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Golden Research Thoughts

A PERFORMANCE ANALYSIS OF PUBLIC, PRIVATE AND FOREIGN BANKS IN INDIA: A COMPARATIVE STUDY

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ABSTRACT

Banks are key financial intermediaries or institutions that serve as "middle man" in the transfer of fund from servers to those who invest in real assets as house, equipment and factories. In the deregulated environment, a series of reformative measures were undertaken to improve the working of Indian banks in line with the international banking practices .The emergence of new private sector banks as well as the entry of new global (foreign) banks in this era has thrown stiff challenges in the form of tough competition among Indian banks. So if the banks want to survive in the competitive edge they should keep their performance up to the high standards. In this respect this paper is en endeavor to evaluate the performance of public, private and foreign banks and make a comparative study in these three categories of banking. For the purpose of this study sample of fifteen banks comprises of five public, five foreign and five private banks has been selected on the basis of stratified random sampling. The major finding of this study is that the performance of foreign banks is better as compare to private and public sector banks.

KEYWORDS :Banking, Public Sector Bank, Private Sector Bank, Foreign Bank, Performance Analysis.

INTRODUCTION :

There is no unanimity among the economists about the origin of the word 'Bank'. The word is derived from the Greek word banque, i.e., a 'bench'. The ancient meaning of bank related with the money changers seating on benches. Peoples could change their money from these persons. They had funds of different currencies and used to change any currency in to another currency as required by the businessman. Afterwards the word 'Bank' was used in the sense of credit. As per another opinion, the word 'Bank' was developed from the German word 'Banck' which means a joint stock firm. Banking is as old as is the authentic history and origins of modern commercial banking are traceable in ancient

time. The New Testament mentions about the activities of the money changers in the temples of Jerusalem. In ancient Greece, around 2000 B.C., the famous temples of Ephesus, Delphi and Olympia were used as depositories of surplus funds of citizens and these temples were the centers of money-lending transactions. The priests of these great temples acted as financial agents until public confidence was destroyed by the spread of disbelief in the religion. Traces of credit by compensation and by transfer orders are found in Assyria, Phoenicia and Egypt before the system attained full development in Greece and Rome. In India, the Banking Regulation Act, 1949 defines bank as a banking company and a banking company is a company which transact the business of banking in India [Section 5(c)]. Section 5(b) defines banking as accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, and order or otherwise.

OVERVIEW OF BANKING IN INDIA

India has a robust banking system; it has 27 state owned banks, 21 private banks and over three dozen foreign banks, regional rural banks and urban cooperative banks. Put all of them together and India has over 1,700 banks of various descriptions. The origin of banking in India can be traced back to almost the Vedic period. During the Vedic period, banking system was found in India in an unorganized manner. The transformation from pure money lending to proper banking appears to have taken place before the times of Manu. Manu, a great Hindu jurist, had devoted a section of his work explaining the deposits and advances and he even laid down certain rules on rates of interest. The modern Indian banking industry is traced as far back as 1806 with the establishment of Bank of Bengal. From 1906 to1911, several banks were set up based on the principles of the Swadesi movement. The movement inspired Indian businessmen and politicians to set up banks for the Indian community and many new banks were launched to promote trade and finance in communal groups. Some of the prominent ones among these are Bank of India, Corporation Bank, Bank of Baroda, Indian Bank, Canara Bank, and Central Bank of India. The first joint stock bank was set up in 1770 at Calcutta under European management by the name of 'Bank of Hindustan. Thereafter, East India Company established three 'Presidency Bank' in India – 'Bank of Bengal' (1806), 'Bank of Bombay' (1840) and 'Bank of Madras' (1843). The first purely Indian joint-stock bank was the 'Oudh Commercial Bank' which came into existence in 1889. Bank of Bengal, along with its sister banks, Bank of Bombay and Bank of Madras, set up by British East India Company, merged in 1921 to give birth to Imperial Bank of India, now known as State Bank of India. On the basis of recommendations of the Hilton Young Commission in 1926, Government passed the Reserve Bank of India Act, 1934 to establish a central bank in the country as a share-holders' bank. Reserve Bank of India was established in 1935. Initially, it was established as a private shareholders' bank with a fully paid-up capital of `5 crore. In 1949 the Banking Regulation Act was passed and the Reserve Bank of India was nationalized on 1.1.1949. This Act gave extensive controlling powers to the Reserve Bank of India and the Government over the commercial banks. Enactment of the Banking Regulation act and nationalization of RBI were the precursor of the structural reforms in the Indian banking system during post-independence period. These two events proved to be the turning points in the development of India's commercial banks.

