PERFORMANCE EVALUATION OF PRIVATE BANKING SECTOR IN INDIA

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ABSTRACT

Indian Banking sector stood to be the sterling example of successful regulatory framework in many turbulent times. It has constructed lucrative avenues for both public and private sector banks to augment their business, notwithstanding the priority sector obligations imposed by the state from time to time. This plaudit undoubtedly demonstrates the commercial caliber of scheduled banks, but at the same time, the key performance indicators of private sector banks like deposit mobilization, capital formation and non performance assets appears to have become vulnerable due to external institutional competition and other vicissitudes of volatile market conditions in all the ancillary financial sectors. Therefore this paper attempts to analyze the performance of private banking sector in India with the help of macro level data.
INTRODUCTION

The practice of lending money and accepting deposits is a quiet old phenomenon and acquired formal shape in mid 16th century with the advent of banking system which took no long time in demonstrating the strong nexus between private entrepreneurs, financial flows and economic development. It is perhaps the reason why Indian Government has accorded special emphasis to banking sector under the aegis of Reserve Bank of India. Indian banking system predominantly represents public sector, as most of the banks were nationalized in 1969 to meet the priority sector obligations of the country. But at the same time there has been a nascent development in private sector banks as well. For example, the 1st private bank is established in the year 1955 with the brand of ICICI and stood to be a sterling example for the indispensable role of private sector banks in economic development. Few more private banks have come into existence during the phase of liberalization and successfully met the financing functions at macro level. Therefore Indian Government has recently decided to license competent private operators to incorporate banking companies and to augment the growth of banking sector in India. Union budget 2011 has specifically laid down the priorities of government which should be met by the new private banks. It is with this intention, a study paper titled “Performance evaluation of private Banking sector in India”, is proposed with the following objectives.
OBJECTIVES OF THE PAPER

1. To identify the key performance yard sticks of the private sector banks in Indian context.
2. To evaluate the performance of private sector banks of the country.

NEED FOR THE STUDY

This paper is considered to be necessary owing to the following tenets:

- There has been a phenomenal growth in the turnover, profitability, deposit mobilization and capital formation in private banking sector with unprecedented rate of volatility and risk. (D N Gosh 2000)
- Private Banks were expected to reach the commanding heights with the liberalization of prudential norms of RBI way back in 90s which need to be examined. (Mithani 2002)
- Private sector banks were allowed to operate divergent portfolios with the advent of financial engineering techniques. (Mithani 2002)
- Like the nationalized banks, private sector banks are also required to meet the priority sector obligations.
- Government may not insulate private banks from external competition which imposes a further need on evaluating the performance of private sector banks.
.Scope of the Study

This paper has got finite but practical scope owing to the following merits:

- This paper shall be executed with the authenticate data provided by the website of RBI as well as the secondary information of the selected financial portals.
- It is extended to the macro level analysis so as to generalize the conclusions.
- It will attempt to cover the contemporary performance measures of the banks like, profitability, deposit mobilization, turnover and such other variables.

Research Methodology

- The 1\textsuperscript{st} objective shall be accomplished in the following manner.
  Basic information pertaining to the performance of private sector banks shall be obtained from the RBI Bulletin, so that it is feasible to form preliminary idea on the private sector banks in the country. Subsequently the theoretical backdrop of banking sector shall be reviewed to bring out the true performance yardsticks of private banking sector.
- The 2\textsuperscript{nd} objective forms the core of this project which shall be executed in the following steps
  1. The performance yardsticks of private sector banks shall be determined on the basis of literature review.
2. Secondary data of the selected yard sticks shall be collected from the RBI website.

3. The data selected in above step shall be plotted on the simple trend lines with the help of spread sheets.

4. The charts are used to draw conclusions on performance levels of private sector banks.

SAMPLE SIZE

This paper proposes the sample size of 10 variables like branch network, profitability, turnovers, etc; these variables are collected from the macro level data. Therefore design of convenient sampling does not arise in this project i.e. Entire population size of parameters of the banking sector is considered to animate this project.

PERIOD OF THE STUDY

This paper proposes to consider 5 years of time span to collect secondary data i.e. from 1\textsuperscript{st} April 2006 to 31\textsuperscript{st} March 2011. So that it gives fair and rational scope to generalize the conclusions.

