CHAPTER I

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1.1 INTRODUCTION

Banking concept has undergone a sea change during the last decade. Banking utility broadly refers to risk-free banking entailing services like deposit taking. Advances and non-fund based services are now an integral part of commercial banking. Banking utility concept is, thus, no more relevant to today's banking practice as universal banking is becoming the order. Banks no more engage themselves only in commercial banking - plain lending or deposit taking or ancillary services. Banks have moved to universal banking in India. They are offering all kinds of banking services and banking related services under one roof, they are a super store that provides varied financial products. Considering their large coverage geographically, they have started giving utility services like bills payments, sale of gold coins and a host of other services like wealth management services. Customers have also welcomed these services, as they are able to complete all their financial needs in one place. Internet banking and mobile banking have truly revolutionized the way banking is being done today. The bank branch has to ultimately convert itself into a financial super market.

Indian Banking sector is evolving at a fast pace, there is a tremendous opportunity to enter new markets and newer businesses by delivering high class customer service. Banking is getting redefined through new technologies. The four major trends altering the banking industry are consolidation, universalizing, and development of new technologies and globalization of operations. In consonance of these objectives, Indian banking structure has witnessed a metamorphosis, both structural and functional with a view to be an effective instrument of social and economic transformation.
Evaluation is an important pre-requisite for the development of any institution, commercial banking being no exception. Profitability of banking operation is very important if banking sector is not to end up as a milestone round the neck of our growing economy. Therefore, in the changing economic environment of competitiveness efficiency and productivity, profits are not a taboo for the banking industry. Thus maintaining continued viability and profitability can be considered as the greatest challenge before banks during this decade. Against such a backdrop, the need for a systematic appraisal of the financial statements of commercial banks operating in India can hardly be overemphasized. In this regard, a new research study is made by applying stakeholders’ perspective.

The purpose of any research is twofold, assessment and development and we need to recognize that inherent tensions exist between them. A study is essentially concerned with reviewing the year and assessing the financial performance -- i.e. looking to the past; and setting objectives for the coming year and considering how to develop -- i.e. looking to the future. Stakeholder’s perspective represents a relatively new and promising innovation done by using various views and techniques from financial statements which includes Borrowers, Creditors, Depositors, Employees, Investors and Shareholders.

**1.2 STATEMENT OF THE PROBLEM**

The most serious problem faced by the scheduled commercial banks is interest fluctuations which affect the depositors, borrowers, creditors, investors, shareholders etc. Further, increase in total earnings has a direct and positive impact on the profitability of commercial banks. Any programme in banking sector is an enduring phenomenon only when the financial health of the same is sound. Lack of proper pre-enquiry by the bank for sanctioning a loan to a customer, willful defaulter etc..
leads to drain of profit, bad effects on good will and equity value. There is a lack of recovery in the advances in backward areas. Also, the use of bank credit for speculative and other unproductive purposes are also found. Mobilization and disbursement of loans always has the negative contribution to bank profit. Incremental flow of other income is positively related to the profitability of commercial banks. Market density and pricing level affects branch performance. Incremental volumes of branch expansion in business generally have a direct and positive bearing on the profit volume of commercial banks. The present study aims at examining the problems with the help of the sample data. Hence in the present study, the researcher is intended to make an elaborate probe into the financial position of scheduled commercial banks with reference to stakeholder’s perspective.

1.3 REVIEW OF LITERATURE

The eventual goal is to bring the reader up-to-date with current literature on a topic and form the basis for another goal, such as the justification for future research in the area. A literature review is a body of text that aims to review the critical points of current knowledge on a topic.

Frey (1970), in the study on ‘Optimal Asset and Liability Decisions for a Rural Bank’ concludes that the extent to which rural bank should make loans hinges on the feedback relationships. Results showed the model bank often meeting less than 50 per cent of its loan demand. The higher interest rates generated a modest increase in loan activity. The study revealed that decreasing capital and liquidity constraints increased profits of the bank.

Allison (1971), Prestopino (1974), Hobson (1978), and Wood (1977) studied the different issues involved in the financial performance of banks. All these studies have been conducted in western countries and are not relevant in Indian context
due to different functional and geographical environment. Nevertheless, these studies provide useful guidelines in the subject concerned.

Klein (1977)\textsuperscript{6} studied the impact of long range planning on profit and growth of commercial banks. The study indicates that bank size is an important variable affecting growth trends in commercial banks. Further, the extent of long range planning efforts undertaken does influence growth trends.

Shah (1978)\textsuperscript{7}, in the paper entitled “Bank Profitability: The Real Issues” concluded that profitability cannot and will not improve merely by increasing the margin between lending and borrowing rates. On the contrary, any increase in income will be observed by latent efficiencies in cost structure. Further, the spread between interest earned and interest paid is declining, not because of interest margin but has been squeezed since staffing and working patterns are inefficient, funds and investment management is poor, credit is not supervised, and forms and procedures are complex and wasteful.

Bupp and David (1978)\textsuperscript{8}, on the basis of a case study “Analyzing Bank office profitability” of the Bank of Hanover Trust Co., pleaded that in order to reach more profitability, more authority and responsibility is to be delegated to the branch office managers including accountability for the quality of their own loan portfolios, marketing in their trading areas, the efficient operation of their offices (branches) and ultimately their office profitability. To measure the target profitability the office profitability analysis, cost of funds was designed. This experiment worked well in the bank in improving the overall profitability.

Kulkarni (1979)\textsuperscript{9}, in the study on developmental responsibility and profitability of banks stated that while considering banks costs and profits, social benefits arising out of banks operations cannot be ignored. The study indicated that profit maximization approach is out of place while referring to profitability of banks, and recognized that
while fulfilling the social responsibility, banks should try to make the developmental business as successful as possible, reduce costs, improve banking system and increase the overall productivity.

Ganesh (1979), in the paper on the system of profit monitoring in banks emphasized that the effectiveness of monitoring system would depend upon profit plan, identification of profit centers, setting of standards for comparison and a proper management information system. The study indicated that the working funds as a base for the purpose of comparing profitability at the branch level, is inadequate and relating it to the total business (i.e., the sum of the total deposits and total advances) will be more suitable.

