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PERFORMANCE OF INDIAN SCHEDULED COMMERCIAL BANKS IN PRE AND POST GLOBAL CRISIS

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ABSTRACT

A nation's infrastructure development plays a significant role in its economic growth. A fast growing economy results an even faster development of infrastructure. Infrastructure is defined as the physical framework of facilities to provide goods and services to the public. The growth of infrastructure helps to increases the per capita GDP of the nation. As a huge infrastructure banking sector plays an important role in the development of an economy. The development of banking sector and its stability is essential for the overall development of the economy. The stability of banking sector is determined on the basis of its performance and quality of assets. In this study, the performance of Indian Scheduled Commercial Banks before and after global financial crisis (2007-09) is highlighted. Various indicators that reflect efficiency of banks were affected during the financial crisis. The various aspects of performance of Indian Scheduled Commercial Bank – group wise are examined here. The Indian banking sector underwent structural changes during post liberalization era with the implementation of prudential norms for income recognition, provisioning and asset classification. The study is conducted using data available for the period 1999-00 to 2010-11. The results of the study indicate the vulnerability of scheduled commercial banks to the financial crisis. The impact of financial crisis on different economies varies and depends on the stability of the banking sector.

KEYWORDS
Banking, Commercial Bank, Financial Crisis, GDP (Gross Domestic Product), Infrastructure.

INTRODUCTION

Global Economic Crisis affects the economies across the globe. Generally, crises have been generated by various factors like credit booms, miscalculations of risk, rapid outflows of capital from a country, unsustainable macroeconomic policies, off-balance sheet operations by banks, overheating of markets, and inexperience with new financial instruments, and deregulation without sufficient market monitoring and oversight. Financial meltdowns have occurred in various countries among the world. It has also a greater impact on the Indian economy. Each financial crisis is unique, yet each bears some resemblance to others. A well functioning financial system in a country regulates funds to the most productive uses and allocates risks to parties who are able to bear them. This leads to rapid economic growth and opportunity. This is only reason why a crisis creates so many difficulties in the smooth functioning of a nation. Generally, countries which are suffering from financial crisis experience vital interruptions in their infrastructure which hampers their growth rates.

Infrastructure is basic physical and organizational structures of a nation. It helps in the operation of a society or enterprise, or the services and facilities, necessary for an economy to function. It can be generally defined as the set of interconnected structural elements which provide framework to support the entire structure of development. Especially it refers to the technical structures that support a society, such as electrical grids, telecommunications, roads, water supply, sewers, and so forth, and can be defined as the physical components of interrelated systems to enable, sustain, or enhance societal living conditions. Infrastructure facilitates the production of goods and services, and also the distribution of finished products to markets, as well as basic social services such as schools and hospitals. Economic infrastructure relates to the financial system, including the banking system, financial institutions, the payment system, exchanges, the money supply, financial regulations, as well as accounting standards and regulations. The provision of quality and efficient infrastructure services is essential to realize the full potential of the growth impulses surging through the economy. In this paper banking sector, an important infrastructure, is taken into consideration.

As it is known that the crisis affects the infrastructure of a nation, this paper highlights the performance of banking sector affected due to global financial crisis. It examines about the performance of banking sector in the global crisis scenario. For the purpose, the scheduled commercial banks in India were grouped into SBI and Associates, Nationalized Banks, Foreign Banks and Other Scheduled Commercial Banks. Data is collected and analyzed for the period 1999-00 to 2010-11.

LITERATURE REVIEW

Banking sector plays a pivotal role in the development of an economy. The stability of banking sectors is very much necessary for the development of an economy. The recent global financial crisis has triggered fall of many economies, contributed by financial losses and large non performance assets in banking sector. There are various literature which highlights about the financial crisis and its impact on the infrastructure.

