Chapter-7

Summary and Conclusion

7.1 INTRODUCTION

Commercial banks play an important role in the economic development of a country. The history of economic growth of different countries of the world shows that banking institutions have always played a significant role in the economic development of a nation. Commercial banks in India has assumed significant role in the development process. The Government of India, realizing the crucial role of banks, nationalized fourteen major commercial banks in the year 1969. Then after, eight more banks were nationalized in the year 1980. After nationalization, majority of the banking business came to the hands of government. The public sector banks accounted for more than ninety percent of the total business and assets of all banks. The main objective of nationalization was social welfare. Since the nationalization, the banks had registered remarkable growth in deposits mobilization, deployment of credit particularly to the priority sector, and branch expansion. Banks, being special vehicles to the growth of the economy, contributed
a lot to the economic development of the country. Commercial banks with too much orientation of social welfare objective, neglected the commercial or profitability aspect in the initial days of the post nationalization period. However, banks as well as the regulators realized the need of profits and profitability for the survival and sustainable growth of the banks in which they can continue to serve the nation. Infact, profit is an important aspect of the performance of any organization. Various studies have been conducted by the scholars and researchers to measure the performance of banks at different times. In our study, a brief review of selected works during the period of 1963 to 2008 has been done.

7.2 REVIEW OF THE LITERATURE AND THE GAP

Most of the studies on performance and efficiency of Indian Commercial Banks are confined to either post-reform or pre-reform period only. No comparative study between pre-reform and post reform period has been made. Studies on performance of commercial banks in pre-reform period were with help of traditional analytical tools like trend and regression analysis using ratios which were mostly parametric in nature. The present study aims at a detailed analysis of performance and efficiency of commercial banks in India during pre-reform as well as post-reform period. The present study makes use of traditional techniques like ratio analysis, analysis of variance and trend analysis along with widely accepted non-parametric test ‘Data Envelopment Analysis’.
7.3 OBJECTIVES AND HYPOTHESES

Keeping in mind, the problem identified for the study, the main objectives set out are: (1) to examine the performance of public, private and foreign sector banks in terms of inputs and outputs in pre-reform and post-reform period; (2) to find out the causes of inefficiency and poor profitability in commercial banks if that exist in any bank group; (3) to review the impact of banking policies in improving the operational efficiency of commercial banks; and (4) to suggest remedial measures to improve efficiency in banks.

Accordingly, the hypotheses have been formulated for test and verification. These are: (1) there is no significant difference in performance of commercial banks in pre-reform and post-reform period; (2) banking policy is a dominant factor in influencing the bank profitability and efficiency; (3) there is no significant difference in financial performance among public sector, private sector and foreign banks; and (4) the size of banks matters on the profitability and efficiency of banks.

7.4 METHODOLOGY OF THE STUDY

7.4.1 Sample and Data. The study includes all scheduled commercial banks in public sector, private sector and foreign sector functioning in India. The study is based on financial and other qualitative data available from secondary sources such as Reserve Bank of India, Indian Banks Association and Government of India publications. The sample of the proposed study includes all commercial
banks in India grouped into five groups as State Bank, Nationalized Banks, Old Private Sector Banks, New Private Sector Banks and Foreign Banks. The total number of banks as on 30th March 2008 was 79 of which State Bank and its associates number 8; nationalized banks including other public sector bank number 20; Old private sector banks number 15; new private sector banks number 8; and foreign banks number 28. The period covered in this study is from 1980 to 2007-08. The period has been divided into pre-reform period (1980 to 1990-91) and as post-reform period (1991-92 to 2007-08). The total number of observations made were 125 of which State Bank Group, Nationalized Bank Group and Old Private Sector Bank Group have 28 observations each while New Private Sector Bank Group has 13 observations.

7.4.2 Techniques of Analysis. The studies made by different authors/researchers show that there are various methods of studying the performance of commercial banks. In fact with the passage of time new techniques and methods have been adopted to study the performance of commercial banks. The initial phase witnesses the use of ratios and trend analysis followed by regression analysis to understand the relationship among various bank related variables and its implications on profitability. The latest technique preferred by researchers in studying the performance and efficiency of banks is Data Envelopment Analysis. These methods have their merits and limitations. The present study adopts an integrated approach by using traditional tools such as ratio analysis and modern tools like Data Envelopment Analysis and statistical analysis.
Ratio analysis includes profitability ratios, expense ratios, and other performance related ratios. Statistical analysis shall be of both parametric and non-parametric depending on suitability and applicability of the data type. The factors affecting the profit performance in terms of deposit, advances, cost etc. is studied by the use of regression analysis while the efficiency of different groups of banks is examined by applying Data Envelopment Analysis.

