©KY PUBLICATIONS
Vol.1.Issue.2.2014

IJBMAS
E ISSN 2349-4638

http://www.ijbmas.in
INTERNATIONAL JOURNAL OF BUSINESS, MANAGEMENT AND ALLIED SCIENCES (IJBMAS)
A Peer Reviewed International Research Journal

FINANCIAL SOUNDNESS MEASUREMENT AND TREND ANALYSIS OF PRIVATE COMMERCIAL BANKS IN INDIA

G.SRINIVASA BABU
HOD, Department of Commerce
The Hindu College, Machilipatnam

Article Info:
Received on:11/08/2014
Revised on:18/08/2014
Accepted on:25/08/2014

ABSTRACT

A bank is a financial institution that provides banking and other financial services to their customers. A bank is generally understood as an institution which provides fundamental banking services such as accepting deposits and providing loans. There are also non- banking institutions which provide certain banking services without meeting the legal definition of a banks are a subset of the financial services industry. A banking system is also referred to as a system provided by the bank which offers cash management, services for customers, reporting the transactions of their accounts and portfolios throughout the day. Indian banking system for the past three decades has several outstanding achievement to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons for India’s growth process. The banks are the main participants of the financial system in India. Financial analysis is the process of identifying the financial strengths and weakness of a firm by properly establishing relationships between the items of Balance Sheet and Profit and Loss Account. Analysis is the process of critically examining in detail accounting information given in the financial statements. Analyzing financial statement is a process of evaluating relationship between component parts of financial statements to obtain a better understanding of firm’s position and performance. In this paper, an attempt was made to analyze the financial soundness and trend analysis of selected private commercial banks using different statistical tools and financial indicators. The study reveals that different financial indicators showed upward trends during the period 2008 to 2012. The study also made a rank of the selected commercial banks based on financial indicators. It was found that a bank with higher deposits, loans & advances, investments, branches, employees does not always mean that has better profitability performance. The Data was collected through secondary sources from Trend and Progress Report of RBI and the tool used for data analysis of the profile of bank group wise is Compound Annual Growth Rate (CAGR) which is expressed in percentages. The results have found strong evidence that the Private Sector Banks surpasses the other bank groups and topped the position in all the parameters, while Public Sector Banks and Foreign Banks are just competing for the 2nd and the 3rd position. The analysis also recommends measures that could be adopted by banks to ensure soundness in their operation.

Key Words: Indian Commercial Banks, Private Banks, Indian Banks, Efficiency, Profitability, Analysis

1. Introduction

Banking sector is the key player of an economy. Since origin this sector has gone through many changes. People today are highly bankable. So there have been many changes and innovations in this sector. Many reforms have been made. Banking is now confined not only in retail banking. Shape of banking has been modified and to meet the demand of people E-banking, etc have been invented. Banking products has been modernized and people are now enjoying so many banking products. This paper focuses on all the changes experienced by banking sector. A Financial Market can be defined as the market in which financial assets are created or transferred. As against a real transaction that involves exchange of money for real goods or services, a financial transaction involves creation or transfer of a financial asset. A financial system provides services that are essential in a modern economy. The use of a stable, widely accepted medium of exchange reduces the costs of transactions. It facilitates trade and, therefore, specialization in production. In 1960, the State Banks of India was given control of eight state-associated banks under the State Bank of India (Subsidiary Banks) Act, 1959. These are now called its associate banks. In 1969 the Indian government nationalised 14 major private banks, one of the big bank was Bank of India. In 1980, 6 more private banks were nationalised. These nationalised banks are the majority of lenders in the Indian economy. They dominate the banking sector because of their large size and widespread networks. In the early 1990s, the then government embarked on a policy of liberalisation, licensing a small number of private banks. These came to be known as New Generation tech-savvy banks, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, UTI Bank (since renamed Axis Bank), ICICI Bank and HDFC Bank. This move, along with the rapid growth in the economy of India, revitalised the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks and foreign banks[1]. In the Current study author compared the financial performance of Indian Private selected banks namely IndusInd Bank, South Indian Bank, Federal bank, Axis Bank, Development Credit Bank and Tamilnad Mercantile Bank for the financial Year 2008 to 2012

2. Literature Review

Malyadri (2011)[2], "A Comparative Study of Non Performing Assets in Indian Banking Industry", The study observed that during 2004-2010 the asset quality management of Indian Public sector and Private sector banks have improved in NPA management by the implementation of prudential regulations of accounting, income recognition, provisioning and exposure, introduction of CAMELS supervisory rating system and reduction of NPA's and up gradation of technology. But inorder to bring on par international level the government should formulate bank specific policies and should implement these policies through Reserve Bank of India enhancement of Public Sector Banks. The researcher noticed that NPA percentage has decline during their period of study i.e. from 2004 to 2010 as percentage of advances to weaker sections from 18.9% to 3% in case of public s to sector banks and from 12.15% to 0.5%.

