Vol.05 Issue-04, (April, 2017) ISSN: 2321-1784
International Journal in Management and Social Science (Impact Factor- 6.178)

PROFITABILITY IN INDIAN PUBLIC SECTOR BANKS: A CASE STUDY OF SBI AND ITS ASSOCIATES

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ABSTRACT

The nationalization of the banks has given rise to variety of new obligations in the area of social banking. The major achievements of the nationalized banks have led to the growth of economy, employment generation and broadening the base of income distribution. After the nationalization of banks, the major concern was the productivity and profitability of public sector banks. The banking system must be on a sound footing to instill public confidence and also to make banks capable of discharging their social responsibility. New economic policy of 1991 announced by Narasimhan Rao Government brought with it challenges and opportunities in all field of economic activities including banking. Indian banks had to face immense competition after the new economic policy of 1991. This paper, thus attempts to show how the profitability SBI & Associates is affected during the last five years. Overall profitability position of the bank is satisfactory during last five years. The study shows all factors taken to analyze profitability are showing increasing trend. But still SBI & Associates needs to gear itself to meet the complex changes and develop such policies & strategies to meet competition effectively and efficiently.

***Key Word**: Spread ratio, Burden ratio, Profitability Ratio*

Introduction

The sustainable growth is the main challenge before any developing country. In order to foster growth of a country its productive capacity has to be extended and strengthened. Financial service plays an important role in the development agenda of any economy, and banking industry is one of the essential part of financial service and thus fundamental instruments for economic growth. It must be on a sound footing as it is an important link between various socio-economic activities. Since, banking is considered as the backbone of economic development, any change in it is deemed to have effect on the country's growth and development. The financial feasibility is the essential part of the banking system not only necessary for its survival and growth but also to discharge various obligations. Earlier, Indian banking sector was operated primarily in the private sector and indigenous banking was organized in the form of individual or family. The inability of the Indian banking sector to develop, help the economy and serve the nation to the desired level, lead to a demand for restructuring the banking system. This restructuring of Indian banking sector got momentum in 1931 when Central Banking Enquiry Committee asked to link prevailing banking system with RBI. Until nationalization, the banking system confined its activities to different class of people and thus only helped big borrowers. In 1955,the nationalization of Imperial Bank of India took place and its working was transferred in hands of State Bank of India (SBI). The basic purpose behind its nationalization was to impose control over Indian banks to ensure that banks would cater the needs of weak and neglected section of the country instead of big business and those connected with them. For enhancing social control in banking sector, on July 19, 1969 14 major banks were nationalized and on April 15, 1980, six more banks were nationalized. The nationalization made banking facilities within the reach of common masses. Therefore, banking industry is one of the fundamental instruments for economic growth. It must be on a sound footing as it is an important link between various socio-economic activities. The nationalization of the banks has given rise to variety of new obligations in the area of social banking. The major achievements of the nationalized banks have led to the growth of economy, employment generation and broadening the base of income distribution. After the nationalization of banks, the major concern was the productivity and profitability of public sector banks. The banking system must be on a sound footing to instill public confidence and also to make banks capable of discharging their social responsibility. For an efficient financial system the up gradation and financial strength of banking sector act as heart line. Thus RBI and Government had initiated the process of banking reforms by setting up Narasimham Committee in 1991. Thus the bank reforms lead to the beginning of implementing prudential norms consisting of capital adequacy ratio, income recognition, asset classification, and provisioning.

The liberalization instilled a higher level of competition for the banks. Each bank was trying its best to perform better in competitive environment, in order to maintain their profitability and growth. In this light the researcher tries to analyses the profitability aspect of SBI & its Associates

Objectives of the Study

1. To examine the profitability aspect of SBI & Associates
2. To suggest suitable measures to improve profitability of the bank where the shortfall is found, if and when necessary.

Research Design

Time Period of Study: The study has been carried out for a period of 5 years (2011-12 to 2015-16).

