Performance of Commercial Banks in India during Global Financial Crisis

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Abstract

After the collapse of Lehman Brothers in September 2008, the global inter-bank financial markets froze in view of large losses suffered by the major financial institutions and the extreme uncertainty over the health of the counterparty balance sheets. This had a knock on effect on various segments of financial markets, including inter-bank markets. All this turmoil in various segments of the financial markets led to a sharp decline in economic activity in the major advanced economies.

India's financial sector is not deeply integrated with the global financial system, which spared it from the adverse effects of the global financial crisis and left Indian banks mostly unaffected. In line with efforts taken by governments and central banks all over the world, the Government and the Reserve Bank of India took aggressive countercyclical measures, sharply relaxing monetary policy and introducing a fiscal stimulus to boost domestic demand. However, this paper is an attempt to measure the performance of various commercial banks operating in India on various parameters during global financial crisis.

KEYWORDS: Performance, SBI and Associates, Other Nationalised Banks, Private Sector Banks, Foreign Banks

I. Introduction:

The financial crisis of 2007–2008, also known as the Global Financial Crisis and 2008 financial crisis, is considered by many economists the worst financial crisis since the Great Depression of the 1930s. It resulted in the threat of total collapse of large financial institutions, the bailout of banks by national governments, and downturns in stock markets around the world. In many areas, the housing market also suffered, resulting in evictions, foreclosures and prolonged unemployment. The crisis played a significant role in the failure of key businesses, declines in consumer wealth estimated in trillions of U.S. dollars, and a downturn in economic activity leading to the 2008–2012 global recession and contributing to the European sovereign-debt crisis.

The Indian economy is the second fastest growing economy in the world after China. Banks, as financial intermediaries, are playing a crucial role by bringing enhanced liquidity and promoting market efficiency by facilitating smooth transfer of funds between borrowers and lenders that will promote capital mobility among nations. A sound banking system is essential for a smooth integration of Indian financial markets with the rest of the world, because banks play a crucial role in facilitating transfer of funds between borrowers and lenders.

Banking sector as country's financial sector influences future economic growth. The banking sector is the most important part of the financial markets. If the Indian banking sector is sound and efficient, it will have a positive impact on India's growth.

We examine the performance of Indian commercial banks during crisis time i.e. the period between 2008-09 to 2012-13. In particular, the behavior of profitability, cost of intermediation, efficiency, soundness of the banking system, and industry concentration are examined in this paper.

II. Literature Review

Previous studies focused on the impact of financial reforms and the liberalization of the Indian economy on the banking sector. Using the data for the period 1985-1996, Kumbhakar and Sarkar (2003) investigate the total factor productivity growth in the Indian banking industry due to deregulation of the industry since 1991. They did not find increase in total factor productivity as a result of deregulation. The study also reports that the private sector banks show improved performance through expanded output, but deregulation did not impact public sector banks in a positive manner. Shanmugam and Das (2004) measure technical efficiency of Indian banks in four different ownership structures during the reform period of 1992-1999. They report that even after the reform process, potential of commercial banks in India has not been fully realized and they are still performing below their potential. They report that State bank group and foreign banks are more efficient in comparison to other banks in India. Das and Ghosh (2006) report that during the period 1992-2002, medium-sized public sector banks performed reasonably well. Their study also shows low non-performing loans contribute to the technical efficiency of banks. Gormley (2010)'s analyzes the impact of foreign banks entry into the Indian market on the access to credit in the Indian market. The study reports that the entry of foreign banks into the Indian market did not improve access to credit for all the firms in India. A Bodla and Verma (2007) study focuses on determinants of bank profitability in India. They find that profit margins have come under pressure due to increased competition and changing face of the Indian banking. The study also reports increased resource productivity, increase deposits, and a decline in non-performing loans as a result of the reform process. Rezvanian, Rao, and Mehdian (2008) use a nonparametric frontier approach to examine the effects of the ownership on the efficiency, efficiency change, technological progress and productivity growth of the Indian banking industry over the period 1998 to 2003. They find that foreign banks are significantly more efficient when compared to other banks, i.e. the Indian privately-owned and publicly-owned-banks. The findings also provide evidence to indicate that a large number of banks operate below their optimal scale. A Zhao, Casu, and Ferrari (2010) study finds that the Indian banking industry experienced sustained productivity growth during the period 1992-2004 due to mainly technological progress. They also find that increased competition does impact total factor productivity growth. Foreign banks have added to the competitive pressure in the banking market through technological innovations. Mariassunta (2005) study focuses on banking in emerging markets. The study shows that liberalization of capital inflows may undermine bank stability in emerging markets. Cole, Moshirian, and Wu's study (2008) documents a positive and statistically significant relationship between bank stock returns and future GDP growth. Tabak and Tecles (2010) reports that for the period between 2000 and 2006, Indian public sector banks were most efficient followed by private and foreign banks in terms of cost and profit efficiencies.

