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A STUDY ON FACTORS EFFECTS THE PROFITABILITY OF SELECT PUBLIC AND PRIVATE SECTOR BANKS IN INDIA

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Abstract

Economic growth and development of any country depends upon a well-knit banking system. Banking system comprises a set of sub systems of financial institutions financial markets, financial instruments and services which help in the formation of capital. Banking system remains a major focal point in the financial setup of any developing Country. Banks are regarded as special in view of their specialized functions in the financial intermediation and payment system. The scope of the study is wider in nature. It covers public sector banks which are under the control of the RBI. The data which is used for this study is based on annual report of the bank and secondary data collected from official website of capital line, therefore the quality of this research depends on quality and reliability of data published in annual report. Research is a serious academic activity with a set f objectives to analyze or understand a problem or finding solution for problem adopting a systematic approach. The study is purely based on secondary data. The main source of data is taken from official website of capital line and financial statements relating to the selected banks. There are currently 27 public sector banks in India out of which 21 are nationalized banks and 6 are State Bank of India and its associate banks. For the purpose of the study, population has been defined in terms of the top 5 public sector banks based on its return on net worth. The banks have been selected through purposive sampling method.

Keywords: Direct & Indirect Effects, Select Public & Private Sector Banks.

Introduction

Economic growth and development of any country depends upon a well-knit banking system. Banking system comprises a set of sub systems of financial institutions financial markets, financial instruments and services which help in the formation of capital. Banking system remains a major focal point in the financial setup of any Developing Country. Banks are regarded as special in view of their specialized functions in the financial intermediation and payment system. Moreover banking plays an increasingly important role in the economy of the nation. Occupying a pivotal position in the organized money market, it has acquired a special place with its large network of branches, with its huge deposits and advances. With the gradual change in the concept of banking and with the entry of State in its administration, banking has assumed enormous importance as a subject of analysis and research. Commercial banks play an important role in the mobilization and allocation of resources in an economy. The efficiency of banks is judged, among others, by their profitability and contribution to the maximization of share value. The banking industry in India is in a midst of transformation, thanks to the economic liberalization of the country, which has changed the business environment in the country. During the pre liberalization period, the industry was merely focusing on deposit mobilization and branch expansion. But with liberalization, it is found that many of its advances are under the NPA list. More importantly, the sector has become very competitive with the entry of many foreign and private sector banks. The face of banking is changing rapidly. There is no doubt that banking sector reforms have improved the profitability and efficiency of banks, but in the days ahead banks will have to prepare themselves to face new challenges. The banking system can be broadly classified as organized and unorganized banking system. The un organized banking system comprises money lenders, indigenous bankers, lending pawn brokers, landlords, traders etc., whereas the organized banking system comprises SCBs - permitted by RBI to undertake banking business. This scale of operations bestows upon a higher bargaining power enabling them to play a dominant role in the liquidity and interest rate level in the system. However, the scenario in the future may undergo a change with the growth of the new private sector banks. These banks are in a much advantageous position because of their superior technology based operations, lower manpower and lower NPA level. The macroeconomic policies initiated by the Government since July '91 saw the economy performing in a much better way. The accelerated pickup in the capital goods pointed to a higher growth rate of the economy in the near future. The RBI has taken up various reform measures to improve the performance of banks with an eye on the betterment of the society and the economy.

Objectives

To analyze the direct and indirect effects of the factors on profitability of select Public and private sector banks in India.

Scope of the Study

The scope of the study is wider in nature. It covers public sector banks which are under the control of the RBI. Further the study has analyzed the profitability of Bank of Baroda, Canara Bank, Indian Bank, State bank of Bokener and jaipur and State Bank of Hyderabad based on return on net worth. Commercial banks are supposed to play an important role in achieving the objectives of economic development by providing effective institutional credit support to various regions. Banking has been viewed as a catalysic agent that must develop and support not only as a single element of the national element but also to provide an effective link between the production, distribution and consumption side of it. One of the major impacts of the banking sector reforms that have escaped attention is the substantial expansion of foreign banks in the country.. Entry of foreign banks may erode the profits of domestic banks and may start capturing the business of these nationalized banks. Though recently a large number of studies evaluating the performance of commercial banks in the reform period have come up yet, certain important aspects of performance of these banks have remained untouched.

Limitations of the Study

The data which is used for this study is based on annual report of the bank and secondary data collected from official website's of capital line, therefore the quality of this research depends on quality and reliability of data published in annual report. The result may not be generalized and may not be applicable to the other sector Banks.

