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PROFITABILITY ANALYSIS OF INDIAN BANKS

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Abstract

The traditional theory of firm, assumes that firms aim to maximize profit. Although the decision maker in firms may have other aims as well-e.g. pleasant working conditions. Under many circumstances it is legitimate to assume that the overriding aim is the maximization of profit. This paper seeks to profitability of Indian banks on the basis of ratio analysis. In this paper an effort has been made to find out the asset quality of the various banking sectors in relation to their Gross profit and Net profit during the period. Since, the net profit is an important parameter for measuring the profitability of banks that is why it has been used.

***Keywords**: Profitability, Net Profit, Gross Profit, Ratio Analysis, Profit Maximization.*

Introduction

Perhaps the reason why companies tend to ignore the importance of productivity is that they often link productivity and profitability as one issue. There is no sense in denying that productivity and profitability are interdependent, but they do not always go hand in hand(West, 1999).

Economists show the relationship between output and input in the form of production function. The production function show the relation between amount of factors used and the amount of output generated for particular period. This is expressed as TPP=t(F1, F2, F3……Fn), where TPP states that total output or total physical product(TPP) depends upon the quality of factors.

Economists also define the operation as short run or long run operation. Normally the short run operation has the time period of a year or less than a year. The output can be increased in short run by increasing the variable cost. Profit is made by earning more from sales or services than the cost of production. This is expressed as TP=TR-TC, where P is the profit and TR is stand for total revenue and TC stands for total cost.

Generally speaking the term profitability is the overriding goal for the growth and success of any business, and it can be defined as the ration between revenue and cost (i.e. profit/assets). However the profitability ratio mainly addresses the needs of shareholders(as the primary interest groups) and many researchers therefore claims that an excessive use of monetary ratio can have disadvantages. For example , it can induce short-termism and discourage a perspective on customers views(see Ghalayini et al , 1997; Jagdev et al, 1997; Kalpan & Cooper, 1998, Gurunberg. 2004) states that profitability does not have a direct impact when it compes to improvement purposes, since it is a result of rather than a contributor to , the action and processes in operations. A significant issue is that profitability can change

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for reasons that have little to do with productivity; for instance, cost of price inflation (Bernolak, 1996) and other external conditions that may bear no relationships to the efficient use of resources.(Stainer, `1997).

Net profit of the bank is an important parameter to measure the profitability of the banks. The performance of the banks can be assessed by the rise and fall of the net profit on absolute figures, but it should be properly interpreted. For commenting on the performance, a comparison of profits with the total assets of the bank will give a true picture. Normally this measured by the ratio called Return on Assets (ROA) which is the percentage ratio of net profit(NP) to Total Assets(TA). However the interpretation needs to be analyses carefully. A high ROA indicates better deployment of funds, low level of losses/bad debts and low level of operating expenses. Since return is directly related to high exposures high ROA may be also due to high exposures taken by the bank.

The profit is defined as the difference between income and expenditures. The income can be from interest income or non-fee/non interest income. Fall in interest income may be due to the fall in assets quality or improper deployment of funds. Increase in interest income may be due to growth in credit or increase in interest rate. Generally major portion of the income is from interest earned from advances and investments. Similarly the expenditures can be grouped into interest expended and operational expenditures. The operational expenditures can again be split into:

- Expenditures related to employees
- Provisions and contingencies
- Other operational expenditures

In short the above facts can be summarized into:

- Profit= Income – Expenditures
- Income= Interest income + Other income
- Expenditures= Interest expended + Employees related expenses + other operational expenses + Provisions & contingencies.

Earnings per share (EPS) calculated by net profit divided by number of equity shares assess the performance of the scripts in the capital market based on profit. Banks with lower leverages will generally report higher Return on Assets but lower Return on Equity. Hence analysis of profitability based exclusively on ROE would tend to disregard the greater risks associated with high leverages. In this chapter the profitability of banks will be analyzed based on-:

- The average of net profit for the five years 1999-00 to 2004-05.
- The growth of the gross profit and net profit
- ROA
- ROE

Net Profit Absolute

From table 1 below it is observed that the average net profit of nationalized banks stood at Rs. 8265 crores followed by SBI and associates Rs. 4814. The total average profit of PSB together amounted to Rs. 13,079 and the private and foreign banks amounted to Rs. 4828 crores.

Net Profit Absolute

Net Profit	00-01	01-02	02-03	03-04	04-05	Average
Nationalized Banks	2095	4855	7784	10928	9494	7031
SBI Group	2222	3449	4512	5619	5676	4296
Private Banks	1141	1779	2958	3481	3534	2579
Foreign Banks	945	1492	1492	2243	2002	1701

The profits of PSBs are 2.7 times more than the combined profit of private and foreign banks. Out of the total average profit of Rs. 17,907, the nationalized banks, SBI and associates, private and foreign banks contributed 46%, 27%, 16%, 11% respectively. The year 2003-04 was the best year for the banks and there is a decrease in profit for all banking sectors in the year 2004-05.

Growth and Consistency of Net Profit

From table 2 below it is observed that nationalized banks and private banks had an average growth of 29.20% and 28.48%. However the nationalized banks had a negative growth in the year 2004-05

0f -13.12% and foreign banks had a negative growth of -10.73%. The growyh rate is minimal for SBI and associates (1.02%) and private banks (1.49%).

Growth of Net Profit of Banking Segments

Net Profit in Rs Crores	Growth %					Rank Average	Rank Cons
	2003	2004	2005	Average	Variance		
SBI Group	30.79	24.54	1.02	18.78	246	3	1
Nationalized Banks	60.32	40.39	-13.12	29.20	1442	1	4
Private Banks	66.24	17.71	1.49	28.48	1135	2	3
Foreign Banks	22.25	22.97	-10.73	11.50	371	4	2

On consistency SBI and associates and foreign banks do better than other segments. It is observed that banks could not maintain the growth rate and it is in the decreasing trend. The year 2004-05 was bad as compared to 2003-04 for all segments of banks.

