PROFITABILITY OF INDIAN BANKS – A COMPARATIVE STUDY OF SBI AND HDFC

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ABSTRACT

The present article discusses the profitability and the reasons thereof with respect to the two largest public and private sector banks of India. It takes into account the various profitability ratios of two banks as the measure of profitability. The common denominator used for developing the various profitability ratios is business volume (deposits + advances). The study analyses the published five-year data from 2007-08 onwards for the two largest banks, i.e., SBI- the largest public sector bank and HDFC- the largest private sector bank. The comparative analysis of the profitability of the two banks clearly reveals that there is a large difference between the profitability of the two banks. HDFC's profitability is more than that of SBI.

Keywords: *Bank's Profitability, Burden Ratio, Business Volume, Spread Ratio.*

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INTRODUCTION:

Profitability is the most important parameter for performance appraisal of any business organization. In the changing economic environment, it is very important to get idea of profitability of various banking groups. Banks play a vital role in the operation of most of the countries in the world. The banking sector is the backbone of the Indian economy and plays an important financial intermediary role. It is generally agreed that a strong and healthy banking system is a prerequisite for sustainable economic growth. Banks are in a business to receive deposits or liabilities and to issue debt securities on the one hand and create or invest in assets on the other hand. A bank collects the savings and disburses in various productive sectors. In this process, the performance of financial institutions in efficient allocation of capital to the productive sectors of the economy is conditioned on its own financial performance. Therefore, it is quite imperative and obvious to study the profitability of the banking sector. Purpose of the present study is to evaluate the financial performance of the selected banks.

Profits are very essential for the survival of every business unit. Not only the survival but the long term growth of the business is also determined by the profits. Study of profitability of banks is a very difficult task because the main purpose of establishment of Indian banks is to serve the society. In the light of this purpose banks had not given much importance to earn profits. In the present study the researcher tried to study the meaning of profitability of Indian banks and make comparison of profitability of Indian banks.

PROFITABILITY DEFINED:

As the banking is a service industry and the profit motive is not the sole motive of the banks, yet the sustainability and efficiency can only be judged by the profitability. The policy makers laid emphasis on profitability as an important benchmark through which the performance of public sector banks is to be judged in the post reform era. Profitability in this regard can be measured by the operational efficiency of a particular bank. The improved profitability is the only key parameter for evaluating performance from the shareholders point of view. Profitability has been defined as profit earning capacity of a particular bank.

If bank's profits are reinvested, this should lead to safer banks and consequently, high profits could promote financial stability. Empirical findings show that bank profitability is an important predictor of financial crises. However, the monitoring of bank profits is made difficult by the fact that bank profit components are observed only at low frequencies, at best quarterly; detailed public information is available only for large and listed companies.

The social responsibility that was entrusted upon the Public sector Banks deviate them from the profit motive. On the other hand private and foreign banks did not make such moves. Instead, they pursued profit making as the major objective for their operations. India's public sector banks are compared unfavorably with their private sector counterparts, domestic and foreign. This comparison rests for the most part on financial measures of performance and such a comparison provides much of the rationale for privatization of PSBs. This study made a comparison between PSBs and their private sector counterparts based on measures of profitability. This study will focus on the achievement and performance of SBI, Public Sector Bank vis-a-vis HDFC, Private Sector Banks. The parameter selected for evaluation of performance of SBI and HDFC is profitability. Performance of the Indian Banking Industry has to be constantly compared with their counterparts in its own and other countries to help bankers make better decisions regarding the direction of their banking industry.

OBJECTIVES OF THE STUDY

The overall objectives of the present study are:

1) To study and analysis the behavior of the profitability of selected banks.
2) To make a comparison of profitability between SBI Public Sector Bank and HDFC Private Sector Banks.

METHODOLOGY

Being a comparative study, the design of the paper is descriptive. It explains the various ratios involved to study the profitability of two banks. The raw data is obtained from the secondary sources and the following profitability ratios are calculated accordingly. The common denominator used for developing the various profitability ratios is business volume (deposits + advances).

