

**A COMPARATIVE STUDY OF THE PROFITABILITY PERFORMANCE IN THE
BANKING SECTOR: EVIDENCE FROM INDIAN PRIVATE SECTOR BANK**

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Abstract

Banks are the backbone of the economy of the country because they play significant role in the effort to attain stable prices, high level of employment and sound economic growth. The objective of the present study is to classify Indian private sector banks on the basis of their financial characteristics and to assess their financial performance. The study found that Return on Assets and Interest Income Size have negative correlation with operational efficiency, whereas positive correlation with Assets Utilization and Assets size. It is also revealed from the study that there exists an impact of operational efficiency, asset management and bank size on financial performance of the Indian Private Sector Banks.

Key Words: Asset Size; Assets Utilization; Operational Efficiency; Private Sector bank

Introduction

The Indian financial system has been regulated mainly by interest rate regulation, credit restrictions, equity market controls and foreign exchange controls. Indian Banking Sector is divided into four categories i.e. Public Sector Banks, Private Sector Banks, Foreign Banks in India and Scheduled Commercial Banks. Banks are considered to be very important financial mediators or institutions because they result into well being of saver as well as investors. Financing facilitates the flow of goods and services and the activities of the government. It also provides a great portion of the medium of exchange to the country. Banks are the backbone of the economy of the country because they play significant role in the effort to attain stable prices, high level of employment and sound economic growth. Improvement of economic efficiency of savers and investors raises overall improvement in living standard of the society at large.

The purpose of this study is to analyze the financial data of twenty one Indian private sector banks for the financial period 2010-11 to 2012-13 with a view to examining the relationships among measures such as bank's size, operational efficiency, asset management, return on assets and interest income and thereby to discuss their impact on performance of the banks. An attempt has also been made to rank the banks on the basis of their financial performance and measures. Therefore, the objective of the study is to classify Indian private sector banks on the basis of their financial characteristics and to assess their financial performance.

With a view to evaluating financial performance of Indian private sector banks, financial indicators such as growth rates of deposits, credits, assets and shareholders' equity have been constructed from their financial statements. Financial ratios such as return on assets, asset utilization and operational efficiency have also been calculated. In order to assess the performance of India private sector banks, measures such as assets size and interest income have also been used.

It is hypothesized for this study that Return on Assets and Interest Income Size have negative relationship with operational efficiency and positive relationship with Asset management and Bank Size. It is also hypothesized that financial performance of the bank is affected by the asset management, operational efficiency and the size of the bank.

This study is organized as follows: the next section following introduction discusses the review of relevant literature. Third section throws light on methodology. The details of the results and analysis of the available data are described in fourth section and the final section presents the main conclusions.

THE LITERATURE REVIEW

Study by (Spathis & Doumpos, 2002) investigated the effectiveness of the Greek Banks on the basis of size of the assets of the bank. On the basis of return and operation factors, they used multi criteria methodology to classify Greek banks on the basis of banks profitability and efficiency between small and large banks.

The study by (Pathak, 2003) focused on financial parameters like deposits, profits, return on assets and productivity from the view point of Indian Private Sector Banks.

Study by (Chien & Danw, 2004) was based on innovative two-stage data envelopment analysis model. Bank with better efficiency does not always mean that it has better effectiveness was the upshot of the study.

Study by (Balasubramanin, 2007) revealed that private sector banks play an important role in development of Indian economy. After liberalization, the banking industry underwent major changes. The economic reforms have changed the banking sector. RBI permitted new banks to be started in the private sector as per the recommendation of the Narashiman Committee.

The study by (Singla, 2008) revealed that profitability position of the banks was reasonable and sustained at a moderate rate during the study period. Increasing interest covering ratio and maintaining debt equity ratio over 1:1 indicated strong solvency position of the banks. Negative correlation between return on net worth and the debt equity ratio was revealed during the study period. Even interest income to working funds also had negative association with interest coverage ratio. It was also divulged from the study that the Non-Performing Assets to net advances was negatively correlated with interest coverage ratio.

The study by (Chaudhary & Sharma, 2011) concluded that an efficient management information system should be developed. The bank staff involved in sanctioning the advances should be trained about the proper documentation and charge of securities and motivated to take measures in preventing advances turning into NPA. Public banks must pay attention on their functioning to compete private banks. Banks should be well versed in proper selection of borrower/project and in analyzing the financial statement.

The study by (Prabhakar & LakshmiPrabha, 2012) found the existence of consistency among the sector and suggested investors to follow perfect portfolio management in order to avoid risk involved in it.

