



## **EVALUATING FINANCIAL PERFORMANCE OF SBI THROUGH FINANCIAL RATIOS**

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**ABSTRACT**

The banking system is an important constituent of the overall economic system. It plays a major role in mobilizing the nation's savings and in channelizing them into high investment priorities and better be described as the kingpin of the chariot of economic progress. Evaluation of the financial performance of the banking sector is an effective measure and indicator to check the soundness of the economic activities of the country. In such a competitive environment, financial institutions are forced to examine their performance give the dynamic economics of the 21st century, and their survival depends upon their productive efficiency. With their view, in the present paper, the financial performance of State Bank of India (SBI) has analyzed. In this way ratio analysis is a very important part of the strategic planning. In this paper, to evaluate the financial performance of SBI, five key financial ratios have been used

The present study adopts an analytical and descriptive research design. Investing valuation ratios demonstrated that SBI has a strong financial position. Investors were confident about investing in SBI's stocks because they were confident that by investing in this stock, not only will their money be safe, but they will get good returns every year.

**Keywords:** Financial performance, public sector banks, financial ratios, investment, profitability, Balance sheet and cash flow.

## INTRODUCTION

Banks play an active role in the economic development the country. Their ability to make a positive contribution in igniting the process of growth depends on the effective banking system. The banking system is an important constituent of the overall economic system. It plays a major role in mobilizing the nation's savings and in channelizing them into high investment priorities and better be described as the kingpin of the chariot of economic progress. Evaluation of the financial performance of the banking sector is an effective measure and indicator to check the soundness of the economic activities of the country.

In a competitive environment, financial institutions are forced to examine their performance as their survival depends upon their productive efficiency. In the present paper an attempt is made to analyse financial performance of SBI. The ratio analysis is a very important part of the strategic planning. To evaluate the financial performance of SBI, five key financial ratios have been used. With the help of these ratios, the financial soundness of SBI is judged. The five key financial ratios considered are a). Investment evaluation ratios b). Profitability ratios c). Management efficiency ratios d). Balance sheet ratios and e). Cash flow ratios.

### Research Methodology

To analyse the financial soundness, and to infer about convergence of the State Bank of India, a very simplified approach was used through ratio analysis. For this analysis, financial data were derived directly from the annual reports and financial ratios were employed for evaluating the performance in financial soundness of SBI for the last six financial years. The present study adopts an analytical and descriptive research design. The data of the sample bank, that is , SBI for a period from 2009-2014 were collected from the annual reports published by the banks, publicly available information published by the Reserve Bank of India (2014) and Money control.com(2014) related to financial ratios were used in this study.

### Analysis and Findings

For the analysis of financial performance of SBI, five ratios were studied. These ratios are a). Investment valuation ratios, b). Profitability ratios, c). Management Efficiency Ratios, d).Balance sheet Ratios and e).Cash Flow Indicator Ratios. All the data shown in the table and figures are these of the financial year, for example, march 2014 corresponds to the march month of the financial year 2013-2014. The required now data for the financial ratios shown in the table 1 to 5 were collected from the annual reports (2009-2014) of SBI (Moneycontrol.com.2014). After analyzing each ratio, the results were calculated. These results are analyzed using the following two normalized ratios, R1 and R2.

- $R1 = (\text{Value in 2014} - \text{value in 2009}) / \text{value in 2009}$
- $R2 = (\text{Value in 2014} - \text{value in 2013}) / \text{value in 2013}$

**Table 1:** Investment Valuation Ratios for the Period from 2009 – 2014

March	2009	2010	2011	2012	2013	2014
Operating profit per share (Rs )	230.04	229.63	255.39	289.44	236.63	199.45
Net Operating profit per share (Rs)	1179.45	1353.15	1504.34	1776.47	1749.29	1826.45
Free reserve per share (Rs )	371.99	412.36	468.29	645.05	642.56	656.58
Dividend per share (Rs)	29	30	30	35	41.5	30
Earning per share (Rs)	143.73	144.73	160.07	174.15	206.20	245.88

Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)

Analysis and findings based on these 5 ratios are described in the following sections:

#### 1) Investment Valuation Ratios:

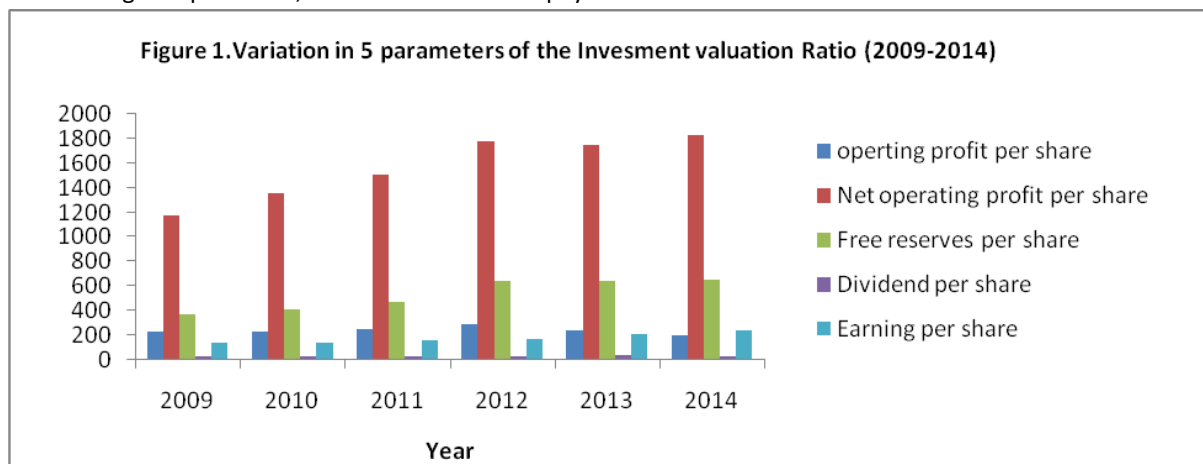
Investment valuation ratio is used an investor to evaluate the investment extracts. It attempts simplicity of the evaluation process by comparing the relevant data, which helps users to gain an estimate of

value. It measures investors' response to owning a company's stock and also the cost of the issuing the stock. The said are concerned with the return on investment for shareholders, and with the relationship between return and the value of an investigate the company's shares. This ratio is analyzed by the following 5 parameters:

- **Operating profit** is a measure of a bank's profit that excludes interest and income tax expenses. It is the difference between operating revenues and operating expenses, that is,  

$$\text{Operating profit} = \text{operating revenues} + \text{Non operating income}$$
- **Net Operating profit:** as banks have non-operating income also, in such cases, net operating profit or earnings before interest and tax (EBIT) is calculated as follows:  

$$\text{Net Operating profit} = \text{Operating profit} + \text{Non operating income}$$
- **Earnings per share (EPS)** are the amount of income that the common stockholder is entitled to receive per share (of stock owned). This income may be paid out in the form of divides, retained and reinvested by the company, or a combination of both.
- **Dividend per share** is the part of the EPS that the company pays to the common stockholders.
- **Free Reserves** are extra cash, a bank keeps in liquid assets (i.e, what it does not loan out) beyond its legal requirement, minus what it must repay.



Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)

The Table 1 shows the values of these 5 parameters in the last 6 financial years (2009-2014). Which are further shown in the figure 1, indicating the variation in these parameters in the form of bar charts. It can be observed from the table1 and figure1, that in general, all the five parameters increased year on year due to inflation. It can be observed from the data that SBI's financial position has been improving constantly. Furthermore, when the operating profit is compared with the net operating profit, it can be inferred that the total income consists of a big proportion of non-operating income. Every year, almost 85% of the total income was generated from the non-operating income. With the help of EBIT (Net operating profit) and EPS analysis, investors are able to zero in on the stocks in which they can invest their surplus money. It is clear from the table 1 that investors can think of investing their surplus money is SBI's stocks. EBIT was rapidly interesting and due to that, EPS was strong. Due to financial soundness, the bank was capable to pay the dividend every year without any interruption. Also, from free reserve's point of view, SBI was a strong position. So, overall, from the investing their surplus money in SBI's stock because their money was invested in a good stock and they will get good returns every year as all the 5 parameters shown in table 1 and figure 1 increased consistently year ratio R1 is quite high as compared to R2, which was as expected as R1 is based on the data for the year 2009, while R2 is based on the data for the year 2013.

**2) Profitability Ratios:** Most of the investors want to invest in banks that are going to be profitable in future. Highly profitable banks translate into a higher return on investment through share price appreciation or a higher dividend yield. As such, there are several popular rations that measure a firm's profitability. These include net profit margin, return on net worth, and return on long term funds. Profitability ratios measure the efficiency of business, operations with the help of profits. It is quite a useful tool to understanding the efficiencies of a business, and thereby assist management on the final goal (that is profit) of a business. The

different stakeholders (owners). The management, creditors, and lenders) of a business are interested in the profitability ratios for different purpose. These ratios show a bank's overall efficiency and performance. It can be divided into two types – margins and returns. Ratios that show margins represent the bank's ability to gain profits. Ratios that show returns represent the bank's ability to measure the overall efficiency of the bank in generating returns for its shareholders. The table 2 show the variation in the 5 parameters of the profitability ratio for the last eleven years (2009 – 2014). Further, 3 key parameters are described in detail and are depicted in the figure 2.

**Table 1R: Values of R1 and R2 based on the Table 1**

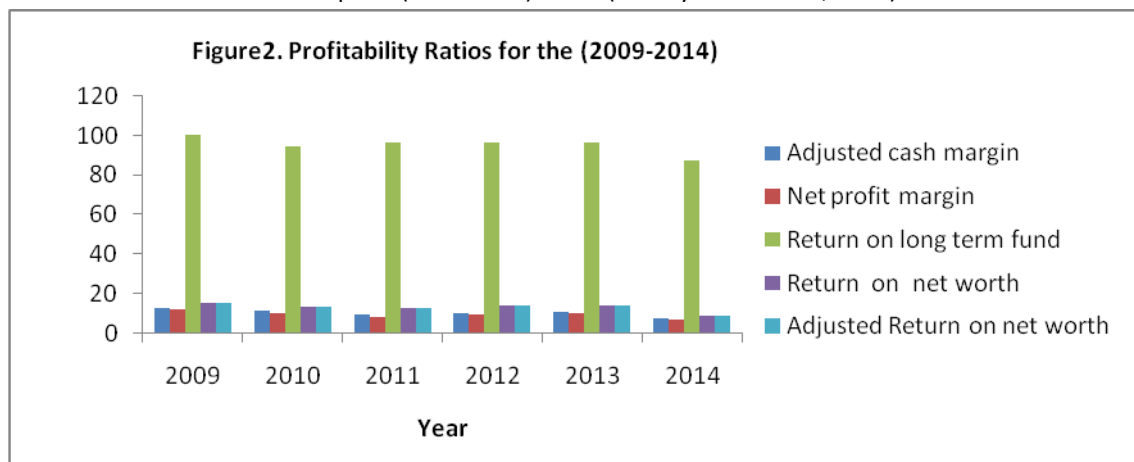
Ratios	R1	R2
Operating profit per share	-13.3	-16
Net Operating profit per share	55	4.41
Free reserve per share	76.51	2.1
Dividend per share	3.45	-27.71
Earning per share	71.4	19.24

