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EFFICIENCY OF INDIAN NATIONALISED BANKS (20008 TO 2012)

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ABSTRACT

After the nationalization of banks in 1969 and 1980, Public Sector Banks dominating the whole banking sector. Even then the role of technology was minimal and the quality of service was not given adequate importance because of the high burden on the Public Sector Banks. The present study was aimed to analyze the efficiency of the Indian Nationalized Banks (2007-08 to 2011-12). The performance is being carried out with the help of certain crucial operational variables of the banks including total income, expenditure and NPAs. To identify the relative performance of the operational variables the annual and compound growth rates have been calculated. The growth rates worked out indicated that on the average in the case of a majority of the operational variables, the performance of the nationalized banks were good in terms of the income growth (17.96 percent) as compare to expenditure growth (17.55 percent) whereas growth of NPAs were 24.79 percent because of the preference of priority sector lending .

Keywords: Nationalized Banks, Total Income, Expenditure. NPAs

INTRODUCTION

Until the early 1990s, the Indian Scheduled Commercial Banks suffered lots of problems because of lack of competition, low capital base, low productivity and high intermediation cost. After the nationalization of banks in 1969 and 1980, Public Sector Banks dominating the whole banking sector. Even then the role of technology was minimal and the quality of service was not given adequate importance because of the high burden on the Public Sector Banks. Banks also did not follow proper risk management systems and the prudential standards were weak. All these resulted in poor asset quality and low profitability. The key objective of reforms in the banking sector in India has been to enhance the stability and efficiency of banks. To achieve this objective, various reform measures were initiated that could be categorized broadly into three main groups: (a) enabling measures, (b) strengthening measures and (c) institutional measures.

Enabling measures were designed for creating an environment, where banks could respond optimally to market signals on the basis of commercial considerations. Salient among these included reduction in statutory pre-emptions so as to release greater funds for commercial lending, interest rate deregulation to enable price discovery, granting of operational

autonomy to banks and liberalization of the entry norms for financial intermediaries. The strengthening measures aimed at reducing the vulnerability of banks in the face of fluctuations in the economic environment viz., inter alia, capital adequacy, income recognition, asset classification and provisioning norms, exposure norms, improved levels of transparency, and disclosure standards. Institutional framework conducive to development of banks needs to be developed. Salient among these include reforms in the legal framework pertaining to banks and creation of new institutions. It was in this backdrop that wide-ranging banking sector reforms in India were introduced as an integral part of the economic reforms initiated in the early 1990s.

Reforms in the commercial banking sector had two distinct phases. The first phase of reforms implemented subsequent to the release of the Report of the Committee on Financial System, 1992 (Narasimham Committee) focused mainly on enabling and strengthening measures. The Committee was guided by the fundamental assumption that the resources of the banks come from the general public and held by the banks in trust. These resources have to be deployed for maximum benefit of their owners, i.e. the depositors. This assumption automatically implies that even the Government has no business to endanger the solvency, health and efficiency of the nationalized banks. According to the Committee, the poor financial shape and low efficiency of public sector banks was due to: (a) extensive degree of central direction of their operations, particularly in terms of investment, credit allocation and branch expansion and (b) excessive political interference, resulting into failure of commercial banks to operate on the basis of their commercial judgment and in the framework of internal economy. Despite opposition from trade unions and some political parties, the Government accepted all the major recommendations of the Committee some of which have already been implemented. Further, the second phase of reforms, implemented subsequent to the recommendations of the Committee on Banking Sector Reforms, 1998 (Narasimham Committee II) placed greater emphasis on structural measures and improvement in standards of disclosure and levels of Transparency in order to align the Indian standards with international best practices. Banking sector reforms since 1991 have included, among others, the following:

1. Granting operational autonomy to banks.
2. Liberalization of entry norms for banks.
3. Reduction in statutory pre-emptions so as to release greater funds for commercial lending.
4. Deregulation of interest rates.
5. Relaxation in investment norms for19banks.
6. Easing of restrictions in respect of banks' foreign currency investments.
7. Withdrawal of reserve requirements on inter-bank borrowings.

