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Address:-Ashok Yakkaldevi 258/34, Raviwar Peth, Solapur - 413 005 Maharashtra, India
Cell : 9595 359 435, Ph No: 02172372010 Email: ayisrj@yahoo.in Website: www.ror.isrj.net

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ORIGINAL ARTICLE

A STUDY OF BANKING SECTOR IN INDIA AND OVERVIEW OF PERFORMANCE OF INDIAN BANKS WITH REFERENCE TO NET INTEREST MARGIN AND MARKET CAPITALIZATION OF BANKS

Limbore Nilesh . V and Mane Baban . S

Abstract:

Finance and banking is the life blood of trade, commerce and industry. Now-a-days, banking sector acts as the backbone of modern business. Development of any country mainly depends upon the banking system. A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it. The banking is one of the most essential and important parts of the human life. In current faster lifestyle peoples may not do proper transitions without developing the proper bank network. The banking System in India is dominated by nationalized banks. The performance of the banking sector is more closely linked to the economy than perhaps that of any other sector. The growth of the Indian economy is estimated to have slowed down significantly. The economic slowdown and global developments have affected the banking sectors' performance in India in FY12 resulting in moderate business growth. It has forced banks to consolidate their operations, re-adjust their focus and strive to strengthen their balance sheets. Here researcher's objective is to study the Indian banking sector and performance of Indian banks.

KEY WORDS:

Banking System, Banking, Indian Economy, Economic Slowdown.

1.1 INTRODUCTION TO MEANING OF BANK

Banks receive deposits from public and also borrow money from other sources for raising Working Capital Funds. They have to pay cost by way of interest on the funds raised. To recover this cost and to meet the administrative and other expenses as also to earn profit, banks have to utilize the working capital funds by either granting advances or making investments. Thus working capital funds, which are banks liabilities, get converted into assets. As we have already seen although a bank's earnings accrue only from advances and investments it has to hold " Cash in Hand" or "Balances with other banks in Current Accounts" and also invest some amounts in premises, furniture, fixtures and other assets which are essential tools for its trade. These assets do not generate any income for the bank on the other hand depreciation has to be provided taking into account their 'ware and tare'.

Banks are obliged by law, to repay the deposits and borrowings as and when they fall due for repayment. As these amounts have already been converted into assets, banks have to ensure all the time that all the assets are releasable, i.e. are liquid and can be fully recovered to meet the liabilities when need arises.

The main object of granting loans or making investments is to earn profit. If any income is not earned on any advances it is treated as a Non- Performing Assets where the accrual or expected income from an asset stops, the possibility of not recovering even the principal amount invested in the asset also arises.

1.2 OBJECTIVE OF THE STUDY

1.To study the Indian banking sector and performance of Indian banks.

1.3 IMPORTANCE OR NEED OF THE STUDY

Before the establishment of banks, the financial activities were handled by money lenders and individuals. At that time the interest rates were very high. Again there were no security of public savings and no uniformity regarding loans. So as to overcome such problems the organized banking sector was established, which was fully regulated by the government. The organized banking sector works within the financial system to provide loans, accept deposits and provide other services to their customers. The following functions of the bank explain the need of the bank and its importance:

To provide the security to the savings of customers.
To control the supply of money and credit
To encourage public confidence in the working of the financial system, increase savings speedily and efficiently.
To avoid focus of financial powers in the hands of a few individuals and Institutions.
To set equal norms and conditions (i.e. rate of interest, period of lending etc) to all types of customers

2.RESEARCH METHODOLOGY

The procedure adopted for conducting the research requires a lot of attention as it has direct bearing on accuracy, reliability and adequacy of result obtained. It is due to reason that research methodology, which researcher used at the time of conducting the research, needs to be elaborate upon. It may be understood as a science of studying how research is done scientifically. So, the research methodology not only talks about the research methods but also consider the logic behind the method used in the context of the research study. Research methodology is a way to systematically study and solve the research problems. If a researcher wants to claim his study as a good study, he must clearly state the methodology adapted in conducting the research the research so that it may be judged by the reader whether the methodology of work done is sound or not.

2.1 RESEARCH DESIGN USED IN THE STUDY:

Descriptive research design is used in this study because it will ensure the minimization of bias and maximization of reliability of data collected. Descriptive study is based on some previous understanding of the topic; research has got a very specific objective and clear cut data requirements. The researcher had to use fact and information already available through financial statements of earlier years and analyze these to make critical evaluation of the available material. Hence by making the type of the research conducted to be both descriptive and analytical in nature. From the study, the type of data to be collected and the procedure to be used for this purpose were decided.

