CHAPTER 5

CONCLUSIONS AND SUGGESTIONS

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5.1 INTRODUCTION

Banking sector is very important for the economy. Banks do not make intermediation only to individuals; they also intermediate to the firms in other sectors. So the performance and soundness of the banking sector is very important for almost all sectors.

To keep performance of the banking sector high, knowing dynamics of it is very important. Our study aims to analyze the performance of the sector in different perspectives and determine factors affecting performance.

The banking system is an integral part of any economy. It is one of the many institutions that impinges **(imposes)** on the economy and affect its performance. Economists have expressed a variety of opinions on the effectiveness of the banking systems in promoting or facilitating economic development. As an economic institution, the bank is expected to be more directly and more positively related to the performance of the economy than most non-economic institutions. Banks are considered to be the mart of the world, the nerve centre of economies and finance of a nation and the barometer of its economic perspective. They are not merely dealers in money but are in fact dealers in development.

The role of banks in accelerating the economic development of a country like India has been increasingly recognized following the nationalization of fourteen major commercial banks in July 1969 and six more banks in April 1980. With nationalization, the concept of banking has undergone significant changes. Banks are no longer viewed as mere lending institutions. They are to serve the society in a much bigger way with a socio-economic development oriented outlook. They are specially called upon to use their resources to attain social upliftment and speedier economic development.

The banking system is indispensable in the modern society. It plays a key role in the economic development and forms the core of the money market in an advanced economy.

The importance of banks for the economic growth and the fact that banks are vulnerable to systematic risk lead governments to regulate banks widely and intensively. Sound regulation restrains excessive bank risk-taking and reduces financial fragility; however, failures in the regulation of banks can jeopardize the financial system.

All countries need efficient financial institutions to promote and support economic growth. Starting with **King and Levine (1993)**, research on the link between finance and economic growth reveals that countries with "better" financial systems tend to grow faster. [1]

Performance evaluation is an important pre-requisite for sustained growth and development of any institution. As in the case of any institution, the evaluation of a bank's performance too has to be undertaken in relation to its goals and objectives.

A bank exists to facilitate the interaction between two parties. Being an intermediary institution, it plays a significant role in the financial system and society, who therefore depend on its prudence and health. More than any other business entities, banks are extremely interconnected with each other, which can lead to a domino effect in times of trouble. Due to its high involvement in people's lives, any malfunction becomes crucial, revealing a considerable scale of adverse externalities. Such structural fragility also comes from the bank-specific balance sheet that contains low portion of cash and capital reserves relative to debt.

Financial performance is a well-known topic when it comes with different types of ownership. Many Studies are available to show the results in different part of the world.

Studies on banking efficiency are relevant in constantly changing economies such as the Indian case. Countries that undergo significant transformations in their financial institutions face different challenges from one year to another, and only efficient institutions will be able to face them successfully. The study of banking performance is important since performance measures are indicators of success. Banks, as any other firm, face numerous sources of competition from both other banks and other firms inside and outside their industry. Presumably, the more efficient

1 Evidence on Banking Efficiency: an Analysis of Financial Intermediation in Mexico by Violeta Diaz Avilez

units, not only in this industry but in general, are the ones that survive. An open and flexible banking environment not only provides more credit, but also better allocation of credit, leading to the funding of more positive net present value projects that contribute to economic growth.

The motivation for this study is at least two fold. First, foreign penetration in the banking sector of an emerging economy is a sensitive issue. Banking regulators are extremely concerned with the impact of foreign entry on local banks' safety, soundness, and efficiency. Second, the steps taken by Indian Banks regarding the net impact of foreign entry on local banks' performance and behavior, and more importantly, how the impact is affected by environmental factors in the recipient **(receiver)** country.

The purpose of this study is to investigate how the competitiveness of the banking environment affects the impact of new foreign entry on the safety, soundness, and efficiency of domestic banks in emerging markets.

This study is an attempt to find out the relationship of the growth performance of banks. It also studies the equality of the performance of all three sectors (Private, Public and Foreign).

The basic performance of banks is that, banks take deposits from individual and institutional customers, which they then use to extend credit to other customers. They make money by earning more in interest from borrowers than they pay interest to those whose deposits they accept.

A bank can typically earn a higher interest rate on loans than on securities. Loans, however, come with risk. If the bank makes bad loans to consumers or businesses, the bank will take a hit when those loans aren't repaid, because loans are a bank's bread and butter.

A bank's assets are its meal ticket, so it's critical for investors to understand how its assets are invested, how much risk they are taking, and how much liquidity the bank has in securities as a shield against unforeseen problems. In general, investors should pay attention to asset growth of the Bank.

The aim of this study is to compare the performance of the India's local (Private and Public Banks) and foreign banks. Performance comparison of these banks can be influenced by several factors like interest income, expenses, return on assets and others as discussed in chapter 4. This study shows performance of Private Bank, Public Bank and Foreign Bank for last 12 years (2001-02 to 2011-13). The findings of the study are based on the data collected from the Indian Banks' Association (IBA). For this analysis, a panel of mean, standard deviation and regression methodology has been applied to empirically investigate the performance of Private Bank, Public Bank and Foreign Bank.

According to **Demirug-count and Huizinga (2001)** the foreign banks' entry in the local market, give a reason to the domestic banks to change their behavior in order to provide lower markup rates on loans and pay more interest on deposits which in turn create tough competition for foreign banks to hold their position in the local market. However, the foreign banks consider the long term goal because this way foreign bank can develop their market and can get more benefits in the shape of the most profitable banks.[2]

Foreign banks mostly operates in urban cities of Indian and don't have a vast branch network to collect the deposit from household customers as well as from business customers.

When we look at the relationship of all the three categories of banks (private bank, public bank and foreign bank) domestic banks have more market share as compared to foreign banks. Domestic banks have more branch network and other facilities to collect the deposits and to carry on the business in remote areas of India. Therefore, Domestic banks have more resources to invest the deposits in the form of loans and get the profit which in turn help the banks to earn more return on assets and equity.

Great importance attached to the profitability element of foreign ownership. Foreign ownership effect on a bank's profitability is tied to the fact that a lot of foreign capital would be attracted to the bank. There would be a corresponding arrival of foreign expertise that is well trained to handle risk management. The expertise would also help in instilling a

2 Domestic Vs. Foreign: A Comparison of Financial Performance of Domestic and Foreign Banks in Pakistan by Adeel Haneef

better corporate governance culture and thereby resulting to an increase in the bank's efficiency. The physical presence of the foreign bank would drive competition uphill and hence motivating the local banks to reduce their costs and interest rates and hence leading to a rise in efficiency. Overall increase in the use of technology from the entry of foreign banks. The foreign competitors would bring about competition through the use of better and more efficient technologies.

Indian banking sector has a long journey of growth, started with the nationalization of the State Bank of India. The first nationalization phase was in 1969, and the second phase in 1980, it lead to rapid expansion of Banks branches all over India. Deposit mobilization and priority sector lending in highly protected environment with extremely regulated framework adversely affected the financial resource mobilization and allocation by the commercial banks. The reforms again needed in this industry. In 1991, The Narsimham Committee report gave a new dimension to Indian Banking sector. The Private Banks and Foreign Banks have entered in the market. So, now, there is a global competition in the banking industry in India.

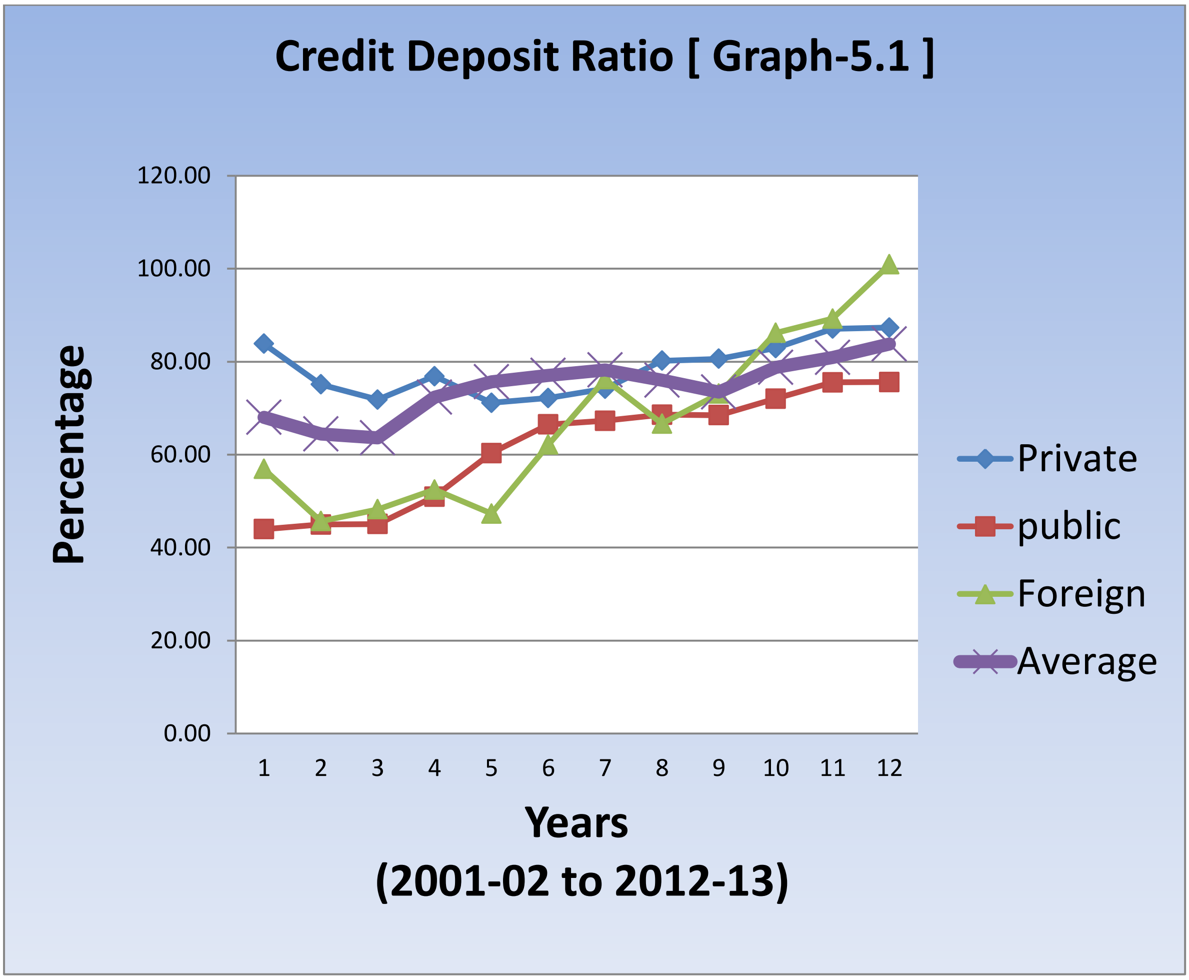
As an effect of liberalization, privatization and globalization policy, there have not only been rapid expansion in the number of banking institutions in the country, but the banking horizon of the country has also changed significantly. The foreign banks, which accounted for only 32% of the total number of banks in the country in 1991, grew up to 42% by 2001. In view of the fact that the Public Sector Banks that have been operating in an extremely protected economic environment and may lost out in the wave of competition from the Private and Foreign Banks, the schemes of financial assistance for capital restructuring for the economically weak Public Sector banks were also introduced. Besides to that, the Public Sector Banks were also given time to meet the prudential and capital adequacy norms as well as norms to manage Non-Performing Assets. So, most of the Public Sector Banks are now working on the concept of universal banking and service oriented banking. The whole process of reforms has intensified competition leading to overall improvement in financial performance.

