PROFITABILITY OF COMMERCIAL BANKS AFTER THE REFORMS: A STUDY OF SELECTED BANKS

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ABSTRACT

Liberalization, globalization and privatization of Indian economy has brought paradigm shift in the entire scenario. These reforms have bought ample opportunities of growth as well as fiery competition from almost every corner of the world. The entry of Private Banks and liberal branching policy for foreign banks has threatened the market privileges enjoyed by public sector banks. This has further lead to the dire necessity for incorporating changes in the operational framework including the range of products and services offered by it. The remedial measures initiated by the banks and profitability of banks depend upon number of factors. In this reference the present study attempts to analyses the profitability of four major banks in India, namely, Punjab National Bank, State Bank of India, ICICI Bank, and Federal Bank, during the post –reforms period from 2007-2012. The sample banks represented different types, namely, Public sector banks, nationalized banks, new private –sector banks, and foreign banks. The paper seeks to examine the factors affecting the profitability of these banks with the help of average and co-efficient of variation. The study has revealed that while the average profitability was highest in the case of ICICI Bank, it was lowest in Federal Bank. On the basis of empirical results, the paper suggests the measures to be taken to curtail the burden and to argument the fund –based activities to increase the level of spread.

Keywords: *Financial Sector Reforms, Indian Banking Industry, Profitability Parameters*

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INTRODUCTION

A bank is an institution which deals with money and credit. It accepts deposits from the public, makes the funds available to those who need them and helps in the remittance of money from one place to another. In India till the eighties, the banks operated in a protected environment characterized by administered interest rates, high levels of pre-emption in the form of reserve requirements and directed credit. Financial and banking sector reforms were initiated in India in 1991 with the report of a committee on the financial system headed by M. Narsimham, against the backdrop of challenges faced by the Indian banks, from within and outside the banking system in the country as well as forces of globalization operating worldwide. As a result of financial reforms, there has been a shift in the focus from quantitative to qualitative growth. The accent of the reform process was to improve productivity and efficiency of the financial system and to provide a highly competitive environment for different bank group i.e. new generation private sector banks, old private banks, public sector banks and foreign banks, which are working in India. The banking Industry has undergone rapid changes, followed by a series of fundamental developments. Significant among them are the advancements in information technology as well as the communication system these have changed the very concept of “Class Banking” to “Mass Banking.” All these changes have caused pressure on their productivity, organizational efficiency and quality of customer services. Thus, there is a tremendous scope for Indian banks to enhance their competitiveness among different segments.

CONCEPT OF PROFITABILITY

In business term, profit is the excess of income over expenditure and is an absolute measure of any firm’s performance. In financial terminology, profit of a certain concert is understood as the quantitative relationship of its profits (net or gross) with various variables relevant to profit generation, such as quantum of owned funds or share capital or the level of working funds or the size of the two mover or the like. Profitability is the most important and reliable indicator as it gives a broad indicator of the ability of a bank to raise its income level.

RELEVANCE OF THE STUDY

Profit is the very reason for the continued existence of every commercial organization. The gains to the economy depend on how efficiency the banks perform the basis function of financial intermediation. Like any other commercial organization, the efficiency of banks is also judged among other by their profitability and contribution to the maximization of Shareholder’s value.

REVIEW OF LITERATURE

Amandeep (1983) studies various factors that affect the profitability of commercial banks with the help of multiple regression analysis. The author has tried to determine the share of each factor that determines the profitability of commercial banks. The trend analysis, ratio analysis, multiple regression analysis has been effectively used to know the profitability of commercial banks. The study is methodologically very sound but the coverage is too small. **Ramamoorthy (1998)** studied profitability and productivity in Indian banking during the four year period from 1993-96. He calculated the profitability as well as efficiency of Indian banks vis-à-vis its global counterparts. The results showed that (1) Indian banks have higher interest spread than banks abroad (2) Indian banks have higher operating cost banks in foreign countries; and (3) Indian banks have higher risk provision levels. The higher interest spread of Indian banks is more than offset by the higher operating coast and higher provision levels thus bringing down the return on assets: **Rao and Parsad (2003)** depicted in their study that increased competition, new information, technologies and thereby declining processing costs, the erosion of product and geographic boundaries, and restrictive governmental regulations have all played a major role for public sector banks in India to forcefully compete with Private and foreign banks. **Satish (2005)** analyzed the performance of 55 banks for the year 2004-05. They concluded that the Indian banking system looks sound and information technology will help the banking system grow in the future. **Pal (2009)** made an assessment of the RBI's Report on 'Trend and Progress of Banking' in India, 2007-08, which reported a relatively healthy position of the Indian banking system. He noted that the various groups of banks reported improvements in net profits, return on assets and return on equity. Two basic indicators of a sound banking system, namely, capital to risk weighted assets and quality of assets, also revealed considerable improvement over the years.

