CHAPTER 7

SUMMARY OF FINDINGS
AND RECOMMENDATIONS

7.0 Backdrop

This study investigated the financial viability of Indian banking industry for the period of 11 financial years (i.e., 2001-02 to 2011-12). It covers the issues such as Liquidity, Profitability and Solvency of banking sector and also assessed the distress among Indian commercial banks. It examines the impact of recent global financial crisis on Indian banking sector. Primarily analysis part of this study is concentrated on financial viability and distress of commercial banks in the light of specified objectives using quantitative techniques.

7.1 Major Findings of the Study

Objective of this section is to summarize the major findings of the present study:

7.1.1 Findings related to Liquidity, Profitability and Solvency of Indian Commercial Banks

Chapter three addressed the first objective of the study which focused on Liquidity, Profitability and Solvency of Indian banking sector. Different ratios are used to measure these three indicators of financial viability using different items of balance sheet and profit & loss account of Indian commercial banks. This is a conventional way of analyzing the performance of the banks. The major findings of this chapter are as following:

- There is a shortage of liquidity in new private sector banks. Nainital bank, South Indian bank and Catholic Syrian bank has excess of liquidity. On an average public sector banks have more liquidity than the private sector banks.

- There is a consistency in liquidity maintenance of the banks during the study period and not much disparity is found in the different liquidity ratios of Indian commercial banks during 2001-2012.
New private sector banks are more profitable banks in comparison to other commercial banks during the last 11 financial years. The profitability of State bank of India and its subsidiaries is higher than the nationalized bank group on the basis of their returns on assets ratio.

Development Credit bank has negative return on its equity. DhanLaksmi bank and ING Vysya bank have lowest profitability among 46 Indian commercial banks.

New private sector banks Kotak Mahindra bank and HDFC bank have high interest income as compared to other commercial banks. SBI and its subsidiaries also have high interest income as compared to the average net interest margin ratio of Indian banking industry.

New private sector banks are also efficient in controlling the operating expenses compared to other banks during 2001-02 to 2011-12. Old private sector banks have highest burden ratio among all the commercial banks.

RBI has recommended the commercial banks to maintain minimum capital adequacy ratio at 12 percent still there are banks as Catholic Syrian bank, Dena bank and IDBI bank having capital adequacy ratio below this minimum level.

Ratnakar bank and Tamilnad Mercantile bank has highest capital adequacy ratio during the study period. SBI and its subsidiaries have low equity to total assets ratio as compared to industry average for the last 11 financial years. State bank of Travancore stands at the last position among 46 Indian commercial banks.

Leverage ratio (debt-equity ratio) is high in Catholic Syrian bank and Bank of Maharashtra. Tamilnad Mercantile bank has lowest of this ratio. Interest coverage ratio of new private sector banks as Axis bank and Kotak Mahindra bank is high as compared to other commercial banks. These banks are efficient in covering their interest charges with other income.

The study also found a significant difference in the liquidity, profitability and solvency of public and private sector banks of India. Liquidity and solvency level is high in private sector banks while profitability is high in public sector banks.
These three parameters (liquidity, profitability and solvency) play an imperative role in determining the financial viability of banks. Excess of liquidity hampers the profitability in the long run and threatens the financial viability of banks. So, Nainital banks, Ratnakar bank and South Indian bank are required to take care of their liquidity. ICICI, HDFC, Axis and Yes bank have high profitability so these banks are required to control their operating expenses to prolong their profitable position. The old private sector banks as Development Credit bank, Catholic Syrian bank and DhanLaksmi bank are poor performer in almost all selected parameters during the study period. These banks are smaller in size and operate in local areas. In order to successfully survive in the market, these banks are required to take drastic steps in restructuring their existing system. They have to manage their liquidity, profitability and solvency to escape them from the threat of bank failure.

