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A comparative study of Operational Effectiveness of Public and Private Sector Banks

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Abstract

Indian banking system was not sound at the time of independence. In 1949, 2 major actions were taken with a view of structural reforms in the banking sector. Banking regulation Act, which provided extensive power to RBI over the commercial banks and another was the nationalization of RBI. Banking regulation act provided excessive power the RBI. In a free enterprise economy, commercial banks operate like any other business entity and gain private profit so at the time of independence it was viewed that the freedom of commercial bank was not in the harmony of the socialistic pattern of society, so they were nationalized in 1969 to establish the control over these banks.

The last decade has seen many positive developments in the Indian banking sector. The policy makers, which comprise the Reserve Bank of India (RBI), Ministry of Finance and related government and financial sector regulatory entities, have made several notable efforts to improve regulation in the sector. The sector now compares favourably with

banking sectors in the region on metrics like growth, profitability and non-performing assets (NPAs).A few banks have established an outstanding track record of innovation, growth and value creation.

This study will attempt to assess the impact of private banks on the traditional public sector banks and a comparative analysis of their working efficiency.

1.1Introduction

We are living in the fast changing world. With new emerging technologies and rapid expansion of internet e-mail etc. excess to global information and knowledge and to commodity markets worldwide is how much easier than before, in a bit to meet commitments to international institutional like world bank, IMF, WTO country after country is pulling down barriers to foreign trade and investment. The government of India has also followed suit with the result that quantitative restrictions on foreign trade are being dismantled speedily. On the domestic front there are clear signals of privatization and liberalization as licensing is being given up, controls are being dismantled, restrictive laws are being removed and the privatization is being used in almost all sectors. India is a developing economy with the low growth of GDP, low per capita income, rapid population growth existence of dualism, technological backwardness etc. At the time of independence it was a close economy with no FDI, no MNC’s, restriction on currency movements, quota raj, permit raj, license raj and socialistic pattern of economy.

Indian banking sector was also working in the close economy scenario. Indian banking system was not sound at the time of independence. In 1949, 2 major actions were taken with a view of structural reforms in the banking sector. Banking regulation Act, which provided extensive power to RBI over the commercial banks and another was the nationalization of RBI. Banking regulation act provided excessive power the RBI. In a free enterprise economy, commercial banks operate like any other business entity and gain private profit so at the time of independence it was viewed that the freedom of commercial bank was not in the harmony of the socialistic pattern of society, so they were nationalized in 1969 to establish the control over these banks.

Private sector banks have introduced various products, mutual funds insurance, share market etc. and they are coming in retail banking with instruments of mobile banking, phone banking, net banking, ATM's, credit card, debit card and bill payments etc. these are called the new age banking companies with advance technology base solutions to multi-location, multi- branch banking based on anywhere, anytime, anyhow solutions. Retail banking in India has assumed great importance recently with a number of retail banking products available to the customer. Off the shelf finance solutions and options too are available today.

The internet has been a successful enabler of retail banking in India. Payments are made through the net, and demand draft prepared and sent to customers online. Phone banking too has become a part of the retail banking scheme. Gone are the days when rule- bound conventional banks used to dictate terms to customers.

1.2Objectives and Research Methodology

Objective of the study are as given below:

i. To find out the scenario of Public and Private Sector Banks in India.

ii. To evaluate the major initiative taken by the private banks for better customer service quality.

iii. To comparative analysis of the working efficiency of Public and Private Sector bank.

Research Methodology

Research methods can be classified in different ways, the most common distinction is between the quantitative and the qualitative approaches (Myers, 2007[1]). Quantitative approaches were originally used while studying natural sciences like: laboratory experiments, survey methods and numerical methods. A qualitative study is used when the researcher wants to get a deeper understanding on a specific topic or situation. Myers (2007)[2] stated that the qualitative approach was developed in social sciences in order to support the researcher in studies including cultural and social phenomena. Sources included in the qualitative approach are interviews, questionnaires, observations, documents and the researcher's impression and reactions. The chosen approach is qualitative.

