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Cooperative performance analysis of select private and foreign banks in India

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Abstract: *The economic reforms in India started in early nineties, but their outcome is noticeable now. Several changes took place in the functioning of Banks in India only after liberalization, globalisation and privatisation. It has become very mandatory to study and to make a comparative analysis of services of Private Sector banks and Foreign Banks in India with the increased competition with Public sector banks and other co-operatives banks operating in India. In this paper an attempt is made to analyse the performance of the selected Private and Foreign banks in India through various financial parameters in terms of adequate capital, quality of asset to be maintained along with other key ratios and suggests to avoid NPA at the nascent stage of credit consideration by putting in place of rigorous and appropriate credit appraisal mechanisms.*

Keywords: Adequate Capital, Asset Quality, Foreign Banks, NPA, Private Banks.

Introduction

As per the Reserve Bank of India, India's banking sector is sufficiently capitalised and well-regulated. The financial and economic conditions in the country are far superior to any other country in the world. Credit, market and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global downturn well. Indian banking industry is expected to witness better growth prospects in 2015 as a sense of optimism stems from the Government's measures towards revitalizing the industrial growth in the country. In addition, RBI's new measures may go a long way in helping the restructuring of the domestic banking industry. The Indian banking system consists of 26 public sector banks, 25 private sector banks, 43 foreign banks, 56 regional rural banks, 1,589 urban cooperative banks and 93,550 rural cooperative banks, in addition to cooperative credit institutions. Public-sector banks control nearly 80 percent of the market, thereby leaving comparatively much smaller shares for its private peers. As of November 11, 2015, 192.1 million accounts had been opened under Pradhan Mantri Jan Dhan Yojna (PMJDY) and 165.1 million RuPay debit cards were issued. These new accounts have mustered deposits worth Rs 26,819 crore (US$ 4 billion).

Standard & Poor's estimates that credit growth in India's banking sector would improve to 12-13 per cent in FY16 from less than 10 per cent in the second half of CY14. The Housing Development Finance Corporation Limited (HDFC) was amongst the first to receive an 'in principle' approval from the Reserve Bank of India (RBI) to set up a bank in the private sector, as part of RBI's liberalisation of the Indian Banking

Industry in 1994. The bank was incorporated in August 1994 in the name of 'HDFC Bank Limited', with its registered office in Mumbai, India. HDFC Bank commenced operations as a Scheduled Commercial Bank in January 1995. HDFC Bank provides a range of commercial and transactional banking services, including working capital finance, trade services, transactional services, cash management, etc. to large, small and mid-sized corporates and agriculture-based businesses in India. The bank is also a leading provider of these services to its corporate customers, mutual funds, stock exchange members and banks. HDFC Bank was the first bank in India to launch an International Debit Card in association with VISA (Visa Electron). The bank also issues the MasterCard Maestro debit card. The Bank launched its credit card business in late 2001. By the end of June 2013, it had a credit card base of 5.94 million. By March 2012, the bank had a total card base (debit and credit cards) of over 19.7 million. The Bank is also one of the leading players in the "merchant acquiring" business with over 240,000 point-of-sale (POS) terminals for debit / credit cards acceptance at merchant establishments. The Bank is positioned in various net based B2C opportunities including a wide range of Internet banking services for Fixed Deposits, Loans, Bill Payments, etc. ICICI Bank (Industrial Credit and Investment Corporation of India) is an Indian multinational banking and fina ncial services company headquartered in Mumbai, Maharashtra, India, with its registered office in Vadodara. As of 2014, it is the second largest bank in India in terms of assets and third in term of market capitalisation. It offers a wide range of banking products and financial services for corporate and retail customers through a variety of delivery channels and specialised subsidiaries in the areas of investment banking, life, non-life insurance, venture capital and asset management. The Bank has a network of 4,050 branches and 13,030 ATMs in India, and has a presence in 17 countries including India. The foreign banks in India are slowly but steadily creating a niche for themselves. With the globalization hitting the world, the concept of banking has changed substantially over the last couple of years. Some of the foreign banks have successfully introduced latest technologies in the banking practices in India. This has made the banking business in the country more smooth and interesting for the customers. The concept of foreign banks in India has changed the prevailing banking scenario in the country. The banking industry is now more competitive and customer-friendly than before. The foreign banks have brought forth some innovations and changes in the banking industry of the country.