3. Statement of the Problem

As lending is considered as the most important function banks exist to provide financial intermediation services while at the same time Endeavour to maximize profit and shareholders' value. Even though loan is major source of banks income and constitutes their major assets, it is riskier, due to uncertainty of counterparty the quality of loans are deteriorating and impairing the profits of the banks. This is leading to the increase of loss of loan assets or Non-Performing Assets.

4. Need of the study

Banking business has done wonders for the world economy. The intensifying competitive environment in the banking sector forcing the banks to focus in their operations. The profile of the banks plays an important role in the performance of the banks and measuring the relative profile of bank group wise has gained academic attentions over the years. Various parameters have been used to determine the profile of the banks. Evaluating the profile of the commercial banks is important to depositors, owners, potential investors, managers and of course, regulators. Moreover, almost every industry, that envisages importance of evaluation, can adopt many methods to evaluate the performance. It prove to be better for performance measurement, evaluation and strategic planning for future growth and development of the Indian banks in the light of changing requirements of this sector so to analyze the comparative profitability performance of banks for the financial periods 2009- 2012. By examining the relationship among banks equity, assets and deposit size to profitability such as ROE, ROA and NIM. The banks will be ranked based on their profitability performance and growth percentage. This will help the banking industry for the improvement or change in their business model.

4.1 Measure of Banks' Performance

Although net income gives us an idea of how well a bank is doing, it suffers from one major drawback. It does not adjust for the bank's size, thus making it hard to compare how well one bank is doing relative to another. A basic measure of bank profitability that corrects for the size of the bank is the return on assets (ROA). Secondly, because the owners of a bank must know whether their bank is being managed well, ROA serves as a good method to identify it.

ROA = Net profit after taxes / assets

However, what the bank's owners (equity holders) care about most is how much the bank is earning on their equity investment. This information is provided by the other basic measure of bank profitability, the return on equity (ROE).

ROE = Net profit after taxes / equity capital

Another commonly used measure of bank performance is called the net interest margin (NIM). NIM is the difference between interest income and interest expenses as a percentage of total assets.

Sample Size: For the in-depth analysis of the profitability, three major public sector and three private sector banks are selected on the basis of their Total Assets from the year 2009 to 2012.

Data Collection: Data was collected through Reserve Bank of India monthly bulletins, annual reports, moneyrediff, moneycontrol , banks websites etc. Five private sector banks were selected on the basis of their total assets.

Data Analysis: Suitable statistical techniques are used for data analysis like ratios and coefficient correlation.

Scope of the Study

This study is undertaken to measure the financial performance of New Generation private sector commercial banks in India. The study will provide details about the growth of deposits and advances, profitability analysis of the selected banks. It is hoped that the result of this study will propose policy measures for the betterment of the new generation private sector banks to achieve the good financial performance.

5. Results and discussion

5.1 Demand Deposit Ratio: The sum of money that is given to a bank but can be withdrawn as per the requirement of the depositor. Amounts that are lying in the savings and current accounts are known as demand deposits because they can be used at any point of time.

Demand Deposit Ratio = Demand Deposit / Total Deposit.

Table 1: Demand Deposit Ratio

YEAR	IndusInd Bank	DCB Bank	Federal bank	South Indian Bank	Tamilnad Mercantile Bank	Axis Bank
2008-9	15.07	9.06	7.59	10.01	20.12	21.36
2009-10	15.07	9.06	7.59	10.01	20.12	21.36
2010-11	15.39	9.61	7.93	15.49	22.46	23.00
2011-12	14.18	8.67	7.65	15.57	22.49	19.71
2012-13	9.52	7.58	7.60	13.83	18.59	18.24
Mean	13.85	8.80	7.67	12.98	20.76	20.73
SD	2.20	0.68	0.13	2.50	1.51	1.62

As shown in table the ratio of demand deposit is more in Tamilnad Mercantile Bank (20.71) followed by another private sector bank AXIS (20.73). Next in order is IndusInd Bank>DCB Bank<Federal bank< South Indian Bank Demand deposit is more in private sector banks than in public banks it may be because no interest is paid on these accounts except in special cases where a large dormant balance is kept which could otherwise be transferred to the savings deposits.