The Asian financial crisis that began in July 1997 impacted the major Asian economies, but proved little impact on countries which had a strong banking sector. A notable feature in the banking sector regulations after Asian financial crisis was the thrust given to balancing financial liberalization with adequate regulatory and supervisory framework (Shirai, S 2001). The financial crises elevate the riskiness and highlight the risk absorption capacity of capital provides valid insight into the quality of assets the bank carries. The stability of financial institution is determined mainly based on its quality of assets and performance indicators. Quality of assets determines the survival and existence of business. Performance is judged on the basis of profitability. The financial institutions were considered stable during crisis period if the profitability and quality of assets is not affected (Wim Naudé, 2011). The stability of banking sector is vital for economic growth.

In a report of Financial Stability, 2010, the Reserve Bank of India (RBI) focuses about the importance of banking sector in Indian economy. It is found that banks have traditionally been the most important financial intermediaries in India, accounting for approximately70% of the total assets in 2009. The commercial banks by comprising more than three-fifths of the financial system assets, dominate the sector. Banks in India has played a central role in supporting the growth process, by mobilizing savings. So, banking sector directly put impact on the nation's economy. The various committees' including Dr.Narasimham Committee and Verma Committee emphasized the need to maintain quality of assets as a prerequisite for a vibrant and strong banking sector. The increased presence of Non Performing Assets (NPA) posed a strategic threat to the existence of banking sector. For banking sector, this can be studied only by addressing the trends of movement of certain financial indicators that affect the asset quality and performance of banks. (Wim Naudé, 2011).

OBJECTIVE OF THE STUDY

The present paper focuses on the global financial crisis as well as its impact on the banking sector. By taking both these themes this study has the following objectives:

- To examine the performance of scheduled banks before global financial crisis.

- To analysis the performance of scheduled banks global after financial crisis.

EVOLUTION OF THE CRISIS

Although it is a myth that the crisis was completely unforeseen, it did come as a surprise to many because it happened after almost a decade of very good global growth (Naudé, 2009; 2010). During 2007 it was realized that growing mortgage loan defaults in US and the failure of Northern Rock in the UK were harbingers of a crisis. In the USA a combination of cheap money, aggressive lending practices, rising house prices, and weak prudential regulation facilitates the extension of mortgage finance to the tune of more than a trillion US dollars, largely to households who had little prospects of ever repaying. Banks 'covered up' the risk by securitizing the expected income streams from these bad loans, packaging them in with other securities such as Collateralized Debt Obligations (CDOs). Problems started when mortgage defaults started rising, foreclosures on houses increased, and short-term interest rates started rising. In March 2007, the US's New Century Financial Corporation stopped issuing subprime mortgages. In July 2007 the Federal Deposit Insurance Corporation (FDIC) took over the Indy Mac Bank. On 7 September 2008 the US Treasury had to rescue (nationalize) the largest mortgage lenders, Fannie Mae and Freddie Mac. By mid 2008 around 40 per cent of all sub-prime mortgages issued in 2006 in the USA were non-performing. The deflation of the house price bubble shook confidence in the US dollar and became an important factor in rising energy and food prices. The price of oil jumped from US$ 90 per barrel in January 2008 to US$147 per barrel in July 2008. Oil and maize prices peaked in July 2008 at record levels, putting enormous economic strain on energy and food importing developing countries. Around 40 poor countries were thrown into an acute food crisis. On 15 September 2008 investment banking firm Lehman Brothers declared bankruptcy at that time the largest in the history of the USA (Naudé, 2009;2010). This caused widespread panic in financial markets. Declining stock markets tumbled further. Uncertainties about bank solvencies lead to a global credit contraction. Losses in wealth, consumer confidence and dwindling trade finance were followed by the news that the US, and most other advanced economies, were in recession. All regions of the world were affected – some regions such as Europe and the transition economies more directly by contagion in financial markets – and other regions, such as Asia, Africa and Latin America, more by the decline in global demand. The initial expectation of the impact of the crisis on global development also did not materialize. Although all countries were affected, what was surprising was the resilience shown by developing and emerging economies, who recovered sooner than many anticipated. Many avoided their own recessions. Even by mid 2009 the USA, the epicenter of the crisis, was not technically in a recession anymore. (Wim Naudé, 2011)