In this study, the financial performance of all the banks has been evaluated. All the banks have been divided into three groups banking sector category wise Private Sector, Public Sector and Foreign Sector and different types of parameters have been used with the help of ratios to evaluate the financial performance for the period of twelve (12) years from the year 2001-02 to 2012-13.

Group wise performance evaluation was made in previous chapters. In this chapter, the researcher has made an attempt to review the overall efficiency related to each ratio in each parameter. The average of twelve (12) years has been taken into the consideration for the comparison of each group.

5.2 CONCLUSIONS AND SUGGESTIONS

5.2.1. CREDIT DEPOSIT RATIO



It is the ratio of how much a bank lends out of the deposits it has mobilized. It indicates how much of a bank's core funds are being used for lending, the main banking activity. A higher ratio indicates more reliance on deposits for lending and vice-versa.

The regulator does not stipulate a minimum or maximum level for the ratio. But, a very low ratio indicates banks are not making full use of their resources. And if the ratio is above a certain level, it indicates a pressure on resources.

The Current Scenario of Credit-Deposit Ratio

At present, the credit-deposit ratio for the banking sector as a whole is 75 per cent. In the case of Indian banks, a credit-deposit ratio of over 70 per cent indicates pressure on resources as they have to set aside funds to maintain a cash reserve ratio of 4.5 per cent and a statutory liquidity ratio of 23 per cent. Banks can lend out of their capital, but it is not considered prudent to do so.

Credit-Deposit Ratio is Considered a Key Parameter

The ratio gives the first indication of the health of a bank. A very high ratio is considered alarming because, in addition to indicating pressure on resources, it may also hint at capital adequacy issues, forcing banks to raise more capital. Moreover, the balance sheet would also be unhealthy with asset-liability mismatches.

But such a situation is considered extreme as there are not many known instances of banks overstretching themselves. But, the Reserve Bank has voiced concerns over the Credit Deposit Ratio of banks as it could have financial stability implication at the systemic level.

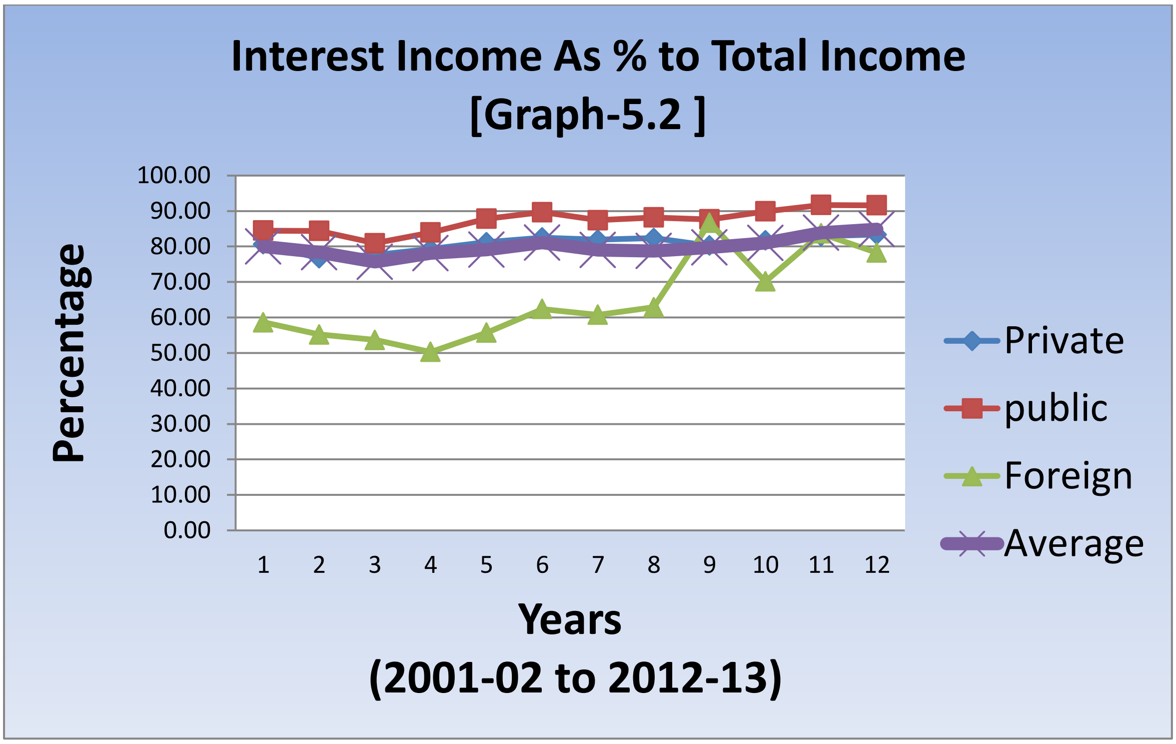
The individual mean of the three categories of our Sample Banks i.e. our selected Private Banks, Public Banks and Foreign Banks (given in table 4.1) are Private Banks 78.60, Public Banks 61.61 and Foreign Banks 67.09. As minimum 75% is needed to maintain Credit-Deposit Ratio, Private Banks's Credit-Deposit Ratio is little higher than prescribed percentage, but still Private Banks are not so much in danger in giving the deposited money to their customers. This shows that borrowings must be little higher but they are not non-controllable. If Private Banks wants they can control their borrowings in time before the percentage is too high.

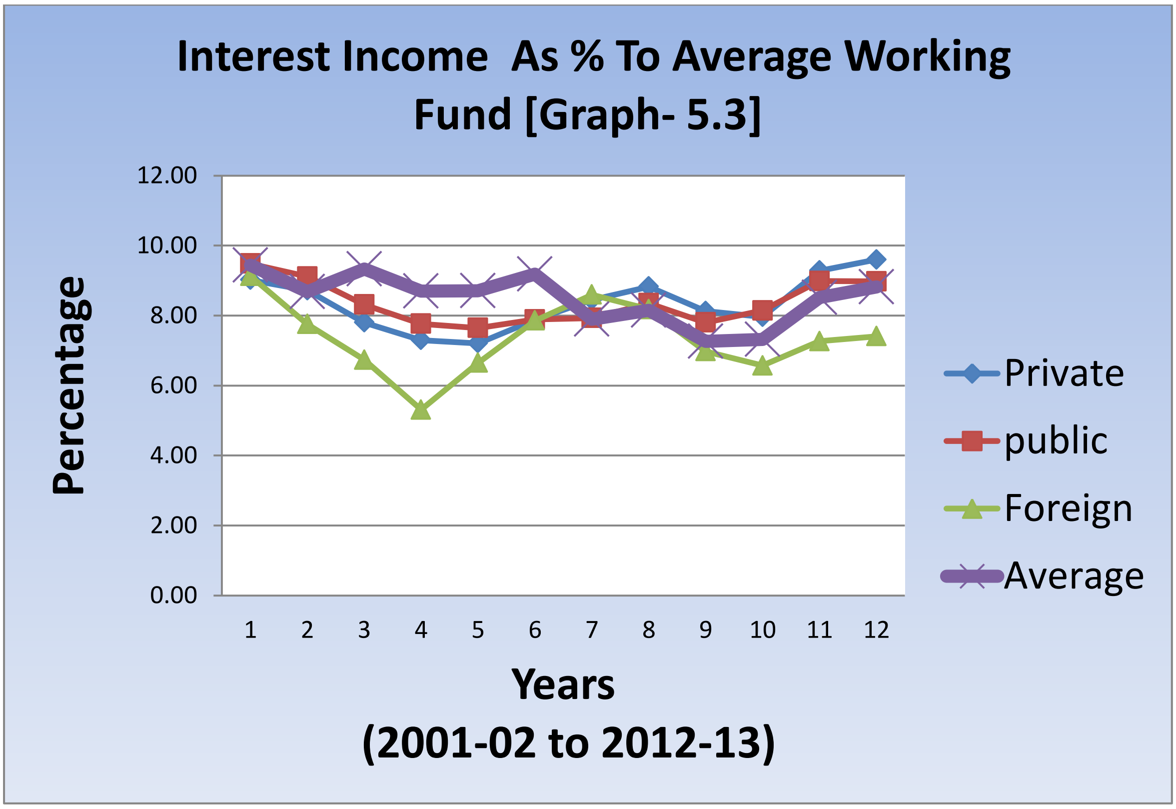
As Credit-Deposit Ratio of Public Banks and Foreign Banks are lower than 75% this indicates that there is scope of maximizing profit by quality advancing.

Maximum of all the three sectors together is 100.92, which is higher than 75%. This is due to ICICI Bank in the year 2001-02 and 2002-03 Credit-Deposit Ratio was 146.59 and 110.60 respectively (given in appendix under the head Credit-Deposit Ratio) as well as in case of Foreign Bank for the year 2001-02 Credit-Deposit Ratio was 124.70. This indicates that Bank resorted to utilize other sources of borrowings than the deposits for advancing. This indicates very critical liquidity position of Bank. ICICI Bank was in liquidity difficulty in the year 2001-02 as the depositors lined up to withdraw their deposits.

Credit-Deposit Ratio of Foreign Banks in Graph 5.1 shows continues rising trend, whereas Credit-Deposit Ratio of Private Banks and Public Banks are either below average or parallel to average.