Review of Literature

Fotios Pasiouras and Kyriaki Kosmidou (2012), in their research report titled "Factors influencing the profitability of domestic and foreign commercial banks in the European Union", indicate Profitability of commercial banks in European Union is affected by both internal characteristics and changes in the overall banking environment. From the model, for domestic banks were much higher than that for foreign banks while F-statistic was significant at the 1% level for all models. Equity to assets was positively related to ROAA whether we examined domestic or foreign banks and appeared to be the most significant

determinant of profitability for domestic banks. Muhammad Hanif, Mahvish Tariq, Arshiya Tahir and Wajeeh-ul-Momeneen (2012), in their research work titled "Comparative Performance Study of Conventional and Islamic Banking in Pakistan", observed that in terms of profitability and liquidity, conventional banking leads, while in credit risk management and solvency maintenance Islamic banking dominates. For in-depth understanding and sound comparison, key performance indicators were divided into external and internal bank factors. The external factor analysis includes studying the customer behavior and perception about both Islamic and conventional banking. Internal factor analysis includes measure of differences in performance of Islamic and conventional banks in terms of profitability, liquidity, credit risk and solvency. Cheenu Goel and Chitwan Bhutani Rekhi (2012), in their report titled "A Comparative Study on the Performance of Selected Public Sector and Private Sector Banks in India" concluded that that new banks are more efficient than old ones. The public sector banks are not as profitable as other sectors are. It means that efficiency and profitability are interrelated. The key to increase performance depends upon ROA, ROE and NIM. Rakhe P.B (2010), in their article titled "Profitability of Foreign Banks vis-à-vis Other Bank Groups in India – A Panel Data Analysis", the study indicate that access to low cost funds, diversification of income, adequate other income to fully finance the operating expenses are the important factors leading to the higher profitability of foreign banks vis-a-vis other bank groups in India. The results of the panel data regression also indicate that efficiency of fund management is the most important factor determining profitability in the banking system followed by generation of other income. However, with regard to the foreign banks policy, a holistic view may be taken by considering factors such as global financial inter-linkages, financial performance of parent banks as also the pursuit of social objectives by these banks. Bahia, K and J Nantel (2000)- The paper suggested an alternative scale for measuring service quality in retail banking and developed a scale called as Banking Service Quality Scale which contained factors like effectiveness and assurance, access, price, tangibles, service portfolio and reliability and was found to be more reliable than SERVQUAL. Sureshchandar (2002).- The relationship between service quality and customer satisfaction in Indian banking sector were found to be independent but closely related. Both constructs were found to vary significantly in core services i.e., human element, systematization of service delivery, tangibles and social responsibility. Arora S (2005)- An analysis influencing customer satisfaction in public sector, private sector and foreign banks in northern India. 300 customers were questioned using questionnaire method which reveled that significant differences exist in customer satisfaction level of customers in each group of banks regarding routine operation and situational and interactive factors. Foreign banks were found to be the leaders in mechanization and automation. Dr Ravichandran et al(2010)- The paper tries to understand socio demographic and rational profile of public retail banking consumers. Also, the importance of service quality dimensions to predict the multidimensional model of behavioral intentions among public sector

consumers in India are studied. Loyalty was found to be influenced by operating hours, error free records etc. Service quality parameters like tangibility, responsiveness were also found to be very important. Sachin Mittal&Rajnish Jain(2010)- The role of banking industry and effect of IT based services on customer satisfaction was studied in this paper. The study highlights customer satisfaction levels among young customers in banking industry. A survey indicates the gaps between customer"s expectations and perception with respect to IT based banking services. Findings indicated need to improve the IT based services for enhancing customer satisfaction. The studies mentioned above clearly points out to the importance of having a structured study, where banks in different categories are compared with respect to the service quality aspect which will help them to find out their core competencies and to capitalize on them and at the same time find out various specific areas where they can improve.

Objectives of the study

1. To compare the performance of banks under study on the basis of Capital Adequacy.
2. To analyse the short-term resilience of the select banks to overcome the liquidity risk.
3. To measure the efficiency of bank's overheads as a percentage of its revenue.
4. To assess and compare the overall asset quality of select banks for the study.