REVIEW OF LITERATURE

Banking developments greatly contributed to economic development of the country. A positive relationship between financial sector development and economic growth was established by economists in various empirical studies (Goldsmith 1969, King and Levine 1993, Levine 1999, Khan and

Senhadji, 2000). In pre-reform period, the commercial banks and other financial institutions were operating in stable environment with little or absence of competition. But in the reform period remarkable changes took place in banking industry. During liberalised era, banking industry entered new phase and became globally competitive. It has to fulfill both social and national objectives. In wake of these changes it is necessary to study the performance of the banks.

Kajal Chaudhary and Monika Sharma (2011) have made a comparative analysis of services of Public sector Banks and Private Sector banks. They believed that it is right time to take suitable and stringent measures to get rid of non-performing asset (NPA) problem. Further they have suggested that an efficient management information system should be developed and 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. They have also recommended that Public banks must pay attention on their functioning to compete with private banks and all the banks should be well versed in proper selection of borrower/project and in analyzing the financial statement. Neha Rani & Dinesh Gaba (2014) have concluded that private sector banks are performing better than other banks because it's substandard, doubtful, losses advances are increasing but their share in total gross advances are decreasing and They have also found that foreign banks performance is better than scheduled commercial banks and public sector banks. It was also established from the study that public sector banks are not performing well because their % share of standard advances are consistently decreasing and % share of substandard and doubtful advances in total gross advances are consistently increasing. Further, it was revealed that gross non-performing asset (NPA) of public sector banks are also increasing. The authors have suggested that public sector banks should decrease their NPA by adopting different measures. Garima Chaudhary (2014) has concluded that during the year 2009-11, most of the new private sector banks have shown better performance than their public sector counterparts. He has revealed that the major area of concern for any bank is the customer service and customer satisfaction, thus just like the private sector banks, it is high time that the public sector banks also start concentrating more on the customers and the services provided to them. According to the author, top most rank held by a private bank is a clear indicator of the better performance of the private banks due to their higher concern towards customer feedback, their efficient management and thus yielding to higher productivity and networks throughout India. Further, he suggested that to strive the cut throat competition given to the public sector banks by the private sector banks, the public sector will have to pull up their shoes to be at the better half part of the race else the time is very near which can make these public sector banks just a memory or a history for everyone. T. Thirunavukkarasu & D. Nachimuthu (2015) have expressed that there are several reasons behind the increasing number of commercialization of banks. They have used public sector banks and private sector banks for their study. Since, it is difficult to quantify the output in the service sector because it is intangible, different proxy indicators were used for measuring productivity of banking sector. Segmentation of the banking sector in India was done on bank assets size. Overall, the analysis supported the conclusion that new banks are more efficient that old ones. Further, it was found that the public sector banks are not as profitable as other sectors. It means that efficiency and profitability are interrelated. The key to increase performance depends upon Return on Asset, Return on Equity and Net Interest Margin.

OBJECTIVE OF THE STUDY

The main objective of the study is to analysis the relative performance of public, private and foreign banks in India applying CAMEL method. (CAMEL evaluates five key components which are

Capital adequacy, Asset quality, Management, Earning quality and Liquidity).

HYPOTHESIS OF THE STUDY

In this paper an attempt has been made to test the hypothesis that the performance of foreign banks is better as compared to performance of private and public sector banks.