Qualitative research typically takes the form of in-depth interviews with a small number of respondents. These interviews may be done one individual at a time, or in groups. Individual interviews have the advantages of providing very rich information and avoiding the influence of others on the opinion of any one individual. Individual interviews are very expensive and time consuming, however, and as a result, it is not

[1] Myers, M. D. (2007), "Qualitative Research in Information Systems", MIS Quarterly, vol. 21 No. 2, pp.241-242.

[2] Ibid

likely that any one research program will interview large number of individuals.

1.3 Overview of Public Sector Banks

Kajal Chaudhary and Monika Sharma (2011)[3] defined that Public sector banks are the ones in which the government has a major holding. They are divided into two groups i.e. Nationalized Banks and State Bank of India and its associates. Among them, there are 19 nationalized banks and 8 State Bank of India associates. Public Sector Banks dominate 75% of deposits and 71% of advances in the banking industry.

The Central Government entered the banking business with the nationalization of the Imperial Bank Of India in 1955. A 60% stake was taken by the Reserve Bank of India and the new bank was named as the State Bank of India. The seven other state banks became the subsidiaries of the new bank when nationalised on 19 July 1960.[4] The next major nationalisation of banks took place in 1969 when the government of India, under prime minister Indira Gandhi, nationalised an additional 14 major banks. The total deposits in the banks nationalised in 1969 amounted to 50 crores. This move increased the presence of nationalised banks in India, with 84% of the total branches coming under government control[5].

Public sector banks account for bulk of the branches in India (83.98 percent in 2011) & deposits accounts for 77.86% of the total deposits. Out of the Ten largest banks in India 7 are from Public Sector. Share of debit card is steady increasing for both nationalized banks & SBI group & declining for private & foreign banks

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[3] Kajal Chaudhary and Monika Sharma, "Performance of Indian Public Sector Banks and Private Sector Banks: A Comparative Study", International Journal of Innovation, Management and Technology, Vol.2 No.3, pp.249-256

[4] "Nationalisation of Banks in India". *India Finance and Investment Guide. Indiamart. Archived from* the original *on 3 January 2014*. Retrieved 29 March 2016.

[5] Banerjee, Abhijit V.*; Cole, Shawn; Duflo, Esther (2004).* "Banking Reform in India". *India Policy Forum (1)*.

The next round of nationalisation took place in April 1980. The government nationalised six banks. The total deposits of these banks amounted to around 200 crores. This move led to a further increase in the number of branches in the market, increasing to 91% of the total branch network of the country.

1.4 Private Sector Banks

The post 1990 era witnessed total investment in favour of Indian private sector. The investment quantum grew from 56% in the first half of 1990 to 71 % in the second half of 1990. This trend of investment continued for over a considerable period of time. These investments were especially made in sector like financial services, transport and social services.

Previously, the Indian market were ruled by the government enterprises but the scene in Indian market changed as soon as the markets were opened for investments. This saw the rise of the Indian private sector companies, which prioritized customer's need and speedy service. This further fuelled competition amongst same industry players and even in government organizations.

The **private-sector banks in India** represent part of the indian banking sector that is made up of both private and public sector banks. The "private-sector banks" are banks where greater parts of state or equity are held by the private shareholders and not by government.

Banking in India has been dominated by public sector banks since the 1969 when all major banks were nationalised by the Indian government. However, since liberalization in government banking policy in the 1990s, old and new private sector banks have re-emerged. They have grown faster & bigger over the two decades since liberalization using the latest technology, providing contemporary innovations and monetary tools and techniques[6].

The private sector banks are split into two groups by financial regulators in India, old and new. The old private sector banks existed prior to the nationalisation in 1969 and kept their independence because they were either too small or specialist to be included in nationalisation. The new private sector banks are those that have gained their banking license since the liberalization in the 1990s.

The importance of private sector in Indian economy has been very commendable in generating employment and thus eliminating poverty.

