Tactful Management Research Journal
Vol. 2 , Issue. 4 , Jan 2014
ISSN :2319-7943
Impact Factor : 0.119 (GIF)

ORIGINAL ARTICLE

A STUDY ON OPERATING PERFORMANCE OF PUBLIC, PRIVATE, AND FOREIGN BANKS IN INDIA

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Abstract:

The operating performance of financial institutions has long been at the center of academic research and has received a substantial amount of attention. This is primarily due to the fact that operating efficiency is of particular interest for both managers, whose aim is to improve the performance of their financial firms , and policy makers, whose task is to assess the effects of market structure on performance and, therefore, to safeguard the stability of the financial system. The banks in India are facing stronger rivalry due to the globalization and liberalization of the financial system. Therefore the study of operating performance of domestic (public and private sector banks) and foreign banks in India becomes important. The objective of the study is to compare the operating performance of public, private, and foreign banks in India, so that they can draw the lessons from each other to be fit and profitable. Findings of study show that the foreign banks operating performance in relation to profitability is better than private and public banks. Further the public banks performance was found inefficient through DEA approach putting their sustainability in danger.

KEYWORDS:

Banks, Operating performance, Profitability, Sustainability.

INTRODUCTION

The optimism about Indian economic growth portends well for Indian banks. There are, however, challenges in retaining profitability and growth in the next decade which affect the sustainability of commercial banks operating in India.

The economic slowdown and global developments have affected the banking sectors' performance in India in FY12 resulting in moderate business growth. It has forced banks to consolidate their operations, re-adjust their focus and strive to strengthen their balance sheets. The banking sector faces seemingly conflicting requirements of strengthening capital ratios, enhancing liquidity and expanding their reach while increasing profitability. Further, the banking regulator Reserve Bank of India (RBI) continues to emphasize on strengthening supervision while promoting the sector's long-term growth and financial inclusion. Economic slowdown coupled with the impact of the changed regulations on the distribution of other financial services products dented the banks' core fee income (commission, exchange and brokerage income), a major component of banks' non-interest income. Consequently, the growth rate of non-interest income was significantly lower (7.97 percent) in FY12 as compared with the growth rate of interest income (33.85 percent) in FY12.IMF also reported strong linkages between macro-economic aggregates such of growth slowdown, weaker terms of trade and rapid credit growth on the one hand, and higher NPA levels on the other. Further RBI added through its macro-stress test that if the current adverse macro-economic condition persists, the system level gross non-performing advances ratios could rise from 3.6 per cent at the end of September to 4 per cent by March-end 2013 and to 4.4 per cent by March-end 2014.

The efficiency of banks is important and should receive greater attention. The foremost reason is that banks play an important role as financial intermediaries. The banks channel funds from those who have

Please cite this Article as : SHAIK SALEEM AND M. SRINIVASA REDDY , A STUDY ON OPERATING PERFORMANCE OF PUBLIC, PRIVATE, AND FOREIGN BANKS IN INDIA : Tactful Management Research Journal (Jan ; 2014)

excess funds to those who have productive needs for those funds. Therefore, their efficiency will indirectly affect the whole country's economics and wealth. Thus, the operating performance of financial institutions, essentially banks has long been at the center of academic research and has received a substantial amount of attention. This is primarily due to the fact that operating efficiency is of particular interest for both managers, whose aim is to improve the performance of their financial firms , and policy makers, whose task is to assess the effects of market structure on performance and, therefore, to safeguard the stability of the financial system.

The banks in India are facing stronger rivalry due to the globalization and liberalization of the financial system. Therefore the study of operating performance of domestic (public and private sector banks) and foreign banks in India becomes important. This study becomes more pertinent in the light of the Banking Bill passed in the Parliament in December, 2012 permitting private banks and the expected M&A activity in the banking sector in the foreseeable future.

The objective of the study is to compare the operating performance of public, private, and foreign banks in India, so that they can draw the lessons from each other to be fit and profitable.

Indian Commercial Banks

The Indian financial system consists of different types of financial institutions which are responsible for the development of the country's economy. Financial institutions can broadly be classified into banking and non-banking institutions. Banking institutions are of three types: Commercial Banks, Industrial or Investment Banks and Rural Banks. The most active sector of the Indian money market is the commercial banking sector.