5.2.2. INTEREST INCOME RATIO





Interest income Ratio is calculated on two bases:

i. As Percentage to Total Income where mean of our selected Sample Private Banks is 80.87, Sample Public Banks is 87.30 and Sample Foreign Banks is 64.85. Mean of all mean is 77.67.

ii. As Percentage to Average Working Fund, where mean of our selected Sample Private Banks is 8.35, Sample Public Banks is 8.37 and Sample Foreign Banks is 7.37. Mean of all mean is 8.03.
(Given in table no. 4.1)

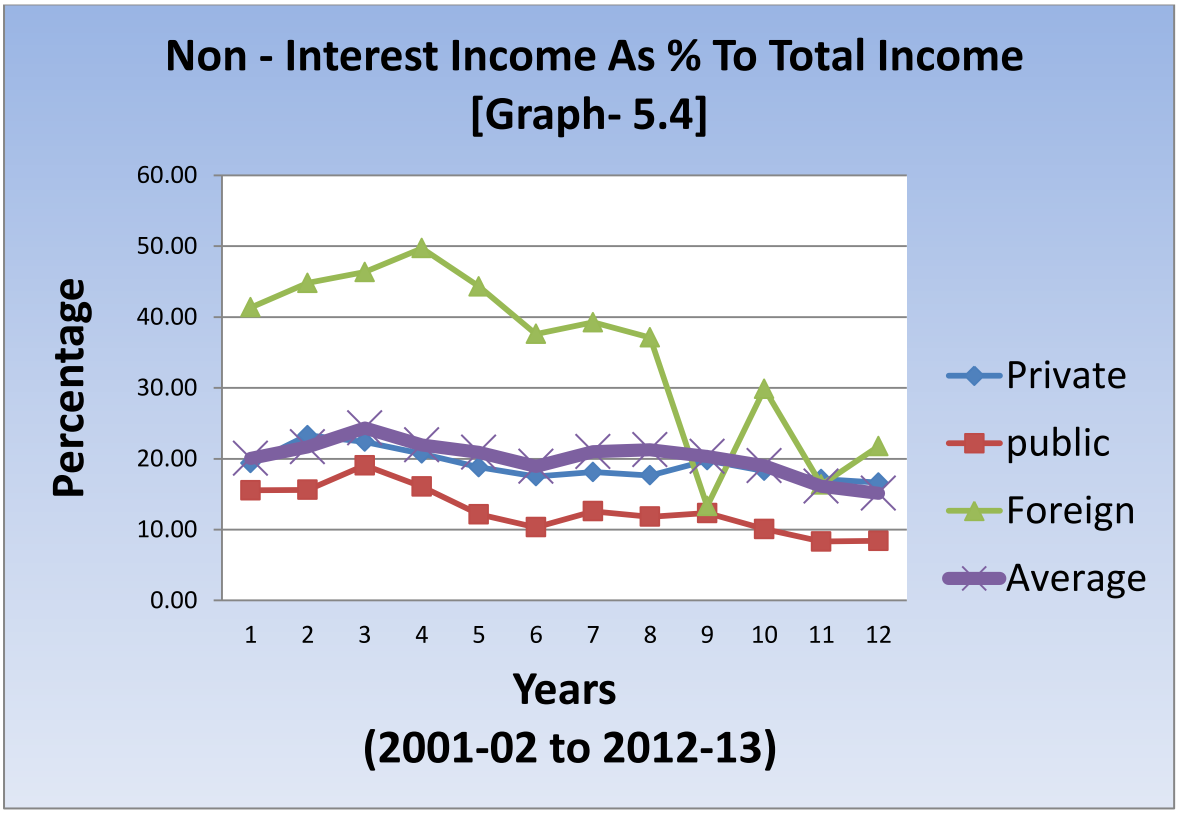
In both the cases above mean of Sample Private Banks and Sample Public Banks is more 77.67 and 8.03. They are above average. This trend can also be seen in Graphs 5.2 and 5.3. This indicates that Private Banks and Public Banks are earning more out of Interest Income. This proves that Private Banks and Public Banks are into pure banking business i.e. advancing and depositing (which is main job of any bank). They are the prime lending banks of the country. Their Income out of Interest is more because they concentrate on all large, medium and small sectors. Public Banks and upto some extend Private Banks, they even carry out their banking business in rural areas also.

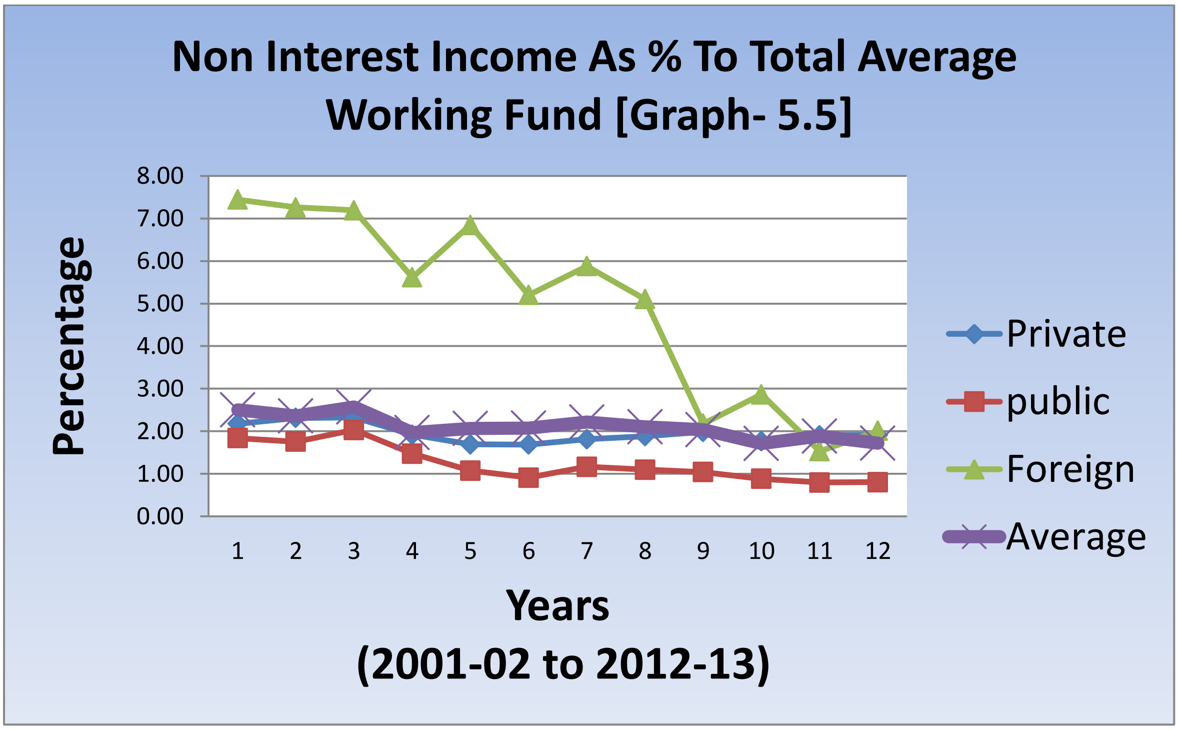
To further grow their income they should keep on doing their business the way they have been doing. Not only this, they should try to reach out to more people as possible and maintain their customer relation so more people come to them.

On other hand if we see, position of Foreign Banks is not satisfactory. In both the case above, mean of Foreign Banks is lower than 77.67 and 8.03. This shows that Foreign Banks are focusing more on fees base income. They earn more from non-interest income rather than interest income. They are more into side jobs than doing core banking job. This is because the foreign banks are playing safe by lending money to large corporates where the security of the fund is high but at low return. The performance of this sector can be improved by taking adequate steps on advancing to small and medium sector industries. But looking at Graph 5.2 and 5.3 it can be said that slowly and gradually Foreign Banks are making an attempt to increase their interest income.

In the crises of 2009-10 where there was a great downfall in financial system and banks around the globe were heavily affected, Indian Banks still stood strong this was because RBI had good control on Indian Banks.

5.2.3. NON-INTEREST INCOME RATIO





Similarly as interest income ratio even Non-Interest Income is calculated on two bases:

i. As Percentage to Total Income where mean of our selected Sample Private Banks is 19.13, Sample Public Banks is 12.70 and Sample Foreign Banks is 35.15. Average of all mean is 22.33.

ii. As Percentage to Average Working Fund, where mean of our selected Sample Private Banks is 1.95, Sample Public Banks is 1.24 and Sample Foreign Banks is 4.93. Average total of all three mean is 2.70
(Given in table no. 4.1)

From the above averages it can be concluded that in both the cases above Foreign Banks are earning more from Non-Interest Income as its mean (35.15 and 4.93) are greater than the average Mean i.e. 22.33 and 2.70.

From the previous point of interest income ratios, Foreign Banks were earning less out of interest and in Non-Interest Income Ratio they are earning more. This indicates that focus of Foreign Banks is not more on advancing activity (which is the main business of Banking).

As Foreign Banks are technically more advanced and they have well trained employees therefore, their main focus is on service rendering activities like forex including hedging, non-funding advances (letter of credit and bank guarantee facilities), equity issue assistance, bond syndications, and merger activities etc.

Interests are earned out of advancing but instead of that Foreign Banks are doing other service base job for which they charge fees or commission.

On other hand if we observe mean of Private Banks and Public Banks, they are lesser than 22.33 and 2.70. Earlier in previous point of interest income ratio we concluded that Private Banks and Public Banks are earning more out of pure banking business i.e. they are more into advancing activity.

Private Banks and Public Banks should focus on service rendering activities like Foreign Bank to earn more income out of Non-Interest Income.

Table Given in Appendix under the head Non-Interest Income as Percentage to Total Income and Non-Interest Income as Percentage to Average Working Fund of Sample Foreign and All Banks is summarized here under :-

TABLE 5.1: Non-Interest Income as Percentage to Total Income of Foreign Banks

YEARS	01-02	02-03	03- 04	04-05	05-06	06-07	07-08	08-09	**09-10**	10-11	11-12	12-13
AVERAGE OF SAMPLE FOREIGN BANKS	41.36	44.80	46.34	49.71	44.32	37.60	39.26	37.11	**13.30**	29.85	16.34	21.76
AVERAGE OF ALL BANKS	20.03	21.67	24.35	21.93	20.90	18.91	20.98	21.26	**20.31**	18.99	16.12	15.15