1.5 Results and Discussions

The major effects that have come due to the private banks may be given below:

i. Increased quality of life
ii. Increased access to essential items
iii. Increased production opportunities
iv. Lowered prices of essential items
v. Increased value of human capital
vi. Improved social life of the middle class Indian
vii. Decreased the percentage of people living below the poverty line in India

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[6] *I*ntroduction to private sector banks, http://www.info2india.com/finance/banks/private-banks, accessed in June 2015.

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viii. Changed the age old perception of poor agriculture based country to a rising manufacturing based country

ix. Effected increased research and development activity and spending

x. Effected better higher education facilities especially in technical fields

xi. Ensured fair competition amongst market players

xii. Dissolved the concept of monopoly and thus neutralized market manipulation practices

Comparative Analyses of Public and Private Sectors Banks

Operating Profit Margins of select Banks

The operating profit margin is a type of profitability ratio known as a margin ratio. The information with which to calculate the operating profit margin comes from a company's income.

Operating Profit Margin = Operating Income / Sales Revenue.

Figure 1: Operating Profit Margins of select Banks

	SBI	BOB	PNB	HDFC	ICICI
2014-15	11.45	13.62	13.89	18.7	16.7
2013-14	10.92	13.28	16.56	17.28	15.26
2012-13	13.52	16.1	16.73	14.9	13.33
2011-12	17.11	18.31	18.4	15.57	10.16
2010-11	12.9	20.17	21.11	19.5	11.4
Average	13.18	16.296	17.338	17.19	13.37
S.D.	2.178	2.65931	2.37569	1.76027	2.40198

Source: Fundamental Analysis of Selected Public and Private Sector Banks in India[7]

Net Profit Margin (NPM)[8]

The net profit margin, also known as net margin, indicates how much net income a company makes with total sales achieved. A higher net profit margin means that a company is more efficient at converting sales into actual profit. The net sales part of the equation is gross sales minus all sales deductions, such as sales allowances. The formula is:

Net Profit Margin = (Net profits / Net sales) x 100

Figure 2: Net Profit Margins

	SBI	BOB	PNB	HDFC	ICICI
2014-15	8.59	7.17	5.88	21.07	18.24
2013-14	7.03	10.46	6.99	17.28	17.96
2012-13	10.39	11.54	10.29	16.04	17.19
2011-12	9.68	16.87	13.4	15.88	15.75
2010-11	7.58	19.38	16.42	16.18	15.79
Average	8.654	13.084	10.596	17.29	16.986
S.D.	1.2539	4.43211	3.92731	1.95301	1.0508

Source: Fundamental Analysis of Selected Public and Private Sector Banks in India[9]

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[7] Amarjot Kaur Sodhi, Simran Waraich, "Fundamental Analysis of Selected Public and Private Sector Banks in India", NMIMS Management Review, Vol.43, pp. 32-48.
[8] Ibid
[9] Ibid

Return on Equity (ROE)

Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested. ROE is expressed as a percentage.

Return on Equity = Net Income / Shareholder's Equity

Figure 3: Return on Equity

	SBI	BOB	PNB	HDFC	ICICI
2014-15	10.62	9.21	8.48	19.37	14.55
2013-14	10.03	13.8	10.17	21.28	14.02
2012-13	15.43	15.68	16.48	20.34	13.1
2011-12	15.72	21.72	21.05	18.69	11.2
2010-11	12.62	24.3	24.45	16.75	9.66
Average	12.884	16.942	16.126	19.286	12.506
S.D.	2.36075	5.4446	6.12528	1.54146	1.82364

Source: Fundamental Analysis of Selected Public and Private Sector Banks in India[10]

Earnings per share (EPS)

Earnings per share is the portion of a company's profit that is allocated to each outstanding share of common stock, serving as an indicator of the company's profitability. It is often considered to be one of the most important variables in determining a stock's value. Higher the EPS, higher is the profitability of the company. EPS is calculated as:

EPS = net income / average outstanding common shares

[10] Ibid

Figure 4: Earnings per share (EPS)