Collection of Data: In order to fulfill the objectives of the study, the secondary data has been used. The data for this study has been collected primarily from the annual reports and other publications of SBI& Associates, reports published by different government institutions and ministries, newspapers, RBI database, journals, other publication and various websites etc.

Data Analysis tools: For the study use of ratio analysis has been made to evaluate the profitability of the bank' as it is a powerful tool of financial analysis. The ratios that have been used to measure the profitability of two banks under study are as:

1. Interest earned ratio(R) = Interest earned ÷ Volume of business
2. Interest paid ratio (P) = Interest paid ÷ Volume of business
3. Non-interest income(N) = Non-Interest income ÷ Volume of business
4. Other operating expense ratio (O) = Other operating expense÷ Volume of business Where,

a) Non-interest income = Total income – Interest income

b) Other operating expense = Total expense – Interest expense

From the above stated ratios following two equations are derived :

1. Spread ratio (S) = Interest earned ratio – Interest paid ratio (R – P)
2. Burden ratio (B) = Other operating expense ratio – Non-interest income ratio (O – N)

The profitability is derived from above stated two equations as : Profitability ratio (P) = Spread ratio – Burden ratio (S – B)

(A) INTEREST EARNED RATIO (R)

Interest earner ratio shows the proportion of interest earned in the total business of the bank. It is calculated by dividing interest earned by total volume of business of bank. Symbolically,

$$\text{Interest Earned Ratio (R)}=\frac{\text{Interest Earned}}{\text{Volume Business}}\times 100$$

Table 1 shows the interest earned ratio of SBI & its Associates for five years. Table shows that the interest earned ratio has shown decreasing trend and has declined in almost all years except in year 2014-15 where it has increased by .41% during the study period.

Table 1 : Interest Earned Ratio of SBI & Associates

Year	Interest Earned Ratio of SBI & Associates (%)			
	Interest Earned	Volume of Business	Interest Earned	%

	(`crore)	(`crore)	Ratio	Growth
2011-12	147197	2578360	05.70	-
2012-13	167978	3020011	05.56	(-)02.42
2013-14	189062	3417129	05.53	(-)0.48
2014-15	207974	3745172	05.55	00.41
2015-16	221854	4124117	05.38	(-)3.07
Mean	186813	**3376957.8**	04.47	

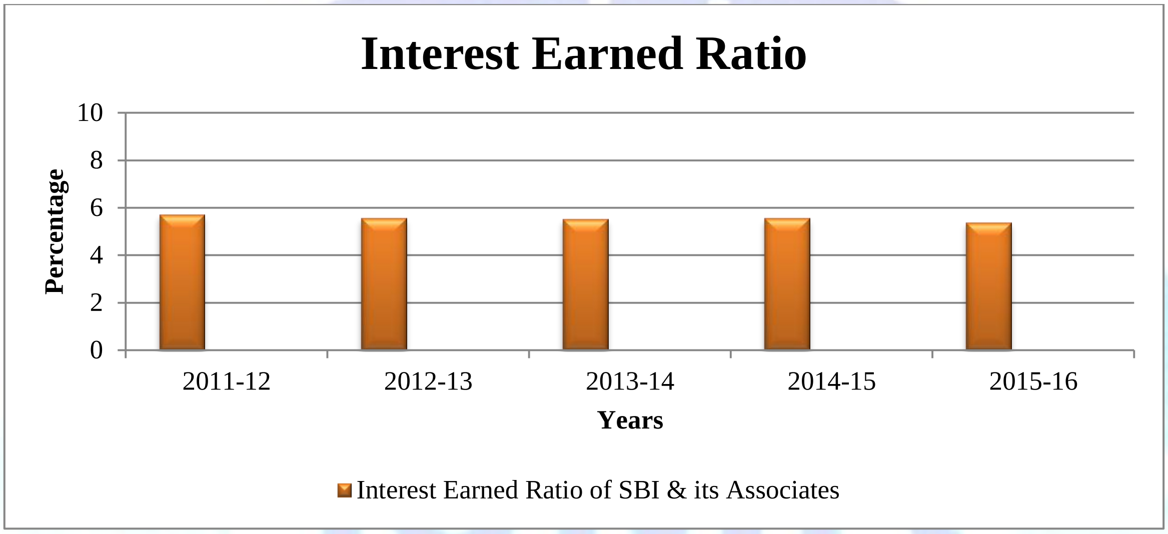

Figure 1: Interest Earned Ratio of SBI & Associates

(B) INTEREST PAID RATIO (P)