Review of Literature

Chaudhry and Singh (2012) analyzed the impact of the financial reforms on the soundness of Indian Banking through its impact on the asset quality. The study identified the key players as risk management, NPA levels, effective cost management and financial inclusion.

L.Saroja (2012) Financial Performance of HDFC and ICICI Bank and offer suggestions for the improvement of efficiency in select banks. For the purpose of analysis of comparative financial performance of the select banks, world-renowned, CAMELS model with t-test is applied. CAMELS stand for Capital Adequacy, Asset Quality, Management, Earning Quality, Liquidity and Sensitivity.

Research Methodology:

Research is a serious academic activity with a set f objectives to explain or analyze or understand a problem or finding solution for problem adopting a systematic approach in collecting, organizing and analyzing the information relating to a problem.

Hypothesis

The increase in credit has an indirect and positive effect on the profitability of select Public and Private Sector Banks.

Data Collection

The study is purely based on secondary data. The main source of data are taken from official website's of capital line and financial statements relating to the selected banks.

Sampling Design

The performance of a bank can be measured by a number of indicators. Almost profitability and growth plays an important role and the selection of banks are based on purposive sampling method, the data collected were grouped according to the requirements of the study keeping in view the problem and the scope of the study the researcher has planned to include public sector banks and private sector banks for the financial period from 2006-07 to 2015-16 for this purpose.

Sampling and Population

There are currently 27 public sector banks in India out of which 21 are nationalized banks and 6 are State Bank of India and its associate banks. For the purpose of the study, population has been defined in terms of the top 5 public sector banks based on its return on net worth. The banks have been selected through purposive sampling method.

Sample Frame Work

Category of Bank	Total No. of Banks	Select Public and Private Sector Banks based on RONW
Public Sector Banks	27	5

Based on the Return on Networth of Select Public And Private Sector Banks

S.No.	Public Sector Banks
1	State Bank of Hyderabad
2	State Bank of Bikaner & Jaipur
3	Syndicate Bank
4	Canara Bank
5	State Bank of India

Period of Study:

The study examines the data for 10 years from 2006-07 to 2015-16 and the essential data for this period have been collected from top 10 public sector banks and 10 private sector. Banks based on its return on net worth. The financial year runs from 1st April to 31st March every year.

Tools and Techniques used

Path Anaysis:

The technique of path analysis is based on a series of multiple regression analyses with an added assumption of causal relationship between independent and dependent variables. The main principle of path analysis is that any correlation coefficient between two variables or a gross or overall measure of empirical relationship can be decomposed into a series of parts; separate paths of influence leading through chronologically intermediate variable to which both correlated variables have links. The direct and indirect effect of independent variables on the dependent variable was calculated for the selected public and private sector banks in India for study period from 2006 -2007 to 2015-16.

Direct and Indirect Effects of Independent Variables on Return on Net Worth – Bank of Baroda

Ratio	Standardized coefficients
Return to Total Assets - E_3	0. 998

It could be observed from table 4.4.1 that the following independent factors have significant correlation co-efficient with the ratio of return on Net worth - E_3- Return on Total Assets (0.998) and they have contributed directly towards the ratio of return on Net worth. Whereas it was also indirectly reasonable when the respective variable was combined with other indirect effects but it was found to be statistically not significant. Finally, an insight into this revealed that the variables E_3 contributed towards profitability position.

Direct and Indirect Effects of Independent Variables on Return on Net Worth – Canara Bank

Ratio	Standardized Coefficients
Return to Total Assets - E_3	0.666
Fixed Assets to Total Assets - R_5	0.256
Debt Equity Ratio - C_2	0.157
Operating to Total Assets - E_2	0.446

An analysis in table 4.4.2 revealed that the following independent factors have significant correlation co-efficient with the ratio of return on Net worth – E_3 Return on Total Assets (0.666), R_5- Fixed Assets to Total assets (0.256), C_2 Debt Equity Ratio (0.157) and E_2 - Operating Profit to Total Assets (0.446).

Other variables have contributed directly towards the ratio of return on Net worth whereas it was also indirectly reasonable when the respective variable was combined with other indirect effects but it was found to be statistically not significant. Further, an insight into this revealed that the variables E_3, R_5, C_2 and E_2 contributed towards profitability positively .