Source: Data in Table 1

**Table 2; Profitability Ratios for the Period from 2009 – 2014**

March	2009	2010	2011	2012	2013	2014
Adjusted cash margin (%)	13.04	11.62	9.6	10.59	11.23	7.89
Net profit margin (%)	12.03	10.54	8.55	9.73	10.39	7.03
Return on long term fund ( % )	100.35	95.02	96.73	96.84	96.35	87.28
Return on net worth (%)	15.74	13.89	12.11	13.97	14.26	9.20
Adjusted Return on net work (%)	15.74	13.91	12.74	13.97	14.26	9.20

Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)



Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)

**Table 2R: Values of R1 and R2 Based on the Table 2**

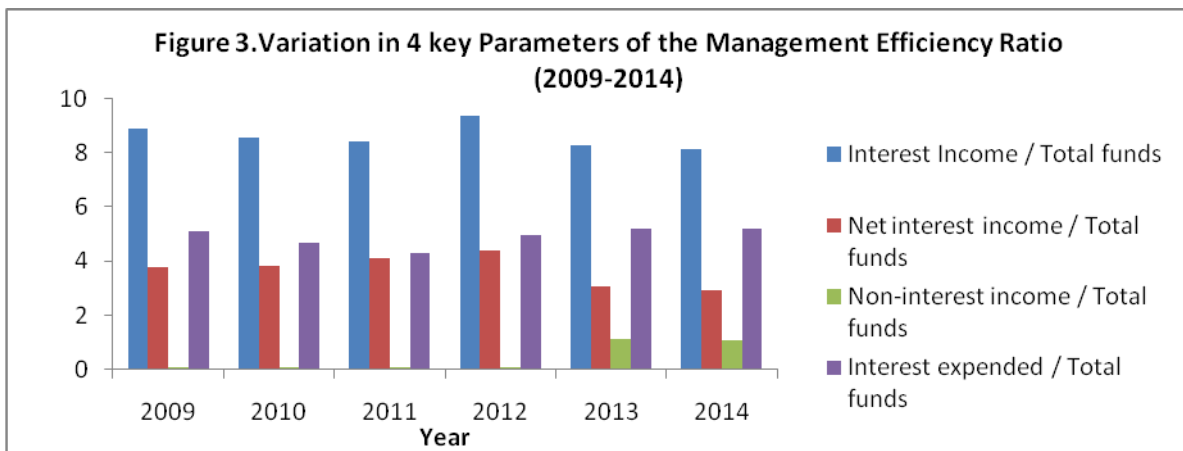
Ratios	R1	R2
Net profit margin	-41.56	-32.34
Return on long term fund	-13.02	-9.41
Return on net worth	-41.55	-35.48

Source: Data in Table 2

**Table 3: Management efficiency Ratios for the Period from 2009 – 2014**

March	2009	2010	2011	2012	2013	2014
Interest Income / Total funds	8.88	8.52	8.39	9.32	8.25	8.12
Net interest income / Total funds	3.79	3.82	4.1	4.37	3.06	2.93
Non-interest income / Total funds	0.11	0.1	0.09	0.08	1.11	1.10
Interest expended / Total funds	5.09	4.69	4.29	4.94	5.19	5.19

Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)



Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)