OBJECTIVES OF THE STUDY

The study was conducted with the following objectives:

1. To examine the profit earning of the four selected major banks in the post-reforms period, and
2. To investigate the factor affecting the profit earning of the selected banks during the period.

RESEARCH METHODOLOGY

Sample Size

For the in depth analysis of the profitability, four major banks, namely, Punjab National Bank (PNB), State Bank of India (SBI), ICICI Bank (ICICI), AND Federal Bank (FB) were selected, one each from different groups, i.e., nationalized banks, SBI and its associates, new private sector banks and old private-sector banks, during the second phase of the banking-sector reforms period, from the year 2008 to 2012.

Data collection

The study is primarily based on secondary data. The data has been collected from the following sources:

1. IBA-Bulletins annual issues and monthly issues.
2. Statistical table relating to banks in India.
3. Reserve Bank of India monthly bulletins and annual reports.

Data Analysis In order to evaluate the trends in profitability, following tools have been used.

- Mean
- Standard deviation
- Coefficient of variation.

We selected the following **7** factors (ratios) which affected the profitability of the banks: 1.Credit –to- Deposits Ratio 2. Investment –to- Deposits Ratio 3. Priority –Sector Advances 4. Ratio of wage bill to total expenses 5.Interest Income to Total Fund 6. Non-Interest Income to Total Fund 7. Operating Expenses to Total Fund

Data Analysis and Findings

Credit –to- Deposits Ratio

Total credits as a percentage of total deposits are shown in Table-1.The CDR is nothing but the quantum flow of advances to the deposits mobilized by banks in terms of percentage. This ratio explains about the bank's credit deployment and mobilization capacity of the banks. The credit / deposit ratio (CD ratio) is a major tool to examine the liquidity of a bank. CD ratio measures the ratio of fund that a bank has utilized in credit out of the deposit total collected. More the CD ratio more the effectiveness of the bank to utilize the fund it collected. The CD ratio is derived by the following formula: **Total Credit/Total deposit collected×100.**This ratio measures the extent to which the banks are successful to mobilize their total deposit on loan and advances. Loan and advances are outside asset which yield profit to the bank.

Increment of loan and advances is the main target of all Commercial Banks. So higher the ratio better is the mobilization of the funds.

Table-1 Total Credits as a percentage of Total Deposits

Years	Punjab National Bank	State Bank of India	ICICI Ltd.	Federal Bank
2007-2008	66.73	77.51	84.49	71.17
2008-2009	71.51	74.97	91.44	71.06
2009-2010	74.16	75.96	90.04	72.29
2010-2011	75.64	79.9	87.81	74.49
2011-2012	77.31	82.14	92.23	75.81
Mean	73.07	78.1	89.2	72.96
Standard deviation	4.14	2.92	3.12	2.1
C.V	5.67	3.74	3.5	2.88

As shown in the table, ICICI Bank had the highest share of this ratio (89.2 percent), which is the vital factor affecting the profitability of this bank. SBI (78.1 percent) took the second rank. This ratio is least in the case of Federal Bank (72.96 percent).While the highest variation was observed in Punjab National Bank (5.67 percent), the lowest variation was in the Federal Bank (2.88 percent).

