the sector. However, before investing in a banking stock an investor should look at certain key performance ratios.

Unlike any other manufacturing service, company bank accounts are presented in a different manner as far as banking regulation is concerned. The analysis of banks accounts differs significantly from any other company due to their structure and operating system. Those key operating and financial ratios which one would normally evaluate before investing in a company may not hold true for a bank. However, there have been standard parameters developed over the years, which can serve as a very effective tool for judging a bank's performance.

REVIEW OF LITERATURE

After the liberalization of the Indian Economy, many private sector banks have started their business in India. The issue that is addressed in this study is how effectively these banks have performed? In the past, various studies relating to the financial performance of banks have been conducted by researchers. In his paper, Das (2002) has attempted to develop an objective method for ranking the nationalized banks, by analysing the performance of 17 public sectors banks. Swami and Subramanayam (1994) have tried to study the inter-bank differences in the performance of public sector banks in India with the help of the "Taxonomic method". It was found in the study that many banks had wide disparities in their measures of performance. Noulas and Ketkar (1996) conducted a study to examine the technical and scale efficiency of banks. Bhattacharya et al. (1997) and Sathye (2005) have studied the impact of privatization on the performance of banks. The results of the studies were, however, contradictory. While Bhattacharya found that performance of the public sector banks was sound as compared to the private sector banks, Sathye found the opposite results in his study. Saha and Ravishankar (2000) rated 25 public sector banks using the data envelopment analysis (DEA). A study on technical efficiency and benchmark performance of 68 commercial banks has been conducted by Mukherjee et al. (2002), which revealed that, in India, public sector banks are more efficient than both private and foreign banks. Swamy (2001) studied the comparative performance of different banks groups. Das (2002) has studied the interrelationship among capital, non-performing

loans and productivity of public sector banks. Uppal (2004) conducted a comparative study of the business, efficiency, soundness and productivity of the new private sector banks. He concluded that private sector banks are sound in urban area and he has ranked the banks as per the parameters. Qamar (2003) has studied the profitability and resource use efficiency in scheduled commercial banks in India. He found that new private sector banks and foreign banks are marginally more efficient than the old private sector and public sector banks.
This study is an addition to the literature by using the modern techniques for evaluating bank performance.

METHODOLOGY OF THE STUDY

OBJECTIVE OF THE STUDY
The basic objective of the study is to analyse the performance of the selected banks- SBI, PNB, BOI, IDBI, AXIS, HDFC and ICICI - through the modern techniques and to rank them according to their performance.

THE UNIVERSE AND SAMPLE OF THE STUDY
For the present study, the universe is all private banks and public sector banks irrespective of their size. From this, a sample is selected which is based on the awareness of the general public regarding different private as well as public sector banks. In order to meet this requirement, a formal public research was carried out, from which it is understood that the seven banks are the more popular banks.

SOURCES OF DATA
The study is mainly based on secondary data. The relevant information in this regard is collected from various sources like the CMIE, stock exchanges and magazines like Analyst, Business today, RBI and IBA bulletins. The period taken for the study purpose is 2009-10.

MODERN TECHNIQUES FOR EVALUATING BANK PERFORMANCE
Traditional analysis, which is more subjective doesn't talk about any ratio but identifies some broad dimension of banking business and it largely dwells on some basic parameters for broadly analysing bank performance. While, the modern techniques lay large emphasis on ratio and they have developed certain standard ratio that will analyse banks from various perspectives. Let's look at some key ratio that differentiates a good bank from a bad one.

KEY OPERATING PERFORMANCE RATIOS

1. NET INTEREST MARGIN (NIM): For bank, interest expenses are their main costs (similar to manufacturing cost for companies) and interest income is their main revenue source. The difference between interest income and expense is known as net interest income. It is the income, which the bank earns from its core business of lending. Net interest margin is the net interest income earned by the bank on its average earning assets. These assets comprise of advances, investments, balance with RBI& Money at call.

$$\text{NIM} = \frac{\text{Interest income} - \text{Interest expenses}}{\text{Average earning assets}}$$

2. OPERATING PROFIT MARGINS (OPM): Banks operating profits is calculated after deducting administrative expenses, which mainly include salary cost and network expanses cost. Operating margin is profit earns by the bank on its total interest income. For some private sector banks the ratio is negative on account of their large IT and network expansion spending.

$$\text{OPM} = \frac{\text{Net interest income (NII)} - \text{operating expenses}}{\text{Total interest income}}$$