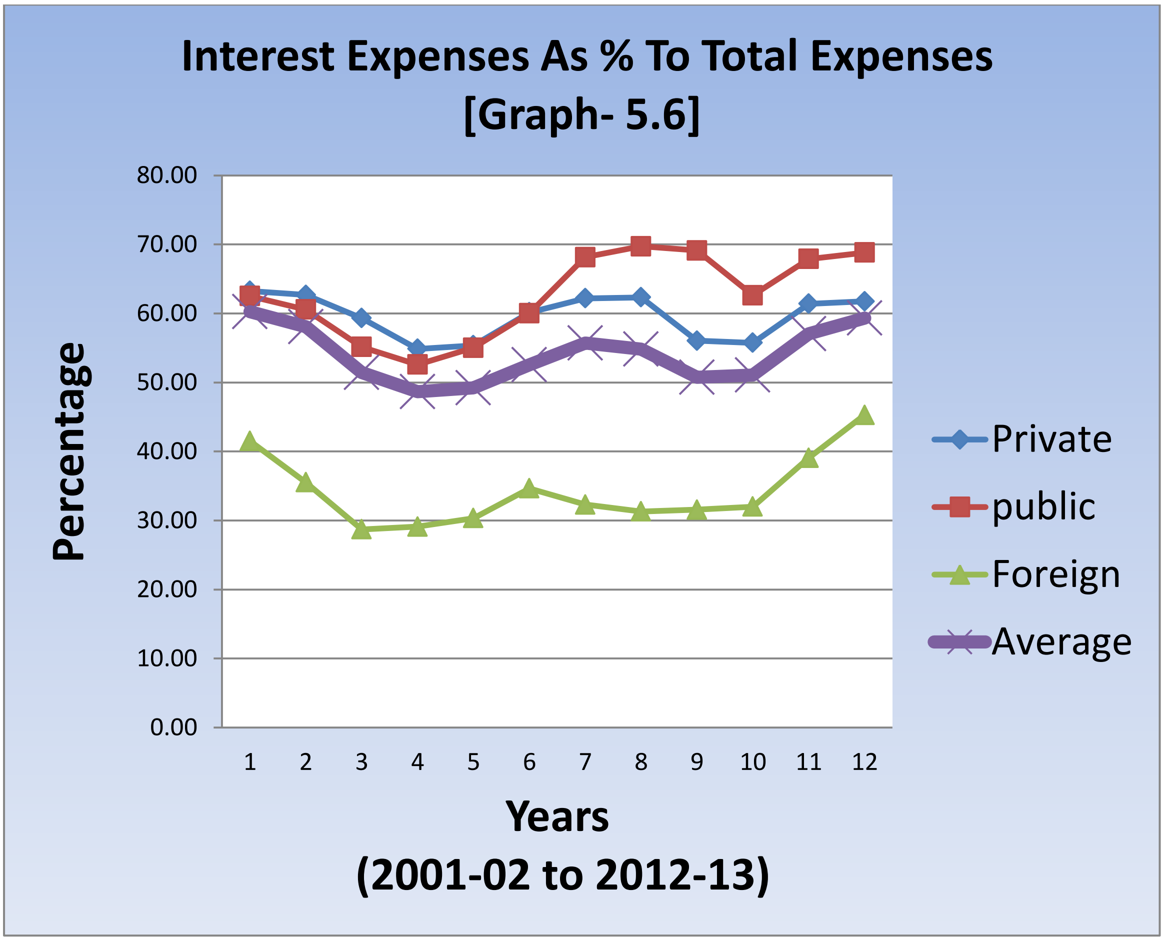
TABLE 5.2: Non-Interest Income as Percentage to Average Working Fund of Foreign Banks

YEAR	**01-02**	**02-03**	**03-04**	**04-05**	**05-06**	**06-07**	**07-08**	**08-09**	**09-10**	**10-11**	**11-12**	**12-13**
AVERAGE OF SAMPLE FOREIGN BANKS	**9.13**	**7.76**	**6.74**	**5.31**	**6.65**	**7.86**	**8.60**	**8.18**	**6.98**	**6.57**	**7.27**	**7.41**
AVERAGE OF ALL BANKS	**9.44**	**8.68**	**9.33**	**8.70**	**8.71**	**9.19**	**7.90**	**8.15**	**7.27**	**7.32**	**8.52**	**8.82**

In Graphs 5.4 and 5.5 and table no. 5.1 and 5.2 above it can be observed that there was a drastic fall in Foreign Bank's other income in the year 2009-10 this was due to the subprime crisis peak on the global level (collapse of Lehman Brothers).

As Foreign Banks are earning more out of Non-Interest Income they were affected more

5.2.4. INTEREST EXPENSES AS PERCENTAGE TO TOTAL EXPENSES



Interest Expenses is the cost suffered by an entity for borrowed funds. Interest expense is a non-operating expense displayed on the income statement. It signifies interest payable as percentage of total expenses.

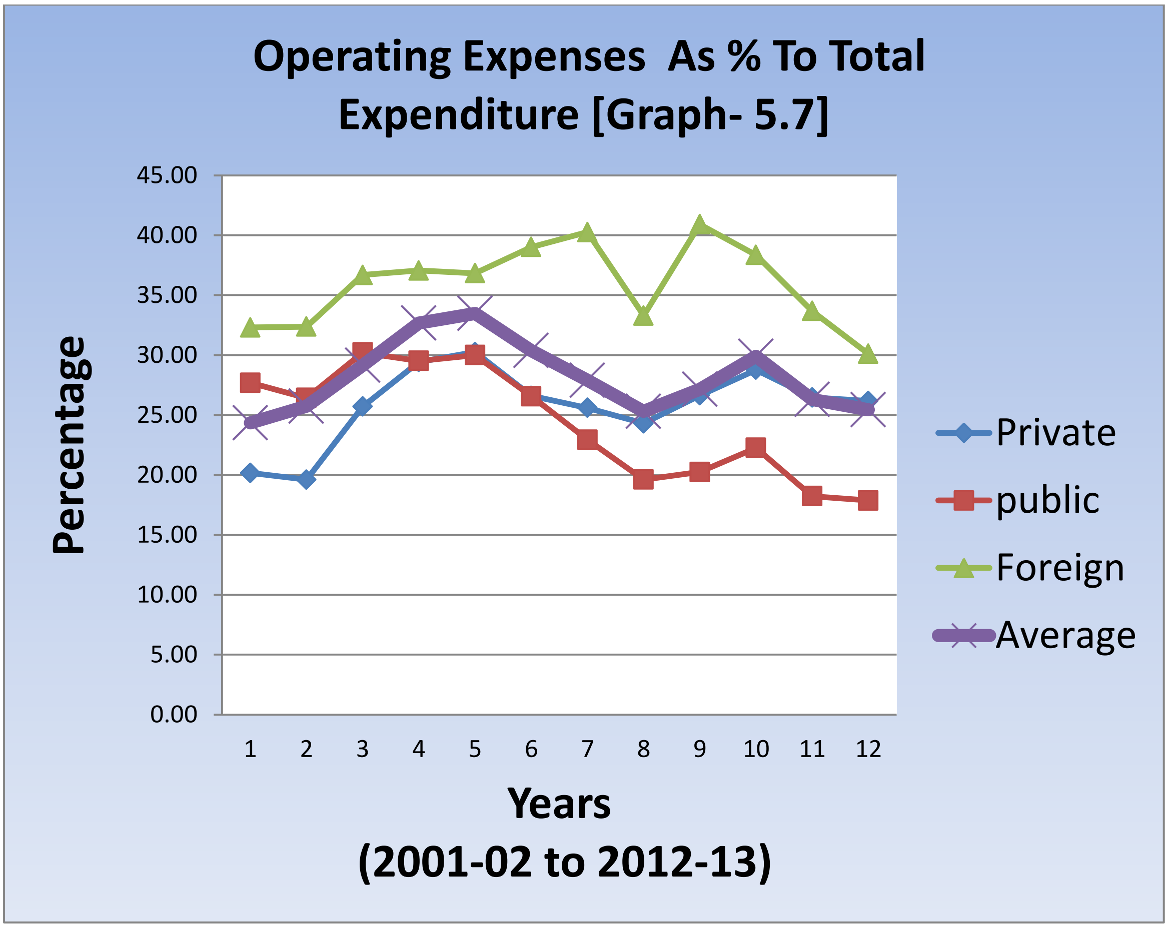
The Interest-Expense ratio is the amount of total expanses that is being paid to pay the interest on borrowed money. The lower the percentages the better it is. If an Interest-Expense ratio is higher, it specifies that the banks are spending too much in paying interest on borrowed money.

From table no.4.1 Interest Expenses as Percentage to Total Expenses of our selected Private Banks is 59.60, Public Banks is 62.69 and Foreign Banks is 34.29. Comparing these Graphs with the average total of all these three sectors i.e. mean of all the three means is 52.19. Mean of and Foreign Banks is lesser than 52.19 but that of Private Banks and Public Banks is greater than 52.19.

This indicates that Foreign Banks are paying less interest on borrowed money. These banks hold large deposits in foreign currency on which they pay interest at lower rates.

Interest Expenses of Private Banks (59.60) and Public Banks (62.69) are higher than the mean of all means 52.19. As earlier mentioned in Interest Income Ratio that the Private Banks and Public Banks are purely into core banking business i.e. their focus is more on lending and advancing the money. In this situation sometimes they have to borrow funds from outside sources to pay their advances at higher rate. As a result of this this Interest Expenses Ratio in case of Private Banks and Public Banks is higher. By focusing on fee base services like hedging, forex etc. they can reduce the burden of borrowings.

5.2.5. Operating Expenses as Percentage to Total Expenditure



These expenses are something that a bank spends on itself for a better performance and to make their customer satisfied. But still they are expenses and it is better to keep expenses under control at lower level. When expenses are high it directly affects the profit.

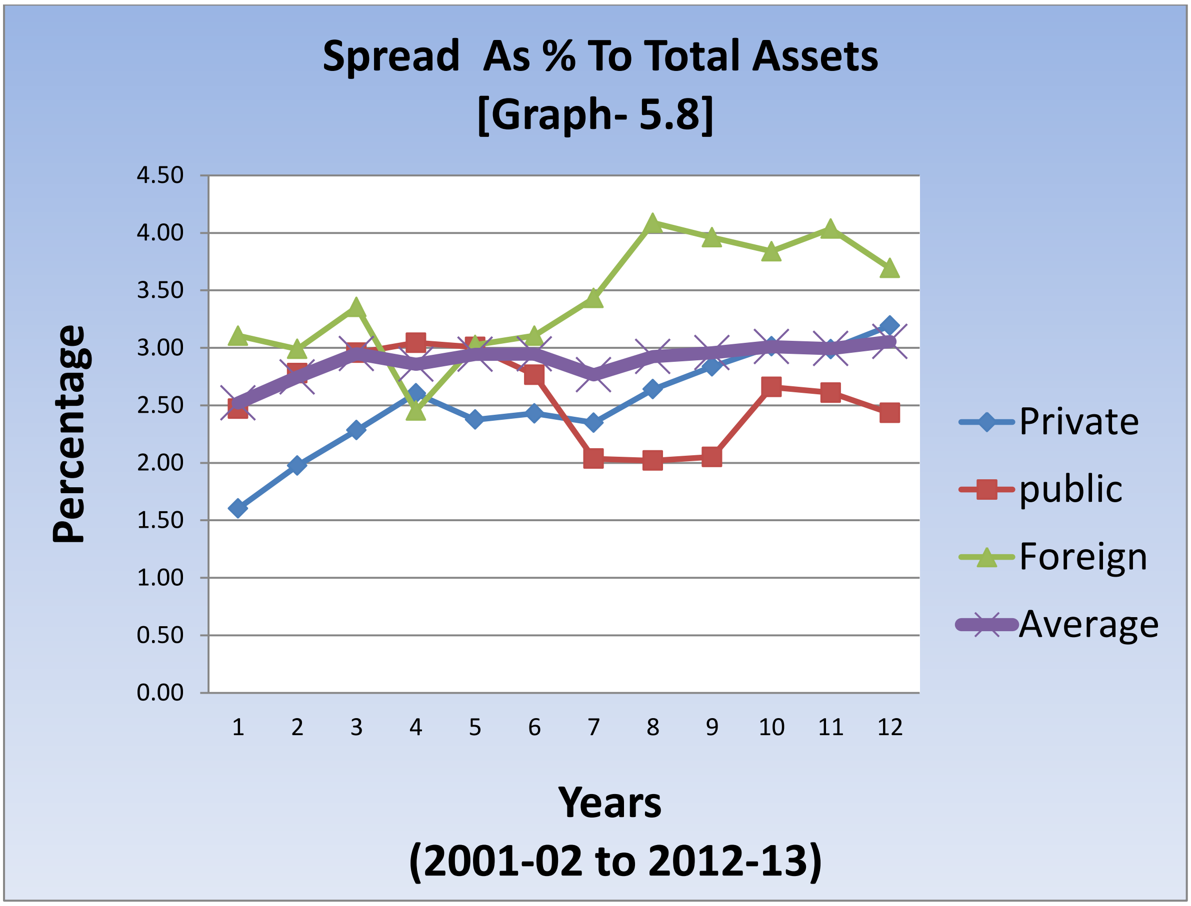
Operating Expenses of three categories are calculated in table 4.1. Mean of Operating Expenses as percentage to total expenditure of Private Banks is 25.81, Public Banks is 24.30 and Foreign Banks is 35.91. Average of all these three sector banks is (Average of mean) 28.67.

