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"A Study of The Performance of Indian Banking Sector in Relation to Net Interest Margin & Profitability"

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Abstract

The process of development could only be started with the creation of social and economic overhead-comprising those basic services without which primary, secondary and tertiary productive activities will not function. In SOC are included investments on education, public health, communications, transportation and conventional public utilities like light, water, power, irrigation and drainage schemes etc and basic inputs also. Private enterprises are not willing as well as capable to undertake these activities as the risks are large and profits are low. Moreover, there is a long gestation period in these activities. The sphere of state action has been very fast and all pervading. It includes maintaining of public services, influencing attitudes, shaping economic institutions, influencing the use of resources, influencing the distribution of income, controlling the quantity of money, controlling fluctuations, ensuring full employment and influencing the level of investment. As a result, public sector in India gained heights in the economy. In 1969, the process of nationalisation of commercial banks started, so that there could be proper loaning to the priority sector in accordance with the country. A commercial bank is a financial institution which deal with deposits of different types and advancing loans apart from other activities. After economic reforms of 1991, the basic purpose is to adopt the market-mechanism. The performance of the banking sector is closely related to the growth in the economy. The performance of the banking sector public and private both has been examined on the basis of set parameters during the period of 2017-18and2018-19. Study is based on both primary with the help of appropriate tools.

Key Words: Public sector Banks, Private sector banks, operating profit, Return on assets.

INTRODUCTION-

Over the last couple of years, Indian banks which are supposed and expected to generate profit and contribute the process of growth, have been mixed in a serious existential threat on account of disproportionately rising non- performing assets. In fact, the whole process of banking sector depends on the conditions ofreliability and confidence. In nutshell, one is supposed to repay the loan alongwith rate of interest in accordance the instalments settled. Commercial banks create credit out of deposits, and this is a cumulative process. If any cog of a big machine does not function properly the whole functioning does not remain smooth with its regular flow. Public sector banks are the banks in which the government has a major holding and the private sector banks are those banks, when there is complete absence of

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government shareholding. After July 1969, onwards, Public sector banks dominated the Indian banking sector in the initial stages but after the adoption of NPE 1991, financial sector reforms were also carried out in the banking industry with the help of adoption of advanced technology and a professional approach of management. From the size and magnitude of NPAs declared so far, three important inferences can be drawn as follows:

1) NPAs are promoters/owner- based enterprises
2) All NPAs were appraised sound and worthy investments by banking system of appraisal.
3) All NPAs were part of growth Agenda initiative of existing enterprises.

That is why the govt. passed the legislation of bankruptcy and made the beginning by initiating insolvency proceeding against some of the defaulters of large size and magnitude.

JUSTIFICATION AND OBJECTIVES:

Before the establishment of banks in organised sector, the whole financial activities were handled by the money lenders (they were generally known as sahukars) and naturally there was no uniformity in the operation of this sector and even of public savings. Organised banking sector was established along with regulatory body to oversee and monitor the functioning as the monetary authority of the country, formulating monetary policies in accordance with the objectives set from time to time by the policy makers and planners. As per reports published in daily HT, sept12,2018, p16, NPAs were staggering around Rs.12lakh crores and the bad loans amounted to Rs. 9,17000 cr. Normal fixed income groups, senior citizens, salaried class, pensioners etc. keep their hard earn savings in banks mainly with the objective of security apart from a nominal earning and to meet their social obligations too. Now it is socially relevant study to go for a detail analysis of the problem. The following are the objectives of this study-

1) The objective of the study is to analyse the compare the overall financial performance of selected public sector banks and private sector banks in India on the basis of standardised indicators.
2) To suggest some remedial measures for the credibility and confidence in the system. There were a few people in the country who knew that they would get Rs 1lakh only in case of a failure of the bank irrespective of their amount of deposits. As per report published in daily HT02 march2020, p 15, bank credit growth declined to 8.5% in Jan 2020 led by a sharp slowdown in loans to service sector. This trend shows there is slowdown in the economy, needs proper investigation.