Makrant (1979), attempted to evaluate the performance of Public Sector Banks in different spheres where much was expected from the banking sector. To prepare performance index of each public sector bank, six quantitative indicators were selected, viz., branch expansion, priority sector credit, deposit mobilization, export credit, net profit to working funds and wage cost of business development. These indicators were assigned appropriate weights and incorporated in the Integrated Priority Index, on the basis of which inter-bank comparisons were made. The study suggested that (i) counseling and expert advice to the priority sectors on diversified activities is essential (ii) apart from top management, the staff at lower level should also be actively involved in the priority sector credit and (iii) necessary lending powers should be vested with the branch managers.

Wadikar (1980), conducted a study on “Private Sector Banking in India since 1969 – A study in its operations”. In the discussion on bank profitability in terms of assets and liability, portfolio management touched upon the trends in income and expenses of the private sector banks. The study revealed that performance of private sector scheduled commercial banks was better than public sector banks during 1969-76.
The branch expansion was at a higher rate in private sector than in public sector banks and their spread in semi urban and rural areas was also better.

**Bilgrami** (1980), studied the banking growth imbalances over a decade since nationalization in branch expansion, deposit mobilization, credit disbursement and priority sector lending. The study concluded that: (i) the rapid expansion of bank branches since 1969 have substantially increased the average number of bank branches per million populations in all regions, but such expansion could not actually prove helpful in eliminating the wide variations between backward and developed regions. (ii) the regions, which were above the national average population served by a bank in 1969, recorded more progress than the regions that were below the national average. Similar trends also emerged in case of deposits, credits and priority sector lending.

**Karkal** (1982), in the work, “Profit and Profitability Planning”, examined the factors that determine the volume of profit and the technique used in profit planning. It was suggested some measures to improve the profitability in banks through increasing the margin between lending and borrowing rates and improving the productivity of staff. But the study did not touch upon the burden related issues.

**Angadi** (1983), measured the efficiency in terms of responsiveness of operating cost which influences the profitability of the banking industry. The study revealed some important yardsticks like operating cost responsiveness and administered prices/interest rates to output of operational efficiency of banks.

**Angadi and Devraj** (1983), in the paper revealed that the difference in cost of working funds (deposits), interest earning, social banking, fund management, earning from sources other than the interest earnings, expansion of banking business, retail banking services, as the main factors contributing to difference in productivity and profitability ratios of the bank groups. The authors concluded that in the prevailing
circumstances, changes in interest rates on deposits and credit, have a decisive impact on earnings and expenses and consequently on profitability of banks.

Varde and Singh (1983)\textsuperscript{17}, of National Institute of Bank Management conducted a number of studies on the Profitability of Commercial Banks and have compiled them in a short book titled “Profitability of Commercial Banks”. The book covers different issues related to profitability of banks like profit management in banks, productivity in banks, profit planning in banks, monitoring profitability of bank branches, measuring cost of funds for banks, matching revenues and costs of commercial banks and operating cost of rural retail banking.

Punjab National Bank (1986)\textsuperscript{18}, hosted the 9\textsuperscript{th} Bank Economists’ Meet at New Delhi. One of the topics discussed in the conference was “Profitability and Profit Planning in Banks”. The major issue deliberated was that bank’s profitability is a function of both exogenous and endogenous factors, wherein the former plays a greater role. The exogenous factors include large pre-emption of bank funds for the purpose of liquidity requirements (viz., SLR and CRR with low yields), administrated interest rate structure with concessional rates on several categories of loans and massive branch expansion in the rural areas. The endogenous factors include increase in establishment expenditure, growing proportion of term deposits in the deposit-mix, inadequate non-found business and low return from ancillary services. The major recommendations which emerged from the discussion were: (i) paying interest on the first 3 per cent of CRR by Reserve Bank of India, although it may mean amendment in the relevant act (ii) professionalization of credit management, diversification of business, increasing service charges and computerization of operations, (iii) increase in rates of interest on priority sector credit, (iv) take over of sick units and their management by banks, (v) better cash management and investment management, (vi) better cost management and
(vii) adoption of techniques like linear programming and zero-based budgeting for
profit planning.

Vashist (1987)\textsuperscript{19}, in the empirical work, “Performance Appraisal of
Commercial Banks in India”, evaluated the performance of public sector banks with
regard to six indicators i.e., branch expansion, deposits, credit, priority sector advances,
DRI advances and net profit over the period 1971-83. A composite weighted growth
index was developed to rank the banks and to classify them into four performance
levels viz., excellent, good, fair and poor. The study ranked Indian Overseas Bank at
the top and Dena Bank at the bottom. An urgent need to check the working of
commercial banks for ensuring rapid and healthy growth in future was stressed; and to
improve the performance of commercial banks, the study suggested: (i) the developing
of marketing strategy for deposit mobilization, (ii) profit planning, and (iii) SWOT
(Strengths, Weaknesses, Opportunities and Threats) analysis in banks.

Piravi Perumal (1990)\textsuperscript{20}, in the article “Focus on Profitability”, analyzed the
causes for low profitability and suggested that improvement in interest income and
other incomes, reducing the expenditures, maximization of yield on funds,
minimization of cost on funds, improving customer service and productivity would
improve the profitability of commercial banks.

Panda and Lall (1991)\textsuperscript{21}, in the research paper attempted to develop certain
internal management techniques for improving the profitability of the Indian banking
system. The authors have identified productivity, development of funds, quality of
advances, information system and organizational set up and branch expansion policy as
the most important factors influencing the profitability.

Shanbhag (1991)\textsuperscript{22}, has critically evaluated various target based social
obligations assigned to banks from time to time after their nationalization. The author
did not dispute the basic need and principles behind social banking in a highly
structured society, however, urged the necessity of redefining the basic ideas and concepts behind social banking, and suggested re-grouping of the priority sectors with the contemporary.

Seth Rajeev, K (1992)\textsuperscript{23}, in the article “Evaluating Branch Profitability – An Integrated Approach”, suggested the importance of comprehensive index of branch profitability. It used Per Employee Profitability Index for analyzing fund – based business, fee – based business, non – quantifiable branch activities etc., and had pointed out the areas where the Per Employee Profitability Index is applied.

Vysya Bank (1992)\textsuperscript{24}, hosted Bank Economists’ Conference at Bangalore, 1991, on ‘Banking for Better Profitability’. Different experts and eminent persons in banking sectors presented papers on profitability of banking operations with their valuable suggestions for enhancing bank profitability.

