Financial Performance of New Private Banks With Other Bank Groups in the Banking Industry

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INTRODUCTION

Like other commercial organisation, banks also perform with assets and liabilities with the intention of creating and maximising profits. For deposits, banks have to pay interest while for advance, banks earns interest. Hence there is interest income and interest expenditure. Any prudent banker lends at a higher rate of interest than he has to pay on the deposit. The difference between interest income and interest expenditure is net interest income or 'spread'. In addition to interest income, there are other non-interest incomes also, like commission, exchange locker rent etc. All this constitutes total income.

Like-wise there is non-interest expenditure also. This includes salary and allowance payable to the workforce, rent, lighting etc, essential for conducting the business. Interest expenditure and non-interest expenditure together constitutes total expenditure for the organisation. Excess of total income over total expenditure is termed as operating profit and excess of total expenditure over total income is operating loss. Moreover due to the inherent risks, banks also make provision and contingencies against these risks. The balance of operating profit after provisions and contingencies is net profit.

OBJECTIVES OF THE STUDY

The new generation private sector banks were functioning along with other banking groups (viz) public sector banks, old private banks and foreign banks. Depict the market domination by the existing banking groups, the nature of penetrating by the new generation private banks. The paper carries out a comparative study of the performance of new generation private banks with other bank groups and analyzes the parameters in which the new generation private banks outperformed other bank groups.

RESEARCH METHODOLOGY

Though the study period is ten years from 1996 to 2005, the census method is adopted. Hence, all the bank group wise data has to be collected for further analysis and comparison. Adoption of census method will give better and accurate result for finding out the impact of new private banks in the banking industry. Accordingly, data for the period ending 31st March of every year has to collect as per bank group wise. Viz.; Public sector Bank group, Old Private sector Bank, Net Private Sector Bank. Among the primary and secondary data collection, secondary data collection method is adopted.

TOOLS AND TECHNIQUES

Impact of new private banks is analyzed on the basis of growth compared to the previous years as well as with reference to other bank groups. For this purpose, the following tools and techniques are adopted.

- Growth Rate (GR)
- Compound Annual Growth Rate (CAGR)
- Ratio Analysis

In this article, important components under Assets and liabilities are analyzed group wise for the period 1995 through 2005. The annual growth rate, compound growth rate (CAGR), the shares in the total are also found out in order to have a valuable conclusion. Further the trend of market share of deposits and advances are also examined so as to get the conclusive proof on the impact of new private banks and also to know the gainers and losers. Within a short span of 10 years, new private banks as a group established their identity in banking industry.

ANALYSIS OF DATA

In this chapter, the following important financial indicators are analyzed.

1. Operating profit
2. Net Profit
3. Wage Bill
4. Spread
5. Operating expenses
6. Burden

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All these parameters are analyzed as a percentage to total assets.

OPERATINGPROFIT

Operating profit is the excess of total income over total expenditure other than the provision and contingencies. Operating profit is an index for the operational efficiency of the organisation. In recent times, treasury operations have emerged as a major profit centre for Indian banks. Forex income although not as large as treasury income, has also contributed significantly to banks' operating profit in recent years. A bank group wise analysis indicates that a major share of profits of public sector banks was on account of trading income while in the case of foreign banks, foreign exchange transaction account for a major share in profits (trend and progress 04-05).

Table -1 Operating Profit as a Percentage to Total Assets

YEAR	Public SectorBanks	Old Private Sector Banks	New Private sector Banks
1995-96	1.49	2.10	2.77
1996-97	1.60	1.89	2.98
1997-98	1.58	1.97	2.86
1998-99	1.37	1.21	1.78
1999-2000	1.47	1.84	2.11
2000-01	1.34	1.75	1.74
2001-02	1.88	2.70	1.22
2002-03	2.31	2.67	2.31
2003-04	2.67	2.64	2.08
2004-05	2.29	1.68	1.85

Source: Statistical Tables Relating to Banks in India-various issues
Report on Trend and Progress of Banking in India-various issues

Operating profit of scheduled commercial banks during 2004-05 declined by 3.1 per cent in 2004-05 as against an increase of 29.3 per cent in the previous year (Appendix table) reflecting largely the impact of decline in non-interest income. Among bank groups, operating profits of nationalised banks, old private sector banks and foreign banks declined in2004-05, while those of SBI group and new private sector banks increased.