2.2 DATA COLLECTION METHOD:

The process of data collection begins after a research problem has been defined and research design has been chalked out. There are two types of data

2.2.1 PRIMARY DATA:

It is first hand data, which is collected by researcher itself. Primary data is collected by various approaches so as to get a precise, accurate, realistic and relevant data. The main tool is gathering primary data was investigation and observation. It was achieved by a direct approach and observation from the officials of the company.

2.2.2 SECONDARY DATA:

It is the data which is already collected by someone else. Researcher has to analyze the data and interprets the results. It has always been important for the completion of any report. It provides reliable, suitable, adequate and specific knowledge. Researcher collected the secondary data by using banks annual reports and authorized websites of banks.

2.3 TYPE OF DATA USED IN THE STUDY

The required data for the study are basically secondary in nature and the data are collected from

The annual report of the Indian banks
INTERNET –In which includes required financial data collected from Indian Bank's official websites i.e. www.axis.com, www.sbi.co.in etc. and some other websites on the internet for the purpose of getting all the required financial data of the banks.
The valuable cooperation extended by staff members and the branch manager of different banks, contributed a lot to fulfill the requirements in the collection of data in order to complete this research.

2.4 METHODS OF DATA ANALYSIS:

For measuring various phenomena and analyzing the collected data effectively and efficiently to draw sound conclusions, certain statistical techniques were used. The data collected were edited, classified and tabulated for analysis. The analytical tool used in this study is graphical method to compare the performance of Indian banks. The MS- EXCEL tool is used to analyze the data.

3.1 REVIEW OF LITERATURE

Banking in India originated in the first decade of 18th century. The first banks were The General Bank of India, which started in 1786, and Bank of Hindustan, both of which are now defunct. The oldest bank in existence in India is the State Bank of India, which originated in the "The Bank of Bengal" in Calcutta in June 1806. This was one of the three presidency banks, the other two being the Bank of Bombay and the Bank of Madras. The presidency banks were established under charters from the British East India Company. They merged in 1925 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India.

For many years the Presidency banks acted as quasi-central banks, as did their successors. The Reserve Bank of India formally took on the responsibility of regulating the Indian banking sector from 1935. After India's independence in1947, the Reserve Bank was nationalized and given broader powers.

3.1.1 EARLY HISTORY OF INDIAN BANKING SECTOR

The first fully Indian owned bank was the Allahabad Bank, established in 1865. However, at the end of late-18th century, there were hardly any banks in India in the modern sense of the term. The American Civil War stopped the supply of cotton to Lancashire from the Confederate States. Promoters opened banks to finance trading in Indian cotton. With large exposure to speculative ventures, most of the banks opened in India during that period failed. The depositors lost money and lost interest in keeping deposits with banks. Subsequently, banking in India remained the exclusive domain of Europeans for next several decades until the beginning of the 20th century.

Foreign banks too started to arrive, particularly in Calcutta, in the 1860s. The Comptoire d'Escompte de Paris opened a branch in Calcutta in 1860, and another in Bombay in 1862; branches in Madras and Pondicherry, then a French colony, followed. Calcutta was the most active trading port in India, mainly due to the trade of the British Empire, and so became a banking center.