IMPACT ON INDIA

Financial crisis has an indirect impact on the Indian economy. This impact is felt both through trade and capital flows. The fall in international commodity prices and more particularly crude oil is reducing sharply the import bill from previous estimates. The recession arises in abroad have an adverse effect on our exports of goods and services. There is a sharp deceleration in the rate of growth of exports in 2008-09. The decreasing growth rate in exports will affect heavily to some sectors like textiles, automobile components and gem and jewelers as the exports contribute a huge portion to the total production of our economy. In contrast, to the strong inflow of over $100 billion in 2007-08, 2008-09 saw a net increase of only $10 billion in capital flows. The flow of portfolio capital turned negative. Indian firms have also experienced difficulties in raising money abroad. All this have a negative impact on the exchange rate.

IMPACT OF GLOBAL FINANCIAL CRISIS ON PROFITABILITY OF COMMERCIAL BANKS

In this article it is highlighted whether the financial crisis has impact on the profitability and quality of assets of scheduled commercial banks or not. The bank-group wise statistics on major performance indicators were divided into two periods, from 1999-00 to 2006-07 and 2007-09 to 2010-11. The first period i.e., 1999-07 indicates financial performance before global financial crisis. The second period i.e., 2007-00 indicates period after the financial crisis. The average annual growth (AAG) rate is calculated on various performance indicators for the two periods. Table 1 highlight about the performance of banking sector before and after global crisis.

TABLE 1: GROWTH RATE BEFORE AND AFTER THE GLOBAL FINANCIAL CRISIS (in %)

Major Performance Indicators	SBI & Associates		Nationalised Banks		Foreign Banks		Other Scheduled Bank	
	2000-07	2008-10	2000-07	2008-10	2000-07	2008-10	2000-07	2008-10
Total Interest Income	10.76	20.49	12.49	23.31	12.31	18.44	30.79	5.77
Total other income	9.55	34.00	14.47	33.31	19.08	27.16	42.50	6.01
Total operating expenses	10.13	16.65	10.24	14.45	14.70	10.51	33.55	3.86
Provision & Contingencies	13.43	57.60	18.27	51.04	39.98	46.33	50.53	34.86
Total Expenses	7.90	22.67	9.71	24.80	8.64	14.45	29.20	2.78
Profit during the year	24.09	24.55	35.40	25.55	34.51	8.99	42.34	11.59

Source: Statistical Tables relating to banks in India. 2000-11

It may be observed from the above table that the growth rate indicates a better performance before the financial crisis. The provision and contingencies that includes provisions towards NPA has grown considerably for all bank groups during 2007-08 to 2010-11. For SBI and associates, the average annual growth rate for the period 199-00 to 2006-07 was 13.43% which increases to 57.60% during 2007-08 to 2010-11. This highlights the vulnerability of the banking sector and the problems in asset quality. It is same for other banks. Only for other scheduled banks, the average annual growth rate showed a declining trend, where it came down from 50.53% to 34.86% during the mentioned period. The foreign banks were very much affected in the financial crisis where the profitability declined from 34.51% during period before financial crisis to 8.99% during periods after financial crisis. It also shows a sharp decline in profitability. The average annual growth rate in profitability during 2007-08 to 2010- 11 was 8.99%, which was far below than its annual average growth rate during 1999-00 to 2006- 07, i.e., 34.51%. SBI and associates reported better performance among the other bank groups, with an increased interest income during the period 2007-08 to 2010-11. So as a general conclusion it is found that the global financial crisis affected the profitability of banks.