RESEARCH METHODOLOGY:

The research work requires a lot of attention as it has a direct bearing on accuracy, reliability and adequacy of the result. Research methodology is a science of studying how research is done scientifically (any branch of knowledge which is systematic and establishes a cause and effect relationship is known as science that is why science is based on observation, experimentation, relationship among different variables ie formulation of hypothesis, data collection and presentation, analysis based on certain tools and parameters, conclusion and inferences, suggestion and limitations). Any research claiming the work of good quality must go through different process of research thoroughly. The crux of research is based on its methodology i.e. research design, data collection, period of study, formulation and testing of hypothesis set and then drawing conclusions and inferences.

LITERATURE REVIEW:

Anand.K(2015) describe banks form a fundamental component of the financial system and are also active players in financial system and are also active players in financial markets. An efficient banking system capable of mobilizing the savings and channelling them to productive purposes are essential for the development of any economy. Besides providing financial resources for the growth, banks can also influence the direction in which these resources are to be utilised. Post liberalization era has spread new colours of growth and development in India. At the same time, it has also created many challenges.

Vidisha shah (2015) discussed about the comparative analysis on performance of new private sector banks and the public sector banks of India during the period 2011-2015 on many key parameters such the P/E Ratio, Dividend Pay-out ratio, Return on equity ratio, Capital adequacy ratio, Credit deposit ratio. The above period is chosen since it is very important to know how different banks performed during the recession and inflation duration. We have done a field study taking ICICI bank as private sector bank and SBI as public sector bank to better understand the above argument.

D. K. Malhotra (2011) analysed the performance of commercial banks in India during the period 2005 to 2009. This period covers the pre-credit crisis and the crisis time period. Specifically, the paper examines the behaviour of profitability, cost of intermediation, efficiency, soundness of the bankingsystem, and industry concentration of public and private sector Indian commercial banks.The empirical results show that competition in the Indian banking industry has intensified while the net interest margin has improved, cost of intermediation is rising, and banks are responding to the increased costs with higher efficiency levels.

PROFITABILITY- The analytical framework

The net interest income, other income, operating expenses and provisioning are the factors which get into the direct calculation of net profit.

NP= (NII+OI) – (OE-Pr.)

Where NP- Net profit, NII- Net interest income, OI- other income, OE- operating expenses, Pr.- provisioning.

The net interest income is the difference between interest income and interest expenditure. The interest income is dependent on the return on funds and the interest expenses depend upon the cost of funds. The cost of funds indicates the efficiency of resource mobilisation by a bank. The capability of raise low cost resources and the ability to design profitable asset creating strategy are the key to increase the net interest income of a bank.

Apart from interest income, banks also have income from other sources such as, commission, profit on exchange, profit on sale of investments etc. Those banks which make conscious efforts to increase income from other sources would register higher net profit than others. On the expenditure side, apart from interest expenses another major expenditure category is operating expenses. The operating expenses mainly consist of payments to the provisions for employees, rent, taxes, printing and stationery, law charges etc. Accordingly, if a bank has more exposures to such sectors, it is likely to impact the profitability of the banks adversely.

FINANCIAL PERFORMNCE-

The financial performance of SCBs in the period under review was marked by PSBs reporting positive net profit after three years. As provisioning requirements slackened and credit growth revived modestly. Interest income increased, even though interest expenses picked upon account of the increase in deposit growth. The net interest margin as well as the spread improved.

On the other hand, SCBs income from non-interest sources declined, contributed by spreading of mark-to market losses in govt. securitiesportfolios and transfer of funds to the investment fluctuation reserve. Apart from these factors, the muted growth in off-balance sheet exposures, mainly guarantees, and a fall in income from trading and forex transactions adversely affected the PSBs.