The purpose of the study by (Kaur, 2012) is to examine the financial performance of public and private sector banks. The study found that the overall performance of Public Sector Banks is better than private Sector Banks over the period of study.

The study by (Kumar & Malhotra, 2013) found that Bank of Baroda was at the first position with overall composite ranking average of 6.05 due to its better performance in the areas of liquidity and asset quality, closely followed by Andhra Bank with overall composite ranking average of 6.15 because of its strength in the spheres of management efficiency, capital adequacy and asset quality. United Bank of India held the bottom most rank with overall composite ranking average of 14.60 due to management inefficiency, poor assets and earning quality. The study recommends that United Bank of India has to improve its management efficiency, assets and earning quality. Similarly Bank of Maharashtra should take necessary steps to improve its liquidity position and management efficiency.

The study by (Goel & Bajpai, 2013) used financial indicators like Liquidity, Capital Adequacy, and Profitability ratios to explain that there is no such great impact on Indian banks due to global recession for the time period 2006-2009.

The study by (Mohanraj & Gomathi, 2013) finds that the banking sector faces profitability pressures due to higher funding costs, mark-to-market requirements on investment portfolios, and asset quality pressures due to a slowing economy. But Indian banks' global exposure is relatively small, with international assets at about 6 per cent of the total assets. The strong economic growth in the past, low defaulter ratio, absence of complex financial products, regular intervention by central bank, proactive adjustment of monetary policy and so called close banking culture has favored the banking industry in India in recent global financial turmoil.

The study by (Yadav, 2014) concludes that before the global recession foreign bank group was performing much better than other banking sectors. Private, Nationalized and SBI bank groups kept on performing almost same, but certainly better than RRBs for all the period of study. But,

Indian banks have to innovate to take advantage of the new business opportunities and at the same time ensure continuous assessment of risks.

From the above review of empirical works, it is clear that different authors have approached profitability performance of banks in different ways in varying levels of analysis. These different approaches helped in the emergence of more and more literature on the subject over time. It gives an idea on extensive and diverse works on profitability performance of banks. It has been noticed that the studies profitability performance of banks in various aspects provide divergent results relating to the study period overlap or coincide. The main reason for divergence in the results is use of different method for the measurement of profitability performance of banks. All the studies aimed to analyze the profitability performance of banks in India & abroad with number of factors. The survey of the existing literature reveals that no specific work has been carried out to examine and ascertain the profitability performance of private sector companies in India. The present study is an attempt in this direction and therefore, aims to enrich the literature of comparative study of profitability performance of banks.

STUDY METHODOLOGY

The data for the accomplishment of the aforementioned research objectives used was secondary. With a view to evaluating performance and calculating financial ratios, the data was gathered from banks' financial statements as published in their annual reports (2010-11 to 2012-13). Besides, the review of different articles and research papers was another source of the data. With a view to describing, measuring, comparing and classifying the financial situations of Indian Private Sector banks, descriptive financial analysis has been used. The sample of this study contains twenty one Indian private sector banks.

Financial performance is the dependent variable and is measured by Return on Assets and Interest Income Size and therefore they are the dependent variables of this study. The independent variables of this study are as under:

1. The Bank Size (Measured by Total Assets of the Bank)
2. Asset management (Measured by Asset Utilization Ratio = $\text{Operational Income} / \text{Total Assets}$)
3. Operational Efficiency (Measured by Operating Efficiency Ratio = $\text{Total Operating Expenses} / \text{Net Interest Income}$)

This study uses the major banking activities comprising of Total Deposits, Total Credits, Total Assets, Total Shareholders' Equity, Return on Equity (ROE = $\text{Net Profits} / \text{Total Shareholders' Equity}$), and Return on Assets (ROA = $\text{Net Profit} / \text{Total Assets}$) with a view to classifying Indian Private Sector banks. In order to examine and compare the impact of independent variables on the dependent variables, techniques of ratio analysis, correlations and regression have been applied. Technique of Analysis of Variance (ANOVA) has also been used in testing the hypotheses.

The selection of the topic is made with a view to evaluating and appraising the financial performance of Indian Private Sector Banks. The following hypotheses have been formulated to test their validity in the context of the selected Indian Private Sector Banks and tested through Correlations and Analysis of Variance (ANOVA):

H_0 : There is no relationship among the financial performance measured by Return on Assets and Interest Income Size and the Independent Variables (Operational efficiency, Asset Management and Bank Size)

H_1 : Return on Assets and Interest Income Size have negative relationship with operational efficiency and positive relationship with Asset management and Bank Size.

H_2 : There exist an impact of operational efficiency, asset management and bank size on financial performance of the Indian Private Sector Bank.

