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BANKING SECTOR- FINANCIAL ANALYSIS DURING POST REFORM ERA

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ABSTRACT

In this paper an attempt has been made to review the performance of banking sector in India during post reform period. For this purpose banks have been broadly categorized into four categories:

i. Foreign Sector Bank
ii Private Sector Bank
iii Nationalized Bank
iv SBI and Associates

A comparative appraisal of banks has been undertaken on the basis of four key indicators of financial performance namely:

i Return on Investment
ii Capital Asset Risk Weighted Ratio
iii Business Per Employee
iv Net Profitability Ratio.

The analysis of the time period will be from 1994 to 2005. Latest trends and developments in the banking sector have also be discussed briefly. It is found that though public sector banks have improved considerably and their performance is comparable with banks in other sector yet they are lagging behind in thrust areas such as business per employee, profitability and asset quality etc.

KEY WORDS: Banking, Trends & Development, Bank peformance, Post Reform Era

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I. Introduction

Banking sector being an integral part of Indian Financial system has undergone dramatic changes reflecting the ongoing economic and financial sector reforms. Main objectives of these reform has been to strengthen the banking system against international best practices and standards which will have lasting effects on the entire fabric of Indian financial system. These financial sector reforms have stimulated greater competition, convergence and consolidation in Indian Banking industry.

Banking industry which was highly regulated in pre-reform period is reorienting itself to face new challenges emerging in the financial sector globally. Basic factors responsible for poor performance of public sectors banks were stringent regulation, administered interest rates, directed and concessional lending, deteriorated portfolio, poor recovery process and above all lack of competition. Against this background, the committee under the chairmanship of M. Narshiman committee has laid down the foundation of banking sector reform in 1991 which entailed several proposals relating to the structure, organization, functions and procedures of financial system. Broadly these reforms were related with dismantling of interest rate, prudential regulation and supervision norms, restructuring of distressed banks, entry of new generation private and foreign banks and liberalized branch licensing policy. This report had recommended a broad structure of the banking system with the primary objectives of having a strong and reliant banking system. These recommendations have induced greater competition with enhanced application of information technology, specialized skills, greater portfolio diversification, better risk management practices and diversified ownerships.

II. Objectives

- To review the financial sector reforms with special reference to the Indian banking sector.
- To conduct a comparative appraisal of financial performance of Public, Private and Foreign Banks in India during post reform period

III. Research Methodology

Data used in this paper are secondary in nature. They have been collected from the published document of Reserve bank of India, Report on trend and Progress of Banking in India, 2003 and 2004 and from websites of Data on Indian Economy for the time period of 1996-97 to 2004-05. For analyzing financial performance of banking sector four key financial performance indicators namely Return on Asset (ROA), Capital Risk Weighted Asset Ratio, Business per Employee, Net Profitability Ratio have been used. For the purpose of analyzing, percentage, tables etc. have been used.

IV Latest Trends and development in Indian Banking Sector

1. Diversification of Banking Services

We may summarize latest trends and development in one word that is diversification of banking services activities. RBI has permitted commercial banks to engaged in diverse activities such as security related transactions, foreign exchange transaction, leasing and cross selling etc. In the present scenario, banks in all sector are concentrating on diversifying their operations to nontraditional banking business such as insurance, underwriting, deposit services. Declining in interest margins and other factors like customers expectations have been instrumental in making banks diversifying their proportions.

2. Changing Composition of Total Earning of Banks

The non-interest income also known as other income has evolved as an increasingly important sources of income for banks. Banks are becoming more reliant on non interest sources of income in which fee based income is a major constituents. They are gradually shifting towards generating more business from fee based non interest income. In India contribution of fee based non interest income is nearly one fifth of total income and this trend is continuously rising with deregulation, atomization and intense competition. The Reserve Bank of India has stated in his report on Trend and Progress of Banking in India (2003-04) that “ the fall in the interest income has been to a large extent compensated by the rise in income from non interest generating sources”.

3. Customer Relationship Management

With the intensified competition, the outlook of banks towards customer has undergone a big change. Especially in Public Sector banks, where they are gradually shifting their emphasis on customer orientation from account oriented. With the help of CRM mechanism bank are making a positive endeavor to ensure enhancement in the profitability ratio by cross-selling more product to the existing customers. Private sector and foreign sector banks are a head of public sector banks in this respect. Although their customer coverage base is low as compared to public sector but they steadily high business from cross selling and up-selling because of effective customer relations management.

4. Consolidation and Mergers and Acquisitions

As a major strategy of restructuring over the last decade merger and acquisition have been used at a large scale as a strategy of diversifying geographically to penetrate new markets. Consolidation through mergers gives benefit of both economies of scale and economies of scope to banks. Centurion Bank Ltd has merged with Bank of Punjab to form a consolidated bank Centurion bank Of Punjab Ltd. As a reformatory measure Global Trust Bank with Oriential Bank of Commerce occurred because of deteriorating financial position.