7.1.2 Findings related to Financial Viability and Distress of Indian Commercial Banks

This section summarizes the major findings of fourth chapter, which has measured the financial viability of Indian commercial banks and also assessed the distress of Indian banking sector. Financial viability means ability of the banks to generate sufficient income to meet operating payments, debt-commitments and also to allow growth while maintaining their service levels. It indicates the operational efficiency of the banks to fulfill its mission in the long run. It also ensures the long term survival of the bank in the market. For this purpose Z statistic has been used to measure the financial viability of the banks. This model has been widely used by different researchers in different countries to measure the default risk of the banks. Z statistic captures the likelihood of bank earnings in a given year becoming low enough to exhaust the banks’ capital base and the likelihood of bank becoming insolvent. The major findings of this chapter are as follows:

- The study found that return on assets and capital to assets ratio (i.e. the major indicators of Z statistic) are high in private sector banks and the volatility of assets (measured by standard deviation of return on assets) is also high in private sector banks.
The Z score is high in public sector banks. There is consistency in the return on assets ratio of public sector banks while there is fluctuation in this ratio in case of private sector banks. That’s why Z score is low in private sector banks.

Z score has declined in the financial year 2007-08 due to the impact of recent financial crisis. The down turn in Z score of private sector banks is more as compared to public sector banks. As major private sector banks of India have large foreign investment and operate at international level, so they are affected at a large extent by this global event.

Z score is high in public sector banks as compared to private sector banks. On the basis of Z score, it is concluded that public sector banks are more financially stable as compared to the private sector banks.

On individual basis, Tamilnad Mercantile bank has highest Z score followed by HDFC and SBI among 46 Indian commercial banks. Development Credit bank, Punjab and Sind bank and Catholic Syrian bank have lowest Z score among all Indian commercial banks. The banks with low Z score are exposed to insolvency risk.

The strong and weak banks are identified on the basis of Z score. There are 12 Indian commercial banks (6 public sector banks and 6 private sector banks) that are identified as weak banks and are exposed to insolvency risk. These are: South Indian bank, Bank of India, Syndicate bank, Indian Overseas bank, Nainital bank, Dena bank, Vijaya bank, Indusind bank, DhanLaksmi bank, Catholic Syrian bank, Punjab and Sind bank and Development Credit bank.

The banks exposed to insolvency risk are further evaluated on different parameters of liquidity, profitability, solvency, stability and growth to assess distress among them. The study found that these banks have low liquidity as compared with industry average. They are not able to meet the current demands of the customers.

These banks are not able to generate a sufficient profit that is an essential condition for remaining financially viable and also for successful survival in the market. These banks does not have sufficient capital base as prescribed by RBI, the minimum capital requirement for commercial banks to absorb unforeseen
shocks. They also don’t have sufficient equity base to fund their assets. Excess use of debts increases the interest burden of these banks against low profits.

- The banks are not able to generate sufficient interest income and also having large amount of non-performing assets. These assets block the interest income and become major hurdle in the well being of the banks. Advances growth rate and deposits growth rate of these selected banks is lower as compared to industry average.

- On the basis of the overall performance of these 12 banks it is concluded that these banks are financially distressed and are exposed to insolvency risk. Tight liquidity, deteriorating assets quality and reducing soundness are the major contributors to the decline in the financial stability of Indian commercial banks.

7.1.3 Findings related to Impact of Global Financial Crisis on Indian Commercial Banks

This section outlines the result of fifth chapter which aimed to measure the impact of global financial crisis on Indian commercial banks. Impact of crisis is verified mainly on the stock price volatility of Indian commercial banks. BSE bankex stock index is used as a proxy of stock returns of Indian commercial banks.

- The study found that bankex stock return series is stationary and has no unit root problem. The study found that average stock prices are higher in pre crisis period as compared to post crisis period.

- The stock return volatility (measured through standard deviation and variance) is high in post crisis period. The stock prices are not normally distributed. The volatility of stock prices is estimated through the GARCH model.

- The coefficient of dummy variable is significant and negative which indicates that the impact of recent financial crisis is negative on stock returns of Indian commercial banks.

- The results of ARCH and GARCH indicate high persistence of stock return volatility. High value of alpha and beta implies a long memory in the stock market. The information effect on conditional variance is persistence and will take a long time to die away.
On the basis of this discussion, it is concluded that global financial crisis has a significant impact on Indian commercial banks’ stock prices.