RESULT AND ANALYSIS

Table 1 Ranks of Indian Private Sector Banks Based on Financial Indicators					
Bank	Indicators				
	Activities			Profitability	
	Deposits	Credits	Assets	Return on Equity (RoE)	Return on Assets (RoA)
City Union Bank Ltd.	14	14	14	1	5
ING Vysya Bank Ltd.	10	9	9	12	14
SBI Commercial & International Bank Ltd	21	21	21	21	21
Tamilnad Mercantile Bank Ltd	13	13	13	3	3
The Catholic Syrian Bank Ltd	17	17	17	19	20
Dhanlaxmi Bank Ltd	16	16	16	20	19
The Federal Bank Ltd	6	6	6	13	12
ICICI Bank Ltd	4	8	7	4	11
The Karnataka Bank Ltd	12	12	12	16	16
The Karur Vysya Bank Ltd	11	11	11	5	8
The Lakshmi Vilas Bank Ltd	15	15	15	15	17
Nainital Bank Ltd	20	20	20	10	9
The Ratnakar Bank Ltd	19	19	19	18	15
The South Indian Bank Ltd	9	10	10	7	13
Axis Bank Ltd	3	3	3	6	4
Development Credit Bank Ltd	18	18	18	17	18
HDFC Bank Ltd	2	2	2	8	2
ICICI Bank Ltd	1	1	1	14	10
Indusind Bank Ltd	7	7	8	9	7
Kotak Mahindra Bank Ltd	8	5	5	11	1
YES Bank	5	4	4	2	6

With a view to summarizing classification of the banks on the basis of activities i.e. total deposits, total credits, total assets and shareholders' equity and profitability ratios i.e. return on Equity and Return on Assets calculated above, ranks have been given to the banks under study. Table 1 reflects the ranks of the positions for the banks under the study. It is clear from the Table that ICICI Bank Ltd is on the first position as far as its activities i.e. total deposits, total credits and total assets are concerned; followed by HDFC Bank Ltd with second place and Axis Bank Ltd with third place. The Jammu and Kashmir Bank Ltd in Deposits and Yes Bank in Credits as well as Assets occupy fourth place. Yes Bank in Deposits and Kotak Mahindra Bank Ltd in Credits as well as Assets occupy fifth position. Sixth place in all the activities is occupied by the Federal Bank Ltd. Indusind Bank Ltd in Deposits and Credits, while the Jammu and Kashmir Bank Ltd in Assets occupy seventh place. Kotak Mahindra Bank Ltd in Deposits, the Jammu and Kashmir Bank Ltd in Deposits and Indusind Bank Ltd in Assets occupy eighth place. The South Indian Bank Ltd in Deposits and ING Vysya Bank Ltd in Credits as well as Assets occupy ninth position; while ING Vysya Bank Ltd in Deposits and the South Indian Bank Ltd in Credits as well as Assets occupy tenth position. The eleventh, twelfth, thirteenth, fourteenth, fifteenth, sixteenth, seventeenth, eighteenth, nineteenth, twentieth and twenty first positions in case of all the activities are occupied by The Karur Vysya Bank Ltd, The Karnataka Bank Ltd, Tamilnad Mercantile Bank Ltd, City Union Bank Ltd, The Lakshmi Vilas Bank Ltd, Dhanlaxmi Bank Ltd, The Catholic Syrian Bank Ltd, Development Credit Bank Ltd, The Ratnakar Bank Ltd, Nainital Bank Ltd and SBI Commercial & International Bank Ltd respectively.

As far as RoE is concerned, City Union Bank Ltd occupies the first place, followed by YES Bank, Tamilnad Mercantile Bank Ltd, The Jammu & Kashmir Bank Ltd, The Karur Vysya Bank Ltd, Axis Bank Ltd, The South Indian Bank Ltd, HDFC Bank Ltd, Indusind Bank Ltd, Nainital Bank Ltd, Kotak Mahindra Bank Ltd, ING Vysya Bank Ltd, The Federal Bank Ltd, ICICI Bank Ltd, The Lakshmi Vilas Bank Ltd, The Karnataka Bank Ltd, Development Credit Bank Ltd, The Ratnakar Bank Ltd, The Catholic Syrian Bank Ltd, Dhanlaxmi Bank Ltd and SBI Commercial & International Bank Ltd,

As far as RoA is concerned, Kotak Mahindra Bank Ltd occupies the first place, followed by HDFC Bank Ltd, Tamilnad Mercantile Bank Ltd, Axis Bank Ltd, City Union Bank Ltd, YES Bank, Indusind Bank Ltd, The Karur Vysya Bank Ltd, Nainital Bank Ltd, ICICI Bank Ltd,

ICICI Bank Ltd, The Federal Bank Ltd, The South Indian Bank Ltd, ING Vysya Bank Ltd., The Ratnakar Bank Ltd, The Karnataka Bank Ltd, The Lakshmi Vilas Bank Ltd, Development Credit Bank Ltd, Dhanlaxmi Bank Ltd, The Catholic Syrian Bank Ltd and SBI Commercial & International Bank Ltd.