SAMPLE OF THE STUDY

Fifteen banks comprises of five foreign, five private and five public banks on the basis of stratified random sampling has been selected which are as follow:

The Selected Banks for the Study

PUBLIC SECTOR BANKS	PRIVATE SECTOR BANKS	FOREIGN BANKS
Canara Bank	HDFC Bank	CITI Bank
Corporation Bank	ICICI Bank	DBS Bank
Punjab National Bank	Karnataka Bank	Bank of America
Andhra Bank	South Indian Bank	Barclays Bank
Bank of India	Laxmi Vilas Bank	Abu Dhbi Bank

RESEARCH METHODOLOGY

The performance of a bank can be measured by a number of indicators. Profitability is the most important indicator because it gives an insight into the broad indication of the capability of a bank to increase its earnings. For measuring the performance of selected banks the present study employed the CAMEL methods. (CAMEL evaluates five key components which are Capital adequacy, Asset quality, Management, Earning quality and Liquidity).

In this regards, to evaluate the comparative performance of the public, private and foreign banks fourteen different analysis under the Camel method has been calculated and compared.

ANALYSIS

1. Capital Adequacy

Capital Adequacy Ratio (Tier I Plus Tier II) (Under Basel I) indicated by a minimum numerical ratio which the Banks are expected to maintain to ensure stability and strength. Capital Adequacy is seen as the measure of a bank's strength to absorb credit risks i.e. its strength is to provide for losses that may arise upon its advance going bad. It is expressed as a proportion of capital to assets weighted according to the risk of default attached to them.

It has been expressed by the analysis that foreign bank is stronger as it has enough capital adequacy to fight against losses that may arise upon its advance going bad as compare to public and private sector banks.

2.Asset Quality

Non-Interest Income Ratio is revenue generated by banks from sources other than yield-generating assets. The main types are fee income (such as from credit cards, granting loans or account maintenance), foreign exchange, trading in securities or leasing. The total income of a bank consists of interest income and non-interest income. Non-interest income includes income earned in the form of commission, exchange and brokerages and income from profit on sale of investments and non-banking assets. Higher the Non – Interest Income as Percentage to Total Income it is better.

It has been found from the analysis that in case of foreign sector banks Non-interest income is higher, this could be due to higher treasury and fee based earnings. Foreign sector banks are earning more from other income rather than interest income.

3.Management

Interest Income Ratio is revenue generated from advancing activities. For banks, the assets typically include commercial and personal loans, mortgages, construction loans and investment securities. Depending on a bank's specific assets (e.g., fixed or floating rate), interest income may be more or less sensitive to changes in interest rates. Higher the Interest Income as Percentage to Total Income is good.

It has been observed from the analysis that in case of Private and Public sector banks, it is indicating higher contribution from interest income than the fee based income as compare to the Foreign banks.

4.Earning

Credit Deposit Ratio is of vital importance to gauge performance of banks. It expresses the relationship between Advances granted by banks and Deposits of the banks. If the ratio is too high, it means that banks might not have enough liquidity to cover any unforeseen fund requirements; if the ratio is too low, banks may not be earning as much as they could be. Thus ratio express to what extent bank has grated Advances out of Deposits accepted.

From the analysis it is observed that among the three sector banks, Private Sector Banks have been able to deploy (use) higher credit during the period. In case of Foreign Banks fluctuation in Credit deposit ratio is more as compared to Public Sector Banks and Private Sector Banks.

5.Liquidity

Interest Expenses Ratio

The cost incurred by an entity for borrowed funds. Interest expense on the income statement represents interest accrued during the period covered by the financial statements, and not the amount of interest actually paid over that period.

The amount of interest expense has a direct bearing on profitability, especially for banking companies with a huge debt load. The Interest-Expense ratio indicates that the amount of gross income that is being spent to pay the interest on borrowed money. The lower the percentages the better it is.

It has been observed from the study that private sector bank and public sector bank are spending too much of its gross income paying interest on borrowed money as compared to foreign sector bank.

Operating Expenses Ratio

The operating expense ratio is calculated by dividing operating expense by its total expenditure. Comparison of operating expenses ratios are generally most meaningful among banks within the same model, and the definition of a "high" or "low" ratio should be made within this context.