LIMITATIONS OF THE PAPER

- It does not consider the data of individual banks.
- It does not pave any way to conduct comparative analysis except with that of average banking statistics.
PERFORMANCE YARDSTICKS OF PRIVATE SECTOR BANKS

GROWTH RATE

Growth rate is an unavoidable yardstick in quantifying the performance of any commercial entity. Most of the Indian banks are scheduled commercial banks wherein profitability and growth rate in business are the key objectives for which nationalized banks are also tuned along with the contemporary needs of the society i.e., Indian banking sector has been according much priority to the growth rate of business variables not withstanding its priority sector obligations and other financial impediments imposed by the state from time to time. (C Rangarajan ¹ 1998 ) Indeed Indian banking sector has been pioneering through a much celebrated phase of growth rate despite of the sterling competition from the foreign banks and NBFCs with similar portfolios. Therefore, the prime performance yardstick is considered to be the sectoral growth rate of Indian banks which is better analyzed in chapter-6.

Number of branches

Banking sector typically represents the branch network of both rural and urban arcades. The main reason why branch expansion is considered to be a performance yardstick in this project is its catalytic role in augmenting the financial inclusion. (Puri and Mishra ⁵ 2007 ) It is learnt from Union Budget 2011 that Government of India has made budgetary allocation of more than 50,000crores to enhance its flagship financial inclusion programmes in the unbanked areas as well. Therefore, it is certainly necessary to cross check hoe far the wings of Indian banks are being expanded into the new territorial

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segments in the form of branch network. Rather it has become the religious job of a skillful banker to improve the performance of his organization through new branches. It is observed that there is healthy competition even among the corporate and nationalized banks is navigating their branch network to the extreme corners of Indian economy.

EMPLOYEE BASE

Human capital is the most magnificent part of intangible property in any organization more particularly in the service sectors like banking where equal priority is given to both circulated capital and fiat capital. Fiat capital is effectively generated only when the ground level staff (branch staff) are committed not only to pool the resources but also in retaining such resources intact. For example, a loan generated at a single branch may create fiat money at other branch unless the potential employees retain the borrowers also in the form of customers. Specifically, banking sector has been functioning on the merits of internal control system which will turn into fiasco unless the employee base of a particular bank is strong enough to meet all the contingencies. It is the reason why banking sector considers employee base also to be the performance yardstick even in the age of process automation.

PRODUCTIVITY LEVELS OF PRIVATE BANKING RESOURCES

Productivity levels of a real sector are measured in terms of tangible units produced which serves the purpose of measuring the efficiency of particular unit. But, this situation is quite capsized in the case of banking sector where
the productivity levels of each resource is complex and can be generalized into the common performance yardsticks like business generated, profit per resource, optimized cost per resource, targeted turnover, etc.,

CAPITAL AND RESERVES

Capital is very wider term in the literature of finance more particularly in banking sector where the large scale economies like investment banking, private equity portfolios and other corporate lending segments are fueled by the long term capital raised by the banks. The performance of the above mentioned portfolios can be better replicated through the spectrum of capital accumulation ability of banks.(Shankar Acharya 6 2000) It is the reason why this project considers capital base of banking sector also to be an important performance yardstick. On the other hand, reserves certainly represents the performance of banks in 3 important aspects namely meeting the statutory requirements, capital adequacy norms and the contingent provisions.

GROWTH OF DEPOSITS

As per banking sector is concerned loan is the function of deposit i.e., the quantum of loans generated in the form of banking business is directly proportional to the quantum of deposits raised by such bank. Apart from which it is also obvious that the rate of interest paid on deposits is less than that of the rate of interest received on loans which is the prime business of a banker. Hence it is hardly possible to ignore the rate of deposits in measuring the performance of private banks in India.
INVESTMENTS MADE BY PRIVATE SECTOR BANKS
Conventionally, bankers were engaged in lending loans but Indian government has amended Banking Regulation Act, 1949 in the phase of economic liberalization allowing the scheduled commercial banks to form subsidiary units in the sphere of financial sector and to make investments in the form of debt and equity. For instance, most of the private banks have started investment banks, factoring services and venture capital institutions to retain the corporate borrowers. It has also become common for Indian banks to make both direct and indirect investments in the business of clients with hands on approach and turn around strategies. Therefore, it is not possible to conglomerate the performance yardsticks of banks in the isolation of rate of investments. Banks are often advised by the central government to provide refinancing facilities and even to acquire the capital of small scale units to meet the priority sector obligations which certainly implies the potential of investments made by the banks.