Table 2 Result of Correlations Analysis

	ROA	Interest Income	Operational Efficiency	Assets Utilization	Assets Size
ROA	1				
Interest Income	0.4500314	1			
Operational Efficiency	-0.493465	-0.074043	1		
Assets Utilization	0.4763422	0.090957	0.27738983	1	
Assets Size	0.4230985	0.996307	-0.0667209	0.0645436	1

Table 2 shows the results of correlations analysis between dependent and independent variables. It is clear that Return on Assets and Interest Income Size have negative correlation with operational efficiency (-0.49 & -0.07 respectively) while positive correlation with Assets Utilization (0.47 & 0.09 respectively) and Assets size (0.42 & 0.99 respectively). Based on these correlations, null hypothesis is rejected and the first alternate hypothesis is accepted.

Table 3 Summary of Result of ANOVA				
	Degree of Freedom	Sum of Squares	Mean Square	F
Regression	3	4.2250516	1.4083505	18.39337
Residual	17	1.3016627	0.0765684	
Total	20	5.5267143		
Predictors: (Constant) Assets Size, Assets Utilization (%), Operational Efficiency Dependent Variable: ROA (%)				
	Degree of Freedom	Sum of Squares	Mean Square	F
Regression	3	1.692E+09	563913413	878.2841
Residual	17	10915065	642062.67	
Total	20	1.703E+09		
Predictors: (Constant) Assets Size, Assets Utilization (%), Operational Efficiency Dependent Variable: Interest Income				

Table 3 shows the summary results of the analysis of variance with a view to testing impact of independent variables i.e. Assets Size, Assets Utilization and Operational Efficiency on financial performance i.e. Return on Assets and Interest Income of the Indian Private Sector Banks. As far as impact of independent variables on Return on Asset is concerned, it is clear that the calculated value of 'F' is 18.39337, which is more than the table value of 'F' (3.196777) at 5% level. Therefore, second alternate hypothesis is accepted. As far as impact of independent variables on Interest Income is concerned, it is clear that the calculated value of 'F' is 878.2841, which is more than the table value of 'F' (3.196777) at 5% level. Therefore, second alternate hypothesis is accepted.

Conclusion

The study found that overall performance covering Deposits, Credits, Assets and Profitability of HDFC, AXIS, YES, Kotak, ICICI and Indusind has been satisfactory out of the sample selected for the study. As far as activities i.e. Deposits, Credits and Assets are concerned, it was found that ICICI, HDFC, AXIS, YES, Kotak and Federal were leading among the selected players. As far as profitability is concerned, City, Tamilnad, YES, HDFC, AXIS and Kotak could be placed in the category of GOOD Performer; whereas SBI, Catholic, Dhanlaxmi, Lakshmi Vilas, Ratnakar and Development could be placed in the category of POOR Performer and the rest could be AVERAGE Performer. It is interesting to observe that the banks having higher ranks in activities need not to have higher ranks in profitability performance and vice-a-versa. The study found that ICICI and Kotak are the banks which had higher ranks in activities but average ranks in profitability, whereas City and Tamilnad are the banks having lower ranks in activities but higher ranks in profitability. The study also found that Return on Assets and Interest Income Size have negative correlation with operational efficiency, whereas positive correlation with Assets Utilization and Assets size. It is also revealed from the study that there exist an impact of operational efficiency, asset management and bank size on financial performance of the Indian Private Sector Banks.

It is suggested that banks should try to retain the talented workforce which contributes most to the profitability goals of the banks to remain competitive in this kind of environment. The management should further try to control the over the expenses and disbursement cost in order to increase the profits. The banks should focus on the risk management while expanding its business internationally. The banks should offer the products to the customers according to their taste. The banks should create a friendly customer environment to satisfy their customers and to retain them. Banks should have an ability to repeat and sustain such efforts in future, which would be critical in maintaining their profitability.

It can be concluded that the present study may help decision makers of Indian Private Sector Banks and other categories of Banks in Indian Banking Sector to concentrate on banking activities and thereby to increase the bank ranking and profitability performance.

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