From the above Graph it can be concluded that though Private Banks and Public Banks were spending more on paying interest on borrowed money here they are spending less on their Operating Expenses as their mean is lesser than 28.67. This is because these banks are spending less on Operating Expenses. It can be concluded here that Private Banks and Public Banks are not spending more compared to Foreign Banks on Operating Expenses.

Observing the average of sample bank year wise, Operating Expenses of Private Banks lowest was 19.60 in year 2002-03 and highest was 30.25 in the year 2005-06. Operating Expenses of Public Banks was lowest in 17.86 in the year 2012-13 and highest in the year 2003-04 was 30.22. (Given in appendix under the head of Operating Expenses as Percentage to Total Expenditure)

On other hand Operating Expenses of Foreign Banks (35.91) is more than the Average of all these three means 28.67. This indicates that even after spending less on interest expense, Foreign Banks turn up spending more on Operating Expenses. This is because they employ highly qualified staff and spend more on technologies and establishment. Operating Expenses of Foreign Banks was highest in the year 2009-10 at 40.19 which was higher than the highest of Private Banks and Public Banks. Operating Expenses of Foreign Banks was lowest 30.10 in the year 2012-13.The lowest of Foreign Banks was on the higher side in comparison with lowest of Private Banks and Public Banks. (Highest and lowest Graphs given in appendix in Operating Expenses as Percentage to Total Expenditure)

5.2.6. Spread as Percentage to Total Assets



Spread is like a profit margin. The greater the spread, the more profitable a Bank is likely to be. Spread is nothing but difference between average earnings of a Bank receives from loans and other interest-accruing activities and the average rate it pays on deposits and borrowings.

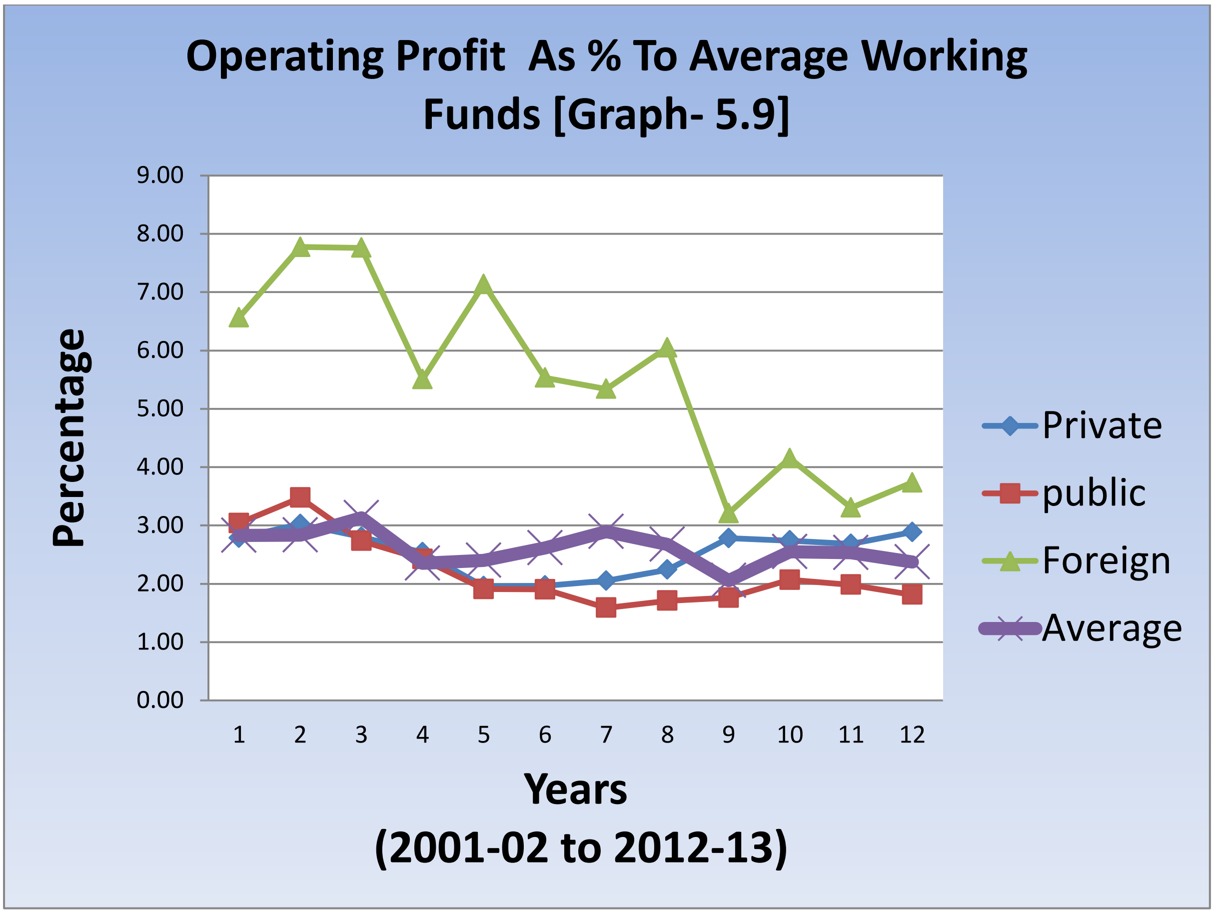
Mean Spread of our sample Private Banks is 2.52, sample Public Banks is 2.57 and sample Foreign Banks is 3.42. Average of all these three is 2.84. (Given in table no. 4.1)

Spread of Private Banks and Public Banks is lower than the average of all three Bank's mean of 2.84 this is on account of their social obligation like concessional financing to priority sector lending like agriculture, rural advancing small scale industries etc. These sector banks have to perform social obligation and therefore, performance of national banks (Private and Public) are lower than Foreign Banks. This is because of the main objective of Foreign Banks is to earn profit whereas this objective in case of local banks (Private and Public) is to support economic activity in the nation by supporting small scale sectors, self-employed youth, farmers and thereby supporting to the government plan of balanced development of the country. Graph 5.8 also shows that Spread of Private Banks and Public Banks are below average.

Another reason for this can be that the net interest income of the banks has come under pressure due to deregulation of interest rates and competitive prices as they came into direct competition with Foreign Sector Banks.

Spread of Foreign Banks is greater than 2.84 which is a good sign for Foreign Banks. This is because Foreign Banks are able to allot funds in good quality assets, high yielding advances and profitable investments and thereby increasing their interest and investment incomes. At the same time they have become cost conscious while borrowing from the market. They have deposits from non-residents in Foreign exchange on which they pay lower rate of interest.

5.2.7. Operating Profit as Percentage to Average Working Funds



Operating Profit is net profit before provisions and contingencies. This display bank's Profitability at the operating level. In other words it shows a bank's operating efficiency. If this ratio improves, operating efficiency is increased. Higher the ratio higher is the profitability of a bank.

Mean Operating Profit of our selected Sample Private Banks is 2.54, that of our selected Sample Public Banks is 2.20 and mean Operating Profit of our selected Sample Foreign Banks is 5.51. The average of all three sector banks is 3.41. (Given in table no. 4.1)

From the above Graph it can be observed that Operating Profit of our selected Sample Foreign Banks is above average i.e. 3.41 it can be concluded that Operating Profit of Foreign Banks is more. As said before higher the Operating Profit the better it is therefore, here Foreign Banks are in good position. This can also be seen in Graph 5.9 that Foreign Banks are above average. This indicates that Foreign Banks are performing good enough at operating level. This is because they are technically advanced, well trained employees, less paper work maintain good relation with customers. They work with less staff. Foreign Banks apply hire and fire policy if performance of any employee is not upto the mark. This way employees work efficiently and this way Foreign Banks can make more profit at operating level.

Foreign Banks target qualitative and remunerative customers on account of specialized services like forex remittance, hedging against forex fluctuation etc.

On other hand mean Operating Profit of Private Banks (2.45) and Public Banks (2.20) are lower than 3.41, indicating that Operating Profit of these banks are below average (also observed in Graph 5.9) the reasons for low Operating Profit of Private Banks and Public Banks can be :

1. Private Banks and Public Banks have excessive and sometimes unqualified staff as compared to Foreign Banks therefore Private Banks and Public Banks end up paying more salaries.