The ratios used for measuring Profitability are:

1) Interest earned ratio (r) = $\frac{\text{Total interest earned}}{\text{Volume of business}} * 100$

This ratio reveals the Interest earning capacity of bank. The interest earned ratio of the two banks will help us understand the earning capacity of the two banks . Higher the Interest earned ratio, higher the profitability of the bank.

$$2)\ \text{Interest paid ratio (p)} = \frac{\text{Total interest paid}}{\text{Volume of business}} * 100$$

This ratio show the interest paid by the bank. Lower the Interest paid ratio, higher the profitability of the bank.

$$3)\ \text{Non-interest income ratio (n)} = \frac{\text{Total income–interest income}}{\text{Volume of business}} * 100$$

This ratio depicts the Non-Interest income of the bank. Non-interest income can be calculated by deducting the interest income from the total income of the bank. Higher the Non-interest income ratio, higher the profitability of the bank.

$$4)\ \text{Other Operating Expenses ratio(o)} = \frac{\text{Total expenses–interest expenses}}{\text{Volume of business}} * 100$$

This ratio reveals the operating expenses of the bank other than the interest expenses. The other operating expenses can be find out by deducting the interest expenses from the total expenses. Lower the other operating expenses ratio, higher the profitability of the bank.

The following equations are derived from the above ratios:

1. Spread ratio (s) = Interest earned ratio – Interest paid ratio (r-p)
2. Burden ratio (b) = Other operating expenses ratio – Non–interest Income(o-n)

The profitability ratio is worked out as follows:

Profitability ratio = Spread ratio – Burden ratio

DATA ANALYSIS

The above profitability ratios depend on the secondary information published by RBI and the same data has been used here. The data takes into account the recently concluded 5 years starting from AD 2007-08 to 2011-12.

Table 1: Interest Earned Ratio (in %)

Year's	SBI	HDFC
2007-08	5.13	6.16
2008-09	4.96	6.76
2009-10	4.94	5.52
2010-11	4.81	5.41
2011-12	5.57	6.17

Source:- Compiled Personally from the Annual Reports.

Interest Earned Ratio can be find out by dividing the Interest earned with the volume of business of the bank. Table 1 depicts the Interest Earned Ratio of the SBI and HDFC banks. SBI's Interest Earned ratio is 5.13% in 2007-08 and 5.57% in 2011-12. Whereas HDFC's Interest Earned Ratio is 6.16% in 2007-2008 and 6.17% in 2011-12. From this we can conclude that interest earned ratio is greater in HDFC as compared to SBI during the period of the study. This affect the profitability of the HDFC in favorable manner.

Table 2: Interest Paid Ratio (in %)

Year's	SBI	HDFC
2007-08	3.35	2.98
2008-09	3.34	3.69
2009-10	3.23	2.66
2010-11	2.89	2.55
2011-12	3.31	3.39

Source:- Compiled Personally from the Annual Reports.

Interest Paid Ratio can be find out by dividing the Interest Paid with the volume of the business of the banks. This ratio indicate the expenses for a bank, hence a lower interest paid ratio is better. Table 2 reveals the Interest Paid Ratio of the SBI and HDFC banks. SBI's

Interest Paid ratio is 3.35% in 2007-08 and 3.31% in 2011-12. Whereas HDFC's Interest Paid Ratio is 2.98% in 2007-2008 and 3.39% in 2011-12. From this we can conclude that interest paid ratio is greater in HDFC as compared to SBI in the last year of the study. This adversely affects the profitability of the HDFC bank.

Table 3: Non-interest income ratio (in %)

Year's	SBI	HDFC
2007-08	0.911	1.39
2008-09	0.988	1.36
2009-10	1.04	1.36
2010-11	0.936	1.18
2011-12	0.751	1.19

Source:- Compiled Personally from the Annual Reports.

This ratio shows the income of a bank other than the interest income. A higher non interest income ratio affects the profitability of a bank in a positive manner. Table 3 Shows the Non-interest income Ratio of the SBI and HDFC banks. SBI's Non-Interest income ratio is 0.911% in 2007-08 and 0.751% in 2011-12. Whereas HDFC's Non-Interest Income Ratio is 1.39% in 2007-2008 and 1.19% in 2011-12. From this we can conclude that Non-interest income ratio is greater in HDFC as compared to SBI during the period of the study.

