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PROFITABILITY ANALYSIS OF ICICI BANK

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ABSTRACT

The key objective of any bank is to earn maximum profit. The banks engaged in the money market are aiming to earn profit and profitability position by providing effective means of services to customers such as accepting deposits and share capital and extending loans and advances. These sorts of services may pave the way to earn income and at the same time incur some expenditure. The income and expenditure are the major components that determine the very profitability and viability of the banks. It is plausible that the operational items and balance sheet items influence the profitability. An exercise in these lines would help to identify the factors influencing profitability. These two major components definitely affect the balance sheet of banks and their profitability. It is in this context, an attempt is made to identify the factors influencing the profitability based on operational and balance sheet items in ICICI bank for the period from 2004-05 to 2008-09. The results of the exercise suggest that the bank could increase its profit and profitability by expanding business operations with an increase in personnel expenses (increase in manpower) and increase current assets – loans and advances.

KEYWORDS

Profitability, Factors, Operational Items and Balance Sheet Items.

INTRODUCTION

The key objective of any bank is to earn maximum profit. The banks engaged in the money market aim to earn profit and wish to keep profitability position by providing effective means of services to customers such as accepting the money in the form of deposits and share capital and dispense the money in the form of loans and advances. These sorts of services may help to earn income while involving expenditure. Thus, the income and expenditure are the major components that determine the very profitability and viability of the banks. If the income exceeds the expenditure, it leads to profit. Conversely, if the expenditure exceeds the income, it leads to loss. These two major components would certainly affect a bank's profitability. There are several items of expenditure and income viz., the operational items and balance sheet items. In the context of assessing banks profitability, one has to take into consideration the operational items and balance sheet items. This would give a fair understanding of factors that influence profitability of a bank. Such an understanding would help take decision to increase the profit and profitability of a bank. There are studies on determinants of profitability of banks with regard to public sector banks in India. The studies with reference to private banks which focus on profitability with more quantitative analysis are less. These and other related facts call for an in-depth analysis. It is in this context, the present study is attempted to ascertain the factors influencing the profitability based on operational and balance sheet items in a private sector bank, ICICI bank.

OBJECTIVES OF THE STUDY

The objectives of the study are

- To identify the operational items influencing the profitability of the bank,
- To identify the balance sheet items influencing the profitability of the bank, and
- To offer suggestions if any required for increasing profitability of the bank.

METHODOLOGY OF THE STUDY

The role played and the performance in terms of profitability by the sample bank in recent years in banking sector necessitates taking this study. The present study makes use of secondary data. The data required for the study were collected from the published annual, half yearly and quarterly reports of the sample bank from its official websites. Analysis and interpretation of data have been carried using the statistical techniques such as percentages, CAGR, correlation and multiple regression analysis using SPSS package. The study covers a period of five financial years, i.e., from 2004-05 to 2008-09.

PROFILE OF ICICI BANK

ICICI bank is India's second- largest bank with total assets of about Rs. 125, 229 crore and a network of over 450 branches and offices and about 1790 ATMs. ICICI bank offers a wide range of banking products and financial services to corporate and retail customers through a variety of delivery channels and through its specialized subsidiaries and affiliates in the areas of investment banking, life and non-life insurance, venture capital, and asset management.

The bank provides varieties of bankable products to the customers in a wide range. Those products include, loans such as Home Loan, Personal Loan, Car Loan, Two Wheeler Loan, Commercial Vehicle Loan, Construction Equipment Loans, Office Equipment Loans, Medical Equipment Loans, deposits such as Savings Bank Account and Current Account, Salary account , Recurring deposits, Fixed deposits and Other Products such as Loans against Securities, Issues of Initial Public

Offerings (IPOs), Sale of Pure Gold, and NRI Services which include money transfer, customized bank accounts, investments, loans, insurances, and property solutions. Added to the above products, there are extensive branches and ATM networks and facilities like mobile, phone, internet and doorstep care banking, and experience banking.

The Indian banks, insurance companies, individuals and corporation of the United States, the British eastern exchange bank and other companies and public of India have subscribed to the issued capital of ICICI.