Commercial banks in India can be classified into three groups: Public Sector, Private Sector and Foreign Banks. The majority of commercial banking in India is in the public sector with the State Bank of India and its associated banks. After liberalization, several private sector banks and foreign banks were allowed to open their business in India. Modern banking in India was developed during the British Era. In the first half of the 19th century, the British East India Company established three banks-the Bank of Bengal in 1809, the Bank of Bombay in 1840 and the Bank of Madras in 1843 and then these three banks were amalgamated into a new bank called Imperial Bank. Later it was taken over by the State Bank of India in 1955. For the purpose of assessment of performance of banks in India, the Reserve Bank of India which was established in 1935, categories them as a Public Sector Banks, Old Private Sector Banks, New Private Sector Banks and Foreign Banks.

Commercial banks are the oldest of all types of banks. They form the base on which other types of banks developed. Commercial banks constitute the larger part of the total banking system and these banks play a vital role in the country's economy and for the general public. The commercial banking activities have a very powerful and strong influence on the Indian financial system. In India, commercial banks are established as joint stock companies with the profit motive. These banks provide short-term financial services to trade, small industry, agriculture, service sector and the general public. They accept chequable deposits called demand deposits and facilitate an easy payment mechanism. Commercial banks pool small savings and canalize the same to all the productive investments. The commercial banking structure in India consists of Scheduled Commercial Banks and Non- Scheduled Commercial Banks. Scheduled Commercial Banks constitute those banks which have been included in the second schedule of the Reserve Bank of India (RBI) Act, 1934. To become a scheduled bank, the bank has to satisfy a few conditions. Scheduled Commercial Banks enjoy several advantages from the Reserve Bank of India and can get loans in times of need.

Under public & private sector, banks are more clearly defined according to nationalization and privatization. The banks under public banks are Nationalized Banks (20) and State Banks of India (with its associates, the number is come to 8). Under Private Bank category, banks are divided into two types i.e., Old private banks (17) and New-private banks (8).

REVIEW OF LITERATURE

A considerable amount of research has been done on the working and performance of commercial banks in India and other foreign countries, by academicians and researchers. A few DEA-based studies Sunil Kumar & Rachita Gulati (2008), Anthony Musonda (2008), Biswa Swarup Misra (2003), Subhash C. Ray & Abhiman Das (2010), and Panayiotis P. Athanasoglou et al. (2009) of efficiency in the Indian banking system and banking system of foreign countries have appeared in recent years. They have used a variety of specifications for inputs and outputs. Inputs vary from purely financial such as interest and non-interest expenses to purely physical like number of branches and employees. Outputs are either income

related interest or non-interest income or product/service related – loans, investments and non-interest income. Deposits appear as inputs or outputs depending upon whether the authors work with the intermediation or production interpretation of banking business. The efficiency scores were found to be relatively sensitive to the specification in terms of inputs and outputs.

Most of the studies focused on the profitability and efficiency of Indian commercial banks in both pre-reform and post–reforms eras, by taking inputs and outputs just as deposits and loans etc. None of these studies analyzed the performance of banks using ratios as input and output to determine the efficiency, hence, there was a need to carry out the present study.

METHODOLOGY

The present study is diagnostic and exploratory in nature and makes use of secondary data. The relevant secondary data has been collected mainly through the data bases of Reserve Bank of India (RBI), various reports and other studies. An attempt has been made in this paper to examine the operating performance of Scheduled Commercial Banks in India which are categorized in to three groups viz., public sector, private sector and foreign banks, since 2008. The study is confined only to the specific areas such as Non-interest expenses, Non-interest income, Interest Expenses, Interest Income, and Assets for the five years period starting from the financial year end 2008 to the financial year end 2012. In order to analyze the data and draw conclusions in this study, various tools like Ratio Analysis and Data Envelope Analysis basic radial model with constant return to scale have been done.

For carrying Data Envelop Analysis variable were define as Return on Assets (ROA) – output and Operating Risk Ratio, Burden Ratio, and Efficiency Ratios – Input variables.

RESULTS AND DISCUSSIONS

It was found that operating performance of private banks (0.57) is better on an average when compared to public (0.62) and foreign banks (0.59) in reference to operating risk ratio (Table-1). Lower the operating risk ratio better the operating performance. Further year by year the operating risk ratio of private banks and foreign bank (except in FY 2010) is decreasing reflecting good operating performance where as operating ratio of public banks is increasing year by year showing poor operating performance.

Table 1: Operating Risk Ratio

Year	Public	Private	Foreign	All Scheduled Commercial Banks
2008	0.59	0.58	0.52	0.57
2009	0.57	0.61	0.57	0.58
2010	0.58	0.59	0.73	0.60
2011	0.67	0.55	0.57	0.64
2012	0.68	0.52	0.55	0.64
Average	0.62	0.57	0.59	0.61

Burden ratio in Table-2 shows that the performance of public banks (0.01) on an average is better than the private (0.02) and foreign banks (0.02). This may be due to non-interest income for public banks is high for the reason that for many transactions related to government services have to be done (in forms of demand draft, challan, online transfer etc.) through nationalized banks only.