4.1 NATIONALIZED BANKS IN INDIA

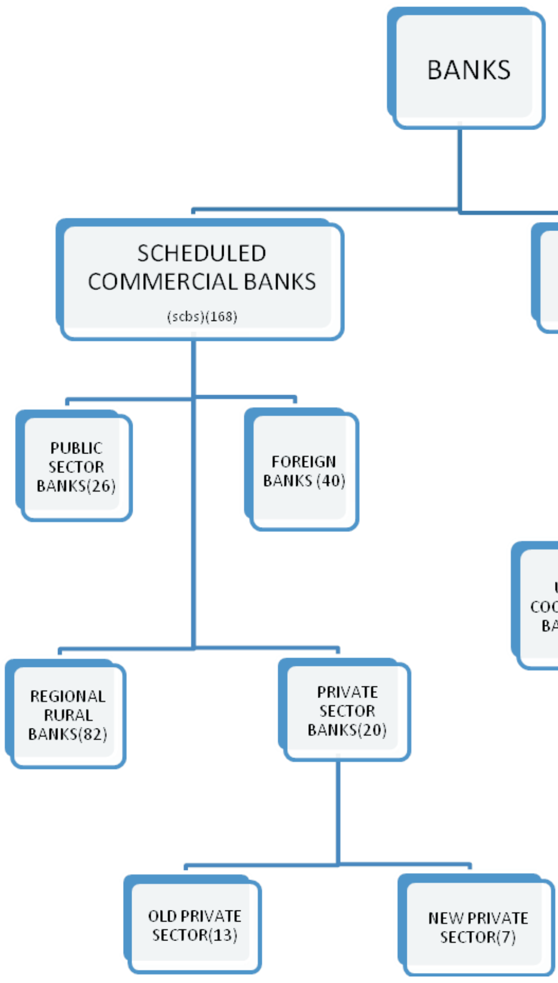
Banking System in India is dominated by nationalized banks. The nationalization of banks in India took place in 1969 by Mrs. Indira Gandhi prime minister of India. The major objective behind nationalization was to spread banking infrastructure in rural areas and make available cheap finance to Indian farmers. Fourteen banks were nationalized in 1969.

Before 1969, State Bank of India (SBI) was the only public sector bank in India. SBI was nationalized in 1955 under the SBI Act of 1955.The second phase of nationalization of Indian banks took place in the year 1980. Seven more banks were nationalized with deposits over 200 crores.

Around the turn of the 20th Century, the Indian economy was passing through a relative period of stability. Indians had established small banks, most of which served particular ethnic and religious communities. The presidency banks dominated banking in India. There were also some exchange banks and a number of Indian joint stock banks. All these banks operated in different segments of the economy. The exchange banks, mostly owned by Europeans, concentrated on financing foreign trade. Indian joint stock banks were generally undercapitalized and lacked the experience and maturity to compete with the presidency and exchange banks. This segmentation let Lord Curzon to observe, "In respect of banking it seems we are behind the times. We are like some old fashioned sailing ship, divided by solid wooden bulkheads into separate and cumbersome compartments." A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India.

4.2 PRIVATE BANKS IN INDIA

Figure no. 1- Structure of Bank



All the banks in India were earlier private banks. They were founded in the pre-independence era to cater to the banking needs of the people. But after nationalization of banks in 1969 public sector banks came to occupy dominant role in the banking structure. Private sector banking in India received a fillip in 1994 when Reserve Bank of India encouraged setting up of private banks as part of its policy of liberalization of the Indian Banking Industry. 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

4.3 STRUCTURE OF BANKS

5.1 PERFORMANCE OF INDIAN BANKING SECTOR

The top 10 banks selected for the analysis, as based on the market capitalization as of 30 March 2012, are: State Bank of India (SBI), Punjab National Bank (PNB), Canara Bank, Bank of India (BoI), Bank of Baroda (BoB), ICICI Bank, HDFC Bank, Axis Bank, Kotak Mahindra Bank (KMB) and IndusInd Bank (IIB).

The performance of the banking sector is more closely linked to the economy than perhaps that of any other sector. The growth of the Indian economy is estimated to have slowed down significantly from 8.39 percent in FY11 to 6.88 percent in FY12. This slowdown could be attributed to a number of factors:

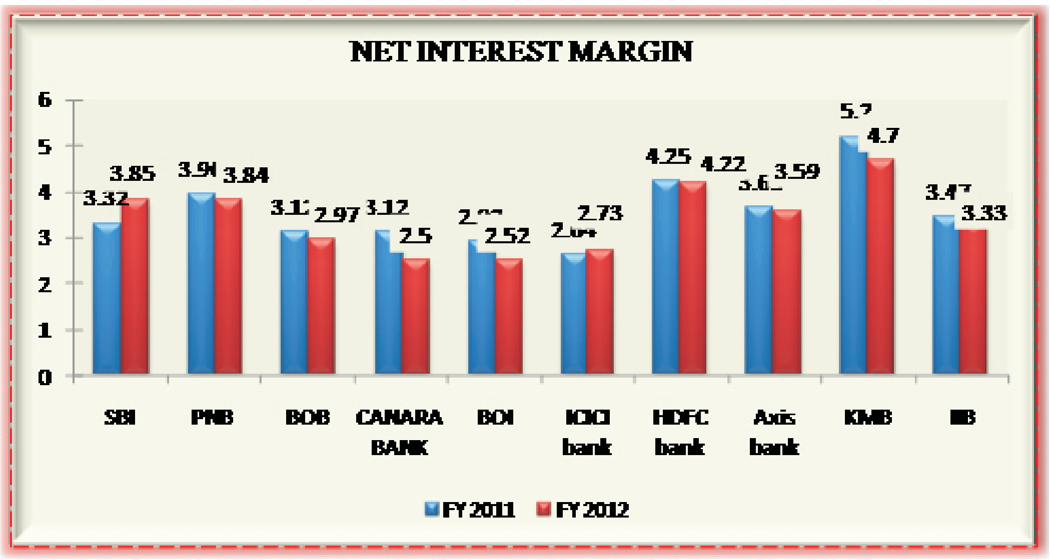
Continuing problems in Europe and economic slowdown in the United States affecting foreign investments coming into India
Policy paralysis in view of the government’s inertia on various policy issues and reforms
Fiscal indiscipline leading to fiscal deficit
High inflation leading to high interest rate
Rupee devaluation which further deteriorates the current account deficit