Chandra (1992)\textsuperscript{25}, studied the profitability aspect of public sector banks. In the study it was highlighted that step-motherly treatment and discrimination which public sector banks are being subjected to, in spite of their predominant role in mobilizing resources and substantial contribution made to the society and concluded that despite massive working funds, public sector banks were not able to show better results due to high cost of operation on account of priority sector advances.

Mishra (1992)\textsuperscript{26}, in the paper, analyzed the profitability of scheduled commercial banks in India, taking into account the interest and non interest income and interest expenditure, manpower expenses and other expenses. The paper concluded that the growing pre-emption of funds in the form of SLR, CRR, in increase of expenses as compared to the income, advances and total investment than interest income and few more have contributed to the declining profitability of commercial banks.

Amandeep (1993)\textsuperscript{27}, in the study on profitability of commercial banks has attempted to examine the trends in profits and profitability of twenty nationalized
commercial banks with the help of trend analysis, ratio analysis and concentration indices of the selected parameters. The study focuses on identifying the various factors and empirical testing as to which of the identified factors have significantly contributed towards bank profitability in either direction. Using multivariate analysis, it was concluded that it is the efficient management of the burden (as against the widely believed ‘spread’ element), which plays a major role in determining the profitability of commercial banks. In spite of lack of control of few determinants of burden, it is inferred that judicious management of the burden can significantly enhance bank profitability.

Chidambaram and Alamelu (1994)\textsuperscript{28}, studied the problem of declining profit margin in Indian Public Sector Banks as compared to their private sector banks. It was observed that in spite of similar social obligations, almost all the private sector banks have been registering both high profits and high rate of growth, with respect to deposits, advances and reserves as compared to public sector banks. Regional orientation, better customer service, proper monitoring of advances and appropriate marketing strategies are the secrets behind the success of private sector banks.

Balasubramaniam (1994)\textsuperscript{29}, has conducted a research study on the “Portfolio Behavior on Indian Commercial Banks”. This study is of an exploratory nature and limitedly demonstrates the use of linear programming in the management of bank funds. An econometric model is designed to explain the portfolio behavior of both the banking system and the individual banks.

Dr.Kaveri (1995)\textsuperscript{30}, in the article entitled “Relationship between Recovery and Profitability of Bank – A study” applied macro and micro level data analysis. The author suggested a default risk provision to monitor and control the non-performing assets, which is a major cost for reducing profitability. It suggested measures to improve the recovery performance and debt securitization.
Kallu Rao and Shaji Thomas (1996)\(^{31}\), in their article “Impact of ‘SLR’ on Banks Income and Profitability” analyzed the impact of Statutory Liquidity Ratio on advances as well as income and profit of three sample banks. The author used five Regression Models along with coefficient of determination and Durbin Waston Test. It analyzed the impact of total advances, advances to priority sectors, advances to agriculture, advances to DRI scheme, SSI advances, change in profits, change in income etc.

Dr. Krishna (1996)\(^{32}\), in the article “Profitability Analysis – An Over – view”, suggested measures to measure profitability. They include earnings before depreciation, interest and tax, earnings before interest and tax, operating cash flow etc. The author used ratio of profit to assets and ratio of profit to sales and return on investment for the purpose of measurement of profitability.

Somaskandan and Neelamegam (1996)\(^{33}\), in their paper “Post – Liberalization Profit Scenario – A Feasible Solution” attempted to utilize a linear programming model for decision making in banks. The author developed a model for maximization of income function with assumptions and constraints and applied simplex method to solve the problem assumed and arrived at their appropriate solutions.

Ramasamy (1996)\(^{34}\), in the article “Efficiency for Productivity and Profitability” studied the productivity measure of banks. In the article, the author identified eight indicators to measure productivity. It also identified eight other indicators to measure profitability and identified two methods for determining the performance of individual banks viz., simple method of Ranking and Ranking Based on factors scores. Also, factor loadings and estimated Eigen Values were applied for purpose of analysis. The main findings were to measure profitability instead of a single indicator a composite index is more meaningful. Assessment of efficiency within
homogenous groups seems more realistic and meaningful rather than measuring
efficiency at the overall levels.

**Kishore, C. Raut** and **Santosh, K. Das** (1996)\textsuperscript{35}, have studied “Commercial
Banks in India – Profitability, Growth and Development”. In this study an attempt is
made to examine measure and analyze the profitability trends of the Indian banking
sector over the period 1980-92. In the process of analysis, the various factors
responsible for the variation of banks profitability in either direction been gleaned over
and also incorporated the empirical analysis of profitability as well as the determinants
of the sample bank groups.

**Gupta** (1997)\textsuperscript{36}, in the article titled “Profitability” defined the concept of
profitability, roll of profitability and suggested some techniques to measure
profitability. The tool suggested is the condensed profit and loss account along with
common size statements, which will be much useful in measuring profitability of
commercial banks.

**Mohan Rao** (1997)\textsuperscript{37}, in his paper entitled “Profitability and Indian Banking:
the Post-Reform Scenario”, analyzed the trends in various bank groups for a 5 year
period from 1991 – 1992 to 1995 – 1996. Author used spread as percentage of working
funds, share of non-interest income to total earnings, share of term deposits to total
deposits, cost of deposits to working funds, priority sector advances to total advances,
operating expense as a percentage of working funds, establishment expenses as
percentage of working funds and net profit as percentage of working funds for the
purpose of analysis of profitability. It was concluded that the emerging trends reflect
upon the resilience of the Indian Banking System in withstanding stresses and strains of
reform process.

**Ramachandran** (1997)\textsuperscript{38}, in his article entitled “Improving Profitability of
Commercial Banks”, analyzed seventeen problems faced by the commercial banks. It
revealed seventeen other reasons for the low profitability of commercial banks and suggested measures to improve the profitability. The important suggestions among them are reduction of cost, improvement of CD Ratio, deregulation of interest rate, prudent cash management, improvement of non-interest income, rehabilitation programme for sick units.

**Dr. Srinivasa Rao (1997)**[^39], in the article “Profitability of Public Sector Banks – Needs for Risk Factoring” analyzed the present profitability trends through ten profitability indicators. The author also gave a detailed analysis about the various types of risk and method of measuring Assets Liability Risk (ALR). It suggested that risk analysis and management are the steps to improve profitability.