Table 2: Burden Ratio

Year	Public	Private	Foreign	All Scheduled Commercial Banks
2008	0.01	0.01	0.02	0.01
2009	0.01	0.02	0.02	0.01
2010	0.01	0.02	0.03	0.01
2011	0.02	0.02	0.02	0.02
2012	0.02	0.01	0.02	0.02
Average	0.01	0.02	0.02	0.02

The study also throw light on efficiency ratio (Table-3) of private banks (0.73) is lower showing good efficiency followed by public banks (0.74) and foreign banks (0.75).

It is very attracting that the return on assets (Table-4) of foreign banks is far better than that of private and public banks. Foreign banks are showing better return on assets (1.77) when compared to private banks (1.30) and public banks (0.96).

Table 3: Efficiency Ratio

Year	Public	Private	Foreign	All Scheduled Commercial Banks
2008	0.73	0.76	0.73	0.73
2009	0.72	0.76	0.77	0.74
2010	0.73	0.75	0.83	0.74
2011	0.75	0.71	0.73	0.74
2012	0.76	0.68	0.71	0.74
Average	0.74	0.73	0.75	0.74

Table 4: Return on Assets

Year	Public	Private	Foreign	All Scheduled Commercial Banks
2008	0.99	1.13	2.09	1.12
2009	1.02	1.13	1.98	1.13
2010	0.97	1.28	1.26	1.05
2011	0.96	1.43	1.74	1.1
2012	0.88	1.53	1.76	1.08
Average	0.96	1.30	1.77	1.10

Overall efficiency (Table-5) of public, private and foreign banks operating in India were assessed by developing relationship between Profitability and Operating performance, using data envelop analysis by taking Return on Assets (ROA) as maximizing output and Operating risk ratio, Burden ratio and Efficiency ratio as inputs. The overall efficiency foreign banks (97.78 close to 100 percent) are comparatively better followed by private and public banks. It can be stated that public banks are inefficient. Overall commercial banks operating performance is decreasing.

Table 5: DEA-Operating Efficiency in per cent

Year	Public	Private	Foreign	All Scheduled Commercial Banks
2008	88.4	100	100	100
2009	90.5	53.5	100	100
2010	94.8	100	88.9	100
2011	55.2	85.2	100	63.2
2012	47.3	100	100	59.3
Average	75.24	87.74	97.78	84.5

Sustainability of Public, Private and Foreign banks operating in India

From Table-6 it can be interpreted that public sector banks have to face many challenges in regard to continue its operations in commercial banking sector to lead private and foreign sector banks. The ROA and efficiency measure on an average of public sector bank is low (0.96) and inefficient (75.24) indicating strong challenging future for and putting public sector banks in danger regard to their sustainability.

Table 6: Sustainability Matrix of Commercial Banks in India

Efficiency Measure	**Efficient**	Foreign Banks (97.88 / 1.77)	
	Inefficient	Private Sector Banks (87.74 / 1.30)	Public Sector Banks (75.24 / 0.96)
		High	**Low**
		Return on Assets (ROA)	

CONCLUSION

It can be concluded from the study that the operating performance of private banks is better than the foreign banks and public banks. But, when operating performance reflection is observed on profitability, the efficiency of foreign banks is found to be much better than private and public banks' efficiency. Further, the public banks sustainability is also in danger bringing more challenges to face. Public sector banks poor performance in non-priority sectors lending indicates their insufficient skills and knowledge base to determine the risk associated with financing to sectors like Airlines (Ex: Kingfisher airlines etc.), Infrastructure projects (delayed executions), Power projects, Telecommunications (2G spectrum funding).

Instead of assessing the risks properly the public sector banks tried to diversify their risk in those sectors by consortium lending. As per RBI the simultaneous failure of two large borrower banks would trigger the failure of nine other banks and result in a loss of over 18 percent of tier-I capital of the system. Hence consortium approach alone cannot be a substitute for proper assessment of risks. Taking advantage of the deregulation of savings bank interest rate since October 2011, foreign banks followed by private sector banks modified the highest proportion of low cost CASA (Current and Savings Account) deposits. Public sector banks are yet to learn to quickly respond to the market trends to mobilize the CASA deposits, by tweaking the interest rates. They should also learn to increase the asset utilization rates by observing the trends and strategies of foreign banks.

Public banks should develop sound management teams of highly qualified personnel with

sufficient skills in assessing the opportunities and managing the risks, for the sustainability of public sector banks.

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