The share holding pattern indicates that, the proportion of non promoters holding institutional investor's is 61.15 per cent. In this, foreign Institutional Investors share is predominant. Other investors such as private corporate bodies, NRIs, OCBs, directors/ employees, and government investors account for 32.73 per cent of total shareholding.

The details of sales operating profit, interest and gross profit, and earning per share are given in table 1.

TABLE 1: SALES AND PROFIT DETAILS OF ICIC BANK

Year/Particulars	Sales	Operating Profit	Interest	Gross Profit	Earning per Share (Rs.)
2004-2005	9,409.90	5,681.95	6,570.89	2,956.00	27.22
2005-2006	14,306.13	7,710.91	9,597.45	4,690.67	28.55
2006-2007	22,994.29	14,077.37	16,358.50	5,874.40	34.58
2007-2008	30,788.34	19,729.57	23,484.24	7,960.69	37.37
2008-2009	31,092.55	20,23918	22,725.93	8,925.23	33.76
CAGR	13.95	14.39	14.22	13.38	3.87

***Source**:* Annual Reports of ICICI Bank www.icici.in

Table 1 shows that the sales and profit details of the ICICI Bank for the period from 2004-05 to 2008-09. Compound annual growth rates have been computed for sales, operating profit, interest, gross profit and earning per share. The total sales volume has increased from Rs. 9409.90 crores in 2004-2005 to Rs. 31,092.55 crores in 2008-09 with a CAGR of 13.95. Operating profit and interest have also increased with the CAGR of 14.39 and 14.22 respectively. Gross profit has increased from Rs. 2956 crores in 2004-05 to Rs. 8925.23 crores in 2008-09 with the CAGR of 13.38. Earning per share has grown with CAGR of 3.87 during 2004-05 - 2008-09.

RESULTS AND DISCUSSION

A) OPERATIONAL ITEMS INFLUENCING THE PROFITABILITY OF THE BANK

The results of operational items influencing the profitability of the bank are presented in this section. Before discussing the results, the variables considered in the study and their descriptions are given below.

DEPENDENT VARIABLE

Y= Reported net profit (Rupees in crores)

INDEPENDENT VARIABLES

x_1 = Operating income (Rupees in crores)
x_2 = Personnel expenses (Rupees in crores)
x_3 = Selling expenses (Rupees in crores)
x_4 = Administrative expenses (Rupees in crores)
x_5 = Adjusted profit before deduction of income tax (PBDIT) (Rupees in crores)
x_6 = Depreciation and other write offs (Rupees in crores)
x_7 = Adjusted profit before tax (PBT) (Rupees in crores)
x_8 = Tax charged (Rupees in crores)
x_9 = Adjusted profit after tax (PAT) (Rupees in crores)

RESULTS OF CORRELATION ANALYSIS

In order to identify the degree of relationship between the selected independent variables with the dependent variable for the period 2004-05 to 2008-09, the lower triangular correlation co-efficient matrix has been computed and presented in the table 2. It can be seen from the table that except two variables namely the selling expenses (x_3) and depreciation and other write offs (x_6), the other variables have significant correlation with the reported net profit (profitability) of the bank.

Variable x_1 is related to the operating income of the bank. As it contains the income earned by the bank from its lending and investment operations. It is expected to have direct relation with the profitability, i.e., the higher the incidence of x_1, the higher will be the profitability. The correlation co-efficient is positive (0.99) and significant at 1 per cent level. Hence, it can be stated that there is positive association between Y and x_1. Higher the operating income, the higher will be the profitability and vice versa. Therefore, it is concluded that the operating income is a major determinant of profitability.

The other variables x_2 and x_4 are related to the personnel and administrative expenses of the bank respectively. These are the variables related to the expenses of the bank for undertaking the various personnel and administrative activities. These two variables are to have an inverse relation with the profitability, i.e., the higher the incidence of x_2 and x_4, the lower will be the profitability. But, the correlation co-efficient is positive and significant at 1 per cent and 5 per cent levels respectively. It suggests that increase in personnel and administrative expenses lead to an increase in profitability and vice versa. It could be inferred that the variables the personnel expenses and administrative expenses do have direct relationship with the profitability of the bank.