3. COST TO INCOME RATIO: Controlling overhead is critical for enhancing the bank return on equity. Branch rationalization and technology up gradation account for major part of operating expenses for new generation banks. Even through, these expanses result in higher cost to income ratio, in long term they help the bank in improving its return on equity .The ratio is calculate as a proportion of operating profit including non-interest income(fee based income).

$$\text{Cost to income ratio} = \frac{\text{Operating expenses}}{\text{NII + non interest income}}$$

4. OTHER INCOME TO TOTAL INCOME: Fee based income account for a major portion of the bank's income. This generates from higher fee income through innovative products and adapting the technology for sustained service levels. This stream of revenues is not dependent on the bank capital adequacy and consequently, potential to generate income is immense. The higher ratio indicates increasing proportion of fee-based income. The ratio is also influenced by gain on government securities, which fluctuated depending on interest rate movement in the economy.

Table: I
Comparative Operating Performance (in %)

FYO9	NIM	OPM	Cost to Income	Other Income to Total income
SBI	2.93	17.5	46.62	16.59
PNB	2.85	13.72	42.50	13.80
BOI	2.43	14.71	64.31	15.72

IDBI	0.75	-0.85	49.26	10.18
AXIS	2.49	7.64	38.76	21.09
HDFC	4.2	15.6	51.65	16.76
ICICI	2.2	4.25	44.11	19.64

Sources: RBI bulletin

Table I indicates that, HDFC banks stands first in Net Interest Margin, on account of it's lending to retail sector, which is considered to be high margins business owing to low cost funds from retail deposits. SBI has upper hand in operating Profit Margin which is the result of higher profit earned by the efficient utilization of resources. AXIS bank is on top position for rest of the two key ratios i.e. cost to Income & Other income to Total Income.

KEY FINANCIAL RATIOS

1. CREDIT TO DEPOSITE RATIO (CD RATIO): The ratio is indicative of the percentage of funds lent by the bank out of the total amount raised through deposits. Higher ratio reflects ability of the bank to make optimal used of the available resource .The point to note here is that loans given by bank would also include its investments in debentures, bonds and commercial papers of the companies(these are generally included as part of investments in the balance sheet).

2. CAPITAL ADEQUACY RATIO (CAR): A banks capital ratio is the ratio of qualifying capital to risk adjusted (or weighted) assets. As per the latest RBI norms, banks in India should have a CAR of 9 %. A ratio below minimum indicates that the bank is not adequately capitalized to expand its operations. The ratio ensures that the banks do not expand their business without having adequate capital.

$$\text{CAR} = \frac{\text{Tier I capital + Tier II capital}}{\text{Risk weighted assets}}$$

Tier-I Capital : It is also known as Core Capital, it provides the most permanents and readily available support to a bank against unexpected loses. It includes the aggregate paid-up capital, statutory reserves and other disclosed free reserves including share premium and capital reserves arising out of surplus on sale of assets.

Tier-II Capital : It contains elements that are less permanent in nature or less readily available, than those comprising Tier-I. It comprises:
Undisclosed reserves and cumulative perpetual preference assets.
Revaluation reserves, which arise from revaluation of assets, are undervalued in the bank's books.
General provision and loss reserves.
Subordinated debt of 5-7 years tenure.

3. NPA RATIO: These are the assets that are doubtful to return the principal and/or interest in the near future. This results in huge losses to a bank. Thus a bank with a low profit but at the same time low NPA is preferable to the one having higher profits and higher NPA. The net non – performing assets to loan (advances) ratio is used as a measure of the overall quality of the bank loan book. Net NPA's are calculated by reducing cumulative balance of provisions outstanding at a period in from gross NPAs. Higher ratio reflects rising bad quality on loans.

$$\text{NPA ratio} = \frac{\text{Net non-performing assets}}{\text{Loans given}}$$

4. ROA: Returns on assets ratio is the net income profit generated by the bank on its total assets (including fixed assets).The higher the proportion of average earnings assets, the better would be the resulting return on total assets. Similarly, ROE (return on equity) indicates return earned by the bank on its total net worth.

$$\text{ROA} = \frac{\text{Net profits}}{\text{Avg. total assets}}$$

Table-II

Comparative Financial Performance (in %)

FY09	CD Ratio	CAR	Net NPA ratio	ROA
SBI	73.1	14.3	1.76	1.04
PNB	73.8	14.0	O.17	1.39
BOI	74.8	13.0	0.44	1.49
IDBI	92.0	11.6	0.92	0.62
AXIS	69.5	13.69	0.40	1.44
HDFC	69.2	15.69	0.63	1.28
ICICI	100.0	15.53	2.09	0.98

Sources: RBI bulletin

Table II shows that, ICICI bank is having the highest CD ratio that shows their promptness to lend fund raised through deposits while HDFC bank have enough capital among all in proportion to the risk-weighted assets of the bank, although all banks are capable enough to maintain the CAR above stipulated limit. PNB bank stands first on account of Net NPA ratio which is the result of having high quality of assets. BOI is the best among all in case of getting return out of the assets invested.