RATE OF GROWTH OF NET NPA

Generally bank's stability and profitability is affected by the NPA. NPA affects stability of the banks since the assets do not generate any income for the bank, and affects profitability since banks have to maintain more provisions towards NPA. The movement of NPA hence is an important indicator that determines whether the Indian banking sector was affected by global financial crisis. (Table 2)

TABLE 2: RATE OF GROWTH OF NET NPA

Year	SBI and associates	Nationalized Banks	Public Sector Banks	Foreign Banks	All Scheduled Commercial Banks
2001	8.03	5.70	13.73	0.16	7.32
2002	-5.15	1.79	-3.36	17.71	1.62
2003	-13.08	-6.88	-19.95	2.01	-0.25
2004	-23.46	-27.63	-51.09	-6.60	-27.26
2005	6.64	-14.73	-8.09	-23.71	-6.73
2006	-4.57	-19.43	24.00	24.00	-15.59
2007	4.73	5.57	10.30	13.56	10.63
2008	32.06	4.04	36.09	36.45	20.51
2009	29.43	10.28	39.70	140.39	29.61
2010	18.05	63.46	81.51	-0.70	23.96

Source: Trend and Progress of Banking in India- various issues.

From the table 2 it is analyzed that the net NPA showed an increased trend after financial crisis i.e., 2007. The NPA grew by 20.51% in 2008, 29.61% in 2009 and 23.96% in 2010 for all scheduled commercial banks in India. The foreign banks show a considerable growth rate. Similarly for SBI & associates it is 32.06% in 2008, 29.43% in 2009 and 18.05% in 2010. Public sector banks have maximum growth rate in 2010 as compared to other banks.
The impact of global financial crisis on profitability and quality of assets is highlighted in the table 3.

TABLE 3: IMPACT OF GLOBAL FINANCIAL CRISIS ON PROFITABILITY AND QUALITY OF ASSETS *(NPA as a percentage of total advances)*

Year	Public Sector Banks	Private Sector Banks	Foreign Banks	All Scheduled Commercial Banks
2000	14.02	8.47	6.99	12.79
2001	12.39	8.54	6.85	11.45
2002	11.09	5.65	5.49	10.42
2003	9.36	9.20	5.38	9.06
2004	7.79	5.83	4.89	7.19
2005	5.73	3.84	3.06	5.16
2006	3.86	2.56	2.11	3.48
2007	2.81	2.36	1.92	2.66
2008	2.34	2.75	1.91	2.39
2009	2.09	3.25	4.30	2.44
2010	2.27	2.97	4.26	2.50

Source: Trend and Progress of Banking in India- various issues.

It may be observed from the above table that there is a gradual reduction in NPA as a percentage of total advances till 2007. The trend is reversed after 2007 especially for private sector and foreign banks which reported a higher NPA as a percentage of total advances. The presence is not seen in public sector banks, due to the higher level of advances. The financial crisis is reportedly affected the foreign banks severely compared to other bank groups. The increased rate is due to the higher levels of NPA generated from 2007 onwards. The result is an increase in total NPA ratio to 2.5% for all scheduled commercial banks for 2010.

CONCLUSION

The results of the study highlights that the banking sector in India is still vulnerable to crises. Even though there were remarkable changes in banking sector intended to improve the efficiency of the sector, the banks are still vulnerable to the financial crisis. The growths of NPA, growth rate before and after financial crisis are the indicators of its vulnerability. Reforms should be further strengthened to improve the financial stability of banking sector. The vulnerability of banking sector is not desirable for the growth of economy, hence require precautionary measures. The lessons from banking sector which are not affected by the financial crisis should be incorporated into the banking sector. More researches are desirable which investigates the methods to reduce the vulnerability in the banking sector. Collectively, this paper provides some indicators which can show the effect of financial crisis in banking sector. NPA is an important factor that still prevails as an alarming signal for banking growth and survival. There are other various other indicators like credit-deposit ratio and other by which the performance of the banking sector can be analyzed in the era of global crisis.

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