Research Methodology

The research design applicable to the study would be a descriptive research. The purpose of using the descriptive research method is to acquire accurate, factual, systematic data that can provide you with an actual picture of the data set that you are reviewing.

Sample size selection and scope:

The data is collected from various journals, annual reports from various websites of Reserve Bank of India, ICICI Bank, HDFC Bank, CITI Bank and HSBC Bank.

Financial tools and techniques:

Various financials tools are necessary to analyse the performance of the selected banks. Capital Adequacy and Asset Quality which results in maintaining adequate capital and the credit risk associated with the loan and investment portfolio; Liquidity risk and Management Efficiency ratios results in meeting short term financial demands effectively and efficiently achieving sufficient Net Interest Income.

Analysis and Interpretation

To compare the performance of selected sector banks, various ratios have been considered. They are discussed as under:

I Capital Adequacy:

Capital Adequacy Ratio (CAR), also termed as Capital to Risk (Weighted) Assets Ratio (CRAR), is the ratio of a bank's capital to its risk. National regulators track a bank's CAR to ensure that it can absorb a reasonable amount of loss and complies with statutory Capital requirements. It is a measure of a bank's capital. Under Basel III, the minimum capital adequacy ratio that banks must maintain is 8%.

The capital adequacy ratio measures a bank's capital in relation to its risk-weighted assets. The capital to risk-weighted assets ratio promotes financial stability and efficiency in economic systems throughout the world. As of 2013, under Basel III, a bank's tier 1 and tier 2 capital must be at least 8% of its risk-weighted assets. The minimum capital adequacy ratio (including the capital conservation buffer) is 10.5%. The capital conservation buffer recommendation is designed to build up banks' capital, which they could use in periods of stress.

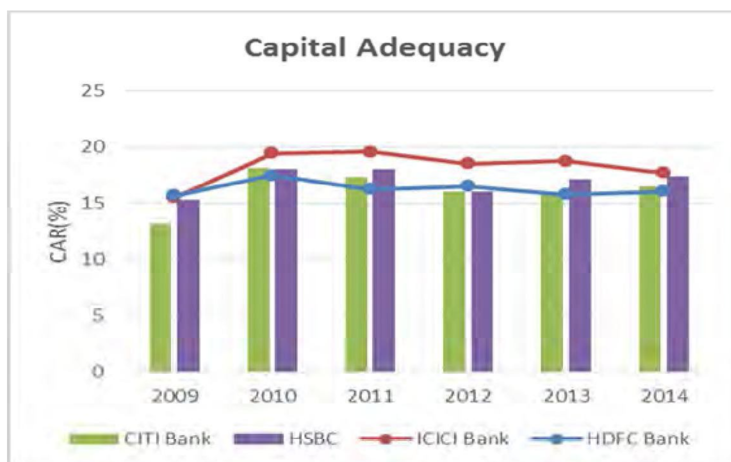

Fig: 1 Capital Adequacy

The Capital Adequacy ratio of ICICI Bank is high, followed by HSBC, HDFC Bank and CITI Bank to the minimum requirement of 8% as per Basel-III. This shows that ICICI bank is in more comfortable position to absorb losses since they have more capital to cover for their risk weighted assets and they have less risky assets in their portfolio for a fixed capital base.

II Liquidity Risk

Liquidity is generally defined as the ability of a bank to meet its debt obligations without incurring unacceptably large losses. Liquidity risk is the risk that a company or bank may be unable to meet short term financial demands. This usually occurs due to the inability to convert a security or asset to cash without a loss of capital or income in the process. It is the ratio of how much a bank lends out of the deposits it has mobilised. It indicates how much of a bank's core funds are being used for lending, the main banking activity.