Thus, financial repression has eased substantially with the deregulation of interest rates and substantial removal of credit allocation. Despite the financial crisis having revealed in 2008, funding mismatches to be one of the major structural weaknesses of international banks, there was little incentive for the banks for lengthening their funding maturities in the current

low interest rate environment. On the contrary, banks are incentivized to "ride the yield curve" and increase maturity of their assets. Such strategies by the banks along with existence of promise of central banks to keep rates at low levels for 'extended period' may create vulnerabilities. Funding markets were vulnerable to negative public announcements as such events could cause short term financiers to pull out, triggering distress sales by the borrowers. Vulnerabilities in global bank funding markets remain a key concern for emerging markets as these could cause disruption in the capital flows, affecting trade credit and impairing the ability of domestic firms to raise capital abroad. In this context, a multinational structure of global banks (operating through sizeable foreign branches and subsidiaries and funding those affiliates locally in the host country and currency) may reduce reliance on cross border funding needs. Banks in India remained resilient even during the crisis and do not face the funding and maturity risks of the kind encountering the global banks. The size of the balance sheet of scheduled commercial banks grew by 16.49 per cent on a year on year basis as at end September 2010 marking an improvement over the growth rate of 14.86 percent witnessed during 2009-10. The higher growth was primarily driven by a recovery in credit off take. However, balance sheet growth rates remained off their pre-crisis peaks.

LITERATURE REVIEW

The concerned literature with the research work is highlighting the work done on the subject in India and abroad which proved useful to delineate the various issues and methodologies. Sarkar and Das (1997) compared the performance of Indian commercial banks for the years 1994-95 by using the measures of profitability, productivity and financial management. They found PSBs being compared poorly with the foreign and private banks. However, they caution that no firm inference can be derived from comparison done for single year. Saha and Ravishankar (2000) rated 25 PSBs using DEA for the period 1991-92 to 1994-95. It has been observed that barring few exceptions, the PSBs have in general improved their efficiency over the period. United Bank of India, UCO bank, Syndicate bank and Central Bank of India are found to be a lower end of the relative efficiency scale. Also Corporation bank, Oriental Bank of Commerce, State Bank of India, Canara Bank, State Bank of Hyderabad, Bank of Baroda and Dena Bank are found to be consistently efficient banks. From the above analysis, it is amply clear that no definite conclusion can be drawn with respect to the impact of deregulation on efficiency and total factor productivity growth of Indian commercial banks. Hence, this necessitates re-examining the estimation of levels of efficiency and its components and total factor productivity growth and its decomposition with respect to Indian commercial banks as a whole as well as classified by ownership after deregulation. This becomes more important in the context of significant changes in the banking landscape and environment in response to the emerging financial and banking scenario of openness, economic liberalization, and globalization and promotion of "greater economic efficiency". Subrato (2007) reveals that in the financial sector, liberalization and technological breakthrough has initiated a restructuring in our banking sector, which is exactly opposite to our structuring norm. Looked at from the administrative angle our banking sector four tier network head office, zonal office, regional office, and branch office. However, computerization, LAN, interconnectivity, email and IT revolution have brought the regional and branch offices closer and many banks started restructuring even going back

to 3 tier structures thus making them cost effective and technologically upgraded. Considered globalization and competition, this repositioning was extremely necessary. In the new era, the banking practices are just like any other service provider and their activities are getting redefined almost every day. To sustain in this context that too with profitability, commercial banks will have to look at 3 major directional changes: redefine their strategy strictly under risk-return framework, implement business process re-engineering and revamp their organizational structure and network in line with global standards. Chen Ping, Yang Hailiang , Yin George(2008) analyzed an asset-liability management (ALM) problem under a continuous-time Markov regime-switching model. By adopting the techniques of Zhou, X.Y., Yin, G. Markowitz's mean variance portfolio selection with regime switching: A continuous-time model. SIAM J., they investigated the feasibility, obtain the optimal strategy, delineate the efficient frontier, and establish the associated mutual fund theorem. The present study is a humble addition to the growing body of literature in this area.

In our study performance of Nationalized Banks has been analyzed during the 2007-08 to 2011-12. In this context, this paper is divided into three sections. Introduction and Review of literature is discussed in Section I, Data and Methodology and Empirical Results have been taken in Section II and III respectively.

DATA AND METHODOLOGY

This study mainly relies on secondary sources of data to achieve its stated objectives. Therefore data has been collected from the Statistical Tables Relating to Banks in India Published by Reserve Bank of India and Report on Currency and Finance. For measuring the performance of the Indian Public Sector Banks Compound Annual Growth Rate (CAGR) approach is used.