A study was conducted by **Ganesan (1998)**[^40] titled “Priority Sector Advances vis-à-vis Profits and Profitability of Public Sector Banks in India (1969-1993)”. In his study, he focused his main attention to analyse the following aspects: i) economies of priority and non-priority sector transactions with reference to spread, burden and surplus; ii) the use of efficiency, liquidity and profitability ratios to assess the operational efficiency; iii) determinants of profitability to derive a profit function model; and iv) the economies of scale regarding cost, production and profit functions. Finally, the study pinpoints certain ideas for the improvement of profitability and the technical change to be made to recover the over dues of priority sector advances.

**Sanjay Ramachander and Harry Thiewes (1999)**[^41], in their study on “the impact of foreign banking activity on the profitability and performance of US Banking markets”, examined the pre and post acquisition performance of both domestic and foreign owned commercial banks operating in the US. More specifically, the study investigated the operating characteristics of foreign owned US banks during the three year pre and post acquisition period. The result of the study indicated that foreign banks typically acquire banks which are slightly below (average performances as
measured ROA). Over the three years and following acquisition, foreign-acquired banks reported a significant improvement in its profitability. They also favored a loan mix that is more heavily weighted towards commercial loans as opposed to consumer loans.

Lacewell and Stephen Kent (1999), examined the association between bank characteristics, efficiency and financial performance. According to the author, the area of performance measurement can be divided into two rather large streams of research: bank efficiency measures and accounting-based financial ratios. This study merges these two seemingly separate areas to determine when and how the two should be used in combination. This study consists of multiple stages. One of the important analyses in his research work is the estimation of cost and alternative profit efficiency scores using a national model and a size-specific model.

Abdulkader et.al. (1999), attempted to assess the financial performance (profitability) of commercial banks in Saudi Arabia. A regression model was employed to test the effect of bank risk, concentration of market size on the profitability of the bank measured in terms of return on assets (ROA), return on equity (ROE) and earning per share (EPS). Both time series and the pooled time series data were used. The empirical results generated from the three models showed that the business risk and the bank size were the main variables which determined bank’s profitability.

Udegbunam Ralph (2001), made an empirical analysis of the determinants of performance of difference among commercial banks in Nigeria, in the early 1990s. Using a pooled time-series cross section data, a simple model of bank performance was estimated by OLS method. Two regression equations were used-return on assets (ROA) and return on equity (ROE) as two measures of bank performance. The results showed that capital adequacy, management quality and credit risk were the key determinants of bank performance, in both the cases. The evidence also suggested
notable differences too; while there was an overwhelming evidence of strong negative effect of credit policy on ROE, the effect was weak on ROA. But, asset growth, liquidity and financial distress were found to exert strong effect on ROA; they appeared to play a less significant role in bank ROE.

Ganesan (2001)\textsuperscript{45}, examined the determinants of profitability of public sector banks in India by an empirical estimation of profit function model. It showed that interest cost, interest income, other income, deposit per branch, ratio of credit to total assets, share of priority sector in total advances and loss of interest income were the significant determinants of profits and profitability of Indian public sector banks. The average establishment cost positively contributed to the profitability but it adversely affected the net profit of the public sector banks.

Ramachandran (2002)\textsuperscript{46}, in “Profits, Profitability and Growth of Commercial Banks”, have analyzed some aspects of factors influencing total earning, total expenditure and profitability of Indian schedule commercial banks. The multivariate analyses of the profitability undertaken disclose the relationship among the earning factor and expenses factor on the profitability of banks which enriches the scope of the study. This study is especially used for policy makers, bankers and researchers as it provides adequate information about the determinant of bank earnings and profits.

Rameshwari (2003)\textsuperscript{47}, found that the monetary tools were the important parameters of the banking financial performance. But they had low or moderate correlation with other variables viz., bank credit, investments, liabilities, assets, other economic, social, political and other factors also influence the growth of these variables.

Kothai (2003)\textsuperscript{48}, in the paper entitled “Non Performing Assets of Schedule Commercial Banks in India: An Analysis” – author has analyzed all the bank groups. Public sector banks have recorded good achievement in terms of branch expansion
deposit mobilization and deployment of credit and regarding non-performing assets the performance of the public sector banks is extremely good. The NPAs of this group has been showing decreasing trend during the study period. The study reveals that the reduction of NPA is mainly due to write off of bad debts and expansion of total advances over the year.

Madhumathi and Lakshmikumar (2004)\(^{49}\), undertook a study entitled “Multifactor Evaluation and Forecasting of Banking Performance in India”, and analyzed the commercial banks operating in India with respect to their financial ratios. The study through factor analysis revealed the most important factors to be considered by the banks. The analysis brought out three clusters into which a bank could fall in namely, nice banks, sound banks and mass bank and justified the same with its distinguishing feature. The analysis also disclosed the strategies to be followed by banks for their long run sustainability.

Rammohan and Ray (2004)\(^{50}\) compared performances of 58 banks comprising public sector, private sector and foreign banks using a revenue maximization efficiency approach for the period 1992-2000. Loans, investments and other incomes were taken as bank outputs. The following inputs are taken for their study – deposits and operating costs. They argued that during the period, Indian banks did not have much freedom in trimming costs, especially, the cost of labor. Under such circumstances, revenue maximization best described the objective that banks have been focusing during the period.

Brinds Jagirdar and Amlendu, K. Dubey (2007)\(^{51}\), in their article “Performance of Public Sector Banks argue that the relative performance of different bank groups, ie, public, private or foreign appears to be correlated with the extent of their link with the market. Foreign banks are found to be more profitable and efficient than traded private banks, which in turn are found to be more profitable than non-traded
private banks. In their analysis they found that the private and the foreign banks are not found to be superior to the public sector banks in any of the performance indicators namely ROA, NIM and OER.

Naganathi (2007)\textsuperscript{52} in “Profitability, Efficiency and Non-Performing Assets – A critical analysis with reference to the State Bank of India and its Associates” examined the trends in profitability, efficiency and non-performing assets of SBI & its associate banks considering interest, working funds, interest expense, gross profits, net profits, spread, etc., that the profitability is on an increasing trend. Per employee and per branch indicators worked out showed that the efficiency of the firms has increased for all the banks during the study period and decline in gross and net NPA.