ADVANCES MADE BY PRIVATE SECTOR BANKS
Giving advances is the business of bank no matter whether such advance is granted to retail borrower or wholesale borrower. Advances are often quantified not only to know the financial position of a banker but also to signify his ability of acquiring the new customers. Infact, the circular flow of money in any given economy depends upon the pivotal point where banks generate loans and advances. Otherwise, the merits of monetary economics would have become
ludicrous. Therefore, it is felt that understanding and analyzing the loans and advances also represents the crucial performance yardsticks of Indian banks.

**EARNING POTENTIAL OF PRIVATE SECTOR BANKS**

Earning potential or Return on Investment is the premier performance indicator of any sector from which banks are not exempted. The earnings per share and price earning ratios of listed banking companies in the stock exchange reveals a hidden fact that bankers have been earning and allowing all the market intermediaries to earn including their borrowers and depositors. Earning potential of bank also reveals its capability of bearing the external shocks like economic recession, defaults and fall in interest rates. Therefore, one of the crucial performance yardstick is considered to be the earning potential of bankers.

**NON-PERFORMING ASSETS OF PRIVATE SECTOR BANKS**

Non-performing assets were considered to be the white elephants of Indian banking sector in the pre-liberalization period. Especially, the nationalized banks giving loans to heavy industries were often victimized in the form of non-performing assets which reduces the lending and earning capacity of banker. Therefore, reserve bank has made it obligatory to rank the banks and their performance in terms of declined NPAs i.e., any bank showing the consistent decrease in NPAs is considered to be the good performer in market. The surprising fact in Indian Banking Sector is that there has been a steep decline in NPAs of private sector banks in the past 10 years. Therefore, their performance is being driven in par with the global markets. However, NPAs cannot be
avoided in totality owing to the formidable default rates prevailing among the borrowers.

DATA ANALYSIS

Growth of Private Sector Banks

![Graph showing growth of private sector banks](GROWTH_OF_PRIVATE_SECTOR_BANKS)

Source: From table 1.1 of the Annexure

It can be seen from the above chart that there has been a decline in number of private sector banks during the past 5 years i.e., there were 25 banks in 2006 which were brought down to 21 in the present financial year which may look alarming but this decline is caused due to the mergers of private sector banks. However, the decline of private sector banks is not so healthy indicator at the macro level which may lead to undue competition among the existing few banks. Therefore, it is very required to examine the reasons for decline in private sector banks other than that of corporate restructuring.
Number of Branches

Source: From table 1.1 of the Annexure

Though number of private sector banks have come down from 25 to 21 units in the past 5 years, there has been a very healthy expansion in terms of the branch network which grew from 7,322 branches in 2006 to 11,968 branches in the current year i.e., number of branches were grown by 61.1% which no other sector in the country has witnessed. However, the intrasectoral comparision reveals that the growth of nationalized banks in terms of the branch network is more attractive comparing to that of private sector branches. It is identified from the review of literature (RBI bulletin 2011) that the prime reason for the slow expansion of private sector branches comparing to that of public sector is the decisions of private banks to confine themselves only to urban and semi-urban areas and to promote the business only in lucrative sectors. Therefore, it is feasible to draw the general interpretation that private sector banks should be forced to open branches in unbanked areas in order to tap the synergies of financial inclusion.
Employee Base

![Graph showing the number of employees of private sector banks over the years 2006-07 to 2010-11.](image)

Source: From table 1.1 of the Annexure

Private sector banks certainly deserve appreciation in terms of enhancing their human resources at the well acceptable level. It can be seen from the above graph that the financial years 2007-08 and 2008-09 have witnessed healthy growth in terms of number of employees which grew by 19,769 and 17,516. However, it is bit concern to monitor that 2009-10 could not provide employment opportunities at a rapid rate in the private sector banks comparing to the other time intervals. On aggregate the employee base in private sector banks has been increased by 63.5%. Such a titanic growth has come due to the most celebrating year 2010-11 for the private sector bankers during which number of employees were increased by 36,159 positions. These statistics make it obvious that private sector banks are not only meeting the priority sector obligations imposed by the state but also discharging the corporate social responsibility by providing huge employment opportunities. By enlarge the selected time period of this project has found 63.5% growth in HR potentials of the banking sector.