V Performance of Banking sector in Post Reform Era

In the post reform period, the performance of banking sector has been reasonably well. For the purpose of analyzing the performance of banks in India, banking sector is broadly categorized into foreign sector banks, Indian Private sector banks, nationalized banks and SBI and Associates. For making comparative analysis four key indicators of financial performance like Return on Asset, Capital Risk Weighted Asset Ratio, Business Per Employee, Net Profitability Ration has been selected from the time period of 1994 to 2004-05

1. Return on Asset

Return on assets is defined as the ratio of profits after tax to average asset. It reflects the efficiency with which banks deploy their assets. Table 1 shows that ROA of public sector banks exceeded that of private and forging banks except in the year 1996-97. In addition to this overall ROA declined in 2004-05. The decline being the biggest in case of private sector banks followed by foreign sector banks and public sector banks. This is because private and foreign banks emphasis more on earning income from non traditional sources of income by selling diversified third party product for which minimum or no capital base is required. Profits from securities, foreign transaction and brokerage commission services contribute significantly in fee based income of these banks.

Table 1 Return on Asset

	YEAR								
Banks	**2004-05**	**2003-04**	**2002-03**	**2001-02**	**2000-01**	**1999-00**	**1998-99**	**1997-98**	**1996-97**
Foreign banks	.55	1.07	1.01	-0.5	-23.43	0.34	0.62	0.71	1.1
Indian private Banks	0.13	0.75	0.83	1.18	-31.43	1.25	0.95	1.43	1.49
Nationalized banks	0.9	1.27	1	0.68	0.42	0.53	0.54	0.66	0.58
SBI & Associate	0.83	1.34	1.15	0.95	0.66	0.85	0.65	1.15	0.76

2. Capital Risk Weighted Asset Ratio

Capital risk weighted asset ratio is a measure of a bank financial health. The ratio is provided by equity plus reserves over total risk weighted assets. It reflects the soundness of a financial institution. As it is shown in the table 2 in the year 2004-05 the capital risk weighted assets ratio of foreign banks is 41.11% as compared to private banks and public sector banks where it is 13.49 and 12.85 respectively. This suggest that foreign banks have greater incentive to lend prudently and remain well capitalized than the three other kind of bank. The balance sheet of foreign banks appear to be more structurally sound than those of domestic and public banks based on this ratio as compared to new technologies private banks and public sector banks. It is noteworthy that advances components of foreign banks is quite low as compared to public sector banks with wide coverage both in terms of quantity and geographical expansion.

Table 2 Capital risk weighted asset ratio

	YEAR								
Banks	**2004-05**	**2003-04**	**2002-03**	**2001-02**	**2000-01**	**1999-00**	**1998-99**	**1997-98**	**1996-97**
Foreign banks	41.11	42.3	53.49	45.22	33.11	31.51	44.22	39.72	62.58
Indian private Banks	13.49	13.51	12.17	9.6	12.37	12.72	12.14	12.21	12.47
Nationalized banks	12.85	13.18	12.21	7.5	10.98	11.14	10.95	10.53	8.67
SBI & Associate	12.15	13.02	13.09	9.48	12.43	11.95	11.89	12.55	10.44

Source: RBI, Data on Indian Economy

3. Business per employee

As shown in table no 3, foreign banks are generating two times higher business per employee as compared to their counterpart Indian Private sector banks and Public sector banks and foreign banks employ personnel with professional skill and experience and these are generally in less number. While in case of public sector banks, they are overstaffed, moreover lack of promotional and incentive policies are the main reasons of poor performance of per employee business generation. As shown in the table 3 foreign banks are generating to the tune of Rs 882.01 lac p.a as compared to nationalized banks which they are getting business per employees at Rs 360.28 lac.p.a

Table 3 Business per Employee

	YEAR								
Banks	**2004-05**	**2003-04**	**2002-03**	**2001-02**	**2000-01**	**1999-00**	**1998-99**	**1997-98**	**1996-97**
Foreign banks	882.01	851.3	814.31	7480.22	777.55	590.72	567.3	542.73	474.02
Indian private Banks	420.71	422.12	405.54	370.97	369.97	383.23	303.81	291.85	210.43
Nationalized banks	360.28	256.01	220.87	193.32	160.91	126.8	106.24	88.57	72.91
SBI & Associate	282.19	226.22	195.19	161.21	133.7	105.63	90.94	78.06	66.25

Source: RBI, Data on Indian Economy

4. Net Profitability Ratio

Net profit of schedule commercial banks has declined marginally in 2004-05. However, except for the new private sector banks, the ratio declined across banks group, the decline being the highest in case of old private sector banks, followed by foreign banks and public sector banks. During the period of 2000-01 to 2003-04, Net profit of public sector bank has increased significantly while income of foreign banks and private sector banks have grown at nominal rate.

With the diversification of banks portfolio, other incomes, comprising of trading income and fee based income has evolved as an important sources of income for banks over the last few years.

VI Conclusion

Banking sector in India has given a positive and encouraging response to the financial sector reforms. Entry of new private banks and foreign banks has shaken up public sector banks to competition. Changing financial scenario have opened up opportunities for banks to expand their global presence through self expansion, strategic alliance etc. The financial sector reforms have brought Indian financial system closer to global standards. The process of strengthening the banking system has to be viewed as continuous one. With the India increasingly getting integrated with the global financial world, the Indian banking sector has a still long way to go to catch up with their counter parts.

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