Besides these factors, rising inflation forced the RBI to tighten the monetary policy during the last two years, increasing the benchmark repo rate 13 times successively. While the high interest rates impacted the economic growth significantly, they had little impact on inflation. Persistent high inflation has led to a slowdown in credit growth and increase in cost of funds, hence adversely affecting the profitability of banks.

A number of changes in the policy and regulatory domain also affected the performance of Indian banks. These included migration to the system tracking of non- performing assets (NPAs) of the entire loan book, increasing the provisioning percentages for NPAs and restructured loans and the mandate to expand in relatively less profitable under-banked and unbanked areas.

5.2 NET INTEREST MARGIN:

Figure no. 2 Net interest margin chart



OBSERVATIONS:

Researcher notice that interest rates had peaked towards the end of FY12 after almost two years of monetary tightening cycle. Consequently, the lag in deposits has come to an end which adversely affected banks' margins. Other factors contributing to contraction in NIMs included moderation in savings deposits growth (due to high interest rate differential), deregulation of savings deposits rate and higher cost of bulk deposits.

NIMs declined in FY12 for eight of the 10 banks under study with SBI and ICICI Bank being the only two exceptions. Here NIM of SBI increased to 3.85 percent in FY12. It was the result of an increase of 30 bps and 54 bps in its NIMs of overseas and domestic operations to 1.67 percent and 4.17 percent, respectively.

Although total operating income ratio for PNB was more or less stable at 76.14 percent, it's NIM declined by 3.96 percent in FY11 to 3.84 percent in FY12. The reduction in the bank's NIM was mainly attributed to the increase in deposits cost from 4.57 percent in FY11 to 5.62 percent in FY12 due to a number of reasons.

The NIM of BoB declined by 2.97 percent, primarily due to a decline of 21 bps in its NIMs of domestic operations to 3.51 percent. The bank's cost of funds primarily increased due to lower CASA deposits and general increase in funding costs.

Canara Bank witnessed a decline in NIM by 2.50 percent in FY12 as increase in yield on advances was lower than the increase in cost of funds.

For ICICI Bank, NIM increased from 2.64 percent in FY11 to 2.73 percent in FY12 on account of shift in deposit mix, shedding of bulk deposits and lower securitization losses. The bank has largely exited unattractive business segments such as small-ticket personal loans in the domestic segment and most non-India related exposures in its international business. The bank's domestic and overseas NIMs increased by 6 bps and 35 bps to 3.04 percent and 1.23 percent, respectively. NIMs of its overseas operations improved primarily due to an increase in yield on overseas advances (due to new disbursements at higher interest rates) and repayment and prepayment of low yielding loans.

HDFC Bank was the collecting banker for some of the tax free bond issuances which resulted in higher current account floats and lower cost of funds, leading to expansion in NIM during the last quarter of FY12. However, the bank witnessed a marginal decline in its NIM from 4.25 percent in FY11 to 4.22 percent in FY12 due to increase in cost of deposits from 4.30 percent in FY11 to 5.72 percent in FY12. The bank's NIM declined from 3.65 percent in FY11 to 3.59 percent in FY12. Similarly, for IIB, the increased cost of funds led to a decline in its NIMs. The dependence of BoI on large corporate and agriculture led to fall in its NIM from 2.92 percent in FY11 to 2.52 percent in Fy12.

