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Topic: Financial Performance of Commercial Banks in India in Post Reforms Era

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ABSTRACT

The banking sector reforms have been introduced in India to strengthen the banking system and to make it internationally competitive. In the context of on-going banking sector reforms, the present study attempts to discuss the banking sector reforms in India and to analyze and compare the financial performance of commercial banks on various aspects such as profitability, liquidity, capital adequacy, assets quality, and off-balance sheet strength in post reforms era. Moreover, it also attempts to extract the financial ratios which significantly predict the financial performance of commercial banks.

The null hypotheses formulated for the study state that there is no significant difference in the profitability, liquidity, capital adequacy, assets quality, off-balance sheet strength, and overall financial performance of Sample Banks (SBs) among different Bank Groups (BGs) on the basis of various financial ratios and composite scores. For the purpose of study, the data has been collected from the Prowess, Statistical Software of Centre for Monitoring Indian Economy and various volume of banking statistics published by RBI and Indian Banking Association. The study includes a sample of 62 Scheduled Commercial Banks in India, comprising of 26 Public Sector Banks (PSBs), 17 Private Banks (PBs), and 19 Foreign Banks (FBs). A ten year period (1999-00 to 2008-09) has been selected for analyzing and comparing the financial performance of commercial banks in India.

The profitability performance of SBs is analyzed and compared with the help of Interest Income Ratio, Non Interest Income Ratio, Interest Spread Ratio, Operating Profits Ratio, Return on Net Worth, Return on Capital Employed, Return on Assets, and Return on Total Income. The liquidity performance of SBs is analyzed and compared with the help of Current Ratio, Quick Ratio, Government Securities to Total Assets Ratio, Liquid Assets to Total Assets Ratio, Liquid Assets to Demand Deposits Ratio, and Liquid Assets to Total Deposits Ratio. The capital adequacy performance of SBs is analyzed and compared with the help of Capital Adequacy Ratio, Capital Adequacy Ratio Tier-1, Capital Adequacy Ratio Tier-2, and Equity to Total Funds Ratio. The assets quality performance of SBs is analyzed and compared with the help of Government Securities Investment Ratio, Debt Investment Ratio, Non Sensitive Sectors Lending Ratio, Gross Performing Assets Ratio, Net Performing Assets Ratio, Net Performing Assets to Net Advances Ratio. The off-balance sheet strength performance of SBs is analyzed and compared with the help of Assets to Contingent Liabilities Ratio.

The necessary data collected for the study was analyzed with the help of SPSS 16.0 version. The descriptive statistics used for the study includes the mean analysis**,** variance analysis, and trend analysis. The inferential statistics used for the study includes ANOVA with post hoc multiple comparisons (Tukey test), correlation analysis (Pearson’s correlation), principal component analysis, and the regression analysis.

Major Findings:

(i) The profitability, capital adequacy, and assets quality of commercial banks in India improved while their liquidity and off-balance sheet strength declined.

(ii) Although financial performance of commercial banks in India has improved as a result of various reforms introduced by RBI, yet the FBs are at the top on various aspects of financial performance such as profitability, liquidity, capital adequacy, assets quality, and overall financial performance.

(iii) The profitability, assets quality, and overall financial performance of FBs is at the top followed by PSBs and PBs. The liquidity and capital adequacy of FBs is at the top followed by PBs and PSBs. The off-balance sheet strength of PBs is at the top followed by PSBs and FBs.

(iv) The variability in the profitability, liquidity, capital adequacy, assets quality, and off-balance sheet strength ratios of FBs is highest followed by PBs and PSBs.

(v) There is a significant difference in the profitability of SBs among different BGs on the basis of Average Interest Income Ratio (AIIR), Average Non Interest Income Ratio (ANIIR), Average Operating Profits Ratio (AOPR), Average Return on Net Worth (ARONW), and Average Return on Capital Employed (AROCE). The liquidity of SBs among different BGs is significantly different on the basis of Average Government Securities to Total Assets Ratio (AGSTAR), Average Liquid Assets to Total Assets Ratio (ALATAR), Average Liquid Assets to Demand Deposits Ratio (ALADDR), Average Liquid Assets to Total Deposits Ratio (ALATDR), and Composite Liquidity Score (CLS). The capital adequacy of SBs among different BGs is significantly different on the basis of Average Capital Adequacy Ratio (ACAR), Average Capital Adequacy Ratio Tier-1 (ACART1), Average Capital Adequacy Ratio Tier-2 (ACART2), and Composite Capital Adequacy Score (CCAS). The assets quality of SBs among different BGs is significantly different on the basis of Average Net Performing Assets Ratio (ANtPAR). The overall financial performance of SBs among different BGs is significantly different on the basis of Overall Financial Performance Score (OFPS).

(vi) AOPR and ARONW are the profitability ratios which significantly predict the profitability. ALATDR is the liquidity ratio which significantly predicts the liquidity. ACART1 is the capital adequacy ratio which significantly predicts the capital adequacy. Average Gross Performing Assets Ratio (AGPAR) and Average Government Securities Investment Ratio (AGSIR) are the assets quality ratios which significantly predict the assets quality. AROCE, Average Quick Ratio (AQR), and AGSIR are the financial ratios which significantly predict the overall financial performance.

(vii) The regression models with AOPR and ARONW as independent variables and Composite Profitability Score (CPS) as dependent variable, with ALATDR as independent variable and CLS as dependent variable, with ACART1 as independent variable and CCAS as dependent variable, with AGPAR and AGSIR as independent variables and Composite Assets Quality Score (CAQS) as dependent variable, with AROCE, AQR, AGSIR as independent variables and OFPS as dependent variable are excellent both in terms of variance explained and significance.