TABLE-1 TRENDS IN INCOME AND EXPENDITURE OF SCHEDULED COMMERCIAL BANKS

SNo.	Item	2017-18		2018-19	
		Amount INR Cr	Percentage Variation	Amount INR Cr.	Percentage Variation
1	Income	1,217,567	1.00	1,323,680	8.70
A	Interest Income	1,021,968	1.00	1,140,727	11.60
B	Other Income	195,598	1.20	182,953	-6.50
2	Expenditure	1,250,004	7.60	1,347,077	7.80
A	Interest Expenses	653,510	-2.30	710,890	8.80
B	Operating Expenses	271,470	9.30	307,457	13.20
	Of Which: Wage Bill	132,479	3.90	148,989	12.50
C	Provisions &Contingencies	325,024	33.30	328,731	1.10
3	Operating Profit	292,587	1.70	305,333	4.40
4	Net Profit	(32,438)		(23,397)	
5	Net Interest Income (1A-2A)	368,458	7.50	429,837	16.70
6	Net Interest Margin	2.50		2.70	

Note: Percentage Variations could be slightly different as absolute numbers have been rounded off to INR to Cr.

Source: Annual accounts of Respective Banks.

TABLE-2 COST OF FUNDS AND RETURNS ON FUNDS-BANK GROUP-WISE

Bank Group/Year		Cost of Deposit	Cost of Borrowing	Cost of Funds	Return on Advance	Return on Interest	Return on Funds	Spread
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9=8-5)
PSBs	2017-18	5.1	4.7	5.1	7.8	7.1	7.5	2.4
	2018-19	5.0	4.8	5.0	8.1	7.2	7.8	2.8
PVBs	2017-18	4.9	6.2	5.2	9.5	6.9	8.8	3.6
	2018-19	5.1	6.6	5.4	9.8	7.0	9.0	3.6
FBs	2017-18	3.9	3.0	3.7	8.1	6.6	7.4	3.7
	2018-19	3.8	2.9	3.6	8.2	6.2	7.2	3.6
All SCBs	2017-18	5.0	5.3	5.1	8.3	7.0	7.9	2.8
	2018-19	5.0	5.5	5.1	8.7	7.1	8.2	3.1

TABLE-3 RETURN ON ASSETS AND RETURN ON EQUITY OF SCBs BANK GROUP-WISE

Bank Group	Public Sector Bank		Private Sector Bank		Foreign Bank		All Schedule Commercial Bank	
	2017-18	2018-19	2017-18	2018-19	2017-18	2018-19	2017-18	2018-19
ROA	-0.84	-0.65	1.14	0.63	1.34	1.56	-6.15	-0.09
ROE	-14.62	-11.44	10.12	5.45	7.16	8.77	-2.81	-1.85

Source; Annual Accounts of Banks.

In case of profitability ratio as well, differentials in performance of PSBs vis-a vis PVBs were evident for PVBs, both return on assets (ROA) and return on equity (ROE) worsen in 2018-19 from the previous year, although they were considerably better than those of PSBs. In contrast, the latter were more successful in reducing their losses, building on the improvement in their asset quality. There was an increase in profitability as interest income accelerated and non-interest income revived.

FINDINGS-

1) Total income in various banks recorded a good growth in total income during all the years of study.

2) Net interest income is showing an increasing trend in banking sector. Net interest margin is quantitatively high.

3) Operating profit and profit margin must increase in all banks.

4) In case of return on assets a steady growth rate is exhibited.
5) Profitability is not correlated with balance sheet size.

SUGGESTIONS-

1) Banking sector must enhance their performance by implementing professionalised management and better customer service.
2) Assets must be utilised effectively by public sector banks. Under -utilised assets must be considered for diversification and new schemes of income generation.

3) Improving the net interest margin through increasing revenue is generally the most popular option.
4) Operating expenses can be reduced by reallocation or reducing the workforce.
5) Corporate social responsibility must be given due weightage.

CONCLUSION-

Financial sector reforms have made favourable changes in the banking industry. The service levels have been redefined by the banks. Public sector banks are lagging in many parameters and face many problems. Public sector banks must redefine their strategies and strengthen their position. Financial performance of banks must analyse at three levels such as interbank comparison within sector, comparison between sectors and comparison between private and public sector banks. Differences in performances have been identified at all level of comparison.

We in Indian need banks which will carter to all people's needs. Currently it is having a such unfair practice which is hurting the common depositor and even to help by forcing the banks to follow strict guidelines.

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