Operating profit, as a percentage to total assets of foreign banks was the maximum for the year 2004-05 followed by public sector banks and new private banks. New private banks exhibited variations in the ratio whereas other groups exhibited a steady improvement except in the year 2004-05.

NET PROFIT

Net profit is the balance of operating profit after the provision and contingencies. Empirical studies reveal that investment in technology yields improved productivity and growth in profit per employee. Public sector banks and old private sector banks have now realised that cost of transaction get drastically reduced when banks change from brick and mortar branches to electronic channels like ATMs, phone banking and internet banking.

Table -2 Net Profit as a Percentage to Total Assets

YEAR	Public SectorBanks	Old Private Sector Banks	New Private sector Banks
1995-96	-0.07	1.06	1.85
1996-97	0.57	0.91	1.73
1997-98	0.77	0.81	1.55
1998-99	0.42	0.48	1.03
1999-2000	0.57	0.84	0.97
2000-01	0.42	0.59	0.81
2001-02	0.72	1.08	0.44
2002-03	0.96	1.17	0.90
2003-04	1.12	1.20	0.83
2004-05	0.89	0.33	1.05

Source: Statistical Tables Relating to Banks in India-various issues
Report on Trend and Progress of Banking in India-various issues.

Net profits declined by 7.0 per cent (excluding the conversion impact) during 2004-05 as against an increase of 30.4 per cent in the last year. While net profits of nationalised banks, old private sector banks and foreign banks declined, those of SBA group and new private sector banks increased. Sharp increase in the net profits of new private sector banks was on account of a sharp decline in provision and contingency (p.p. 86 Trend and progress)

As a ratio, net profit as a percentage of total assets of new private banks fared well than other groups. This ratio improved much when compared to operating profit to Total Asset. IT driven business models have helped foreign banks and new private banks in providing better customer service, improved market share, risk management asset, liability management and thereby increasing probability to a great extent.

WAGE BILL

Wage cost account for a major share in operating cost of the banking industry, especially public sector banks (PSB). The more technology intensive new private sector banks and foreign banks had a significantly lower proportion of wage bill in operating expenses as compared with old private sector banks and public sector banks (pp.85 trend 04-05). Wage bill for the banking sector on the whole declined as percentage of operating expenses (58.0 per cent in 2004-05 compared with 60.3 per cent in 2003-04(trend & Progress)

Table -3 Wage Bill as Percentage to Total Assets

YEAR	Public SectorBanks	Old Private Sector Banks	New Private sector Banks
1995-96	2.20	1.70	0.27
1996-97	2.09	1.53	0.30
1997-98	1.94	1.40	0.31
1998-99	1.93	1.41	0.31
1999-2000	1.84	1.39	0.28
2000-01	2.03	1.24	0.32
2001-02	1.65	1.26	0.25
2002-03	1.59	1.23	0.43
2003-04	1.54	1.16	0.48
2004-05	1.44	1.09	0.50

Source: Statistical Tables Relating to Banks in India-various issues.
Report on Trend and Progress of Banking in India-various issues

For new private sector banks, the wage bill as a percentage to total assets declined marginally. But that of public sector bank and old private sector banks decreased more. The ration of wage bill to total assets showed large divergence among the different bank groups. While it was the highest in the case of public sector banks, it was the lowest in the case of new private sector banks reflecting the greater impact of computerization in the latter. The public sector bank's ratio is three times higher than that of new private banks implying the greater advantage on automation leading to leaner wage bills for the new private banks ultimately resulting in higher profits.

SPREAD

The spread or the net interest income, defined as the difference between interest income and interest expenses, constitute an important indicator of efficiency of banks since it drives a wedge between interest received by depositors and the interest charged to borrowers on their loans.

In 2004-05, the spread of Commercial banks remains unchanged at the previous year's level and continues to be high in comparison with international standards. While Net interest margin of SBI group new private sector and old private banks increased, that of nationalized banks declined.