7.4.3 Basis of Analysis. The study has been based on comparative analysis of public sector and private sector banks in India. Public sector banks have been divided into two groups viz. State Bank Group and Nationalized group that includes nationalized banks and IDBI Bank, which has got a commercial bank status of late. Private sector banks refer to domestic private banks and foreign banks. Domestic private banks have been grouped into old economy banks and new economy banks on the basis of private sector banks up to 1992 and after 1992. Performance of commercial banks is analyzed on the basis of comparison of selected indicators such as deposits per rupee man-power cost, advances per rupee man-power cost, business per rupee manpower costs, profit, interest income and non-interest income, interest cost, manpower cost and facility cost in relation to assets These techniques are used for different groups as mentioned so as to infer on the sectoral performance i.e. performance of various bank groups. Statistical techniques such as Analysis of Variance (ANOVA) and t-test are used to test the significance of differences.
The Data Envelopment Analysis, which is a non-parametric test, is used on the basis of inputs and outputs. Using these inputs and outputs, the efficient frontiers of the different bank groups are estimated for pre-reform and post-reform period. Conclusions are drawn on that basis.

7.4.4 Performance Evaluation. The following performance indicators have been identified for the purpose of performance and efficiency measurement of banks.

1. Return on Assets/ Net Profit to Total Assets.
2. Spread to Total Assets.
3. Burden to Total Assets.
4. Interest Income to Total Assets.
5. Interest Cost to Total Assets.
6. Manpower Cost to Total Assets.
7. Facility Cost to Total Assets.
8. Non-interest Income to Total Assets.
10. Credit to Manpower Cost.
12. Credit-Deposit Ratio.
7.5 FINDINGS OF THE STUDY

One of the important objectives of banking sector reform is to bring the banking practices of India at par with the best practices at the international level. Since 1991, several reform measures such as deregulation of interest rates, rationalization of CRR and SLR, more autonomy to banks, commercial viability and efficiency have been initiated. The present study is a modest attempt to examine the impact of the reforms in the banking sector. The performance of banking sector as a whole has been analyzed by using accounting measures and statistical tools like Analysis of Variance (ANOVA), graphical analysis and trend analysis. Accounting measures include profitability ratios and profit related ratios, viz. spread ratio, burden ratio, interest income ratio, interest cost ratio, manpower cost ratio, facility cost ratio and non-interest income ratio. Productivity and efficiency measures such as deposit to manpower cost, credit to manpower cost and business to manpower cost, credit-deposit ratios have been examined. ANOVA has been used to test the significance of difference in banking sector reform between pre and post reform period. The study period has been grouped into two groups viz. 1980-1991 as pre-reform period and 1991-2008 as post reform period. Post reform has been further divided into first phase (1991-98) and second phase (1998-2008) for a detailed analysis.

The detail findings of the study are more interesting and can be useful to different groups. The findings or observations made in due course of our study are presented here.
(a) Return on assets or profitability of the banking sector as a whole, has improved in the post reform period and particularly in the second phase of post reform period i.e. during 1998 to 2007.

(b) Interest Spread of All Scheduled Commercial Banks has improved significantly in relation to the performance in the pre-reform period. This was possible due to an increase in the interest income. Interest cost has increased in the post reform period and this indicates the increasing cost of acquiring funds though the increase noticed is marginal.

(c) Burden that is defined as total of manpower and other operational cost reduced by non-interest income, for all the banks, has increased during the post reform period. In other words, either the operational cost has increased or non-interest income has reduced during the said period. It has been observed that non-interest income of all banks in our study has increased during post reform period. That means increase in the operational cost has contributed to increase in the burden.

(d) The performance of banks with regard to management of manpower cost has remained satisfactory during the post reform period, as the manpower cost ratio has reduced in comparison to the same of pre-reform period. However, an increase in facility cost that is operational cost other than manpower cost has increased considerably.
(e) Performance of all the banks in terms of business done i.e. both deposits and credits shows significant improvement in the post reform period as compared to that of pre-reform period.

(f) Credit-deposit ratio of all scheduled commercial banks in the study has declined marginally during the post reform period. However, this ratio has shown improvement in the second phase of post-reform period as compared to the first phase.

(g) Performance of foreign banks in terms of return on assets has been found better than that of domestic banks. Among domestic banks, State Bank Group has performed better than all other groups in terms of return on assets. Again, profit performance of all the groups of bank have improved in the post reform period as compared to the pre reform period. Foreign banks are on the forefront followed by New Private Sector Banks, Old Private Sector Banks, State Bank Group and Nationalized Banks in order.