5.2 Debt Equity Ratio: The debt-to-equity ratio (debt/equity ratio, D/E) is a financial ratio indicating the relative proportion of entity's equity and debt used to finance an entity's assets. If the ratio is increasing, the company is being financed by creditors rather than from its own financial sources which may be a dangerous trend. A debt-to-equity ratio is calculated by taking the total liabilities and dividing it by the shareholders' equity: Debt-to-equity ratio = Debt / Equity

Table 2: Debt Equity Ratio

YEAR	IndusInd Bank	DCB Bank	Federal bank	South Indian Bank	Tamilnad Mercantile Bank	Axis Bank
2008-9	15.05	13.78	15.14	15.05	9.87	12.60
2009-10	15.35	14.06	15.45	15.35	10.07	12.86
2010-11	14.86	14.66	16.45	14.86	7.98	9.87
2011-12	16.65	15.45	15.15	16.65	8.67	11.27
2012-13	14.76	14.56	14.56	14.76	8.97	11.17
Mean	15.33	14.50	15.35	15.33	9.11	11.55
SD	0.69	0.58	0.62	0.69	0.77	1.08

As shown in table debt equity is ratio is maximum in case of three banks i.e. IndusInd Bank, Federal bank, South Indian Bank and least in Tamilnad Mercantile Bank (9.11).

5.3 Return on Assets (ROA)

The return on assets ratio, often called the return on total assets, is a profitability ratio that measures the net income produced by total assets during a period by comparing net income to the average total assets. In other words, the return on assets ratio or ROA measures how efficiently a company can manage its assets to produce profits during a period.

Return on assets is the ratio of annual net income to average total assets of a business during a financial year. It measures efficiency of the business in using its assets to generate net income.

ROA= Net income / Total assets

Table 3: Return on Assets (ROA)

YEAR	IndusInd Bank	DCB Bank	Federal bank	South Indian Bank	Tamilnad Mercantile Bank	Axis Bank
2008-9	0.81	1.32	1.10	0.70	1.20	1.20
2009-10	0.80	1.31	1.20	0.70	1.20	1.20
2010-11	0.80	1.33	1.10	1.00	1.30	1.40
2011-12	0.61	1.24	1.20	1.10	1.40	1.40
2012-13	0.80	1.12	1.10	1.30	1.50	1.50

Mean	0.76	1.26	1.14	0.96	1.32	1.34
SD	0.08	0.08	0.05	0.23	0.12	0.12

As shown in table ROA is highest in case of Axis followed by Tamilnad Mercantile Bank and DCB 1.34 , 1.32 and 1.26 respectively and variation is more in case of South Indian Bank and least in case of IndusInd Bank . This return is related with overall profitability.

5.4 Return on Equity

One of the most important profitability metrics is return on equity (or ROE for short). Return on equity reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet.

ROE= Net Income/ Shareholders Fund.

Table 4: Return on equity (ROE)

YEAR	IndusInd Bank	DCB Bank	Federal bank	South Indian Bank	Tamilnad Mercantile Bank	Axis Bank
2008-9	15.05	20.44	17.85	7.58	14.86	17.75
2009-10	14.06	21.14	20.14	9.07	13.86	15.45
2010-11	12.76	20.14	20.24	10.97	15.55	17.65
2011-12	14.36	17.15	18.34	12.46	17.35	18.54
2012-13	13.93	16.63	17.79	12.09	16.83	17.99
Mean	14.03	19.10	18.87	10.43	15.69	17.48
SD	0.75	1.84	1.09	1.85	1.27	1.06

As shown in table ROE is maximum in case of DCB 19.10 followed byFederal bank 18.87, Axis bank 17.48, Minimum is South Indian Bank 10.43. Relatively high or low ROE ratios will vary significantly from one industry group or sector to another. When used to evaluate one company to another similar company the comparison will be more meaningful. Even within the same industry group, comparing the ROE of a company that pays a large dividend with a firm that doesn't can also be misleading[3].

5.5 Net Interest Margin: A measure of the return on a Company's investments relative to its interest expenses. The net interest margin helps a company determine whether or not it has made wise investment decisions. A negative net interest margin indicates that interest expenses exceed investment returns and that the company therefore has a net negative return. A positive net interest margin indicates the opposite.The net Interest margin can be expressed as a performance metric that examines the success of a firm's investment decisions as contrasted to its debt situations. A negative Net Interest Margin indicates that the firm was unable to make an optimal decision, as interest expenses were higher than the amount of returns produced by investments. Thus, in calculating the Net Interest Margin, financial stability is a constant concern

Net Interest Margin (NIM)= (Investment Returns – Interest Expenses) / Average Earning Assets

Table 5: Net Interest Margin (NIM)

YEAR	IndusInd Bank	DCB Bank	Federal bank	South Indian Bank	Tamilnad Mercantile Bank	Axis Bank
2008-9	2.39	2.99	2.19	2.09	3.89	2.89
2009-10	2.89	3.19	2.59	2.09	4.09	2.79
2010-11	3.29	2.99	2.39	2.29	3.89	2.89
2011-12	2.71	2.99	2.39	2.16	4.01	2.79
2012-13	2.77	3.05	2.44	2.21	4.09	2.85
Mean	2.81	3.04	2.40	2.17	3.99	2.84
SD	0.29	0.08	0.13	0.08	0.09	0.04

As shown in table 5, NIM of Tamilnad Mercantile Bank is more than others i.e. 3.99 which shows that interest earned by TMB bank is much more than expended and other banks are earning less interest. Interest earned by bank is there foremost income which is more in case of TMB and other banks following are almost at same level and chart shows that there is very less variation in case of TMB bank and more variation in Axis bank and DCB.