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Productivity levels at private sector banks

The productivity levels of private sector banks or that of any other service sector are measured in terms of the business generated by the organization per employee. Therefore, the above graph replicates productivity levels of employee by means of average business generated per employee which was 6.9523 crores in 2006 which has been consistently increasing year by year except during 2008-09 when business per employee has come down from 7.5142 crores to 7.4385 crores. This decline could have been caused due to the global recession which has impacted all the sectors more particularly private sector banks in terms of reduced NRI remittances, covered positions in money markets, etc., nevertheless there is 84%. Similarly, the profit per employee has also been increased consistently from 4.65 lakh in 2006 to 8.10 lakh in the current year. The surprising fact in this study is that the year 2008-09 has also witnessed an increasing trend with respect to profit per employee although there was a decline in business per employee. In the nutshell, it can be interpreted that

Source: From table 1.1 of the Annexure
productivity levels of private sector banks have been growing on the sound track which need to be further augmented in order to make private sector banking more vibrant and viable in long run.

**Capital and reserves of private sector banks**

![Graph of Capital & Reserves Surplus of Private Sector Banks]

**Source:** From table 1.1 of the Annexure

Capital fuels the growth of any organization with which business is generated. This principle does not hold much sway in banking sector where business is generated through public deposits and not by mere capital. However, the graphical analysis of the selected time period reveals that private sector banks are very much successful in accumulating capital, reserves and surplus which rose from 50,473 crores in 2006 to 1,38,589 crores in the current fiscal. These statistics makes it obvious that capital and reserves of private sector banks are alone amounting to 2.7% of the GDP. Capital accumulation process was however slow in 2008-09, perhaps the decreased business generated in this time period is one of the reasons why capital accumulation was below the expectation in 2008.
The major comments received by private sector bankers includes the channelization of capital & reserves to unproductive purposes which can be rectified if RBI allows scheduled commercial banks to use free reserves at the optimum level.

**Growth of deposits in private sector banks**

![Chart showing deposits of private sector banks from 2006-07 to 2010-11](chart.png)

Source: From table 1.1 of the Annexure

Public deposits are the prime sources of mobilizing liquid funds and generating business in banking sector. Banks are entitled to collect two types of deposits namely, demandable deposits and term deposits. This project could not bifurcate the growth of aggregate deposits into demandable and term deposits due to the constraints of data sources. However, the fresh bulletin released by RBI has projected the total value of deposits pooled by private sector banks which has been increased from 5,51,987 lakh crores in 2006 to 10,02,759 lakh crores in the current year i.e., the percentage of deposits has been increased by 155%. The positive indicator with respect to private sector banking deposits is that there is no declining trend even in the single interval of the selected time period.
Investments made by private sector banks

Private sector banks can make investments only in the selected portfolios i.e., a scheduled bank is not allowed by virtue of Banking Regulation Act, 1949 to make the investments other than in approved securities of RBI, despite of this hurdle private sector banks have made aggregate investments of Rs.4,22,020 lakh crores in the current fiscal which was only Rs.2,14,655 lakh crores in 2006. It is better to analyze the pattern of investment as the ratio between investments and deposits which was 38.8% in 2006 and it has been increased to 41.2% in the immediate year gradually reached to 42.08%, the aggregate percentage increase in investment deposit ratio is only 3.28%. It is certainly a negative indicator although there is the positive growth in terms of investments.

Source: From table 1.1 of the Annexure
Advances made by private sector banks

Advances are referred to the term loans granted by the banks which not only generates business to banking entities at micro level but also helps in accelerating the process of capital formation at macro level which in turn is integrated to the productive prosperity of the country. Therefore, advances made by private sector banks is also considered to be an important performance yardstick in this project. The above graph shows that total advances made by private sector banks has been increased from Rs.4,14,751 lakh crores in 2006 to Rs.7,97,534 lakh crores in the current year i.e., private sector banks have helped forming the capital in real sector additionally by 52%. This interpretation has been drawn on the fundamental principle “formation of capital in real sector is directly proportional to the advances granted by financial sector”. However, it may not be feasible to state that entire advances made by private sector banks are used for productive purposes because there is an increased trend in terms of personal loans which is used for the purpose of meeting the consumption needs.
Earning potential of private sector banks

The major revenue source of banking sector is income earned in the form of interest. However, banks are not barred from earning income other than that of interest. Therefore, it is preferred to study the earning potential of private sector banks by conglomerating interest and other income sources on a single chart.