(h) It has been observed that the performance of all bank groups with regard to interest spread has improved in the post reform period. This can be attributed to an overall improvement registered by all the bank groups in the post reform scenario with regard to interest income but not interest cost. Foreign banks are in the lead position with regard to interest income as compared to other groups of bank. On the other side they are quite efficient in controlling the interest cost also as compared to the other competing groups.
(i) All the bank groups have succeeded in reducing the manpower cost in the post reform period as compared to the pre reform period. New private sector banks and foreign banks could succeed in maintaining these expenses at low.

(j) All the bank groups except old private sector banks have recorded a decline in the facility cost in relation to total assets in the post reform period. Again, foreign banks have been incurring significantly more amount under this head. This may be due to their technical advancement over the other banks. However, the group could succeed in reducing the same cost significantly in the post reform period.

(k) Non-interest income indicates the efficiency of a bank in mustering income from non-conventional banking business. All the bank groups have shown remarkable growth in earning non-interest income in the post reform period and foreign banks have on the forefront in this respect. Foreign banks have fared well in both pre and post reform period as compared to other groups of bank in doing business other than pure banking.

(l) It is observed that foreign banks had the highest volume of business in terms of deposits mobilized and credits deployed per rupee of manpower cost in the pre reform period and this position was taken by new private sector banks in the post reform period. New private sector banks are doing extremely well in this regard which may be due to dependence on automation and computerization in the new environment. It is also noticed that all the bank groups have improvement with regard to the volume of business in the post reform period.
(m) The study found that there is a significant difference in the credit-deposit ratios among various groups. Except foreign banks and new private sector banks no other group have shown progress of credit-deposit ratios over the period of study. Hence there is a need to look into this issue and banks as well as policy makers should take care of the same.

(n) In the post reform period, Foreign Banks rank in the first position with regard to efficiency. New private sector banks, Old Private Sector Banks, State Bank Group and Nationalized Bank Group are next to it in order. Performance of old private sector banks, state bank group and nationalized banks are far away from the efficient frontier which indicates the scope for improvement in these groups of bank.

(o) The study found that size of banks had influenced the performance and efficiency. Large size banks are found to be more efficient than small size banks. The classification of banks into large and small size has been made not on the basis of total asset size but total assets per branch.

Thus, to sum up at the end we can say that there has been a significant difference in the banking sector performance with regard profitability and productivity performance between the pre-reform and post-reform period. It has been also adjudged that the banking policy and reform measures have played a significant role in influencing the bank profitability and efficiency. In other words, the banking sector has gained impressively in the post reform period and the reform measures have been thus justified.
In the study, it has been also observed that, for State Bank, Old Private Sector Bank, New Private Sector Bank and Foreign Bank groups, there has been a significant difference with regard to profitability and productivity of commercial banks in the pre-reform and post-reform period. Thus, the first hypothesis, “there is no significant difference in performance of commercial banks in India” has been rejected. This conforms to the findings made at the aggregate level study of all banks in the previous chapter. Again, the second hypothesis, which is stated as “banking policy has not played a significant role in influencing the bank profitability and efficiency has been rejected and we found that the banking policy has influenced the performance and efficiency of banking sectors. On testing the validity of the third hypothesis, “there is no significant difference in financial performance of public sector, private sector and foreign banks”, we found that the hypothesis does not hold good. In other words, a significant difference has been observed among public sector, private sector and foreign banks. Private sector banks have outperformed public sector banks in the pre-reform as well as post-reform period. Foreign banks have been found on the forefront in the race. It has been seen that though all the bank groups have improvement in terms of profitability and efficiency in the post-reform period, the pattern remains same i.e. the status or rank of the groups have not changed significantly. This gives an indication that public sector banks need measures to be at par with their foreign and private counterparts. Again we found that the size of banks has a bearing on the performance and efficiency. Large size banks are found to be more efficient as
compared to small size banks. Thus, the fourth hypothesis “the size of banks matters on the profitability and efficiency of banks” is accepted. It is also observed that foreign banks and new private sector banks, which fall in the category of large size banks, have concentration in the urban and metro areas and have an edge over public sector banks. As public sector banks assume more moral responsibility towards social welfare, these bank groups may not be restructured in the line of foreign banks and private sector banks. Therefore, more research studies are desired in this area.

The major findings of the study, based on the test of hypotheses and our discussions made so far, may be summed up as follows:

(a) There is significant difference in performance of commercial banks in between pre-reform and post-reform period. All the bank groups have witnessed remarkable improvements in terms of both profitability and productivity in the post reform period.

(b) Banking policy has played a dominant role in influencing the bank profitability and efficiency. The impact of reform measures has been seen in form of improvements in performance and efficiency of all groups of bank in the post reform period.

c) There is significant difference in the financial performance of among public, private sector and foreign banks. Foreign banks have fared well in comparison to other groups of bank.
(d) Size of the banks influence bank profitability and efficiency. Large size banks are found to be more efficient than the small size banks. However, the size of bank has been taken in relative form i.e. assets per branch but not the absolute total assets.