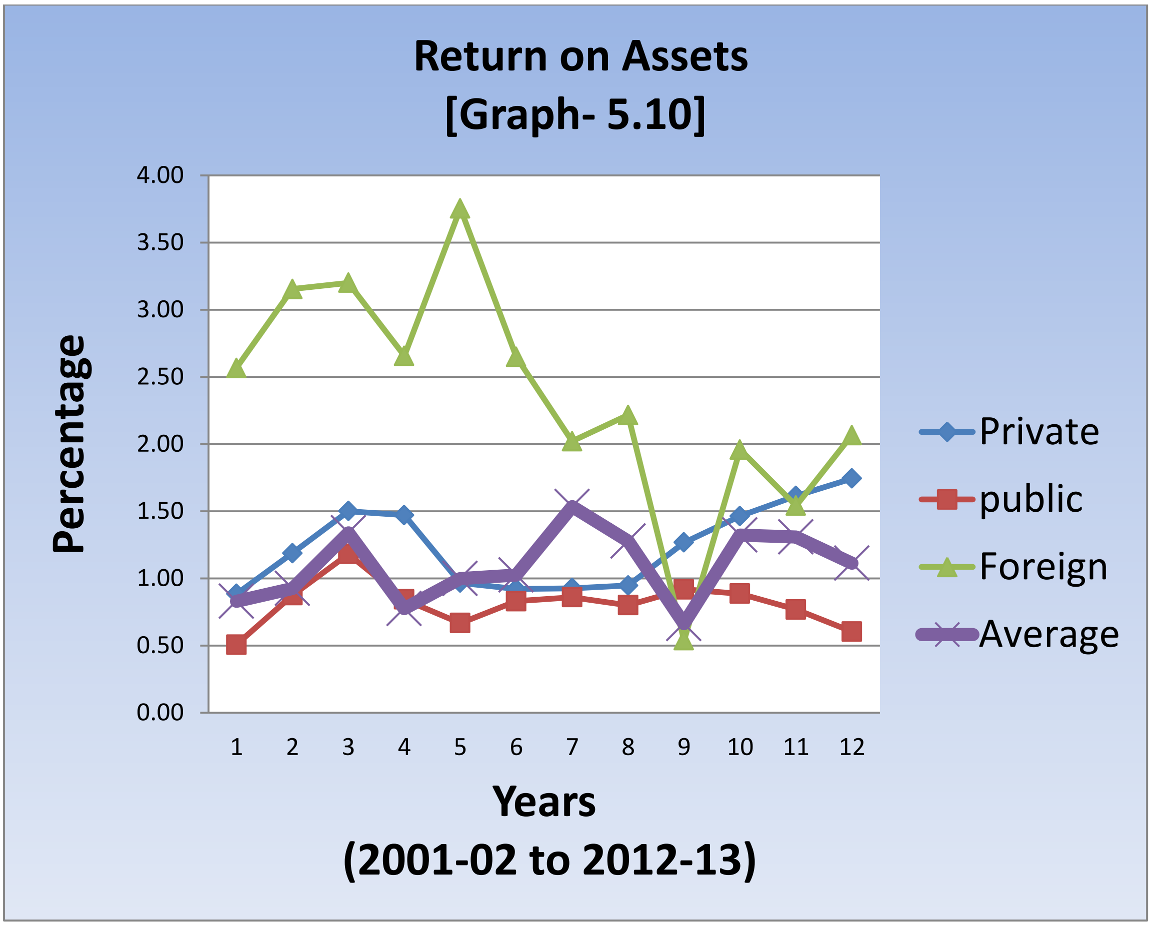
2. Public Banks give permanent employment and they provide retirement benefits to employee.

3. More paper work and less technical work this takes lots of time to complete work and even sometimes customer end up waiting in a queue for a long time for the service from these banking sectors.

4. Public Banks and upto some extend Private Banks have to work with lower interest margin because they have to perform social obligation like they give loan to even a person with very low income where return sometimes is uncertain (Foreign Banks give only to large industries and well-earned person only where return is certain), they do agriculture financing, rural financing etc.

5. Social responsibilities are casted on Private Banks and Public Banks to provide services in small villages and remote areas. They provide banking services to common man and they participate in government programmes like “zero” balance account scheme, subsidy deposit scheme, pension scheme etc. where lots of work is involved with less remuneration and sometimes they have to provide these services regardless of margin.

5.2.8. Return on Assets



Return on Assets is another indicator to measure profitability. How much return achieved on the assets, is an important factor.

This is probably the most important single ratio comparing the efficiency and operating performance of banks as it indicates the returns generated from the assets that bank owns. The ROA measures bank profits per unit of assets.

The higher the ROA the better it is.

Mean Return on Assets of Sample Private Banks is 1.24, Sample Public Banks is 0.81 and Sample Foreign Banks is 2.36. Average total of all three sectors Banks is 1.47. (Given in table no. 4.1)

Higher bank ROAs are on average associated with traditional basic banking fundamentals: a business model based on lending (not security investments), with solid underwriting standards and loan administration practices that minimize nonperforming loans, and management attention focused on maximizing the use of core funding and minimizing overall funding costs.

Return on Assets of Foreign Banks (2.36) is above average (1.47) which is good sign for Foreign Banks. A good amount of return is generated over the assets of Foreign Banks. In Graph 5.10 it is observed that performance of Foreign Banks in Return on Assets is above excellent. This is because they are managing their assets in a planned way. They provide loans with high rate of interest and as far as possible to sound customers only where they are assured that income is certain from that customer this takes Return on Assets on higher level. They make intelligent investments (investments are assets). All these are assets of a bank which Foreign Banks are maintaining efficiently and generating good returns out of these assets.

The return on assets (ROA) ratio illustrates how well Foreign Banks are in employing the Bank's total assets to generate profit. The higher the return, the more efficient management is in utilizing its asset base.

TABLE 5.3: Return on Assets of Foreign Banks

YEARS	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	**09-10**	10-11	11-12	12-13
AVERAGE OF SAMPLE FOREIGN BANK	2.57	3.15	3.20	2.66	3.75	2.65	2.02	2.22	**0.54**	1.96	1.54	2.07
AVERAGE OF ALL BANKS	0.83	0.92	1.34	0.78	1.00	1.02	1.53	1.28	**0.66**	1.32	1.31	1.11

(Table given in Appendix under the head Return on Assets)

The trend of Foreign Banks as observed in Graph 5.10 and table no. 5.3 above was upward and above average line from the year 2001-02 to 2008-09. But there was extreme downfall in the year 2009-10 (total of sample foreign bank 2.69 and average of sample foreign bank 0.54). This was due to the subprime crisis in September 2008 following the collapse of Lehman Brothers. There was a critical situation for financial institution around the globe. Even Foreign Banks got affected (as their parent offices are outside India, when they got affected even their foreign branches in India got affected). But there was a strong hold of RBI on all the banks in India including Foreign Banks in India therefore Foreign Banks had chance to recover the downfall. The Graph 5.10 shows slow but gradual recovery trend of Foreign Banks.

Return on Assets of Private Banks (1.24) and Public Banks (0.81) both are average 1.47. But in Graph 5.10 Return on Assets of Private Banks and Public Banks are either lower or parallel. Due to social obligation they have to provide loans at lower rate of interest this can bring down their income. They also have to provide loans to medium and small sector industries also. Not only this, Public Banks and upto some extend even Private Banks have to give loan to lower income earning customer also where they sometimes are not able to pay their loan amount back to bank this also reduces their Return on Assets.

To improve Return on Assets, Private Banks and Public Banks should keep a proper watch on solvency of customer and should make sure that they collect their advances on time. They should increasing services rendering business also (which they have slowly started).

TABLE 5.4: Return on Assets of Private Banks

YEARS	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	**09-10**	10-11	11-12	12-13
AVERAGE OF SAMPLE PRIVATE BANK	0.88	1.19	1.50	1.47	0.97	0.92	0.93	0.95	**1.27**	1.46	1.61	1.74
AVERAGE OF ALL BANKS	0.83	0.92	1.34	0.78	1.00	1.02	1.53	1.28	**0.66**	1.32	1.31	1.11

TABLE 5.5: Return on Assets of Public Banks

(YEAR)	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	**09-10**	10-11	11-12	12-13
AVERAGE OF SAMPLE PUBLIC BANK	0.51	0.87	1.18	0.84	0.67	0.83	0.86	0.80	**0.92**	0.89	0.77	0.60
AVERAGE OF ALL BANKS	0.83	0.92	1.34	0.78	1.00	1.02	1.53	1.28	**0.66**	1.32	1.31	1.11

(Table given in Appendix under the head Return on Assets)

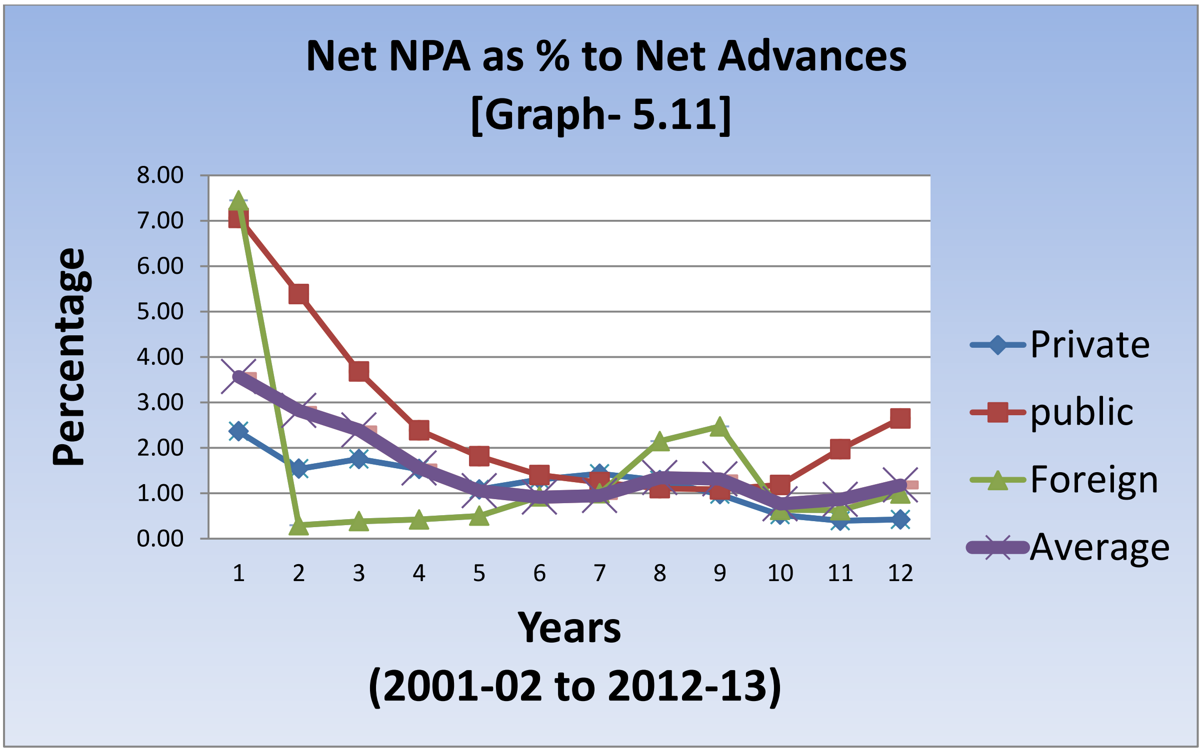
From the Graph 5.10 and the table no. 5.4 and 5.5 above it can be said that Private Banks and Public Banks were not much affected by the crisis that financial institution around the globe had to face. This was due to strong control of RBI on banking sector in India.