III. Objectives of Study

1. The study aims at appraising the performance level in respect of certain parameters of various segments and sectors of banking industry, and
2. To suggest the areas for improvements in various segments and sectors of banking industry.

IV. Research Methodology

a) Data Collection: The study is based on secondary data which is collected and compiled from the various IBA Bulletins of Indian Banks Association as well as from RBI Publications.
b) Tools for Analysis: Ratio analysis is used as a tool for data analysis.

V. Classifications of Banks

The present study classified the entire banking industry into following sectors and segments:

1. State Bank of India and its associates
2. Public Sector Banks including IDBI Bank Ltd.
3. Private Sector Banks consisting or two segments i.e. Old Private Banks and New Private Banks
4. Foreign Banks

VI. Conceptual Framework

Given the significance of banking in economic growth, banks are considered to play an important role in the economic system of any of the country. They seek to create value for all the stakeholders and maximize shareholder wealth subject to the constraints of risk, market competition, social, and the legal/regulatory framework. Profitability is important for the viability of a bank, but safety and security is also critical for the survival of the financial system. Banks make a trade-off between the profitability level they strive to achieve and the risks they are willing to take. Therefore, when evaluating the performance of banks, we should consider both their profitability and financial condition to avoid misleading conclusions. Therefore, in order to evaluate banks, we consider the following four broad sets of ratios:

Return on Assets
Return on Equity
Capital Adequacy Ratio
Cost of Funds
Net Interest Margin
Net NPA Ratio

In addition, we also compute the **business per employee** and **profit per employee** in order to analyze the actual productivity on the basis of human resource.

VII. Empirical Results

1. Return on Assets:

Bank Categories	2008-09	2009-10	2010-11	2011-12	2012-13
SBI & Associates	1.02	0.91	0.79	0.89	0.88
Other Nationalised Banks	1.03	1.00	1.03	0.88	0.74
Private Sector Banks	1.13	1.28	1.43	1.53	1.63
Foreign Banks	1.99	1.26	1.75	1.76	1.94

(Source: Calculated from Banks Profile, Reserve Bank of India)

Return on assets is an important yardstick to assess the performance of a bank. The impact of global financial crisis can be seen on the performance of performance of all public sector banks decline during the financial crisis. While the private sector and foreign sector banks' earnings on the assets are showing increasing trends in the given period.

2. Return on Equity:

Bank Categories	2008-09	2009-10	2010-11	2011-12	2012-13
SBI & Associates	17.74	15.92	14.11	16.00	15.29
Other Nationalised Banks	18.05	18.30	18.19	15.05	12.34
Private Sector Banks	11.38	11.94	13.70	15.25	16.47
Foreign Banks	13.75	7.34	10.28	10.79	11.52

(Source: Calculated from Banks Profile, Reserve Bank of India)

One of the most important profitability metrics is return on equity (or ROE for short). Return on equity reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. The higher the ratio percentage, the more efficient management is in utilizing its equity base and the better return is to investors. The Nationalised Banks' ROE is highest in the given period of time but it declined in the year of 2011-13. While Private Banks shows an increasing trend in ROE. It shows that this sector remained unaffected from the global economic meltdown.

3. Capital Adequacy Ratio:

Bank Categories	2008-09	2009-10	2010-11	2011-12	2012-13
SBI & Associates	13.96	13.46	12.25	13.70	12.67
Other Nationalised Banks	13.24	13.18	13.47	13.03	12.26
Private Sector Banks	15.23	17.43	16.46	16.21	16.84
Foreign Banks	14.19	17.26	16.97	16.75	17.88

(Source: Calculated from Banks Profile, Reserve Bank of India)

The increased competition, multiplicity of products and global banking necessitates sufficient capital. The Basel Accord directs the banks to progressively attain the capital adequacy norms. The above table shows the capital adequacy ratio of various sectors of

Banks. The private sector banks as well as foreign banks are performing better on the given yardstick, their capital adequacy ratio is highest as compared to the different other sector of banks.