The other variables namely adjusted PBDIT ($x_{5)}$, adjusted PBT (x_7) and adjusted PAT (x_9) are related to adjusted profit level even before and after calculating depreciation, interest and tax expenses of the bank respectively. These three variables bear positive sign and significant at 1 per cent level. It indicates that there is positive association of these variables with profitability.

Another variable x_8 is related to tax charges of the bank. It is an expense made by the bank so as to fulfill statutory norms related to income to the bank. It has to have an inverse relation with the profitability and vice versa, i.e., the more the tax charges lower will be the profitability. But, the correlation co-efficient of the variable x_8 is positive and significant at 5 per cent level. It leads one to conclude that the increased tax charges result in increased profitability.

TABLE 2: LOWER TRIANGULAR CORRELATION COEFFICIENT MATRIX OF THE BANK BETWEEN 2004-05 AND 2008-09

Variables	Y	x_1	x_2	x_3	x_4	x_5	x_6	x_7	x_8	x_9
Y	1.00									
x_1	0.99(**)	1.00								
x_2	0.99(**)	0.98(**)	1.00							
x_3	0.54	0.50	0.55	1.00						
x_4	0.95(*)	0.98(**)	0.98(**)	0.39	1.00					
x_5	0.97(**)	0.97(**)	0.95(*)	0.33	095(*)	1.00				
x_6	0.14	0.18	0.13	-0.73	0.30	0.36	1.00			
x_7	0.98(**)	0.98(**)	0.96(**)	0.39	0.95(*)	0.99(**)	0.32	1.00		
x_8	0.93(*)	0.96(*)	0.93(*)	0.27	0.97(**)	0.98(**)	0.37	0.97(**)	1.00	
x_9	0.99(**)	0.99(**)	0.98(**)	0.51	0.95(*)	0.98(**)	0.16	0.99(**)	0.94(*)	1.00

*** Correlation is significant at the 0.05 level**
****Correlation is significant at the 0.01 level**

RESULTS OF MULTIPLE REGRESSION ANALYSIS

In the earlier section, attempt was made to identify the relationship of each independent variable with the dependent variable without having control over the influence of other variables. Therefore, in order to identify the factors influencing the profitability, the stepwise multiple regression analysis has been used. In the first step, since the variable x_9 (adjusted PAT) has the highest positive correlation with profitability, the variable x_9 is excluded from the regression analysis. Subsequently, other variables were added one by one as predictors to show maximum fit. The final results reveal that the variable x_2 (personnel expenses) is the variable which explains the profitability of the bank.

TABLE 3: REGRESSION ANALYSIS DEPENDENT VARIABLE Y = REPORTED NET PROFIT

Model	Beta In	T	Sig.	Partial Correlation	Collinearity Statistics
					Tolerance
x_1	.488(a)	.378	.742	.258	.006
x_3	-.004(a)	-.033	.977	-.023	.693
x_4	-.369(a)	-.832	.493	-.507	.044
x_5	.322(a)	1.175	.361	.639	.091
x_6	.011(a)	.101	.929	.071	.982
x_7	.387(a)	1.388	.299	.701	.076
x_8	.052(a)	.169	.881	.119	.121

a. Predictors in the Model: (Constant), x_2

TABLE 4: REGRESSION CO-EFFICIENT OF SELECTED VARIABLE DEPENDENT VARIABLE Y = PROFIT TO VOLUME OF BUSINESS

Model	Un-standardized Coefficients		Standardized Co-efficients	t	Sig.	R^2	F	Sig.
	Beta	Std. Error						
1 (Constant)	865.900	211.039		4.103	.026			
x_2	1.501	.133	.988	11.267	.001	.977	126.94	.001[a]

a. Predictors in the Model: (Constant), x_2

The co-efficient of multiple determination (R^2) as per step one, being 0.977 indicates that 97.70 per cent of the variations in dependent variable are explained by the independent variable in the model.
The above analysis indicates that the variable viz., the personnel expenses has a significant bearing on the profitability of the bank.