7.6 SUGGESTIONS FOR IMPROVEMENT

The policy and other implications of this research work are important and the researcher would like to suggest in the following aspects, which may be considered for adoption by different user groups.

1. The banking sector has seen impressive improvements in the post reform period. These improvements are definitely the reflection of the policies and reform measures. The reform measures have given its benefit to the society and the formulators and implementers deserve appreciation for this. Therefore, reform measures should continue in the future to make the Indian banking system as one of the best at international level.

2. It has been noticed that interest cost has increased in the post reform period. Higher interest cost means lower profit. Therefore, to improve the profitability of banks, attention be given to reduce and control this cost through judicious deposit-mix. Foreign banks have shown their efficiency in managing this cost as compared to other groups of bank. Other groups of bank should learn from the experiences of foreign
banks by rationalizing their deposit-mix and by shifting to cheaper source of fund.

3. All the banks have shown improvement in their performance during the post reform period in getting non-interest income. This shows the banks endeavour in expanding their business horizon. This is a welcome effort and banks should be encouraged to keep up the practice.

4. Foreign banks have been found most efficient in every respect of financial management. Even new private sector banks have proved their efficiency, which is very close to the performance of foreign banks. Other groups of bank should learn from the experience of foreign and private sector banks and make necessary efforts to improve their performance and efficiency.

5. There should be more research to find out the economic size of bank, so as to justify the performance and efficiency.

6. Entry of private sector banks has resulted in improvement on profitability and performance of public sector banks. Hence, competition in the banking sector should be continued to get the leverage in future also.

7. It has been noticed that foreign and new private sector banks are relatively efficient. This means that there is scope for improvement in public sector banks. Public sector banks need rationalization of their size and cost structure to enhance their profitability and efficiency.
8. Researchers should carry on research in the areas of size and its impact on profitability and efficiency. Such studies at bank and branch level may be done to get an insight into the break-even level and optimum output level so that operation of a branch may be justified. Again, this will help to take decisions on the issue of merger and demerger in future.

9. The study has found that traditional forms of performance and efficiency analysis is still relevant and can give insights in many respect. It is suggested that, future researchers should consider both traditional and modern techniques like Data Envelopment Analysis for a better and meaningful understanding.

10. The present work has not examined the impact of various polices and reforms measures at grass root level. Such studies may be carried in future by the researchers to throw new light into these issues.

7.7 LIMITATIONS OF THE STUDY

The present study, like other studies has certain limitations that need to be mentioned to understand the present work. These are stated below.

(a). The study has been done on the basis of broad classification of public sector, private sector and foreign banks. Further, public sector banks are grouped into State Bank group and nationalized group. Similarly, private sector banks are
grouped into old private sector and new private sector banks. As the study has coverage for the period 1980 to 2008, some banks have been found included or excluded during the period, and the data sources have updated accordingly. Therefore, the banks in the groups for study have not remained same for the period of study. However, this is not a serious drawback to interfere the conclusion as the study has used inputs and outputs model.

(b) The present study uses the accounting ratios, data envelopment analysis, input and output models for analysis purpose. These tools are not free from their limitations. However, our attempt is to put the best of efforts with our limited resources so as to generalize from the study.

(c) Non-financial parameters like achievements of social importance such as branch expansion, priority sector lending, Non-performing assets are not included in the study though the impact of these are reflected in the profitability of study. This has been made to focus on the main issues of the study and avoid any sort of dilution.

(d) The study is based on data available through secondary sources. It is believed that the data are reliable, as the data have been sourced from authentic sources. However, variations have been found in between different sources. The researcher has examined and scrutinized such issues to make the study more accurate and meaningful.
7.8 CONCLUSION

In our study, it has been found that: (1) there is significant difference in performance of commercial banks in India; (2) banking policy has played a significant role in influencing the bank profitability and efficiency; (3) there is significant difference in financial performance of public sector, private sector and foreign banks; and (4) the size of banks matters on the profitability and efficiency of banks. The study shows that foreign banks and new private sector banks outperform the public sector banks in terms of profitability and productivity. Further, there is scope of improving profitability of public sector banks by managing the operating cost particularly manpower cost. Non-interest income of public sector banks needs to be improved so that they can compete with the private sector and foreign banks. The banking sector reform has delivered good to the banking system and in the right direction so far and the reform process should continue in the same direction. Banking system, being a vital organ of the financial and economic system, needs appropriate policy and implementation. New research on micro aspects of the profitability, impact of reform on profitability and productivity should continue to give more insights.

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