4. Cost of Funds:

Bank Categories	2008-09	2009-10	2010-11	2011-12	2012-13
SBI & Associates	6.00	5.32	4.85	5.66	5.96
Other Nationalised Banks	6.09	5.37	4.93	6.22	6.39
Private Sector Banks	6.27	4.83	4.60	5.84	6.12
Foreign Banks	4.46	2.83	3.11	3.88	4.05

(Source: Calculated from Banks Profile, Reserve Bank of India)

The cost factor describes the profitability of the banks. Table shows the Cost of Funds for all the sectors of banks in the given period. It declined substantially for each sector of banks in 2010-11 except foreign banks. The cost of funds in case of Other Nationalised Banks is highest in the given period. The banks need to impose a check on the cost for raising the funds. It is rising because of changing financial conditions and economic crisis in the given period.

5. Net Interest Margin:

Bank Categories	2008-09	2009-10	2010-11	2011-12	2012-13
SBI & Associates	2.39	2.36	2.84	3.25	2.98
Other Nationalised Banks	2.32	2.26	2.74	2.55	2.39
Private Sector Banks	2.86	2.90	3.10	3.09	3.22
Foreign Banks	4.33	3.96	3.86	3.89	3.89

(Source: Calculated from Banks Profile, Reserve Bank of India)

Net Interest Margin is defined as ratio (in %) of Net Interest Income to Total Assets. It is a performance metric that examines how successful a Bank's investment decisions are compared to its debt situations. Foreign Banks are performing better as compared to any other segment of Banks on this parameter. We can even witness the tremendous improvement of the Private Sector Banks. While Other Nationalised Banks' performance remain almost unchanged for the given period.

6. Net NPA Ratio:

Bank Categories	2008-09	2009-10	2010-11	2011-12	2012-13
SBI & Associates	1.47	1.50	1.49	1.76	2.04
Other Nationalised Banks	0.68	0.91	0.92	1.44	2.00
Private Sector Banks	1.29	1.04	0.56	0.46	0.52
Foreign Banks	1.81	1.82	0.67	0.61	1.01

(Source: Calculated from Banks Profile, Reserve Bank of India)

The Non Performing Assets are the one of the biggest challenge for the development of commercial banks in India. As a yardstick, it must be less than 1. The table shows the Net NPA Ratio of the different sectors of the banks. A drastic change can be seen in the NPA's of all Private Sector Banks as well as Foreign Banks in the given period. It shows an increasing trend in 2008-09 and 2009-10 and later on in 2010-11 it improved several folds. While Other Nationalized Banks have shown the upward trend over the period. It is also rising for the SBI & Associates. In 2012-13 it is rising for each and every segment of the bank over the previous year.

7. **Business per Employee:**

Bank Categories	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
SBI & Associates	65.02	73.74	79.05	91.38	101.97
Other Nationalised Banks	78.32	93.59	115.25	127.85	142.23
Private Sector Banks	67.76	77.27	82.60	86.23	94.06
Foreign Banks	128.27	141.14	155.55	195.62	217.33

(Source: Calculated from Banks Profile, Reserve Bank of India)

This parameter shows the efficiency and productivity of the human resource for the banking industry. The above table shows the Business per Employee for the different sectors of banks operating in India. The data shows that foreign banks employees are generating more business as compared to all other sectors employees for the given period of time. A drastic improvement can be seen in the performance of Other Nationalized Banks, as their employees are generating more business year after year.

8. **Profit per Employee:**

Bank Categories	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
SBI & Associates	0.44	0.47	0.42	0.55	0.60
Other Nationalised Banks	0.49	0.57	0.70	0.69	0.65
Private Sector Banks	0.56	0.70	0.81	0.92	1.07
Foreign Banks	2.54	1.69	2.75	3.64	4.56

(Source: Calculated from Banks Profile, Reserve Bank of India)

The table shows the profit per employee for all sectors of banks. The foreign banks profit per employee is highest and no other sector banks are near to them. Their profit per employee is several folds as compared to other sector banks; the reason can be low cost of funds, better capital adequacy ratio and other operating benefits. While other sectors are improving gradually on the given parameter.

VIII. Summery and Conclusions

The economic crisis that started in 2007 with the banking and finance world of the United States shook the entire world and the financial markets in general and the banking sector in particular is still trying to recover from this economic tsunami. In this paper, we analyze the performance of commercial banks in India during the period 2008-2009 to 2012-13. The study focuses on the impact of the current economic crisis on soundness of the different sector banks in India. Our analysis shows that the Indian banking sector remained relatively healthy during the current economic crisis and the performance of the banks was not impacted negatively in a significant manner. The different sectors show healthy capital adequacy ratios throughout the sample period. Although the banking sector was opened up only after 1991 reforms, we find that competition in the Indian banking industry has intensified.

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