Table 4: Other Operating Expenses ratio (in %)

Year's	SBI	HDFC
2007-08	1.32	2.28
2008-09	1.22	2.29
2009-10	1.41	2.03
2010-11	1.36	1.94
2011-12	1.36	1.94

Source:- Compiled Personally from the Annual Reports.

Table 4 depicts the Other Operating Expenses Ratio of the SBI and HDFC banks. SBI's Other Operating Expenses ratio is 1.32% in 2007-08 and 1.36% in 2011-12. Whereas

HDFC's Other Operating Expenses Ratio is 2.28% in 2007-2008 and 1.94% in 2011-12. From this we can conclude other operating expenses ratio is greater in HDFC as compared to SBI during the period of the study, this will adversely affect the profitability of the HDFC bank.

Table 5: Spread ratio (s) = Interest earned ratio – Interest paid ratio (r-p)

Year's	SBI	HDFC
2007-08	1.78	3.18
2008-09	1.62	3.07
2009-10	1.71	2.86
2010-11	1.92	2.86
2011-12	2.26	2.78

Source:- Compiled Personally from the Annual Reports.

Spread, which is the difference between the interest earned on loans and advances and interest paid on deposits and borrowings by the banks. It is the net amount available to banks for meeting the various expenses. Table 5 reveals the Spread Ratio of the SBI and HDFC banks. Spread ratio can be find out by deducting the interest paid ratio from the interest earned ratio. SBI's Spread ratio is 1.78% in 2007-08 and 2.26% in 2011-12. Whereas HDFC's Spread Ratio is 3.18% in 2007-2008 and 2.78% in 2011-12. From this we can conclude that Spread ratio is greater in HDFC as compared to SBI during the period of the study, this will affect the profitability of a bank in a positive manner.

Table 6:. Burden ratio (b) = Other operating expenses ratio – Non–interest Income(o-n)

Year's	SBI	HDFC
2007-08	0.409	0.89
2008-09	0.232	0.93
2009-10	0.370	0.67
2010-11	0.424	0.76
2011-12	0.609	0.75

Source:- Compiled Personally from the Annual Reports.

It is a difference between non-interest expenditure and noninterest of a commercial bank. While making an profitability analysis of commercial banks, burden plays an important role. Table 6 depicts the Burden Ratio of the SBI and HDFC banks. Burden ratio can be find out by deducting the Non-interest Income from the Other operating expenses. SBI's Burden ratio is 0.409% in 2007-08 and 0.609% in 2011-12. Whereas HDFC's Burden Ratio is 0.89% in 2007-2008 and 0.75% in 2011-12. From this we can conclude that Burden ratio is greater in HDFC as compared to SBI during the period of the study, this will adversely affect the profitability of HDFC bank.

Table 7: Profitability Ratio = Spread ratio – Burden ratio (in %)

Year's	SBI	HDFC
2007-08	1.371	2.29
2008-09	1.388	2.14
2009-10	1.340	2.19
2010-11	1.496	2.10
2011-12	1.651	2.03

Table 7 reveals the Profitability Ratio of the SBI and HDFC banks. Profitability ratio can be find out by deducting the Burden ratio from the Spread ratio. SBI's profitability ratio is 1.371% in 2007-08 and 1.651% in 2011-12. Whereas HDFC's Profitability Ratio is 2.29% in 2007-2008 and 2.03% in 2011-12. From this we can conclude that profitability ratio is greater in HDFC as compared to SBI during the period of the study. Hence we can conclude that profitability of the HDFC bank is greater than the SBI.

CONCLUSION

It is very important to study the profitability of the banking sector. It is only profits that make the banking sector healthy and strong. The comparative analysis of the profitability of the two banks clearly reveals that there is a large difference between the profitability of the two banks. HDFC's profitability is more than that of SBI. SBI as a public sector bank play a vital role in the development of the banking base in the country. Lower profitability of the SBI may be due to the reason because profit earning is not the sole motive of the SBI. But now a day's higher profitability is very essential for the success of any business organistion.

Hence, SBI should also take into consideration the profitability while performing its operations.

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