It has been expressed by the analysis that indicates that foreign bank is spending more on operating expense like Rent, taxes, lightening etc. private banks and public banks have really kept their operating expenses in control which is good on their part.

Interest Spread Ratio

The excess revenue that is generated from the spread between interest paid out on deposits and interest earned on assets is the net interest income. The net interest rate spread is a key determinant of a financial institution's profitability (or lack thereof).

It has been found that in case of spread ratio, foreign bank is in better position as compare to the public and private sector banks.

Interest Income as Percentage to Average Working Fund

This ratio deals with the major income of interest in banks. But only the interest income is not important, the average working fund is also important. The efficiency will be measured according to this ratio. If this ratio is high, the operational efficiency will be also good.

It has been observed that in case of this ration public and private sector banks are in better position as compare to foreign banks.

Non – Interest Income as Percentage to Average Working Fund denotes a bank’s ability to earn from nonconventional sources. In a liberalized environment, this ratio assumes greater significance for; it mirrors a bank’s ability to take full advantage of its operational freedom. Some foreign banks term non-interest income as other income.

It has been discovered by the analysis that foreign banks are earning from non-interest income while private banks and public banks are purely earning from interest income. So considering this ratio foreign banks are in better position as compare to public and private sector banks.

Operating Profit as Percentage to Average Working Funds This ratio is a profitability parameter for the performance of a bank. This Ratio relates to operating profit with average working funds. If this ratio improves, operating efficiency is believed increased.

It has been observed from the analysis that foreign sector bank is showing more profit in this ratio as compared to private and public bank.

Return on Assets indicates what earnings were generated from assets. It measures the amount of profit the Bank generates as a percentage of the value of its total assets. The profit percentage of assets varies by Banking industry, but in general, the higher the ROA the better. It indicates how well the bank’s assets are managed to bring profit of asset that has been invested to the bank.

It has been found that foreign bank is making more earnings from Return on Assets as compared to other two sector bank.

Gross NPA as Percentage to Net Advances is the amount outstanding in the borrowal account, in books of the bank other than the interest which has been recorded and not debited to the borrowal account.

It has been found from the analysis that considering this ratio private sector banks are in better position as compare to public sector banks and foreign banks.

Net NPA as Percentage on Net Advances indicates interest debited to borrowal and not recovered and not recognized as income and kept in interest suspense and made provision of the bad debt. Lower the ratio better it is.

It has been observed that out of three categories of banks selected public sector banks are not doing good in collecting their debt.

Net Profit (PAT) on Owned Fund represents the difference between bank’s operating revenues and bank operating costs.

It has been found that considering this ratio private banks are operating better as compare to public and foreign banks.

FINDINGS OF THE STUDY

- Average Credit Deposit Ratio across all three Bank Categories is different.
- Average Interest Income as % to total income across all three Bank Categories is different.
- Average Non-Interest Income as % to total income across all three Bank Categories is different.
- Average Interest Expense as % to total expenses across all three Bank Categories is different.
- Average Operating Expenses as % to total expenditure across all three Bank Categories is different.
- Average Spread as % to total assets across all three Bank Categories is different.
- Average Interest Income as % to average working fund across all three Bank Categories is different.
- Average Non-Interest Income as % to total average working fund across all three Bank Categories is different.
- Average Operating Profit as % to average working funds across all three Bank Categories is different.
- Average Return on Assets (PAT /Total ASSETS) across all three Bank Categories is different.
- Average Gross NPA as % to net advances across all three Bank Categories is alike.
- Average Net NPA as % to net advances across all three Bank Categories is alike.
- Average Net Profit (PAT) on owned funds across all three Bank Categories is alike.
- Average Capital Adequacy Ratio (Tier I plus Tier II) (Under Basel I) across all three Bank Categories is different.

Overall Findings

- The Comparative performance of Private Sector Banks is better than Public Sector Banks.
- The Comparative performance of Foreign Sector Banks is better than Public Sector.
- The Comparative performance of Foreign Banks is better than Private Sector Banks.
- The Comparative performance of Foreign Sector Banks is better than Private and Public Sector Banks.

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