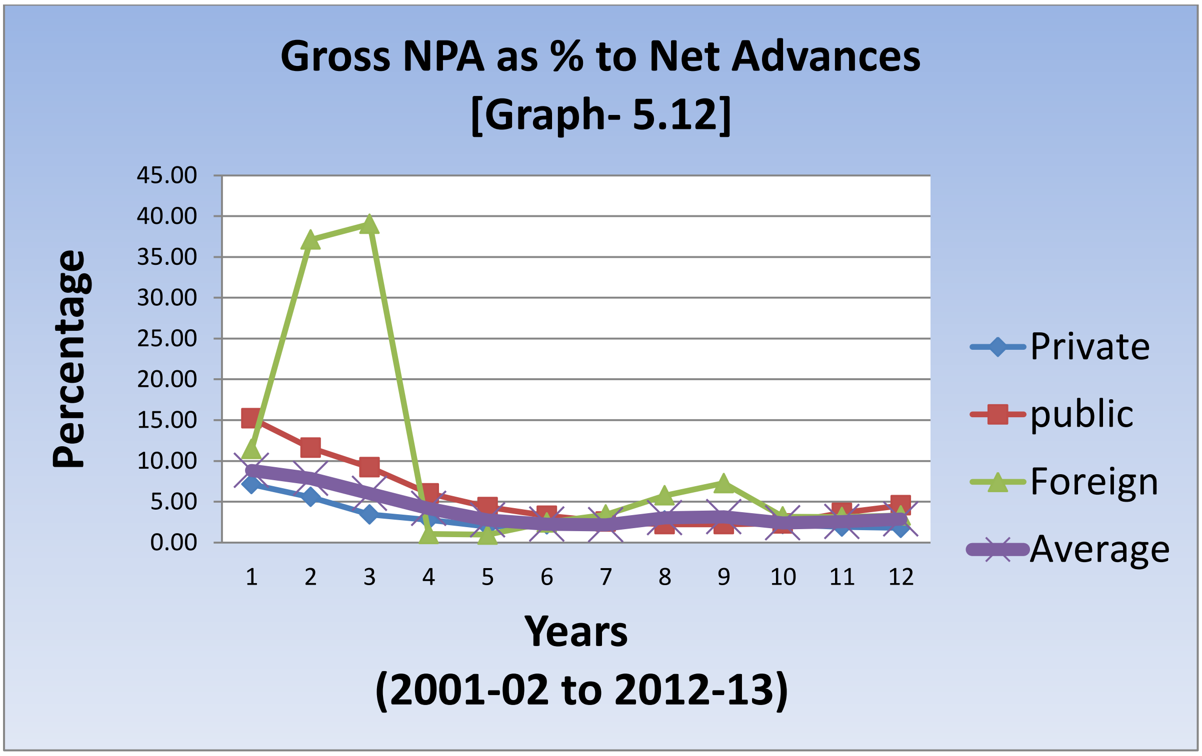
India, despite having danced to the tune of the international financial advisers in opening up its doors to the external trade, appears to have eluded the waves of the financial crisis thanks to the strong regulatory institutional mechanism, which functions under the unparalleled stewardship and acumen of the Reserve Bank of India.

Banks managed a return on assets near to 1% in both 2007-08 and 2008-09, slightly higher than the 0.9% return of 2006-07. This should place the Indian banking sector amongst the most profitable in the world today. Banks elsewhere saw their capital eroded and required infusions of capital from governments. In India, capital adequacy actually improved in 2008-09. World-class profitability and improved capital, indicates a better banking soundness in India, even in the midst of devastation in the banking sector worldwide.

In 2007-08, commercial credit growth slowed. It slowed further in 2008-09. But banks maintained their return on assets in 2008-09 at the same level as in the preceding boom years. This is truly astonishing. It suggests that no matter what the ups and downs of the economy, the Indian banking sector can deliver a return of 1% on assets, a benchmark of good performance in banking. India today seems to have a crisis-proof banking sector.

5.2.9. Net NPA as Percentage to Net Advances





If the borrower fails to make interest or principal payments then the loan is considered to be a non-performing asset (NPA). Therefore lower the NPA the better it is.

i. Net NPA as Percentage to Net Advances of our selected Sample Private Banks is 1.22, selected Sample Public Banks is 2.58 and that of our selected Sample Foreign Banks is 1.49. Average of all there Banks is 1.76.(Given in table no. 4.1)

ii. Gross NPA as Percentage to Net Advances of our selected Sample Private Banks is 3.08, selected Sample Public Banks is 5.59 and that of our selected Sample Foreign Banks is 9.84. Average of all there Banks is 6.17.(Given in table no. 4.1)

Gross NPA of Sample Foreign Sector is high (9.84) because of shift to NPA recognition norms of less than 90 days. One of the sample bank Barclays Bank PLC registered heavy Gross NPA in 2002-03 and 2003-04 (177.83 and 188.67 respectively). Otherwise if we see Gross NPA of All Foreign Sector Banks in India it is only 3.07 which is at par with other sectors banks. (Given under the head Gross NPA as Percentage to Net Advances)

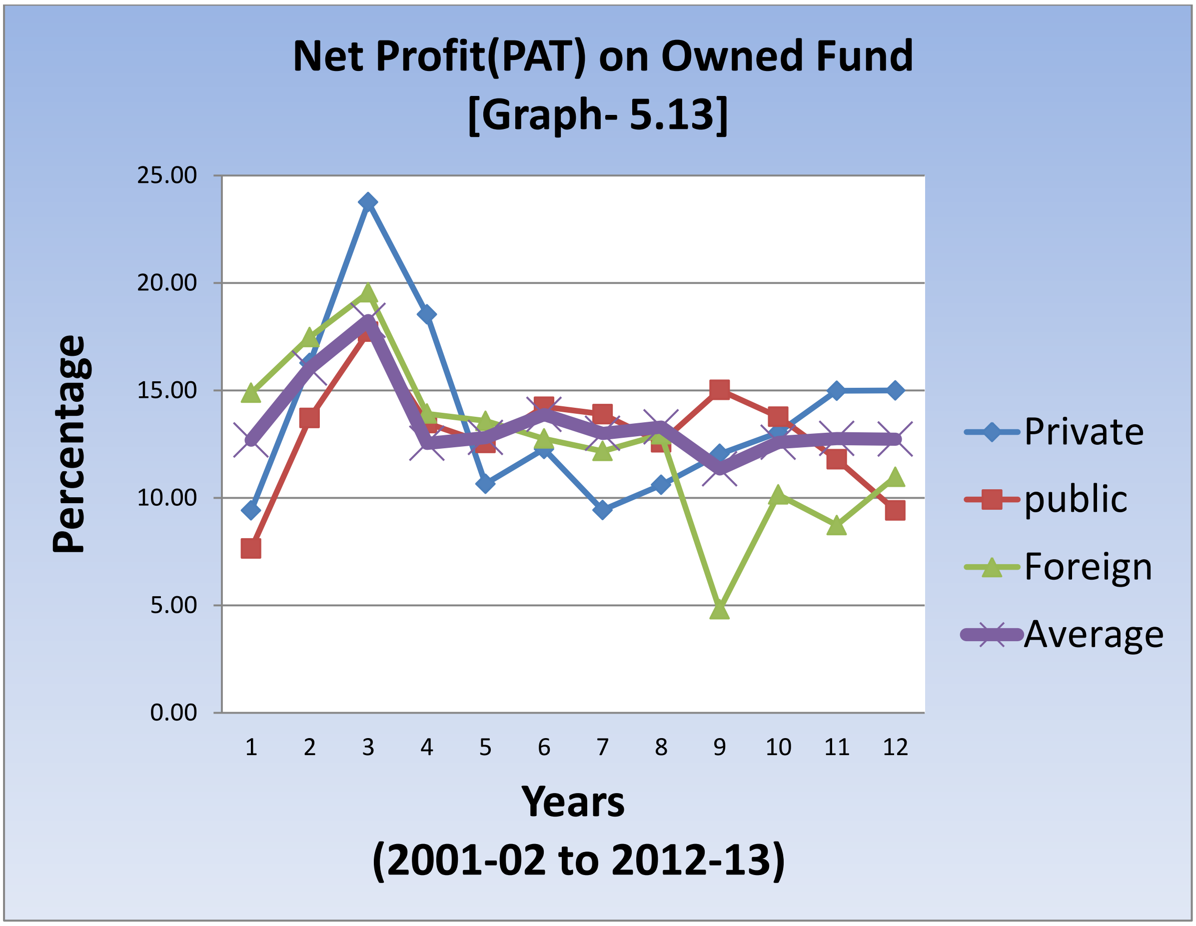
In order to conclude on over all control of NPA, Net NPA is better tool than Gross NPA. Therefore relying on Net NPA to Net Advances the conclusion is that NPA in Private Sector Banks as well as Foreign Sector Banks is under control (their mean is below average 1.76 which is good sign).

This may be on account of their better assessment of the proposal of the client before advancing. Private Sector Banks and Foreign Sector Banks are collecting their debts from their clients in time.

Whereas in case of Public Sector Banks they are under pressure of fulfilling their social obligation of upliftment of economically poor class of the country. After nationalization of Banks, Government Conducted Programme of opening branches from metros to urban Sector to Semi urban Sector and even in remote rural area. In opening these branches profit is not the motive but social, political and mass banking is the objective. Public sector bank branches are opened in remote areas to finance rural poor without motive of profit. Therefore the NPA in case of public sector are more than private sector bank which has opened branches only with objective of profit. Therefore they are in better position than public sector banks. Whereas foreign sector bank have very negligible branches in rural area and as they are more conservative in advancing, the ratio of NPA to Advance is lowest in foreign sector banks.

Banks have to closely monitor the end use of advances given for the projects. This requires improvement in sanctioning proposal, disbursement of loans, careful creation of charges on the assets of the borrower, post disbursement monitoring and follow ups.

5.2.10. Net Profit (PAT) on Owned Fund



Net Profit (PAT) on Owned Fund as calculated in table 4.1 is as follows:-

i. Net Profit (PAT) on Owned Fund of our selected Sample Private Banks is 13.83.
ii. Net Profit (PAT) on Owned Fund of our selected Sample Public Banks is 12.98.
iii. Net Profit (PAT) on Owned Fund of our selected Sample Foreign Banks is 12.66.
iv. Average mean of all the three sample banks is 13.16.

Higher Net Profit (PAT) on Owned Fund the better it is.

Net Profit (PAT) on Owned Fund of Private Banks is above average (13.83 is higher than 13.16) which is better position for Private Banks.

Net Profit (PAT) on Owned Fund of Public Banks and Foreign Banks is slightly lower than average (12.98 and 12.66 respectively is lower than 13.66).

It is observed that in Indian Banking Industries all Banks have shown almost equal level of performance with regards to Net Profit (PAT) on Owned Fund. This is also seen in Graph 5.13.