Interest paid ratio shows the proportion of interest expenses in total volume of the business of a bank. This ratio is calculated by dividing interest expenses by total volume of business. Symbolically

$$\text{Interest Paid Ratio (P)}=\frac{\text{Interest Expenses}}{\text{Volume of Business}}\times 100$$

Table 2 shows the interest paid ratio (P) of SBI & Its Associates. During the period the Interest paid ratio of SBI & its Associates on average was 3.512 %. Furthermore the IPR of SBI & its Associates showed a mixed trend and decreased during the period from 2014-16.

Table 2 : Interest Paid Ratio of SBI & Associates

Year	Interest Paid Ratio (P) of SBI & Associates (%)			
	Interest Expenses (`crore)	Volume of Business (`crore)	Interest Paid Ratio (%)	% Growth
2011-12	89321	2578360	03.46	-
2012-13	106818	3020011	03.53	02.22
2013-14	121479	3417129	03.56	00.70
2014-15	133179	3745172	03.55	(-).11
2015-16	143047	4124117	03.46	(-)02.29
Mean	118768.8	**3376957.8**	03.512	

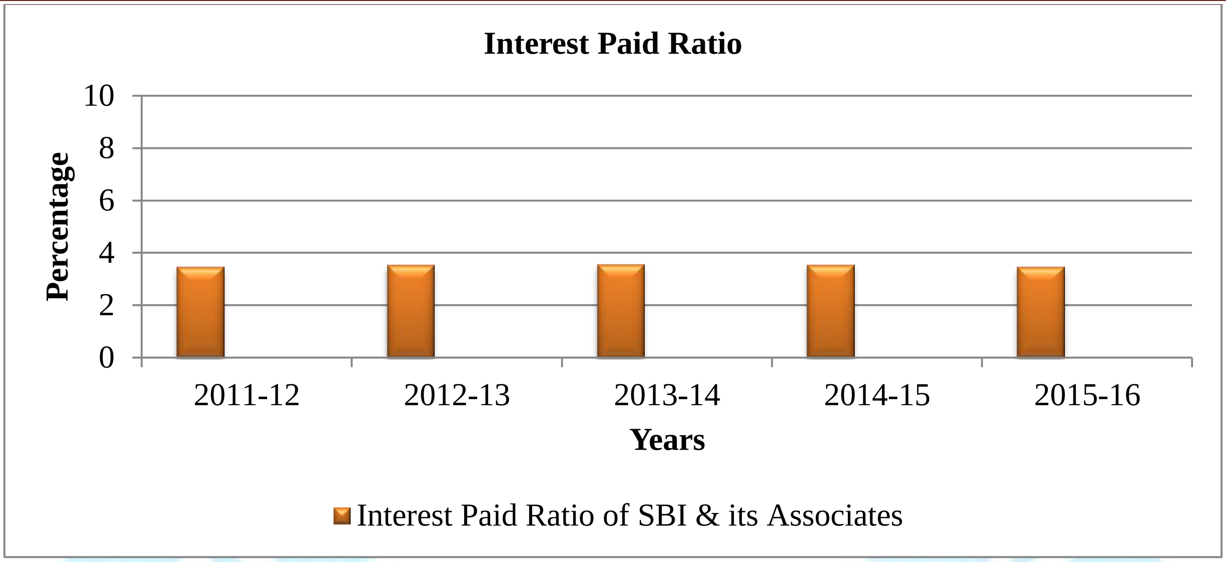

Figure 2 : Interest Paid Ratio of SBI & Associates

(C) NON-INTEREST INCOME RATIO (N)