Table -4 Spread as a Percentage to Total Assets

YEAR	Public SectorBanks	Old Private Sector Banks	New Private sector Banks
1995-96	3.08	3.14	2.84
1996-97	3.15	2.93	2.88
1997-98	2.91	2.57	2.23
1998-99	2.80	2.15	1.98
1999-2000	2.70	2.33	1.95
2000-01	2.86	2.51	2.14
2001-02	2.73	2.39	1.15
2002-03	2.91	2.47	1.70
2003-04	2.98	2.60	2.03
2004-05	2.92	2.70	2.17

Source: Statistical Tables Relating to Banks in India-various issues.
Report on Trend and Progress of Banking in India-various issues

Spread, as a percentage to total assets was lowest for new private sector banks while it was higher for foreign banks. During the entire study period (1996-2005) this ratio remained at a lower rate for new generation banks.
The Net interest margin (NIN) or spread of a bank reflects the efficiency of its intermediation process, a lower margin being indicative of higher efficiency. Most countries in developed and several emerging economics have spread of around 2 percent of total assets.

OPERATIVE EXPENSES

Expenses, which are essential for the operation of the business, are known as operating expenses. In banking industry, operation expenses includes the following.

1) Payments to and provisions for employees.
2) Rent taxes and lighting.
3) Printing and Stationary.
4) Advertisement and Publicity.
5) Depreciation on Banks property.
6) Director's fees allowances and expenses.
7) Auditor's fees and expenses.
8) Law charges.
9) Postage, Telegrams and Telephones etc.,
10) Repairs and maintenance.
11) Insurance.
12) Other Expenditure.

An indicator of competitiveness in banking is the intermediation cost. (i.e) Operating expenses as a proportion of total assets. Intermediation cost has shown wide variance among various bank groups.

Table -5 Operating Expenses as a Percentage to Total Assets

YEAR	Public SectorBanks	Old Private Sector Banks	New Private sector Banks
1995-96	2.99	2.60	1.88
1996-97	2.88	2.51	1.93
1997-98	2.66	2.31	1.76
1998-99	2.65	2.26	1.73
1999-2000	2.53	2.17	1.42
2000-01	2.72	1.99	1.75
2001-02	2.29	2.07	1.10
2002-03	2.25	2.05	1.96
2003-04	2.21	1.97	2.04
2004-05	2.09	1.95	2.16

Source: Statistical Tables Relating to Banks in India-various issues.
Report on Trend and Progress of Banking in India-various issues.

New Private sector banks had a lower ratio when compared to other bank groups except in 2003-04 and 2004-05. New private banks profit is indicative of the lower operating expenses. Banks have been able to contain operating expenditure despite a significant increase in retail loans which, being small, carry higher transaction cost. From the overall profitability viewpoint, operative expenses need to be seen in conjunction with non-interest income. Operation expenditure normally exceeds non-interest and this has been the case in India as well.

BURDEN

The excess of non-interest expenditure and non-interest income is called burble. Operating expenditure normally exceeds non-interest income. This results in sharp increase in bank's burden.

Table - 6 Burden as a Percentage to Total Assets

YEAR	Public SectorBanks	Old Private Sector Banks	New Private sector Banks
1995-96	3.15	2.08	0.98
1996-97	2.59	2.01	1.14
1997-98	2.14	1.76	0.68
1998-99	2.38	1.67	0.95
1999-2000	2.12	1.52	0.99

YEAR	Public SectorBanks	Old Private Sector Banks	New Private sector Banks
2000-01	2.44	1.91	1.32
2001-02	2.01	1.31	0.71
2002-03	1.95	1.29	0.80
2003-04	1.85	1.40	1.20
2004-05	2.14	2.37	1.12

Source: Statistical Tables Relating to Banks in India-various issues.
Report on Trend and Progress of Banking in India-various issues.

During the entire study period from 1996 through 2005, new generation private sector banks exhibited the lowest burden as a percentage to total assets followed by public sector banks and old private sector banks.

FINDINGS OF THE STUDY

Operating and Net Profit

In the year ending March 2005, only the new generation banks could produce positive growth in operating profit and net profit thereby proving their ability to withstand in case of adversities. All other bank groups had negative growth. Even though the operating and total expenditure are more, the new private banks established their operational efficiency by generating higher operating and net profits particularly after the year 2002.