The above chart shows that interest income has been increased by 110% whereas the other income has been increased by 168%. However, this analysis may appear ludicrous unless the interest income is measured as a percentage of advances made which was 11.9% in 2006 and found to be 12.1% i.e., only 0.2% increase has been found in terms of interest advances ratio. However, this unworthy increase has been compensated by the return on advances in aggregate which grew from 10.93% to 14.54%.

Source: From table 1.1 of the Annexure
Decline in NPAs of private sector banks

**Source:** From table 1.1 of the Annexure

Non performing assets have become the major concern in the minds of financial practitioners especially among the bankers. Unlike, the public sector banks, the NPAs of private sector banks has come down from 0.97% in 2006 to 0.56% in 2011 which certainly grants approbation to the branch managers who are prudent enough in analyzing the credit worthiness of potential borrowers due to which the default rate has come down to reduce the burden of non-performing assets. However, it is not possible to draw complete comparison of NPAs in private sector banks with that of public sector banks as public sector banks are forced by the government to give loans to vulnerable sectors either where the rate of bad debts are more.

**CONCLUSIONS**

There is a decline in number of private sector banks during the past 5 years which may lead to undue competition among the existing few banks.
There has been a very healthy expansion in terms of branch network of the private sector banks which no other sector in the country has witnessed.

Private sector banks are confined themselves only to urban and semi-urban areas and to promote business only in lucrative sectors.

Private sector banks are discharging the corporate social responsibility by providing huge employment opportunities.

The productivity levels of private sector banks have been growing on the sound track which need to be further augmented in order to make private sector banking more vibrant and viable in long run.

The private sector banks are very much successful in accumulating capital, reserves and surplus.

The private sector banking deposits has no declining trend even in the single interval of the selected time period.

Private sector banks can make investments only in the selected portfolios which is certainly a negative impact though there is positive growth in terms of investments.

The total advances made by private sector banks has been increased in terms of personal loans which have helped to form the capital in real sector.
There is an increase in terms of interest advances ratio which has been compensated by the return on advances in aggregate.

The NPAs of private sector banks has come down which certainly grants approbation to the branch managers due to which the burden of non-performing assets reduces.

**ANNEXURE**

Private Sector Banks

*(Amount in Rs. crore)*

<table>
<thead>
<tr>
<th>ITEMS</th>
<th>BANK GROUP-WISE AGGREGATES</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>2006-07</td>
</tr>
<tr>
<td>No. of banks</td>
<td></td>
</tr>
<tr>
<td>2006-07</td>
<td>25</td>
</tr>
<tr>
<td>No. of offices</td>
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<tr>
<td>No. of employees</td>
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<tr>
<td>Profit per employee (in Rs. Lakhs)</td>
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<td>Capital reserves and surplus</td>
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<td>Deposits</td>
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<tr>
<td>Investments</td>
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<tr>
<td>Advances</td>
<td>414751</td>
</tr>
<tr>
<td>Interest income</td>
<td>49567</td>
</tr>
</tbody>
</table>
Other income | 12313 | 17006 | 17860 | 20423 | 20726  
Interest expended | 32856 | 48495 | 56957 | 51206 | 57115  
Operating expenses | 15320 | 20267 | 21779 | 22851 | 27606  
Cost of Funds (CoF) | 5.18 | 6.13 | 6.18 | 4.83 | 4.56  
Return on advances adjusted to CoF | 4.38 | 4.88 | 5.23 | 5.06 | 5.11  
Wages as % to total expenses | 10.93 | 10.35 | 10.83 | 12.73 | 14.54  
Return on assets | 1.02 | 1.13 | 1.13 | 1.28 | 1.43  
CRAR | 12.01 | 14.34 | 15.23 | 17.43 | 16.46  
Net NPA ratio | 0.97 | 1.09 | 1.29 | 1.03 | 0.56  

Table 1.1

REFERENCES

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