This ratio shows the proportion of non-interest income to total volume of business. The ratio is calculated by dividing non-interest income by total volume of business. Symbolically,

$$\text{Non-Interest Income Ratio (N)}=\frac{\text{Non-Interest Income}}{\text{Volume of Business}}\times 100$$

Table 3 shows the non-interest income ratio of SBI & its Associates. On an average Non Interest Income ratio remained 1.172. And has shown highest growth in 2014-15 with 19.70% increase.

Table 3 : Non-interest Income Ratio of SBI & Associates

Year	Non-interest Income Ratio of SBI & Associates			
	Non-interest (`crore)	Volume of Business (`crore)	Non-interest ratio (N)	% Growth
2011-12	29691	2578360	01.15	-
2012-13	32581	3020011	01.07	(-)6.18
2013-14	37882	3417129	01.10	03.60
2014-15	49315	3745172	01.31	19.70
2015-16	51016	4124117	01.23	(-)5.57
Mean	40097	**3376957.8**	01.172	

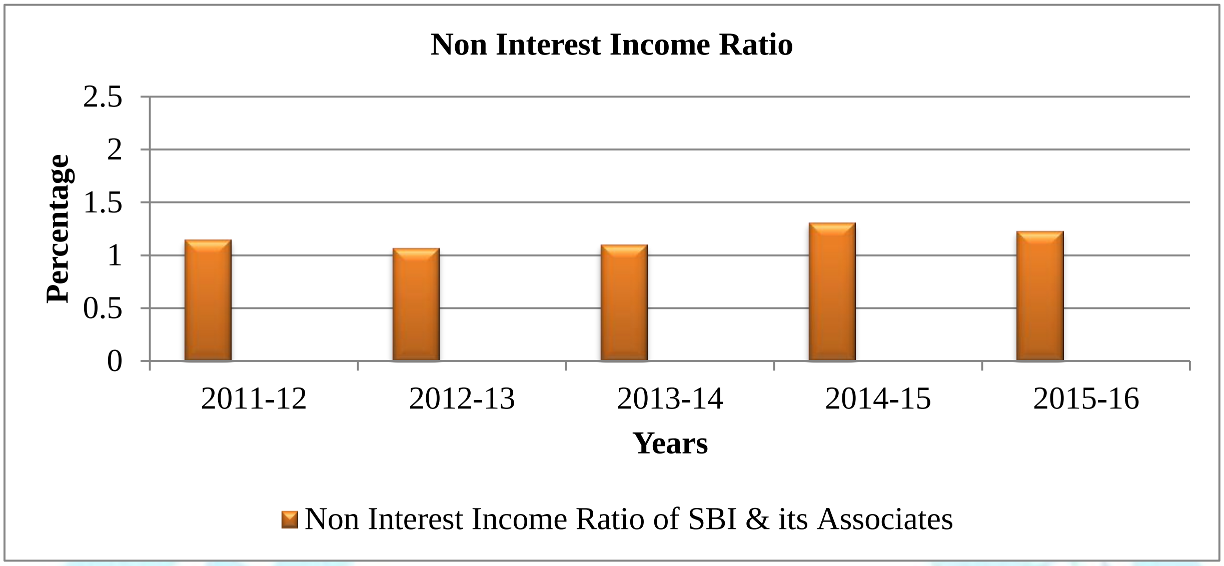

Figure 3: Non-interest Income Ratio of SBI & Associates

(D) OTHER OPERATING EXPENSE RATIO (O)

This ratio shows the proportion of other operating expense (total expense-income expense) to total volume of business. Symbolically

$$\text{Operating Expenses Ratio(O)} = \frac{\text{Other Operating Expenses}}{\text{Volume of Business}} \times 100$$

Table 4 shows the other operating expense ratio of SBI & its Associates for the period from 2011-12 to 2015-16. On an average the other operating expense ratio recorded is 1.832 . and has shown a mixed trend of increase and decrease during the study period.