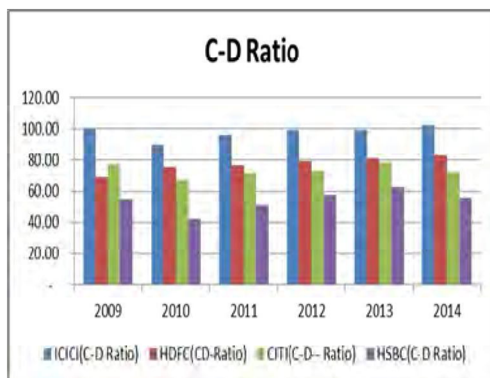

Fig: 2 Credit Deposit Ratio

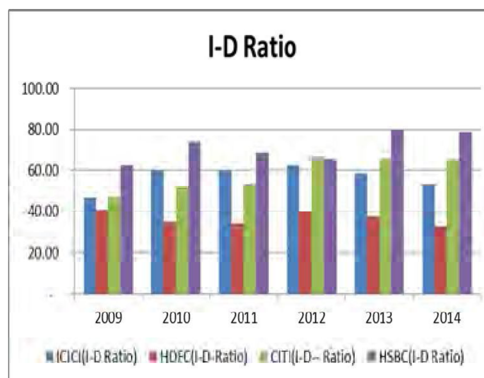

Fig: 3 Investment Deposit Ratio

A very high ratio indicates that the bank doesn't have enough liquidity to cover any unforeseen needs. A very low ratio might indicate that the bank is not earning as much it can on its deposits. Therefore it is essential for the banks to have a stock of short-term investments to ensure higher liquidity. The Credit Deposit ratio of ICICI and HDFC Bank are higher compared to CITI Bank and HSBC.

III Efficiency of Management

The efficiency ratio is calculated by dividing overhead expenses by the sum of net interest income and non-interest or fee income. It is a measure of how effective a bank is in using overhead expenses including salaries and benefit costs and occupancy expenses as well as other operating expenses in generating revenues. Other things being equal, a decrease in the efficiency ratio is viewed as a positive while a rising efficiency ratio is generally undesirable. The efficiency ratio can rise temporarily when a bank expands facilities. For example, opening a new branch immediately adds to overhead costs including staffing. New loans may not be immediately forthcoming. Fee income may be slow developing as well. As a result there can be a short-term spike in the efficiency ratio.

Bank and creditor income derived primarily from fees. Examples of non-interest income include deposit and transaction fees, insufficient funds, annual fees, monthly account service charges inactivity fees, check and deposit slip fees, etc. Institutions charge fees that provide non-interest income as a way of generating revenue and ensuring liquidity in the event of increased default rates. The excess revenue that is generated from the spread between interest paid out on deposits and interest earned on assets is the net interest income.

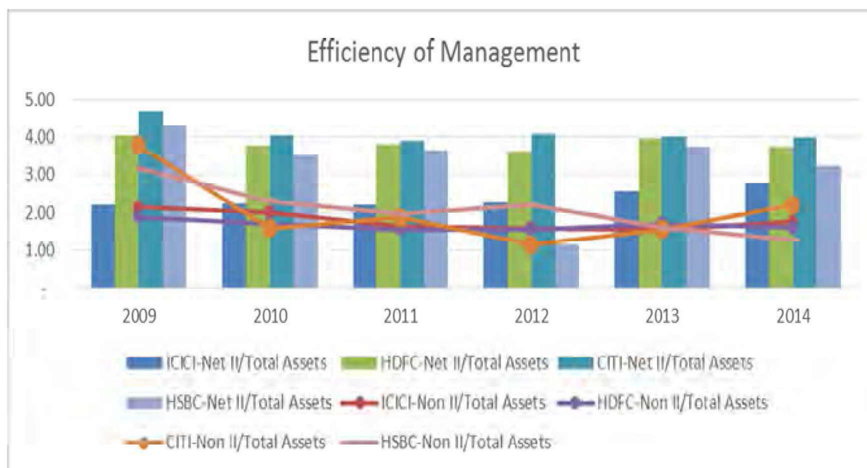

Fig: 4 Efficiency of Management

Net Interest Income is higher than non-interest income in both private banks and foreign banks which indicates their efficiency in generating sufficient net interest income. In the year 2009 the non-interest income in CITI Bank and HSBC were higher compared to ICICI and HDFC Banks.

IV Asset Quality

Asset quality is one of the most critical areas in determining the overall condition of a bank. The primary factor affecting overall asset quality is the quality of the loan portfolio and the credit administration program. Loans typically comprise a majority of a bank's assets and carry the greatest amount of risk to their capital. Securities may also comprise a large portion of the assets and also contain significant risks. Other items which can impact asset quality are other real estate, other assets, off-balance sheet items and, to a lesser extent, cash and due from accounts, and premises and fixed assets. Asset Quality reflects the amount of existing credit risk associated with the loan and investment portfolio. The asset quality of banks can be judged by the non-performing assets (NPA) ratio.