**Table 3 R: Values of R1 and R2 based on the Table 3**

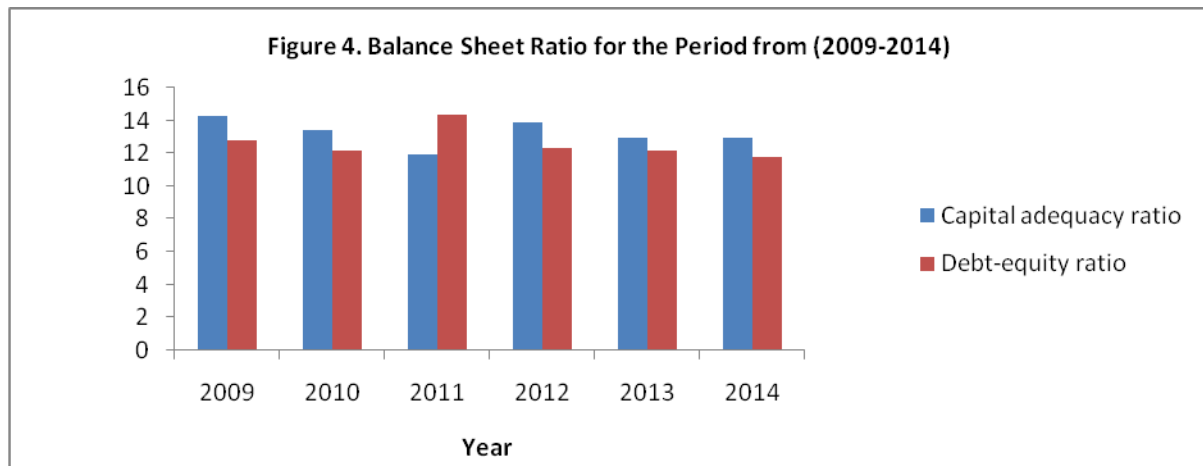
Ratios	R1	R2
Interest Income / Total funds	-8.56	-1.57
Interest expended / Total funds	1.96	0
Non-interest income / Total funds	900	-0.90
Net interest income / Total funds	-22.69	-13

Source: Data in Table 3.

**Table 4: Balance sheet Ratios for the Period from 2009 – 2014**

March	2009	2010	2011	2012	2013	2014
Capital adequacy ratio	14.25	13.39	11.98	13.86	12.92	12.96
Debt-equity ratio	12.81	12.19	14.37	12.43	12.16	11.79

Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)

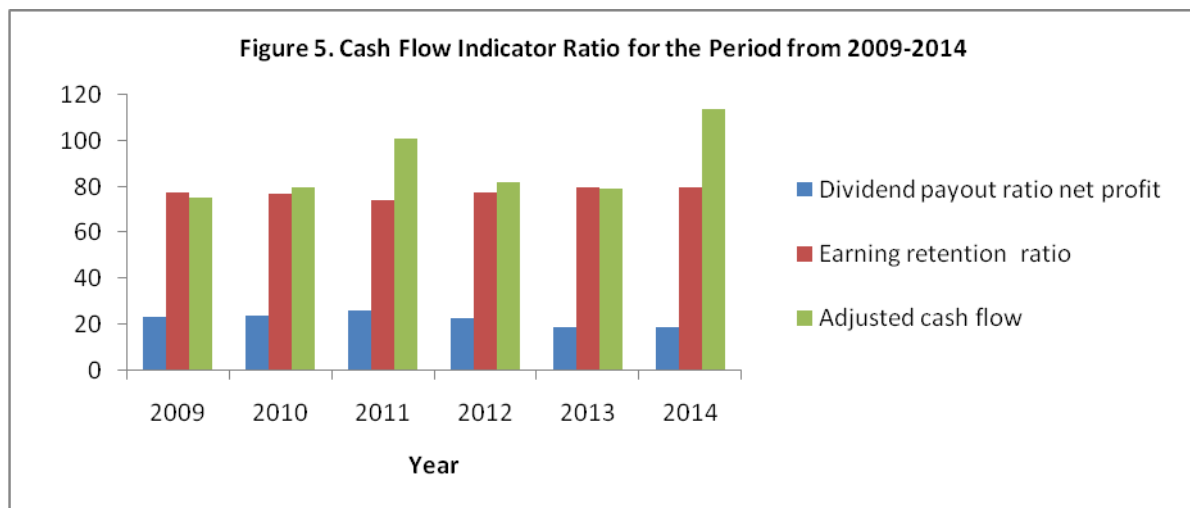


Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)

**Table 5: Cash Flow Indicator Ratios for the Period from 2009 – 2014**

March	2009	2010	2011	2012	2013	2014
Dividend payout ratio net profit	22.9	23.36	26.03	22.59	18.62	18.32
Earning retention ratio	77.11	76.67	74.03	77.45	79.88	79.44
Adjusted cash flow	75.05	79.54	100.71	81.94	78.90	114.06

Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)



Source of Raw Data: Annual Reports (2009-2014) of SBI (Moneycontrol.com, 2014)

- **Net profit margin** is a key financial indicator used to assess the profitability of a bank. It is an indicator of how efficiently and how well a bank controls its costs. The higher the margin, the more effective the bank is converting revenue into actual profit. As for the table 2, in 2014 the net profit margin was 7.03%. it measures profitability after consideration of all expenses, include taxes, interest and depreciation. The net profit margin is calculated by using the following formula:

$$\text{Net profit margin} = (\text{Net operating profit (after tax) by net sales}) \times 100$$

Both terms of this equation come from the income statement. It is also a good time – series analysis, whereby bank owners can look at data for their own bank across different time periods to see how the net profit margin is trending.

- **Return on long term fund ratios** Establish the relationship between net profit and the long-term funds. The term, long-term funds refer to the total investment made in a business for the long term. It is calculated by earnings before interest and tax (EBIT) by the total long-term funds. Return on term funds is calculated on the basis of the following formula:
- $\text{Return on long term fund} = (\text{Net operating profit(EBIT)} / \text{long-term funds}) \times 100$
- **Return on net worth or Return on Equity Ratio** is perhaps the most important of all the financial ratios for investors. It measures the return on the money the investors have put into the company. This is the ratio potential investors look at when deciding whether or not to invest in the company. The calculation is  $(\text{Net Income} / \text{stockholder's Equity}) \times 100$

Net income comes from the income statement and stockholder's equity come from the balance sheet. In general, the higher the percentage, the better it is, as it shows that the company is doing a good job using the investors' money.

It can be observed from the Table 2 and Figure 2 that the net profit margin ratio, return on long term fund ratio, return on the worth ratio, all the three ratios were fluctuating during the study period. In general, the overall net profit margin ratio decreased year wise up to 2014. However, return on long return fund ratio and return on net worth ratio it is decreased up to three years and increased than decreased and net profit margin is also same.

**3) Management Efficiency Ratios:** management efficiency ratio reflects the growth and survival a bank. Management efficiency means adherence to set norms, ability to plan and respond to changing environments, leadership and administrative capability a bank. The ratios in this segment involved subject analysis to measure the efficiency and effectiveness of the management. With the help of this parameter, the bank is able to evaluate the efficiency and take the corrective action to improve the quality, 4 parameters used for the management efficiency ratio are described as:

- **Interest income/Total Funds Interest Income** is a basic source of revenue for the banks. Interest income includes interest from loans, advances and investment, interest on deposits with the RBI, and dividend income.
- **Non-interest Income/total Funds:** Non-interest income includes fee based income accounts (exchange commission, brokerage), gains on sales, revaluation of investments, fixed assets and profits from exchange transactions. SBI generated higher fee income through innovative products and by adopting latest technology for sustained service levels. This ratio measures the income from operations, other than lending of the total income. A higher ratio indicates the increasing proportion of fee-based income.
- **Interest Expended/total Funds:** Interest expended/total funds ratio means how much interest a bank is paying on borrowings. Lower ratios on interest expended/total funds indicates the decreasing proportion of interest paid by banks on borrowings.
- **Net interest income/total funds:** Net interest income is defined as :

$$\text{Net Interest Income} = \text{Interest Income} + \text{Non-invest Income} - \text{Interest Expended}$$

The variation in the aforementioned 4 parameters for the periods from 2009 – 2014 are shown in Table 3. There is no trend in variation; rather, the values fluctuated for different years. Furthermore, variation of interest income and interest expected is shown in figure 3, which indicates that the former is always greater than the latter. The interest expended is about 50% - 60% of the interest income. Table 3 that if the interest income increases, then the non-interest income decreases and vice-versa. Banks' growth depends on lending and borrowing transaction. These transactions depend upon the money market conditions. Due to economic fluctuations and inflation, till 2012.