Direct and Indirect Effects of Independent Variables On Return On Net Worth – Indian Bank

Ratio	Standardized Coefficients
Return to Capital Employed -E_8	0.945

It can be observed from above table that the following independent factors have significant correlation co-efficient with the ratio of return on Net worth E8- Return to Capital Employed (0.945). Other variables have contributed directly towards the ratio of return on Net Worth and it was also indirectly reasonable.

When the respective variable was combined with other indirect effects, it was found to be statistically not significant. Finally, an insight into this revealed that the variables E_8 contributed towards profitability position positively.

Direct and Indirect Effects of Independent Variables on Return on Net Worth – State Bank of Bikaner & Jaipur

Ratio	Standardized Coefficients
Provision and Contingencies to Total Assets - L_3	-0.519
Return on Advances - A_1	0.506

It can be observed from the above table that the following independent factors have significant correlation co-efficient with the ratio of return on Net Worth - L_3–Provision and Contingencies to Total Assets (-0.519) and A_1-Return on Advances (0.506) and other variables have contributed directly towards the ratio of return on Net Worth . It was also indirectly reasonable when the respective variable was combined with other indirect effects but it was found to be statistically not significant. Finally, an insight into this revealed that the variables A_1 and L_3 have reduced the profitability of the company.

Direct and Indirect Effects of Independent Variables on Return on Net Worth – State Bank of Hyderbad

Ratio	Standardized Coefficients
Operating Profit to Total Assets -E_2	0.566
Net worth to Capital Employed - A_4	-0.484
Interest Cover Ratio - S_2	0.255

It could be observed from the above table the following independent factors have significant correlation co-efficient with the ratio of return on net worth E_2- Operating Profit to Total Assets (0.566), A_4 – Net worth to Capital Employed (-0.484) and S_2-Interest Cover Ratio (0.255) and the other variables have contributed directly towards the ratio of return on net worth whereas it was also indirectly reasonable when the respective variable was combined with other indirect effects. But it was found to be statistically not significant. Finally, an insight into this revealed that the variables E_2, and S_2 contributed towards profitability position. A_4 reduces the profitability.

Findings:

Bank of Baroda

It could be observed that the following

independent factors have significant correlation co-efficient with the ratio of return on Networth - E_3- Return on Total Assets (0.998) and they have contributed directly towards the ratio of return on Networth. Finally, an insight into this revealed that the variables E_3 contributed towards profitability position.

Canara Bank

An analysis revealed that the independent factors have significant correlation co-efficient with the ratio of return on Net worth – E_3 Return on Total Assets (0.666), R_5- Fixed Assets to Total assets (0.256), C_2 Debt Equity Ratio (0.157) and E_2 - Operating Profit to Total Assets (0.446) and other variables have contributed directly towards the ratio of return on Net worth. Further, an insight into this revealed that the variables $E_{3,}$ $R_{5,}$ C_2 and E_2 contributed towards profitability positively .

Indian Bank

It can be observed that the following independent factors have significant correlation co-efficient with the ratio of return on Net Worth E8- Return to Capital Employed (0.945). Other variables have contributed directly towards the ratio of return on Net Worth and it was also indirectly reasonable. Finally, an insight into this revealed that the variables E_8 contributed towards profitability position positively.

State Bank of Bikaner & Jaipur

It can be observed that the independent factors have significant correlation co-efficient with the ratio of return on Net Worth - L_3 – Provision and Contingencies to Total Assets (-0.519) and A_1-Return on Advances (0.506) and other variables have contributed directly towards the ratio of return on Net Worth . Finally, an insight into this revealed that the variables A_1 and L_3 have reduced the profitability of the company.

State Bank of Hyderbad

It could be observed that independent factors have significant correlation co-efficient with the ratio of return on net worth E_2-Operating Profit to Total Assets (0.566), A_4 – Net worth to Capital Employed (-0.484) and S_2-Interest Cover Ratio(0.255) and the other variables have contributed directly towards the ratio of return on net worth whereas it was also indirectly reasonable. Finally, an insight into this revealed that the variables $E_{2,}$ and S_2 contributed towards profitability position. A_4 reduces the profitability.

Conclusion

This research explains the importance of using the path analysis as financial indicators as a tool of for measuring the performance select public sector banks in India.

It is purely based on assessing the financial performance and to identify the profitability variables, various analyses have been used to test and brought out the variables which directly contribute profit. This study cares on the variables which contribute towards the "performance of select public and private sector banks in India".

The improvement in the profitability of public sector banks will improve the growth rate of Gross domestic product.

This study is useful for policy makers, the banking sector, Reserve bank of India and Government of India

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