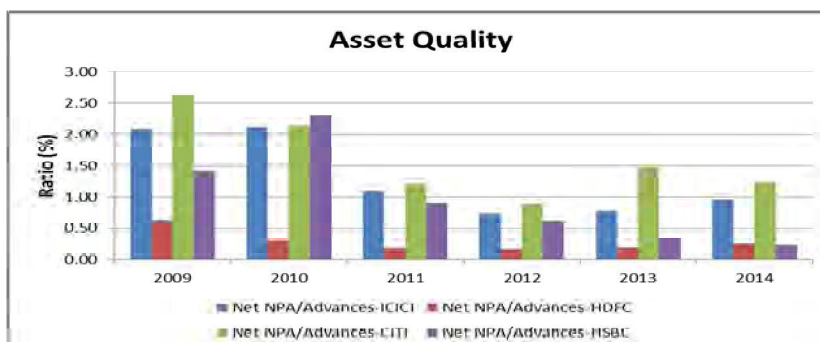

Fig: 5 Asset Quality

In the year 2009 & 2010 the Net NPA to Advances ratio were too high compared to the following years. It is evident from the above figure that the Net NPA has gradually decreased, but CITI bank has the highest ratio leading to poor asset quality followed by ICICI bank. The asset quality of a bank directly affects its credit rating.

Summary findings

- The Capital Adequacy ratio of ICICI Bank is high, followed by HSBC, HDFC Bank and CITI Bank to the minimum requirement of 8% as per Basel-III norms.
- The Credit Deposit ratio of ICICI and HDFC Bank are higher compared to CITI Bank and HSBC.
- Net Interest Income is higher than non-interest income in both private banks and foreign banks which indicates their efficiency in generating sufficient net interest income. In the year 2009 the non-interest income in CITI Bank and HSBC were higher compared to ICICI and HDFC Banks.
- From the above analysis, it is evident that the Net NPA has gradually decreased, but CITI bank has the highest ratio leading to poor asset quality, followed by ICICI bank.

Conclusion

This discussion provides an insight how the above mentioned banks are performing towards the efficiency and effectiveness banking in India.

- It is evident from the above, capital adequacy, that there is adequate capital in ICICI and HDFC banks than foreign banks. However, the minimum requirement of 8% as per Basel-III, ICICI and HDFC bank are in more comfortable position to absorb losses since they have more capital to cover for their risk weighted assets and they have less risky assets in their portfolio for a fixed capital base.
- In terms of Liquidity risk, Credit deposit ratio, ICICI banks showing higher ratio than other banks, which indicates that the bank doesn't have enough liquidity to cover any unforeseen needs. On the other hand, a very low ratio might indicate that the bank is not earning as much it can on its deposits.
- Under Investment deposit ratio, HSBC is showing higher and an increasing trend in all the years mentioned above which also states that investments are more compared to its own deposits.
- Net Interest Income and non-interest income in both private banks and foreign banks are efficient in generating sufficient interest income resulting in efficiency of management. In terms of asset quality, the Net NPA in ICICI, CITI banks and HSBC are high compared to HDFC bank in the year 2009, 2010 and has gradually decreased in the subsequent years.

Suggestions

As discussed above, it has been observed that the major area of concern for any bank is the customer service and customer satisfaction.

- As the Capital Adequacy ratio of ICICI Bank is high compared to other banks in the study, it is advised for the HDFC, CITI and HSBC banks to have sufficient capital to withstand

the shock over and above the prescribed standard of 8% as per Basel III norms.

- In terms of Credit deposit ratio, ICICI and HDFC banks are higher compared to CITI Bank and HSBC, where it is advised to maintain sufficient balance between loans and deposits by having a stock of short-term investments to ensure higher liquidity.
- It might be beneficial for banks to increase their share of non-interest income to become more stable, since this allows them to better diversify their income structure and to become more resilient to overall economic conditions that affect their loan portfolio.
- As there is a huge increase of NPA in CITI bank, measures to be taken to increase the potential high quality advances and by implementing suitable credit assessment methods. Also the Net NPA of ICICI bank to be reduced as there is an increase of 20% which is the highest among the new private sector banks in India. It is better to avoid NPAs at the nascent stage of credit consideration by putting in place of rigorous and appropriate credit appraisal mechanisms.

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