EFFICIENCY RATIOS

1. Interest Income per Employee: It is computed by dividing total Interest Income earned by the banks, in a particular year, by the total number of employees.
2. Profits per Employee: It is computed by the dividing the profit after tax earned by the bank by the total number of employees. A higher ratio indicates higher efficiency of management.
3. Business per Employee: It is computed by dividing total business by the total number of employees. Business includes the sum of total advances and deposits in a particular year.

These ratios indicate the productivity level of the bank's employees. Since public sector banks are operating with large employee base, the productivity ratio for these banks lags behind when compared with new generation private sector banks. Banks can improve these ratios by increasing the technology infrastructure, frequent offering of innovative products and also employee rationalization.

Table : III
Productivity Comparisons

FY09	Interest Income (in Rs cr.)	Profit (amount in Rs lakh)	Business
	Per Employee		
SBI	0.30	4.74	556.00
PNB	0.35	5.64	654.92
BOI	0.40	7.49	833.00
IDBI	1.14	8.42	2030.33
AXIS	0.31	10.02	1060.00
HDFC	0.30	4.18	446.00
ICICI	0.89	11.00	1154.00

Sources: RBI bulletin

Table III shows that, IDBI bank is having high Interest Income as well as Business per employee among all. The reason behind this is the small number of employee than other banks and on the other front, it reflects that their men-power are efficient. ICICI bank ranks first in profit per employee criteria, which shows the efficiency of their management and aggressive attitude towards earning profit from the point of view of their employees.

OVERALL PERFORMANCE ANALYSIS OF BANKS BY RANKING METHOD

Table: IV
Composite Index

Ratios / Banks	NIM	OPM	Cost/ Income	O.I/T.I	CD ratio	CAR	Net NPA ratio	ROA	Int.Inc. /Emp.	Profit /Emloy.	Busi. /Employ.	Total	Rank
SBI	2	1	4	4	5	3	6	5	6	6	6	48	V
PNB	3	4	2	6	4	4	1	3	4	5	5	45	IV
BOI	5	3	7	5	3	6	3	1	3	4	4	44	III
IDBI	7	7	5	7	2	7	5	7	1	3	1	52	VI
AXIS	4	5	1	1	6	5	2	2	5	2	3	36	I
HDFC	1	2	6	3	7	1	4	4	6	7	7	48	V
ICICI	6	6	3	2	1	2	7	6	2	1	2	38	II

As indicated in Table IV, ranks are assigned to every bank on the basis of their performance in each aspect separately and then the total obtained is given individually. The bank having the least total is considered the best among all. The result of overall ranks of the selected banks indicates that AXIS bank is the topmost bank, followed by ICICI, BOI and so on.

CONCLUSION

From the analysis, it can be concluded that the banking stocks have witnessed a sharp run-up over the last twenty four month period. The fundamentals of the sector have been negatively impacted on account of a slowdown in the credit growth resulting due to financial uncertainty spread all over the world. Private sector banks have, however, managed to perform better on account of their aggressive retail lending which fuelled their total income. Nevertheless, competition among banks is tough and the consumer benefits from it. Now the customer enjoys better service quality, innovative products, and better bargains. The increasing size of banking itself indicates that there is a lot of untapped potential in the market for banking. Given the base rate environment and economic recovery, banks have been able to increase credit off-take. Growth has been tremendous, particularly in the retail segment, including housing loans, vehicle loans, and credit cards. The loss due to fluctuating interest rates is a thing of the past, interest rate are all set to comparatively stabilize in the future. This could mean a loss in the treasury income for banks. But expert's contended that the loss in treasury income would be more than offset by the interest income on advances, assuming that credit off-take will be as good as in the earlier years. The coming fiscal will prove to be a transition phase for Indian banks as they will have to align their strategic focus on increasing their interest rate.

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