Kanjana (2007)\textsuperscript{53} “Efficiency, Profitability and Growth of Scheduled Commercial Banks in India” – tested whether the establishment expense being a major expense, out of total expense which is met by scheduled commercial banks is more due to excessive number of employees. In its empirical study, it was disclosed that the earning factor and expense factor which are controllable and non-controllable by the bank itself.

Harpreet Kohli and Chawla (2007)\textsuperscript{54}, in the paper entitled “Profitability trends in Commercial Banks: A study of select Commercial Banks” compared the profitability performance of different banks during the study period found that most of the indicators that have been shown the performance of the two private sector banks via ICICI Bank and Bank of Punjab has been better that the two Public sector Banks via SBI Group and Punjab National Bank. It is concluded that the entry of private sector banks has undoubtedly contributed to the strengthening of the Indian banking system by creating a competitive atmosphere. Enhancing efficiency and performance of public sector banks is a key objective of economic reforms in many countries including India. It is believed that private ownership helps improve efficiency and performance of
banks. The study examined the impact of privatization on bank performance and
efficiency using data of banks in India for the five year period 1998-2002. No
significant performance or efficiency difference was seen in these two cohorts of banks.
Overall, going by the results of the study, partially privatized banks have continued to
show improved performance and efficiency in the years after privatization.

Performance of Scheduled Commercial Banks in India” examined to assess the extent
of variation in profits and profitability and present the progress of scheduled
commercial banks in India. It is found that all the banks performed more or less in the
same fashion in its achievement. It was revealed that banks should initiate direct efforts
to maximize revenue to improve the profitability

Ashok Kumar (2009)\textsuperscript{56} in his study examines how the financial performance of
SBI group, Nationalized banks group, private banks group and foreign banks group has
been affected by the financial deregulation of the economy. The main objective of the
empirical study is to assess the financial performance of Scheduled Commercial Banks
through CRAMEL Analysis.

After going through various studies conducted by way of research articles,
journals, magazines, M.Phil and Ph.D. thesis and various books yet there is a gap where
other factors must be found out. The above studies have applied various tools and
applications to find the funds management of the banks under the study. Here, the
researcher has applied techniques and various statistical applications to bring out the
factors determining Funds Management. To study the factors the following were the
objectives framed for the study.

It is being observe that the earlier studies were conducted on the different
aspects of the scheduled commercial banks. It is new attempt for the researcher to make
an analysis on appraisal of financial statements of scheduled commercial banks in India with reference to stakeholder’s perspective.

1.4 OBJECTIVES OF THE STUDY

The broad objectives of the study are as follows:

i. To frame a design on the financial appraisal in relation to performance evaluation of scheduled commercial banks in India.

ii. To assess the financial position of scheduled commercial banks in relation to borrowers, customers, depositors, employees, investors, shareholders and profitability.

iii. To identify the direct and indirect effect of the selected variables on the profitability with reference to stakeholders perspective.

iv. To assess the funds management position of scheduled commercial banks in India; and

v. To offer suitable suggestions for the improvement of financial performance of scheduled commercial banks in India.

1.5 SCOPE OF THE STUDY

The study is limited to analyze the financial position of scheduled commercial bank reference to stakeholder’s perspective. The analyses is processed by considering Top five and lower most five banks in Public sector and Private sector banks. Return on Equity is considered for priority of categorizing banks. An extensive analysis is possible for the researcher to probe the entire banks including foreign banks. This analysis may focus on financial health and efficiency of banks in the millennium and perhaps focus on these issues will end up in fruitful results. A study on financial position paved a way for the researcher to look in to the stakeholder’s perspective and prospects of commercial banks from a different angle. The data is obtained from the
published records of various government and other agencies which limit the scope of the study pertaining to financial statements. The study was carried at macro level which leads to an overall observation of stakeholders.

1.6 PERIOD OF THE STUDY

The present study attempts to evaluate the financial position of scheduled commercial banks in India over a ten years period covering 2002 – 2012.

1.7 CONCEPTUAL DEFINITIONS

Accounting of economic activity

Economic activity involves production, consumption, saving, accumulation and distribution. The productive process constitutes the axle of the wheel of economic activity. The modern system of accounting is a mixture of the real variables with money variables. The Reserve Bank of India’s control over banks is comprehensive and extended to all their activities. The important activities of commercial banks are acceptance of deposits, purveying credit to the various sectors of the economy such as industry, trade and commerce, agriculture, small industries, etc. The reserve bank as the banker and the controlling authority of banks has to ensure that the provisions and other regulations are in accordance with the banks. Financial statement analysis is a judgmental process. One of the primary objectives is identification of major changes in trends, and relationships and the investigation of the reasons underlying those changes. The judgment process can be improved by experience and the use of analytical tools. Probably the most widely used financial analysis technique is ratio analysis, the analysis of relationships between two or more line items on the financial statement. Financial ratios are usually expressed in percentage or times.

Theory of Banking

Commercial banks form the most important part of the Indian financial landscape in terms of their role in channeling credit to the commercial sector and
facilitating the process of financial inclusion. With the onset of economic reforms, the commercial banking sector, which has retained its predominantly public character, has undergone a number of changes on terms of size, efficiency of operation and financial soundness. Banks are looking for ways to reduce inefficiencies and improve integration to keep up with changing market demands. Banking is now an international industry and competition is fierce at the global level. The majority of the banks are still successful in keeping with the confidence of the shareholders as well as other stakeholders. However, with the changing dynamics of banking business brings new kind of risk exposure.

**Stakeholders**

The stakeholders in banking industry are Borrowers, Employees, Depositors, Investors, Shareholders and Creditors.

**Depositors**

Banks are dependent on depositor’s money as a source of funds. There are three main motives why people hold money: transaction, precautionary and investment motives. In order to cater for these motives commercial banks offer three categories of deposit facilities that are demand, savings and time deposits.

**Borrowers**

Banks in developing countries are highly dependent on bank loans as a source of capital and the ability of banks in giving loan are depend much on their ability to attract deposits. It helps lenders to make better loan decisions, mitigate risk and improve their loan portfolio.

**Investors**

An investor can perform fundamental analysis on a bond's value by looking at economic factors, such as interest rates and the overall state of the economy, and information about the bond issuer, such as potential changes in credit ratings. Key
factors should include entry price, expected time horizon and reasons for making the decision at the time. For assessing stocks, this method uses revenues, earnings, future growth, return on equity, profit margins and other data to determine banks potential for future growth.