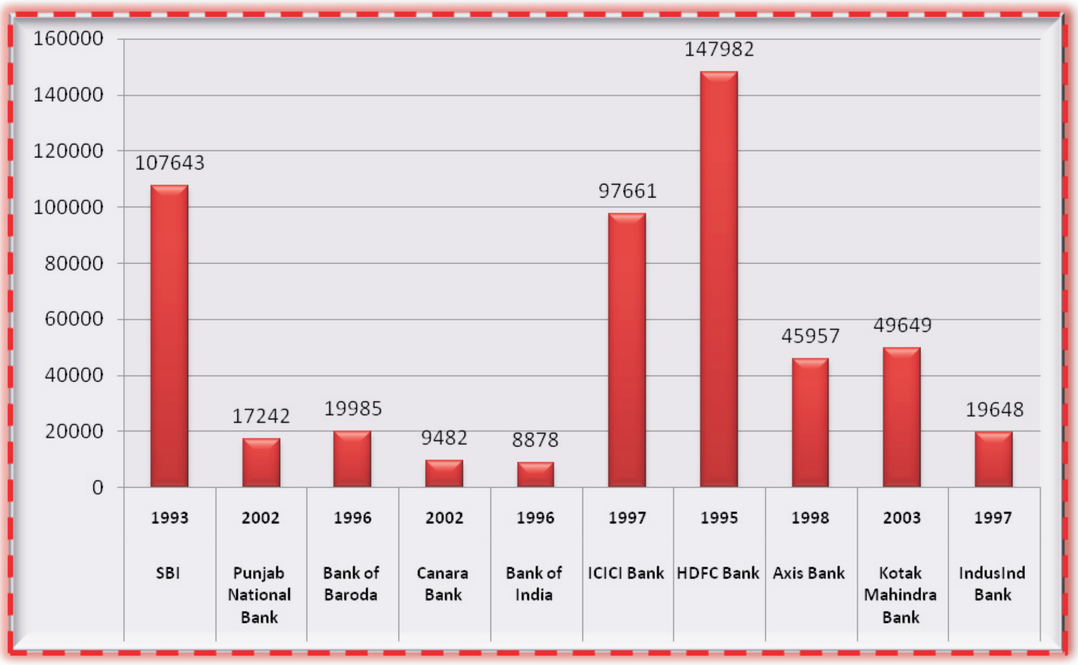
Table no. 1 Market Capitalization of Banks Currently Under Review

Name of Bank	Year of Listing	Market Cap (INR crores)*	Name of Bank	Year of Listing	Market Cap (INR billion)*
SBI	1993	107643	ICICI Bank	1997	97661
Punjab National Bank	2002	17242	HDFC Bank	1995	147982
Bank of Baroda	1996	19985	Axis Bank	1998	45957
Canara Bank	2002	9482	Kotak Mahindra Bank	2003	49649
Bank of India	1996	8878	IndusInd Bank	1997	19648

* As of 08/26/2013 (rounded off)

Source: www.moneycontrol.com
Note: Market cap on a particular day has been used for illustrative purposes.

Figure no.3 Market Capitalization of Banks Currently under Review



Observations:

In the above figure researcher notice that the market capitalizatipon of banks currently under reviev. The SBI is the highest market capitalizatipon with market cap INR 107643 crores.The other nationlized banks are shows the less market capitalizatipon with small market cap value compare to the SBI market cap value. HDFC and ICICI shows highest market capitalizatipon in private banking sector with market cap INR 147982 and INR 97661 billion respectively. Othe private banks are shows variation in market cap value.

6.1 CONCLUSIONS

Today the banking sector in India is fairly mature in terms of supply, product range and reach. As far as private sector and foreign banks are concerned, the reach in rural India still remains a challenge.

A growing economy like India requires a right blend of risk capital and long term resources for corporate to choose an appropriate mix of debt and equity, particularly for infrastructure projects which is the need of the day. A well functioning domestic capital market is also necessary for the banking sector to raise capital and support growth and also have suitable capital adequacy ratio to mitigate risk. Bank investments are also showing an increasing trend. After researching banking sector researcher found that different problems are increasing to banking sector because of the money market has always down.

6.2 LIMITATIONS OF THE STUDY:

Difficulty in data collection.
Generally the organization does not allow outsiders to conduct any study or research work in the organization. Therefore, get the research done in the organization itself was very difficult.
Limited knowledge about the bank in the initial stages.
Branch manager was reluctant for giving financial data of the bank
The analysis and interpretation are based on secondary data contained in the published annual reports of the Indian banks for the study period
Due the limited time available at the disposable, the study has been confined for a period of 5 years (2009-2013).

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