TABLE 5.6: Net Profit (PAT) on Owned Fund of Private Banks

YEAR	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	**09-10**	10-11	11-12	12-13
AVERAGE OF SAMPLE PRIVATE BANK	9.41	16.27	23.75	18.54	10.65	12.27	9.42	10.60	**12.04**	13.04	14.98	14.99
AVERAGE OF ALL BANKS	12.68	16.03	18.25	12.53	12.80	13.88	13.00	13.29	**11.35**	12.58	12.75	12.73

Table 5.7: Net Profit (PAT) on Owned Fund of Public Banks

(YEAR)	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	**09-10**	10-11	11-12	12-13
AVERAGE OF SAMPLE PUBLIC BANK	7.64	13.71	17.72	13.47	12.54	14.23	13.89	12.58	**15.02**	13.77	11.79	9.41
AVERAGE OF ALL BANKS	12.68	16.03	18.25	12.53	12.80	13.88	13.00	13.29	**11.35**	12.58	12.75	12.73

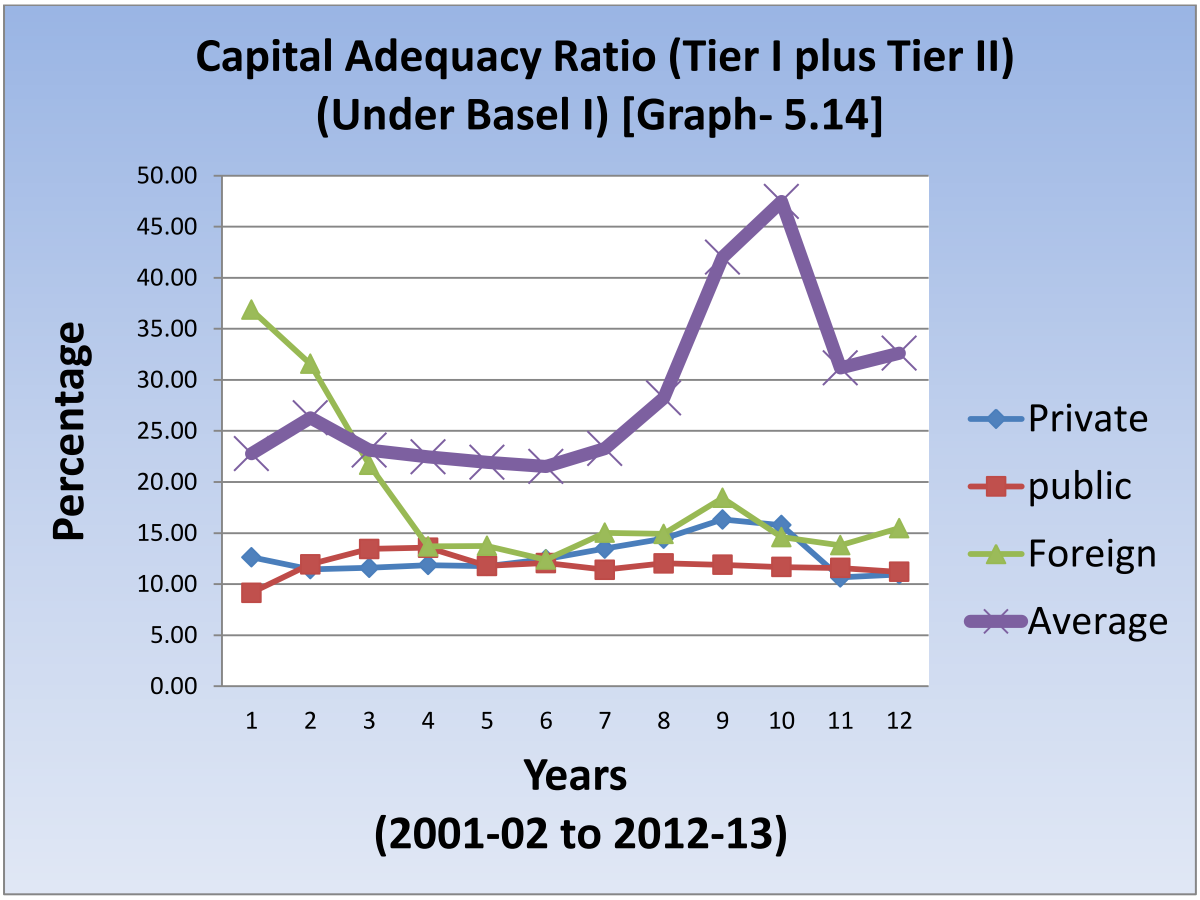
TABLE 5.8: Net Profit (PAT) on Owned Fund of Foreign Banks

(YEAR)	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	**09-10**	10-11	11-12	12-13
AVERAGE OF SAMPLE FOREIGN BANK	14.88	17.48	19.55	13.91	13.58	12.75	12.17	12.95	**4.81**	10.15	8.73	10.97
AVERAGE OF ALL BANKS	12.68	16.03	18.25	12.53	12.80	13.88	13.00	13.29	**11.35**	12.58	12.75	12.73

(Tables given in Appendix under the head Net Profit (PAT) on Owned Fund)

From the Graph 5.13 and table no. 5.6, 5.7 and 5.8 above it is observed that in the year 2009-10 there was an unexpected downfall in Foreign Banks this was due to the effect of 2009-10 Lehman crises. Foreign Banks that are in India, also shows downfall trend because of their Foreign business linked with India. But in India RBI has good hold on their Banks therefore from the very next year Foreign Banks shows recovery trend. Private Banks and Public Banks were not much affected due to this crisis.

5.2.11. Capital Adequacy Ratio (Tier I Plus Tier II) (Under Basel I)



Capital adequacy is indicated by the ratio which the Banks are expected to maintain to ensure stability and strength. It is stated as a proportion of capital to assets weighted according to the risk of default attached to them. Capital Adequacy is seen as Bank's strength to afford losses that may rise upon its advance going bad.

Capital Adequacy Ratio of Private Banks is 12.78, Capital Adequacy Ratio of Public Banks is 11.81 and Capital Adequacy Ratio of Foreign Banks is 18.52. Average of these three bank categories is 14.37. (Given in table no. 4.1)

When compared with average 14.37 Capital Adequacy Ratio of Sample Private Banks (12.78) and Sample Public Banks (11.81) are lower. This indicates that Capital strength of these Banks are comparatively slightly lower than Foreign Banks.

Capital Adequacy Ratio of Sample Private Banks, Sample Public Banks and Sample Foreign Banks are in the range of 10% to 15% (as given in Graph 5.14). However average of all banks is high on account of exceptionally high Capital Adequacy in all Foreign Banks. Therefore it can be said that Foreign Banks have better capital strength and stability to fight future losses if any.

5.3 PERFORMANCE OF BANKS IN INDIA

During the period 2001-02 to 2012-13 Indian banking sector has seen steady upward growth in terms of performance. During this phase, number of foreign banks entered into market and as a result of this local – private as well as public sector banks had to face stiff competition. This has a far reaching impact on the way of working pattern of Local banks. As effect of this there has been technological advancement in banks, an important development was near completion of computerization and an increase in the extent of adoption of core banking solution (CBS) in public sector banks. Change in service hours and verity of banking products available at competitive rates. There has been change in monitoring the advances etc. However year 2009-10 witnessed a relatively sluggish performance of the Indian Banking Sector with some emerging concerns with respect to asset quality and a slow deposit growth. Gross NPA as percentage to Net advance of all bank increased from 2.18 percent in 2007-08 to 3.13 percent in 2009-10 and net NPA as percentage to net advance increased from 0.95 percent in 2007-08 to 1.32 percent in 2009-10. In 2009-10 the profitability of Indian banks captured by the return on assets was a notch lower at 0.66 percent than 1.53 percent in 2007-08. Lower level of financial penetration, Global meltdown in banking industry, foreign competition continued to be an area of concern for the Indian banking sector. Gross NPA to Net advances ratio in 2010-11 is 2.38 and Net NPA to advances is 0.77. In spite of failure of banks in advance countries, Indian banks showed a great come back on account of measures taken by RBI.

In Short-term, the Indian banking sector needs to lend support to the process of economic recovery , while in the medium to long-term, it needs to transform itself to become more efficient and vibrant so as to ensure a more suitable and inclusive pattern of economic growth.

During 2009-10 and 2010-11, there has been steady increase in the number of foreign banks and their branches operating in India. The largest branches network of foreign banks in India was that of Standard Chartered back followed by HSBC Ltd, City bank and Royal bank of Scotland M.V. In the same period, Indian banks continued to expand their presence overseas. While Bank of Baroda had the largest overseas branch network. The presence of State Bank of India in the overseas banking system was increasing felt, as the bank expanded its branch network.

The growth in profitability of banks exhibited a steady growth denoted by every indicator of profitability including , Spread as percentage to total asset, Interest income and Non-Interest income as percentage to average working fund, Operating profit as percentage to average working fund and return on assets showed a steady growth during the period 2001-02 to 2012-13. However during 2009-10, on account of Bank failure in USA, apart from the slight decline in profitability, the other emerging concern was with regard to NPA ratio which showed a marginal increase, it affected to all sector banks but worst in case of foreign sector banks in India. After the Lehman collapse, many forecast that the moment of reckoning for Indian banks had arrived. They said banks would face a mountain of non-performing assets as Indian companies and housing sector felt the impact of the global crises. However, this did not happen. A decision was taken to hike the interest on foreign currency deposits to address the problem of the depletion of foreign exchange reserve. Rules regarding the external commercial borrowing by Indian companies were liberized to pave the way for large foreign exchange inflows. While the crises had its ill effect on sectors like Information Technology enables services, Business processing outsourcing, Back office operations etc. Indian banking sector remain unaffected to the external financial turbulence. The main reason, that the crises in India has been an imported one and hence it has little to do with the fundamentals of the real economy. Indian banking sector has remain in strict control and regulated and directed by RBI. Deregulation of banking sector is essential, but it should be closely monitored

5.4 RECOMMENDATION FOR FUTURE SCOPE OF RESEARCH

The suggestion of this Thesis for future studies is to introduce additional bank specific and macroeconomic variables in order extend these results. Regarding the policy maker, it would be better to encourage domestic banks by providing some support such as providing subsidy or making a reduction on their taxes comparably to foreign banks.

Further area of research could use pool data and multiple regression models with more detailed data results to predict some strong policy for the banking industry in India. Another further recommendation of the research is to conduct an individual study on domestic and foreign banks to evaluate the ownership structure more in depth. This may provide the inside story to show the impact on financial performance of the banks.

Most of the studies conclude that internal factors explain a large proportion of banks profitability nevertheless external factors have also an impact on the performance. However, the relations between bank's characteristics or external factors and profits and margins are not constant across countries or different periods within the same country. Therefore, further research is required. In addition given the differences in the banking sectors among countries, it is interesting to observe if the this results are applicable to other locations.

5.5 LIMITATION OF THIS STUDY

There is a limitation to this study. There are many more parameters that could have a significant effect on the performance of the banks. Those variables may further be studied and the results of those studies may be shared for more information on the performance/profitability aspect of the banking industry in the country. Again, instead of just performance, there must be other measures in the banking industry that could be considered for further studies. Therefore, there is a vast and potential area to be considered for future research.

5.6 AT THE END

India’s banking sector, as in many other developing countries, experienced periods of privatization and liberalization of Banks with the entry of foreign participation. The incursion of foreign banks into the Indian banking sector increased both capitalization and asset quality contributing to the reduction of bad debt in the banking sector.

As a result of banking revolution, the old concepts, attitudes and methods of banking in India have changed. Now the credit institutions in the country are required to participate in the nation building activities and help in bringing about socio-economic changes. Banks, as social institutions have to go the people and assist the weaker and neglected sections of the society in achieving their socio-economic aspirations. They are to act as promoters in the development of the country mobilizing resources wherever they may be, and channelizing them towards productive purposes.