**Creditors**

Borrowings are the major non-deposit liability for banks. Credit Analysis is the process of analyzing financial statements issues in order to estimate the ability of the issuer to live up to its future contractual obligations such as long term contracts, prompt payment and growth of purchasing.

**Employees**

Employees banking proposition understands employers' requirements to provide and implement structured domestic and regional staff benefits. Financial statement ratios includes such as salaries & wages, Profit per employee etc.

**Shareholders**

Shareholders or stockholders own parts or shares of companies. Owning shares of a company often entitles an investor to a part of the company's profits, which is issued as a dividend. In addition, shareholders are typically offered a fixed payout per share if the company is bought out.

**Profitability**

Profitability determines the ability of a bank to increase capital (through retained earnings), absorb loan losses, support the future growth of assets, and provide a return to investors. The largest source of income for a bank is net interest revenue (interest income from lending activity less interest paid on deposits and debt).
<table>
<thead>
<tr>
<th>BORROWERS</th>
<th>EMPLOYEES</th>
<th>PROFITABILITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>B₂  Return on Advances</td>
<td>E₂  Wage Bill to Total Expenses</td>
<td>P₂  Operating Profit to Total Income</td>
</tr>
<tr>
<td>B₃  Bills Purchased and Discounted to Total Advances</td>
<td>E₃  Wage Bill to Intermediation costs</td>
<td>P₃  Operating Profit to Interest Income</td>
</tr>
<tr>
<td>B₄  Cash credits, Overdrafts &amp; loans to Total Advances</td>
<td>E₄  Business per Employee</td>
<td>P₄  Net Profit to Total Income</td>
</tr>
<tr>
<td>B₅  Term loan to Total Advances</td>
<td>E₅  Profit per Employee</td>
<td>P₅  Return on Equity Capital</td>
</tr>
<tr>
<td>B₆  Priority Sector Advances to Total Advances</td>
<td>E₆  Operating Expenses to Total Income</td>
<td>P₆  Net Profit to Working Funds</td>
</tr>
<tr>
<td>B₇  Public Sector Advances to Total Advances</td>
<td></td>
<td>P₇  Return on Equity Capital</td>
</tr>
<tr>
<td></td>
<td>E₇  Non-Interest Income to Working Funds</td>
<td>P₈  Net Profit to Total Deposits</td>
</tr>
<tr>
<td></td>
<td>E₈  Non-Operating Expenses to Working Funds</td>
<td></td>
</tr>
<tr>
<td></td>
<td>E₉  Intermediation Cost to Working funds</td>
<td>P₉  Burden to Total Income</td>
</tr>
<tr>
<td></td>
<td>E₁₀ Secured Advances to Total Advances</td>
<td>P₁₀ Burden to Working Funds</td>
</tr>
<tr>
<td></td>
<td>E₁₁ Unsecured Advances to Total Advances</td>
<td>P₁₁ Spread to Working Funds</td>
</tr>
<tr>
<td></td>
<td>E₁₂ Cost of Advances</td>
<td>P₁₂ Net Interest Margin to Total Income</td>
</tr>
<tr>
<td></td>
<td></td>
<td>P₁₃ Interest Expended to Total Expenses</td>
</tr>
<tr>
<td></td>
<td></td>
<td>P₁₄ Interest Coverage Ratio</td>
</tr>
</tbody>
</table>

| B₁  Advances to Working Funds              | E₁  Wage Bill to Total Income            | P₁  Operating Profit to Interest Income    |
| B₈  Bank Sector to Total Advances          | E₆  Operating Expenses to Total Income   | P₃  Operating Profit to Total Income       |
| B₉  Other Sector to Total Advances         |                                          | P₉  Burden to Total Income                |
| B₁₀ Secured Advances to Total Advances     |                                          | P₁₀ Burden to Working Funds               |
| B₁₁ Unsecured Advances to Total Advances   |                                          | P₁₁ Spread to Working Funds               |
| B₁₂ Cost of Advances                       |                                          | P₁₂ Net Interest Margin to Total Income   |
| B₁₃ Return on Advances Adjusted to Cost of Funds |                          |
| B₁₄ Net NPA to Net Advances                |                                          | P₁₃ Interest Expended to Total Expenses    |
| B₁₅ Gross NPA to Gross Advances            |                                          | P₁₄ Interest Coverage Ratio               |
| DEPOSITORS | | INVESTORS | | SHAREHOLDERS | | CREDITORS |
|---|---|---|---|---|---|
| D₁ | Cash Deposit Ratio | D₈ | Term Deposits to Total Deposits | D₉ | Interest Income to Total Deposits |
| D₂ | Credit Deposit Ratio | D₁₀ | Net Interest Margin to Total Deposits | D₁₁ | Interest Income to Total Income |
| D₃ | Cost of Deposits | D₁₂ | Interest Income to Working Funds | D₁₃ | Interest Expended to Interest Earned |
| D₄ | Interest on Deposits to Interest Expended | | | | |
| D₅ | Deposits to Working Funds | D₁₄ | | |
| D₆ | Demand Deposits to Total Deposits | | | |
| D₇ | Savings Bank Deposits to Total Deposits | | | |
| I₁ | Investments to Working Funds | I₈ | Other Approved Securities to Total Investments | |
| I₂ | Credit + Investments Deposit Ratio | I₉ | Shares to Total Investments | |
| I₃ | Investments Deposit Ratio | I₁₀ | Debentures and Bonds to Total Investments | |
| I₄ | Investments to Advances | I₁₁ | Subsidiaries and Joint Venture to Total Investments | |
| I₅ | Return on Investment | I₁₂ | Other Securities to Total Investments | |
| I₆ | Income on Investments to Interest Earned | I₁₃ | Investment in Non-approved Securities to Total Investments | |
| I₇ | Government Securities to Total Investments | I₁₄ | Return on Investment adjusted to Cost of Funds | |
| S₁ | Equity paid up to Capital Employed | S₉ | Operating Profit to Working Funds | |
| S₂ | Equity paid up to Net Worth | S₁₀ | Provision & Contingencies to Working Funds | |
| S₃ | Return on Net Worth | S₁₁ | Debt-Equity Ratio | |
| S₄ | Return on Capital Employed | S₁₂ | Earnings Per Share | |
| S₅ | Net Worth to Capital employed | S₁₃ | Capital Adequacy ratio | |
| S₆ | Net NPA to ROI | S₁₄ | Capital Tier - I | |
| S₇ | Return on Working Funds | S₁₅ | Capital Tier - II | |
| S₈ | Fixed Assets to Net Worth | S₁₆ | Rural Banks to Total Banks | |
| C₁ | Borrowings to Working Funds | C₉ | Inter-office Adjustments to Other liabilities | |
| C₂ | Borrowings in India to Working Funds | C₁₀ | Interest Accrued to Other liabilities | |
| C₃ | Borrowings outside India to Working Funds | C₁₁ | Interest on RBI/Inter-Bank Borrowings to Interest Expended | |
| C₄ | RBI to Borrowings | C₁₂ | Cost of Borrowings | |
| C₅ | Other banks to Borrowings | C₁₃ | Liquid Assets to Total Borrowings | |
| C₆ | Other Institutions and agencies to Borrowings | C₁₄ | Other Assets to Total Borrowings | |
| C₇ | Other Liabilities to Working Funds | C₁₅ | Fixed Assets to Total Borrowings | |
| C₈ | Bills Payable to Other liabilities | | | |
1.8 METHODOLOGY