Gross Profit to Total Assets

Gross Profit/Total Assets of Various Banking Segments

	99-00	00-01	01-02	02-03	03-04	04-05	Min	Max	Avg	Var	Rank	Rank
G. Profit/ T. Assets											**Avg**	**Cons**
Nationalized Banks	1.30	1.29	1.83	2.34	2.70	2.20	1.29	2.70	1.94	0.33	4	4
SBI Group	1.74	1.42	1.94	2.27	2.62	2.43	1.42	2.62	2.07	0.20	2	3
Private Banks	1.95	1.74	1.74	2.44	2.27	1.79	1.74	2.44	1.99	0.09	3	2
Foreign Banks	3.24	3.05	3.10	3.20	3.68	2.98	2.98	3.68	3.21	0.06	1	1

Gross Profit to Total Assets

From the table 3 it is observed that the average value of gross profit/total assets of foreign banks, State banks Group, Private Banks, Nationalized banks are 3.21, 2.07, 1.99, and 1.94 respectively. In case of consistency foreign and private banks do better than other segments.

Net Profit to Total Assets

Net Profit/Total Assets of Various Banking Segments

	99-00	00-01	01-02	02-03	03-04	04-05	Min	Max	Avg	Var	Rank	Rank
Net Profit/ T. Assets											**Avg**	**Cons**
Nationalized Banks	0.44	0.33	0.69	0.98	1.19	0.89	0.33	1.19	0.75	0.11	4	4
SBI Group	0.80	0.55	0.77	0.91	1.02	0.91	0.55	1.02	0.83	0.03	3	2
Private Banks	0.88	0.70	0.66	1.00	0.95	0.83	0.66	1.00	0.84	0.02	2	1
Foreign Banks	1.17	0.93	1.32	1.56	1.65	1.30	0.93	1.65	1.32	0.07	1	3

Net Profit to Total Assets- From the table 4 it is observed that the Average value of net Profit to Total Assets of foreign banks, SBI group, private banks, nationalized banks is 1.32, 0.84, 0.82, 0.75 respectively. In case of consistency foreign and State banks do better than other groups.

Comparison with Asian Banks

Net Profit/Total Assets of Banks in Asian Countries

Country	2000	2001	2002	2003	Avg.	Var.
China	0.21	0.20	0.20	0.12	0.183	0.002
Indonesia	0.46	0.87	1.30	1.61	1.060	0.252
Korea	0.37	0.76	0.60	0.15	0.285	0.257
Malaysia	1.29	0.68	1.03	1.08	1.020	0.064
Philippines	0.03	0.48	0.60	1.08	0.533	0.208
Thailand	0.15	1.46	0.21	0.63	0.538	0.480
India	0.48	0.69	0.97	1.14	0.820	0.086

Comparison with Asian Banks

From the table 5 it is clear that India is in the third position with an average of 0.82 and Indonesia and Malaysia stand first and second with the average of 1.060 and 1.020 respectively.

Return on Equity

ROE	99-00	00-01	01-02	02-03	03-04	04-05	Min	Max	Avg.	Var.	Rank Avg	Rank Cons
Nationalized Banks	18.64	13.5	18.42	20.89	22.09	18.76	13.5	22.09	18.72	8.68	1	1
SBI Group	8.24	6.65	13.89	19.50	23.27	16.53	6.65	23.27	14.68	41.4	3	4
Private Banks	8.11	7.80	14.19	16.86	17.04	13.45	7.80	17.04	12.91	16.75	4	2
Foreign Banks	7.60	10.41	15.29	18.57	20.64	15.83	7.60	20.64	14.72	24.14	2	3

Return on Equity

From the table 6 it is clear that nationalized banks and foreign banks top the list with 18.72 and 14.72, closely followed by foreign banks. Nationalized banks and private banks are more consistent.

Ranking of Various Banking Sectors

Rank based on Average							
Ranking	**NP**	**NP Gr.**	**GP/TA**	**NP/TA**	**ROE**	**Total**	**Rank**
Nationalized Banks	1	1	4	4	1	11	1
SBI Group	2	3	2	3	3	13	3
Private Banks	3	2	3	2	4	14	4
Foreign Banks	4	4	1	1	2	12	2
Rank Based on Consistency							
Ranking		**NP Gr.**	**GP/TA**	**NP/TA**	**ROE**	**Total**	**Rank**
Nationalized Banks		4	4	4	1	13	4
SBI Group		1	3	2	4	10	3
Private Banks		3	2	1	2	8	1
Foreign Banks		2	1	3	3	9	2
Over all Rank							
Ranking		**NP Gr.**	**GP/TA**	**NP/TA**	**ROE**	**Total**	**Rank**
Nationalized Banks		5	8	8	2	23	4
SBI Group		4	5	5	7	21	3
Private Banks		5	5	3	6	19	2
Foreign Banks		6	2	4	5	17	1

Ranking and summary findings-: The table 7 indicates the ranking based on the above parameters. On profitability analysis foreign banks do better than other banking segments on overall evaluation followed by private banks. Hence the hypothesis public sector banks are less profitable than the private and foreign banks are proved.

Conclusion

In case of ROE the nationalized banks are better on average for the five years. The nationalized banks lead the group in absolute profit. It is worth to mention that the 70% of total profit is generated by PSBs. The nationalized banks had shown 29% growth followed by private banks. On GP/TA and NP/TA foreign banks do better than other segments.

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