Investment –to- Deposits Ratio

Investment policy is the proper management of any fund or wealth to maximize value or to obtain this high or favorable return with low risk considering the protection of Invest forms the inflation and other possible harms. The banks also offer investment and insurance products. As a variety of models for cooperation and integration among finance industries have emerged, some of the traditional distinctions between banks, insurance companies, and securities firms have diminished. Investment / Deposit Ratio help to know how the banks are mobilizing their deposit in the investment of the various securities. A high ratio indicates the success in mobilizing the funds in securities. The ID ratio is derived by the following formula:

Total Investment/Total deposit collected×100

Table-2 Total Investment as a percentage of Total Deposits

Years	Punjab National Bank	State Bank of India	ICICI Ltd.	Federal Bank
2007-2008	34.63	34.81	42.68	35.92
2008-2009	33.55	36.38	46.35	38.11
2009-2010	32.12	36.33	53.28	36.88
2010-2011	31.30	33.45	59.77	34.89
2011-2012	31.03	30.73	61.16	34.79
Mean	32.53	34.34	52.64	36.12
Standard deviation	1.53	2.35	8.1	1.4
C.V	4.7	6.8	15.38	3.88

As shown in Table 2, the ICICI Bank had the highest share (52.64 percent) in the total investment to Total deposits which indicate that ICICI Bank had to obtain high or favorable return with low risk. Federal Bank (36.12 percent) took the second rank. Moreover, the variations in ICICI Bank were maximum (15.38 percent), while the FB showed only 3.88 percent variations.

Priority –Sector Advances

Priority-sector Advances as a Percentage of Total Advances indicates that as per the guidelines of the RBI, every commercial bank of the Indian origin shall have to provide at least 40%, credit lending for agriculture should be at least 18 percent, while for SSIs and other priority sector, it should be 12 percent and 10 percent respectively. The ratio of priority-sector advances as a percentage of the total advances during the study period is shown in Table-3.

Table -3 Ratios of Priority sector advances as a percentage of total advances

Years	Punjab National Bank	State Bank of India	ICICI Ltd.	Federal Bank
2007-2008	36.33	31.96	28.43	48.64
2008-2009	32.41	29.66	31.34	38.80
2009-2010	35.70	26.99	29.79	36.55
2010-2011	32.48	30.61	24.68	33.13
2011-2012	31.33	28.84	23.37	32.28
Mean	33.65	29.61	27.52	37.88
Standard deviation	2.22	1.87	3.39	6.56
C.V	6.6	6.32	12.32	17..32

As shown in the table, this ratio, in terms of average, was highest in Federal Bank (37.88 percent), followed by Punjab National Bank (33.65 percent).

Ratio of wage bill to total expenses

Wage bill is a major constituent of total expenses, especially in case of public sector banks due to their less capital-intensive nature. However, new private sector banks had a significantly lower proportion of wage bill in total expenses as compared to public sector banks and old private sector banks due to their intensive use of capital. Wage bill for public sector banks and old private sector banks is depicting more consistency than new private sector banks.

Table -4 Ratio of wage bill to Total expenditure

Years	Punjab National Bank	State Bank of India	ICICI Ltd.	Federal Bank
2007-2008	17.32	15.29	6.57	12.82
2008-2009	15.27	14.47	6.62	12.35
2009-2010	17.63	18.86	8.21	12.45
2010-2011	20.71	21.16	11.95	15.29
2011-2012	15.74	19.01	11.47	11.86
Mean	17.34	17.76	8.96	12.95
Standard deviation	2.14	2.8	2.6	1.35
C.V	12.34	15.77	29.02	10.42

As shown in table Punjab National Bank (17.34 percent)& State Bank of India(17.76 percent) have maximum wage bill followed by old Private sector Federal Bank(12.95 percent)and new private sector bank ICICI(8.96 percent).As the value of wage bill for public sector banks and old private banks is reflecting decline over the period of time, it indicates the adoption of information technology and computerization of banks with the passage of time.

Interest Income to Total Fund

Banks borrow money in the form of deposits and lend money as advances (loans) to needy borrowers. Their main income is therefore, interest income. Income of a bank, in view of the nature of banking business, can be classified as interest income and other income. Interest Income of banks depends on the size of the asset portfolio, the rate of interest and the percentage of standard performing assets, i.e. the earning assets. It consists of **:(1)** Interest on advances and discount on bills, which includes interest and discount on all types of loans and advance (2) Income on investments, which includes all income derived from the investment portfolio by way of interest and dividend. At present, banks fix the interest rate for borrowers based on prime lending rate, risk rating of the borrower and other business related factors.