1.8.1 Sampling Design

For the present study, all scheduled commercial banks in India functioning during the study period are considered which constitute the sampling design. It excludes the foreign banks operating in India. Hence purposive sampling technique is adopted for complete enumeration of each and every unit of the universe. A total of State Bank of India and its subsidiaries, nationalized banks and private sector banks functioning in India are selected for the study which is in operation during the study period. However, due importance is attached in constituting the sampling design based on average return on equity. Based on that the Top most five banks and Lower most five banks in Public sector and Private sector banks are grouped for the purpose of the study.

1.8.2 Data Collection

The present study is based on the information’s that are secondary in nature. The data required for the study are gathered from financial statements of various issues, reports and publications of Reserve Bank of India. More relevant information’s required for the study are collected from the publications of RBI, various economic surveys by Government of India, books and Journals. The other useful information and statistics to the study are collected from the websites of the selected banks. The collected data are grouped as given under and they are examined by applying various ratios based on stakeholder’s perspective.

<table>
<thead>
<tr>
<th>TOP FIVE BANKS</th>
<th>PRIVATE SECTOR</th>
<th>LOWER MOST FIVE BANKS</th>
<th>PUBLIC SECTOR</th>
<th>PRIVATE SECTOR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector</td>
<td>Private sector</td>
<td>Public sector</td>
<td>Private sector</td>
<td></td>
</tr>
<tr>
<td>State Bank of Travancore</td>
<td>City Union Bank</td>
<td>Punjab and Sind Bank</td>
<td>ING Vysya Bank</td>
<td></td>
</tr>
<tr>
<td>Andhra Bank</td>
<td>Karur Vysya Bank</td>
<td>Dena Bank</td>
<td>Dhanalakshmi Bank</td>
<td></td>
</tr>
<tr>
<td>Indian Overseas Bank</td>
<td>Jammu &amp; Kashmir Bank</td>
<td>United Bank of India</td>
<td>Lakshmi Vilas Bank</td>
<td></td>
</tr>
<tr>
<td>State Bank of Mysore</td>
<td>HDFC Bank</td>
<td>Indian Bank</td>
<td>Indusind Bank</td>
<td></td>
</tr>
<tr>
<td>State Bank of Hyderabad</td>
<td>Catholic Syrian Bank</td>
<td>Central Bank of India</td>
<td>ICICI Bank</td>
<td></td>
</tr>
</tbody>
</table>
1.8.3 Tools and Techniques

The researcher has adopted BEPA-DISCA dimension to understand the financial performance of scheduled commercial banks in India. Based on the data available in the financial statement of commercial banks they are grouped under stakeholder’s perspective as Borrowers ratio, Employees ratios, Profitability ratios and Depository ratio, Investors ratio, Share holder’s ratio and Creditors ratio.

The following frame work of the study is being applied to observe and analyze the financial position of scheduled commercial banks in India. Findings are made with the help of various tools and technique and suggestions are made to reveal the various aspects.

1.8.3.1 Assessing the Financial Performance through Ratios

Ratio analysis is one of the effective tools of financial analysis of banks. For measuring profitability of banks, analysis of relevant ratios is the best available method because of their conciseness, comparability and the direct relevance of the relationships established to various earning capabilities of the banks. To evaluate the profitability performance of Scheduled Commercial Banks, seven dimensions such as Borrowers, Employees, Profitability, Depositors, Investors, Shareholders and Creditors (BEPA-DISCA) have been employed.

1.8.3.2 Measuring the Extend of Factors Affecting the Profitability, Efficiency and Growth of Scheduled Commercial Banks in India – Shareholders Perspective

a) Correlation Analysis

Correlation Analysis attempts to study the relationship that exists between two variables. The correlation co-efficient of the selected independent variables with the bank profitability has been worked out in order to identify the most important variable, which have higher association with the dependent variable. Also, the correlation co-efficient among the different variables has been worked out so as to arrive at a
correlation matrix, which incorporates correlation co-efficient if all the selected variable with the dependent variable, as well as correlation coefficients among different independent variables. The test of significance has also been applied in order to identify the variables, which have significant correlation.

b) Factor Analysis

One of the major problems associated with regression analysis is that of multi co-linearity. The consequences of multi co-linearity are imprecise and unstable estimates. Usually, the problem of multi co-linearity is solved by selecting one or more of the highly collinear variables. Hence, the technique of factor analysis is often applied to isolate the different factors.

The procedure of factor analysis attempts to estimate the value for the coefficients of regression when the variables are regressed upon the factors. These coefficients are referred to as ‘factor loading’. The matrix of factor loading provides the basis for grouping the variables into common factors. Each variable is assigned to the factor, where it has the highest loading. The Varimax Rotation method is used in the factor analysis.