B) ANALYSIS OF THE BALANCE SHEET ITEMS INFLUENCING THE PROFITABILITY OF THE BANK

This section presents the analysis and results pertaining to balance sheet items influencing the profitability of the bank. The variables considered and their descriptions are as follows.

DEPENDENT VARIABLE

Y= Reported net profit (Rupees in crores)

INDEPENDENT VARIABLES

x_1 = Total Owner's Fund (Rupees in crores)
x_2 = Borrowed Funds (Rupees in crores)
x_3 = Net Fixed Assets (Rupees in crores)
x_4 = Capital work in progress (Rupees in crores)
x_5 = Investments (Rupees in crores)
x_6 = Current Assets, Loans & Advances (Rupees in crores)
x_7 = Current liabilities (Rupees in crores)
x_8 = Total Net Current Assets (Rupees in crores)

RESULTS OF CORRELATION ANALYSIS

In order to assess the degree of relationship between the selected independent variables with the dependent variable for the period 2004-05 to 2008-09, the lower triangular correlation co-efficient matrix has been computed and presented in the table 5.
It can be seen from the table that the variables namely total owned funds (x_1), borrowed funds (x_2), investments (x_5), and current assets and loans & advances (x_6) have significant correlation with the profitability of the bank.
Variable x_1 is related to the total owners' fund of the bank. This fund naturally enhances the total funds as well as helps the expansion of the bank. It has a direct relation with the profitability, i.e., the higher the incidence of x_1, the higher will be the profitability. The correlation co-efficient is positive (0.95) and significant at 5 per cent level. Hence, it can be concluded that more the owners' fund, the higher will be the profitability and vice versa. The owners' fund acts as a major determinant of profitability.
The other variable x_2 is related to the borrowed funds of the bank. These funds are mobilized through external sources which help keeping business expansion, but require payment of interest on borrowings. So, it may have an inverse relation with the profitability, i.e., the higher the incidence of x_2, the lower will be the profitability. But, the correlation co-efficient is positive and significant at 5 per cent level. Hence, it can be concluded that increased borrowed funds result in more profitability and vice versa. It could be explained in such a way that with the borrowed funds business expands and more profit is generated even after payment of interest.

Another variable x_6 is related to current assets and loans and advances of the bank. This variable brings returns as interest in short period, which enhances the profitability. Therefore, any increase in current assets and loans and advances will result in increase in the profitability and vice versa. The results show that this variable has positive sign and significant at 1 per cent level. Hence, it can be stated that the positive association of x_6 boosts the profitability level. It could also be stated that current assets and loans and advances is a determinant of profitability.

Another variable x_7 is related to current liabilities and provisions of the bank. This variable signifies the bank's position to repay the liabilities, sometimes if necessary, along with interest and to make the provisions in the short run. So, it should have an inverse relation with the profitability, i.e., more the current liabilities and provisions, the less will be the profitability and vice-versa. But, the correlation co-efficient of the variable x_7 is positive and significant at 5 per cent level. Hence, it can be concluded that increase in current liabilities and provisions result in increased profitability and vice versa.

TABLE 5: LOWER TRIANGULAR CORRELATION COEFFICIENT MATRIX OF THE BANK FROM 2004-05 TO 2008-09

Variables	Y	X_1	X_2	X_3	X_4	X_5	X_6	X_7	X_8
Y	1.00								
X_1	0.95(*)	1.00							
X_2	0.91(*)	0.76	1.00						
X_3	- 0.11	- 0.27	- 0.20	1.00					
X_4	- 0.64	- 0.78	-0.26	-0.02	1.00				
X_5	0.99(**)	0.91(*)	0.96(**)	-0.19	-0.52	1.00			
X_6	0.96(**)	0.97(**)	0.87	-0.37	-0.65	0.96(*)	1.00		
X_7	0.71	0.64	0.86	-0.32	-0.06	0.80	0.68	1.00	
X_8	- 0.18	0.12	- 0.47	-0.14	-0.48	-0.27	-0.10	-0.22	1.00

*** Correlation is significant at the 0.05 level**

**** Correlation is significant at the 0.01 level**

RESULTS OF MULTIPLE REGRESSION ANALYSIS

In order to identify the combined impact of relevant variables affecting bank profitability, the stepwise multiple regression analysis has been used. In the first step, the variable x_5 (investments) has the highest positive correlation with profitability so the variable $_{X5}$ is excluded from the regression model. Thereafter, subsequent variables were added one by one as predictors to show maximum fit. The final results revealed that the variable $_{X6}$ (current assets and loans & advances) is the variable which explain the variations in profitability of the bank.