	SBI	BOB	PNB	HDFC	ICICI
2014-15	17.55	15.37	16.51	40.76	19.28
2013-14	145.88	105.75	92.32	35.34	84.95
2012-13	206.2	106.37	134.31	28.27	72.17
2011-12	174.46	121.79	144	22.02	56.09
2010-11	116.07	108.33	139.94	84.4	44.73
Average	132.032	91.522	105.416	42.158	55.444
S.D.	64.5813	38.5245	48.1483	22.051	22.6866

Source: Fundamental Analysis of Selected Public and Private Sector Banks in India[11]

Compound Annual Growth Rate (CAGR)

The Compound Annual Growth Rate (CAGR) is the mean annual growth rate of an investment over a specified period of time longer than one year. It is a business and investing specific term for the geometric progression ratio that provides a constant rate of return over the time period. It is particularly useful to compare growth rates from different data sets such as revenue growth of companies in the same industry.

$$\text{CAGR} = \left(\frac{\text{Ending Value}}{\text{Beginning Value}}\right)^{\left(\frac{1}{\text{Number of Years}}\right)} - 1$$

[11] Ibid

Figure 5: CAGR

	SBI	BOB	PNB	HDFC	ICICI
OPM	-2.36	-7.55	-8.03	-0.83	7.94
NPM	2.53	-18.03	-18.57	5.42	2.93
ROE	-3.39	-17.64	-19.09	2.95	8.54
EPS	-31.47	-32.33	-34.78	-13.55	-15.49
P/E Ratio	-13.35	2.5	-1.77	-0.51	-6.59
DPS	-34.93	-27.97	-31.57	-13.48	-18.61
D/P Ratio	-5.46	7.06	5.46	0.07	-3.69

Source: Fundamental Analysis of Selected Public and Private Sector Banks in India[12]

Suggestions for improving the customer services by the banks, Malik & Prakash(2008)[13], The researcher also gave some suggestions as given below:

i) The extension of services to rural parts will enhance the customer base and volume of transactions of the bank. It will facilities the bank to reap the benefits of large scale operations.

ii) In order to speed up the banking transactions of the customers, necessary steps have to be initiated by the banks for creating awareness among the customers and to educate them regarding the utilization of various e-banking services and facilities. The first suggestion is to the old private sector banks must possess a professional attitude, which was lacking in these banks.

iii) The bank officials should maintain a good rapport with the customers; this will develop a social banking environment.

[12] Ibid
[13] Ibid

iv) The banks have to focus more on CRM. It will enhance the customer satisfaction and maintain a sustained relationship with the customers in the long run and enhance the customer loyalty.

v) Appropriate promotional strategies have to be initiated by the banks with a view to motivate the customers to make use of the variety of products offered by the banks.

vi) At present the new private sector banks have made impact on the business of the old private banks. Therefore the old private banks must equip itself to face the rising competition from the new private sector banks in India.

1.6 Conclusions

Banks being an important group of financial organizations of our economy, act as the back-bone of economic growth and prosperity. These banks are, therefore, treated as the instruments for conversion of static credit into dynamic credit. In terms of the role of Public and Private Sector Banks in a planned economy, they may be distinguished from other financial institutions in as much as the former assist in the implementation of Government plans by providing the sinews of development. Primarily, the banks perform functions of a technical nature including the fulfilment of credit requirements as per Government’s economic plans and controlling the utilization of these credits according to planned priorities.

The researcher has applied the different ratios and found significant of debt to equity, other assets to total assets, fixed assets to total assets, fixed assets to Networth and other liabilities to total assets. In terms of profitability, Majority of the banks has registered above the benchmark (more than one per cent) on ROA, Equity paid up to Networth, Return on capital employed and deposits to total assets. It has been observed that the banking sector in

India has responded very positively in the field of enhancing the role of market forces regarding measures of prudential regulations of accounting, income recognition, provisioning and exposure and introduction of CRAMELS supervisory rating system. Though the Private banks are doing better, yet all the banks has to take necessary steps to improve the over all performance of the banking sector.

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