For example, there are k(I=1…….k) variables, n(j=1……..n) banks and m factors. The factor analysis model, in the matrix notation then, may be written as follows:

$$X_{(k \times n)} = A_{(k \times m)} \times Z_{(m \times n)}$$

Where:

- $X$ = the matrix of variables of order $(k \times n)$
- $A$ = the matrix of factor loadings of order $(k \times m)$
- $Z$ = the matrix of factors of order $(m \times n)$

In the factor analysis, factors are formed in such a way that (i) those variables that are most clearly inter-correlated are combined within a single factor, (ii) the variables allocated to the given factor are those that are most nearly independent of the variables
allocated to the other factors, (iii) the factors are derived in a manner that maximizes
the percentage of the total variance attributable to each successive factor (given the
inclusion of the preceding factors) and (iv) the factors are independent (uncorrelated
with each other).

c) Growth Analysis

The growth pattern of the commercial banks has been analyzed by adopting
the following techniques: a) Compound Annual Growth Rate Technique (CAGR)
and b) Linear Trend Method.

**Compound Annual Growth Rate Technique and Linear Trend Method**

The general performance of the banks can be analyzed more meaningfully and
objectively for a given period of time by comparing their growth patterns over the
period rather than on a year-to-year basis. The best measure available for such an
exercise is the compound growth rates or exponential growth rates.

Since the growth curves for many of the variables are non-linear, the compound
growth rates were estimated using the following equation.

Let, \( Y_t = Y_0 \left( 1 + \frac{r}{100} \right)^t \) be the growth curve where \( Y_0 \) and \( Y_t \) are the initial and the
\( t^{th} \) period value of \( Y \) respectively and \( r \) is the compound growth rate.

Taking logarithms on both sides,

\[
\log Y_t = \log Y_0 + t \log \left( 1 + \frac{r}{100} \right)
\]

i.e., \( \log Y_t = A + B_t \)

where \( B = \log[1+(r/100)] \) and \( A = \log Y_0 \). Using the value of \( B \), \( r \) can be
obtained from the following formula:

\[
r = [\text{antilog}(B) - 1] \times 100
\]

If \( Y_1 \) consist of random errors which follows the usual classical assumptions,
\( B \) can be estimated by the least square method i.e., \( Y_c = a + bx \).
d) Path Analysis

In statistics analysis, path analysis is considered an extension of the regression model. In a path analysis model from the correlation matrix, two or more casual models are compared. In path analysis, the path of the model is shown by a circle and an arrow, which shows the causation. In path analysis, regression weight is predicated by the model, and is compared by the observed correlation matrix. Then the goodness of fit statistic is calculated in order to see the fitting of the model.

Direct and indirect effect in path analysis

In path analysis, the path model has two types of effects. The first is the direct effect, and the second is the indirect effect. When the exogenous variable has an arrow directed towards the dependent variable, then it is said to be the direct effect. When an exogenous variable has an effect on the dependent variable, through the other exogenous variable, then it is said to be an indirect effect. To see the total effect of the exogenous variable, we have to add the direct and indirect effect. In path analysis, one variable may not have a direct effect, but it may have an indirect effect.

e) Z score Analysis

Z scores attempts to have an insight into the financial stability and operational health of the selected Indian commercial banks. Altman’s ‘Z’ score analysis has been applied by financial analysts to evaluate the general trend in the financial health of an enterprise over a period. Many of the individual accounting ratios used frequently to predict the financial performance of an enterprise may only provide warnings when it is too late to take a corrective action. Further, single ratio does not convey much of the sense. There is no internationally accepted standard for financial ratio against which the results can be compared. The objective of this part is to predict the financial health and viability of the selected Commercial bank with an objective to improve its operational efficiency, effectiveness and profitability. The data collected are first analyzed with the
help of the accounting ratios. These different ratios are combined into a single measure ‘Z’ score analysis with the help of Multiple Discriminant Analysis (MDA).

The formula used to evaluate the ‘Z’ score analysis as established by Altman is:

\[ Z = 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4 \]

Where ‘Z’ is the overall index

\[ X_1 = \frac{\text{Current Assets - Current Liabilities}}{\text{Total Assets}} \]

\[ X_2 = \frac{\text{Retained Earnings}}{\text{Total Assets}} \]

\[ X_3 = \frac{\text{Earnings before Interest and Taxes}}{\text{Total Assets}} \]

\[ X_4 = \frac{\text{Book Value of Equity}}{\text{Total Liabilities}} \]

1.8.4 Hypotheses of the Study

The following hypotheses are framed for the study to probe further to achieve the objectives of the study which substantiate the arguments and discussions coming under the study and also to draw logical conclusion.

i. The return on working funds contributes much towards the profitability of banks;

ii. The increase in credit has a positive effect on the profitability of banks;

iii. The increase in the non-interest income has a direct and positive impact on the profitability;

iv. There is no positive relationship between return on working funds and BEP ratio of the selected banks and

v. There is no positive relationship between return on working funds and DISC ratio of the selected banks.

1.9 LIMITATIONS OF THE STUDY

Considering the objectives and time frame set, it is exposed to the following limitations.
• Though the origin and development of the Scheduled commercial banks are considered for the present study, a period of ten years only taken into account for analysis and observation hence the need for considering the vital information during other period may not arise.

• Only quantitative figures are extensively used for analysis and observation in the study hence the qualitative aspects of the Commercial banks are not study widely.

• There are chances of minor variation in ratio while converting the statistical figures into the same where approximation of decimal places are inevitable and also variations would occur when the actual money values are converted into nearest rupee value in crores.

• The data collected for the present study are secondary in nature hence the limitations of the same are inherited in the present study.

1.10 CHAPTER SCHEME

Chapter I presents the Introduction, Design and Execution of the study. It includes Introduction, Statement of the Problem, Review of literature, Objectives, Period of the study, Scope of the study, Conceptual framework, Methodology, Hypotheses, Limitations and Chapter Scheme.

Chapter II deals with framework of financial appraisal such as BEPA – Borrowers, Employees, Profitability Analysis; DISCA – Depositors, Investors, Shareholders, Creditors Analysis and summary.

Chapter III is devoted to study an appraisal on the financial position of scheduled commercial banks in India with reference to BEPA (Borrowers, Employees and Profitability Analysis).
Chapter IV is deals with an appraisal on the financial position of scheduled commercial banks in India with reference to DISCA (Depositors, Investors, Shareholders and Creditors Analysis).

Chapter V is the concluding portion of the research in which the findings, suggestions and conclusion are presented. It also throws light on the future extension of the present study.
References