TABLE 6: REGRESSION ANALYSIS DEPENDENT VARIABLE Y = REPORTED NET PROFIT

Model	Beta In	T	Sig.	Partial Correlation	Co linearity Statistics
					Tolerance
x_1	.315[a]	.434	.707	.293	.069
X_2	.309[a]	.920	.455	.545	.247
X_3	.282[a]	3.569	.070	.930	.864
X_4	-.033[a]	-.127	.911	-.089	.580
x_7	.103[a]	.391	.733	.267	.536
X_8	-.082[a]	-.427	.711	-.289	.990

a. Predictors in the Model: (Constant), x_6

TABLE 7: REGRESSION CO-EFFICIENT OF SELECTED VARIABLES DEPENDENT VARIABLE Y = ADJUSTED NET PROFIT

Model	Un-standardized Coefficients		Standardized Coefficients	T	Sig.	R^2	F	Sig.
	Beta	Std. Error						
1(Constant)	1147.572	356.898		3.215	.049			
X_6	.085	.014	.959	5.899	.010	.921	34.793	.010[a]

a. Predictors in the Model: (Constant), x_6

The co-efficient of multiple determination (R^2) as per step one, being 0.921 indicates that 92.10 per cent of the variations in profitability of the bank is explained by x_6.

The above analysis clearly indicates that the variable viz., the current assets and loans and advances influences the profitability of the bank very much.

SUMMARY OF MAJOR FINDINGS

- The total sales volume has increased from Rs. 9409.90 crores in 2004-2005 to Rs. 31,092.55 crores with a CAGR of 13.95. Operating profit and interest have also increased with the CAGR of 14.39 and 14.22 respectively. Gross profit has increased from Rs. 2956 crores in 2004-05 to Rs. 8925.23 crores in 2008-09 with the CAGR of 13.38. Earning per share has grown with CAGR of 3.87 during 2004-05 to 2008-09.

- The results of correlation related to the operational items influencing the profitability of the bank reveal that except two variables namely the selling expenses (x_3) and depreciation and other write offs (x_6), the other variables have significant correlation with the profitability of the bank. However, the results of regression related to the operational items influencing the profitability of the bank reveal that the variable x_2 (personnel expenses) is the major determinant of profitability of the bank.
- The results of correlation related to the balance sheet items influencing the profitability of the bank reveal that the variables namely total owner's funds (x_1), borrowed funds (x_2), investments (x_5), and current assets and loans & advances (x_6) have significant correlation with the profitability of the bank. However, the results of regression analysis related to the balance sheet items influencing the profitability of the bank reveal that the variable x_6 (current assets and loans & advances) is the variable which influences the profitability of the bank significantly in the model.

CONCLUSION

The analyses on factors influencing profitability of ICICI bank reveal that two variables viz., one among operational items and the other among balance sheet items seem to clearly explain the variations in profitability (reported net profit) of the bank during the period 2004-2005 to 2008-2009. These variables are personnel expenses and current assets and loans and advances respectively. These variables have positive and significant influence on profitability. If personnel expenses increase, it influences profitability via expansion of business operations. The current loans and advances also have positive and significant bearing on profitability. Given the other factors, the influence of these two variables suggests the expansion of business operations of the bank under study. If at all the bank has to increase its net profit it can do so either by increasing personnel expenses or by expanding current assets, loans and advances or increasing both in a judicious combination. Hence, the bank needs to expand its business operations by increasing personnel expenses (expanding man power) and increasing current assets, loans and advances so as to increase its profitability.

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