Table-5 Interest Income to Total Fund

Years	Punjab National Bank	State Bank of India	ICICI Ltd.	Federal Bank
2007-2008	7.86	8.82	10.60	9.34
2008-2009	8.87	8.88	9.82	9.90
2009-2010	9.83	8.52	8.82	9.78
2010-2011	8.99	8.39	8.41	8.96
2011-2012	8.85	9.32	9.07	10.61
Mean	8.88	8.79	9.34	9.72
Standard deviation	0.7	0.36	0.87	0.62
C.V	7.88	4.1	9.3	6.4

Table -5 Shows that Indian banking industry has fluctuating trend in regard to the share of Interest Income in the Total Fund in all the years under study .On an average, from all the bank groups old private sector Federal Bank & new private sector ICICI banks shows the highest interest income ratio that is 9.72% & 9.34% followed by Punjab national bank with 8.88 % and SBI & its Associates that is 8.79%.

Non-Interest Income to Total Fund:

Non-interest income of banks arises from sources other than money lent. It comprises of: (1) Commission, exchange, brokerage (2) Profit on sale of investment (3) Profit on sale of land, buildings and other assets.

Table-6 Non-Interest Income to Total Fund

Years	Punjab National Bank	State Bank of India	ICICI Ltd.	Federal Bank
2007-2008	.12	.14	.02	0.66
2008-2009	.13	.11	.08	0.77
2009-2010	.26	.10	.08	0.65
2010-2011	.17	.09	.05	0.62
2011-2012	.20	.08	.03	0.19
Mean	0.18	0.104	0.052	0.58
Standard deviation	0.057	0.023	0.028	0.224
C.V	31.67	22.12	53.85	38.62

Table -6 Shows that On an average, the share of Non- Interest income in the Total Fund is highest in case of Old private sector (Federal Banks) that i.e. 0.58% followed by Punjab National Bank i.e. 0.18 %.

Operating Expenses to Total Fund

Operating expenses consists of those expenses which are essential for the operation of the business. The major constitutes of operating expenses are as follows:(1)Payment to and provisions for employees(2)Rent, taxes and lighting(3) Printing and stationery(4)Advertisement and publicity(5)Law charges etc.

Table-7 Operating Expenses to Total Fund

Years	Punjab National Bank	State Bank of India	ICICI Ltd.	Federal Bank
2007-2008	2.39	2.16	2.76	2.19
2008-2009	2.05	2.06	2.60	2.45
2009-2010	2.15	2.38	2.59	2.52
2010-2011	2.02	2.67	2.09	2.67
2011-2012	2.40	2.86	1.89	2.04
Mean	2.2	2.42	2.39	2.37
Standard deviation	0.182	0.337	0.374	0.255
C.V	8.27	13.93	15.65	10.76

Table-7 shows that Punjab National Bank has a lower ratio (2.2 percent) when compared to other bank groups, so far as operating expenses are concerned which is an indicator of competitiveness in banking. The co-efficient ratio was quite high in ICICI Bank (15.65 percent) & State Bank of India (13.93 percent) followed by Federal bank and Punjab National Bank.

CONCLUSION

The performance of the Indian banking sector during past few years indicates a possible growth rate trend with a little exception particularly after the subprime crisis. The study reveals that the profitability of different bank groups operating in India significantly differ from each other. The profitability and efficiency of Private sector banks are comparatively higher to other banks. Private sector banks are performing better so far as financial parameters of Interest income, non-interest income and wage bill are concerned. Public sector banks are competitive enough so far as the financial parameters like operating expenses, Priority sector advances to total Advances are concerned. It is clear from the fact that public sector banks (Punjab National bank & State bank of India) have considerable growth in net profits. Operating expenses of these banks have shown a declining trend over the period of time. It seems that old private bank (Federal bank) is also in the race.

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