**4. Balance sheet Ratios:** Balance sheet ratios are used for examining the financial condition of any organization. These ratios are based on data reported in the balance sheet. Certain ratios are particularly applicable banks. The most important are the adequacy ratio and the debt-equity ratio.



- **Capital Adequacy Ratio (CAR)** is important for a bank to maintain the depositor's confidence and also reveals the ability of the management to meet the need for additional capital. The CAR was developed to ensure that banks can absorb a reasonable level of losses occurred due to operating losses and can determine the capacity of the bank in meeting the losses.
- **The Debt-Equity Ratio** show how much proportion of the bank's business is financed through equity and how much is financed through debt. It is calculated by dividing total borrowing with shareholders' net worth. A high ratio is an indication of less protection for the depositors and creditors and vice-versa.

The Table 4 show the variation in the aforementioned 2 parameters for the last six years (2009-2014), which are also shown in figure 4. From the Table 4 and Figure 4, it can be observed that SBI's financial position is very strong. The average CAR the period from 2009-2014 was 12.96%. This show with that SBI has maintained a higher CAR than the prescribed level.

#### 5 .Cash Flow indicator Ratios

- **Dividend payout Ratio** compares a dividend paid by an organization to its earnings. The relationship between dividends and earnings is important. The part of earnings that is not paid out in dividends if used for reinvestment and growth in future earnings. Investor who are interested in short-term earnings prefer to invest in companies with high dividend payout ratio. On the other hand, investors who prefer to have capital growth like to invest in companies with lower dividend payout ratio. Dividends are paid in cash; therefore, high dividend payout ratios have implications for the cash management of the company.
- **Earning Retention Ratio** is also called as plowback Ratio. It is the ratio that measure the amount of earnings retained after dividends have been paid out to the shareholders. The objective to calculate the earnings retention ratio is that the more the bank retains, the faster are its chances of growth its business. The growth dividends and the stock price is dependent on the bank's growth. However, the earnings retention ratio is related to the bank's growth rate. It is the amount of earnings the company reinvest business rather than distributing it to the shareholders as a dividend. Since the some of the retention rate and the dividend payout ratio equal unity, it follows that:  

$$\text{Earnings Retention Ratio} = 1 - \text{Dividend payout Ratio} = (\text{Net Income} - \text{Dividends}) / \text{Net Income}.$$
- **Adjusted Cash Flow or Adjusted Net Income** represents a business earnings after expenses. It show the earnings before interest, Depreciation and taxes, but it also includes additions or subtractions for such items as the owners salary and discretionary, one-time, and non-cash expenses. It show whether business returns are positive, break-even, or loss. The adjusted net cash flow provides a starting point determine potential profit under a new owner and new management style.

The table 5 shows the variation in the abovementioned 3 parameters for the last six years (2009-2014).which are also show in the Figure 5. It is observed from the Table 5 and Figure5 that in general, the dividend payout ratio increased year-wise and reached the peak value in 2001, after which it decreased slightly. The value of earning retention ratio was almost stable, indicating that SBI's growth was increasing over time. Adjusted cash flow show that the bank's returns were positive, and that the investors felt safe about their money as well as about their reruns.

#### CONCLUSION

The paper has made an attempt to examine the financial performance of the largest public sector banks in India the State Bank of India (SBI). The study is based on ratio analysis, and has brought out interesting results which are summarized as. Investing valuation ratios demonstrated that SBI has a strong financial position. Investors were confident about investing in SBI's stocks because they were confident that by investing in this stock, not only will their money be safe, but they will get good returns every year. The profitability ratios indicated that return on long term and return on net worth clearly proved the financial soundness of SBI. The Management Efficiency ratio showed that the growth and survival prospects of SBI are excellent. SBI had a CAR at a higher level than the prescribed level, and the dependence on the capital decreased over the last 6 years.

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