The use of net interest margin is helpful in tracking the profitability of a bank's investing and lending activities over a specific course of time. Besides, a period end balance sheet, average balance sheet published by the banks indicating the breakdown of bank's loans, deposits, investments, and borrowed funds, and their related interest rates provides more insight to investors seeking for more info on the fluctuation of Net Interest Margin.

One of the drawbacks of Net Interest Margin is that it does not measure the total profitability of the bank as most of them earn fees and other non-interest income through services like brokerage and deposit account services, without taking account operating expenses, such as personnel and facilities costs, or credit costs. Besides, net interest margin of two banks can't be contrasted as both the banks are poles apart in their own way, like in the nature of their activities, composition of customer base, and similar more.

6.0 Comparative study of Scheduled Commercial Private and Public banks during 2008 to 2012

The Table 6 depicts that there is a steady increase in Advances of both Scheduled Commercial Banks and Public Sector Banks from 2008-09 to 2012-13[4]. The study observed that the movement of absolute NPAs has a mixture of increasing and decreasing trends. The NPAs CAGR of the Scheduled Commercial Banks and Public Sector stood at 8.87 and 10.23 respectively, which indicates that the major part of NPAs in Scheduled Commercial Banks is from Public Sector Banks. In contrast to that the percent of NPAs CAGR of Scheduled Commercial Banks is -9.32 and Public Sector Banks is -8.49[5].

Table 6: Comparative study of Scheduled Commercial Private and Public banks during 2008 to 2012

	Scheduled Commercial Banks			**Public Sector Banks**		
Years	**Advances**	**NPAs**	**% NPAs**	**Advances**	**NPAs**	**% NPAs**
2007-08	24769.4	247.3	1	17974	178.4	1
2008-09	29999.2	315.6	1.1	22592.1	211.6	0.9
2009-10	34970.9	387.2	1.1	27013	293.8	1.1
2010-11	42987	417	1.1	33056.3	360	1.2
2011-12	50735.6	652	1.3	38773.1	593	1.5
2012-13	58797	986	1.7	44727.7	900	2
CAGPR%	**20.21**	**8.87**	**-9.32**	**20.43**	**10.23**	**-8.49**

Source: RBI, Handbook of Statistics on the Indian Economy 2013-2014

Conclusion and Findings

The foregoing analysis for Axis, TMB Have revealed that the overall profitability is not that high because they there NIM is less and need to gear up the NIM i.e. spread . The deposits are being utilised in good manner as they are giving credit on it and there CDR and profitability is well associated. Debt equity ratio is also very high. To increase the profitability their capital adequacy ratio should also be looked into. The empirical observations primarily revealed that the performances of NPA in terms of absolute value are high from Public Sector Banks in total of Scheduled Commercial Banks. For AXIS ROA is quite high as compared to other banks and is –ve associated with CAR. Profitability is +ve associated with NIM and CDR. The examination of the data over the 6 years period of study from 2008-09 to 2012-13 has found that the asset quality of all sectors banks made a consistent improvement in asset quality. This can be acknowledged through trend in the percentages of NPAs of absolute value of NPAs i.e., trend ratio of NPAs to advances of Public Sector Banks from 5.8% to 2%, Private Sector Banks from 12% to 1.1% and Foreign Sector Banks from 1.9% to 1%. By end period of study as the percent of NPAs to advances are in decline trend says that all Scheduled Commercial Banks are consistently trying to reduce the cost of creation of NPAs and to improve the asset quality. The study even revealed that there is major penetration of advances from Public Sector Banks indicating higher share among all Scheduled Commercial Banks[6].

References

1 https://en.wikipedia.org/wiki/Banking_in_India

2 Malyadri P, Sirisha S (2011) A Comparative Study of Non-Performing Assets in Indian Banking Industry. International Journal of Economic Practices and Theories.

3 https://www.investopedia.com/terms/r/returnonequity.asp

4 (2014) Handbook of Statistics on the Indian Economy 2013-14.

5 Kumar M, Singh G (2012) Mounting NpasIn Indian Commercial Banks.

6 Poongavanam.S (2011) Non-Performing Assets: Issues, Causes and Remedial Solution.