7.2 Suggestions and Recommendations

On the basis of the results and conclusion of this study following policy implications can be suggested for the bankers and policy makers:

7.2.1 General Suggestions and Recommendations

These are some of the general suggestions that Indian commercial banks should opt to enhance their financial viability and improve their financial health:

➢ The economic environment for the banks has been changing and banks need flexibility to respond in this changing situation.

➢ Technology plays an important role in reducing the operating cost and increasing the income of the banks. Public sector banks and old private sector banks are required to focus on technological up-gradation to enhance their efficiency.

➢ In India, there are several areas that are still unbanked. The commercial banks are required to focus on these areas to increase their business. But at the same time bank branch viability must be ensured.

➢ These days’ customers require more and more facilities ready at hand from the banks. So banks are required to adapt consumer oriented products to attract more and more customers.

➢ The banks are diversifying their business these days. Interest income is the not only focused area. The banks are required to take care of non-interest income to enhance their earning capacity.

➢ Some of Indian commercial banks are very small in size and focused in local areas only. So these banks are required to change their organizational structure and adopt customer oriented business models to ensure their smooth survival.

➢ Risk management plays very important role in the well being of commercial banks. The banks have to ensure proper risk management against liquidity risk, interest rate risk, credit risk and insolvency risk.
Banks are required to take care of best practices of corporate governance and corporate social responsibility to cater the needs of different stakeholders.

Competition is increasing day by day. Indian banks have to operate at international level. So Indian commercial banks are required to ready for adoption of international standards to successfully survive in the international markets.

With the implementation of Basel III banks are required high capital and liquidity base that would negatively affect their profitability. So Indian commercial banks have to maintain a balance between their liquidity and profitability to enhance their solvency level.

7.2.2 Specific Suggestions and Recommendations

These are the particular suggestions derived from the present study that Indian commercial banks must adhere to successfully survive in the market:

- Private sector banks are suggested to maintain adequate liquidity so that the situation of illiquidity would not arise. Especially private sector banks that have high foreign investment and carried out business at international level are required to maintain sufficient liquidity to meet any of the worst condition as happened in recent financial crisis.

- Old private sector banks mainly Development Credit bank, Dhanalakshmi bank and ING Vysya bank are required to enhance their profitability in the form of return on assets, return on equity, interest income as well as non interest income to improve their financial health.

- The banks having capital adequacy ratio below minimum required limit as per RBI are suggested to take care of their solvency position. Capital is an essential condition to bear unforeseen shocks without this it is possible to remain financially solvent.

- The banks with high Z score are suggested to maintain this level of financial viability and banks having low Z score are required to improve their financial viability otherwise it would threaten their existence in the market.
The financially distressed banks are suggested to take care of each and every dimension of their financial performance to successfully survive in the present competitive environment.

7.3 Limitations of the Study

The present work has some of the limitations as mentioned below:

- An effort has been made to review extensive literature to conduct the present study. Yet it is possible that some important studies may be left out due to wide range and non-availability.
- This study is based on secondary data. Primary data is not used in this study. Secondary data has its own limitations.
- Only public and private banks of India are included in the sample, foreign banks are excluded in this study.
- Only selected parameters have been used to measure the different parameters of financial viability and distress of only weak bank is assessed. The selected statistical tools and techniques have their own inherent limitations.

Therefore it is advised that the researchers may cautious for comparison of results with the results of other studies and also for the comparison of results for different time periods.

7.4 Scope for Future Research

The following recommendations should be considered for future research:

- The present study has used limited number of variables (as available) related to liquidity, profitability and solvency, large number of other variables can be included to carry out similar type of study.
- The time period of recent 11 financial years is used in this study. Long time period can be used to produce more enhanced results.
- Similar type of study can be carried to compare public, private and foreign banks to provide some insight regarding the financial health the banks with different ownership.
- Comparison of small banks with leading banks on the basis of advances, deposits, operational management and risk management can be carried out in the same line of the present research.

- The research can be carried out to check the effect of recession in the form of specific events like Lehman brother bankruptcy on Indian commercial bank.

- Extensive research can be carried out to check the financial distress of banks in detail using different methods.

- The research can be carried out to check the viability of banks at branch level also on regional rural banks and also on urban co-operative banks.

- The research can be carried out to check the effect of macro level policy change such as implementation of Basel III on the banks’ financial viability.