Return on Investments, Return on Advances and Cost of Funds

Though return on investments as a percentage was lower than other groups, the new private banks maintained the return on advance at par with other groups. But these banks succeeded in attracting deposits and borrowings at a lesser cost. New private banks attracted low cost deposits when compared with other bank groups. The lower cost of funds resulted in higher spread ultimately leading to more profits indicative of operational efficiency.

Loans to Sensitive Sectors

Lending to sensitive sectors though more profitable, is highly risky also. Like the old private sector bank, new private sector bank's exposure to sensitive sectors as a percentage to total advances was higher than the other groups. In this aspect public sector banks had a cautious approach. When new private sector banks extended 5.65 per cent of advances to sensitive sectors, public sector banks extended only 2.75 per cent in the year 2004-05. It is worthwhile to note down that the ratio of 16.03 per cent in 2000 was brought down to 5.65 per cent by the year 2005, by the new private banks. This is an indication of prudent credit management.

Wage bill

During the entire period of study (1996-2005), the new generation private sector banks maintained the lowest ratio of wage bill as a percentage to total assets reflecting the lesser number of branches and greater impact of technology. This ratio is highest for public sector banks followed by old private banks and foreign banks.

Rural Network

New private banks have failed to reach rural masses on a large scale and have not met the stipulation of opening 25 per cent of branches in rural and semi-urban areas. The joint parliamentary Committee headed by Sri.Janardhana Reddy observed that “these banks (new private banks) failed to reach the rural masses on a large scale”. While old Private sector banks have 24.23 per cent branches in rural areas; new private banks have only 9.52 per cent of their branches in rural areas.

Professionalism

Income earned over Government business was a major income for almost all-public sector banks. Though the Govt. has to incur charges for governmental business, ultimately these amount flows back into the govt. treasury in the form of dividend at the year-end. Since Oct 2001, 2003, four of the new private sector banks viz., HDFC Bank, UTI Bank, ICICI Bank and IDBI Bank were authorized to handle govt. transactions such as revenue collection, pension payment and expenditure related functions of all central govt. ministries/Departments. This indicates that the new private banks can easily penetrate even in a dominated market, without much difficulty.

SUGGESTIONS AND RECOMMENDATIONS

Operating and Net Profit

Every commercial activity is with the intention of creating and maximizing the profit. Inspite of adversities in the market, the new private banks generated higher profits. Other groups especially the public sector banks, lags behind in this sector.

Low Cost Funds

Inspite of the accumulation of borrowings and robust growth in deposits, new generation banks pegged the cost of funds to the lowest when compared to other bank groups. This may be due to the sound marketing intelligence prevalent in the new private banks. Professionalism is the order of the day and banks especially public sector banks lags behind in this aspect.

Total Expenditure and Operation Cost

When compared to other groups, new private banks had a higher expenditure. But their profit is also more. Though expenditure was high, they reaped more income resulting in higher profits. They incurred expenditure where they could get proportionately higher income. Avenues for income both interest as well as non-interest income has to be searched.

Credit Management

Because of the sensitiveness, loans to capital market, real estate segment and commodities segment has to be regulated and maximum exposure ceilings has to be implemented. Better follow up and monitoring can reduce non-performing assets. Despite the growth in advances, all bank groups could reduce their NPAs substantially. Better credit management, asset-liability management has to be emphasized and implemented without fail.

Increase CRAR

For better international acceptability and also for projecting the financial soundness, banks should be persuaded to keep a higher CRAR than the stipulated norms.

Access to Rural Network

New private banks are networked across major cities and potential centers. Their rural access is very low. This has to be changed. These banks should not be allowed to open new branches in urban areas unless they reach the rural masses as per the stipulated 25 per cent branches in rural areas.

CONCLUSION

At the same time, the disaster of Global Trust Bank reminds us of several risks. If the absorption by another bank does not takes place, what will happen to their depositors and investors? Despite the existence of several watchdogs, none of the authorities could smell the rottenness in the Global Trust Bank. It is high time to plug the loop holes; else one disaster may follow another. Because the withdrawal of major portion of deposit in panic may challenge the very existence of banks. If the faith of Indian public in the public system is to be sustained, the erring promoters and management must be taken to task. In future, more than the pattern of ownership, more important will be competitiveness, effectiveness, market intelligence, adaptability to customers' needs and professionalism reinforcing the Darwinian philosophy, "Survival of the fittest and extinction of the weakest".

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