Compound Annual Growth Rate - CAGR

The compound annual growth rate is calculated by taking the nth root of the total percentage growth rate, where n is the number of years in the period being considered.

$$\mathrm{CAGR}(t_0, t_n) = (V(t_n)/V(t_0))^{\frac{1}{t_n - t_0}} - 1$$

$V(t_0)$: Start value, $V(t_n)$: finish value, $t_n - t_0$: number of years.

Actual or normalized values may be used for calculation as long as they retain the same mathematical proportion.

The CAGR can also be calculated as the geometric mean of 1 plus each year's return minus

This can be written as follows:

$$\mathrm{CAGR} = \left(\frac{\text{Ending Value}}{\text{Beginning Value}}\right)^{\left(\frac{1}{\text{\# of years}}\right)} - 1$$

Indicators for the performance of the Nationalized Banks can be measured in terms of Total Income (Interest Income + Other Income) and Non-Performing Assets (NPAs). In our study performance is measured in terms of Income, NPAs and Expenditure (Operating Expenditure

and Other non-operating) of the Nationalized Banks and Nationalized Banks Category given in Appendix-A

EMPIRICAL RESULTS

Table 1 show the performance of the Nationalized Banks during the years 2007-08 to 2011-12. Total Income during the aforesaid period increased from Rs. 163627 Cr. to 373719 Cr. indicates the Compound Annual growth of 17.96 percent. Whereas, annual growth rate of total income decreased in 2010, because of the huge increase in the NPAs in the Priority sectors in the economy, though banks were able to control the expenditure growth. Compound annual growth rate of the expenditure of the Nationalized Banks was 17.55 percent indicating that these banks were able to control their expenditure over their income. Though in the year 2012 annual expenditure was 34.6 percent because of the heavy cost of borrowings and high cost of employees. NPAs in the Nationalized Banks continuously increased from 2008 to 2012. Annual growth in the NPAs was more in 2010 as compare to 2008 and 2009 because of the huge loans provided to the priority sector as compare to non-priority sector and priority sector loans are more risky and Nationalized Banks were giving the emphasis on the priority sector lending for the purpose of generation of future income. Even Compound Annual Growth Rate of NPAs are 24.79 percent which is higher than the total income 17.96 percent indicating that Nationalized Banks were unable to control over the recovery of their old debts.

Table 1: Performance of Nationalized Banks (2007-08 to 2011-12)

Years	Total Income (Cr.)	Percentage Change	Expenditure (Cr.)	Percentage Change	NPAs (Cr.)	Percentage Change
Col.(1)	Col. (2)	Col. (3)	Col. (4)	Col. (5)	Col. (6)	Col. (7)
2008	163627	-	130763	-	36901	-
2009	210340	28.5	166780	27.5	44036	19.3
2010	238528	13.4	186504	11.8	57293	30.1
2011	285115	19.53	217954	16.8	71081	24.06
2012	373719	31.07	293507	34.6	111664	57.09

Note: Col. (3), Col. (5) and Col. (7) are calculated.

Source: Off-site returns (Domestic and Provisional of Banks, Divisions of Banking Supervision, RBI

CONCLUSION

Post-nationalization, Public Sector Banks dominating the whole banking sector. The growth rates worked out indicated that on the average in the case of a majority of the operational variables, the performance of the nationalized banks were good in terms of the income growth (17.96 percent) as compare to expenditure growth (17.55 percent) whereas growth of NPAs were 24.79 percent because of the preference of priority sector lending . Though Nationalized Banks were increasing their total income and controlling their expenditure but unable to control over the growth of NPAs during the studied period. Banks did not follow

proper risk management systems and the prudential standards were weak. All these resulted in poor asset quality and low profitability. Therefore, there is need to formulate the policy by the banks to control over their NPAs. Banks can control the increasing NPAs by the fixation of the minimum limit of loans to the priority sector.

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Appendix-A

List of Indian Nationalized Banks

Allahabad Bank
Andhra Bank
Bank of Baroda
Bank of India
Bank of Maharashtra
Canara Bank
Central Bank of India
Corporation Bank
Dena Bank
Indian Bank
Indian Overseas Bank
Oriental Bank of Commerce
Punjab & Sind Bank
Punjab National Bank
Syndicate Bank
UCO Bank
Union Bank of India
United Bank of India
Vijaya Bank