Table 4 : Operating Expenses of SBI & Associates

Years	Operating Expenses of SBI & Associates (%)			
	Other operating expenses (`crore)	Volume of Business (`crore)	Other operating expense ratio (O)	% Growth
2011-12	46856	2578360	01.81	-
2012-13	52820	3020011	01.75	(-)03.37
2013-14	63369	3417129	01.85	05.97
2014-15	73848	3745172	01.97	06.58
2015-16	73717	4124117	01.78	(-)09.27
Mean	62122	**3376957.8**	01.832	

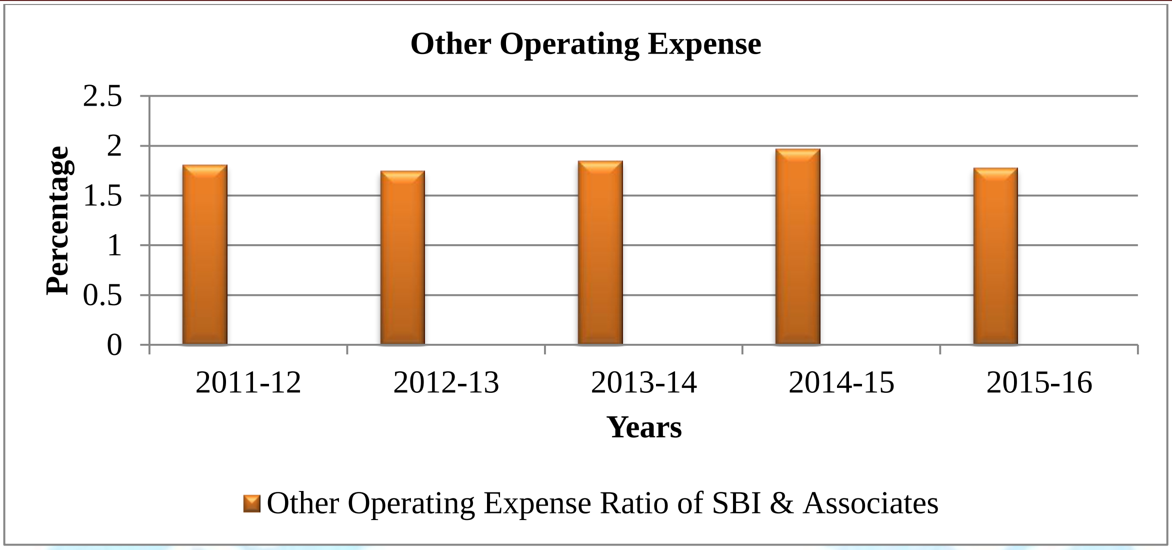

Figure 4 : Operating Expenses of SBI & Associates

(E) SPREAD RATIO (S)

This ratio shows difference between interest earned ratio and interest paid ratio. This ratio helps in determining the actual percentage income from the interest. Symbolically

Spread Ratio = Interest Earned Ratio – Interest Paid Ratio

S = R – P

The table 5 shows the spread ratio of SBI & its Associates of the period2011-12 to 2015-16.The spread ration on an average was recorded as 2.032 and has increased in the year 2014-15 with growth of 1.52%.

Table 5 : Spread Ratio of SBI & Associates

Year	Spread Ratio of SBI & Associates (%)			
	Interest Earned Ratio (R)	Interest Paid Ratio (P)	Spread Ratio (S)	% Growth
2011-12	05.70	03.46	02.24	-
2012-13	05.56	03.53	02.03	(-)09.38
2013-14	05.53	03.56	01.97	(-)02.96
2014-15	05.55	03.55	02.00	01.52
2015-16	05.38	03.46	01.92	(-)04.00
Mean	04.47	03.512	**02.032**	

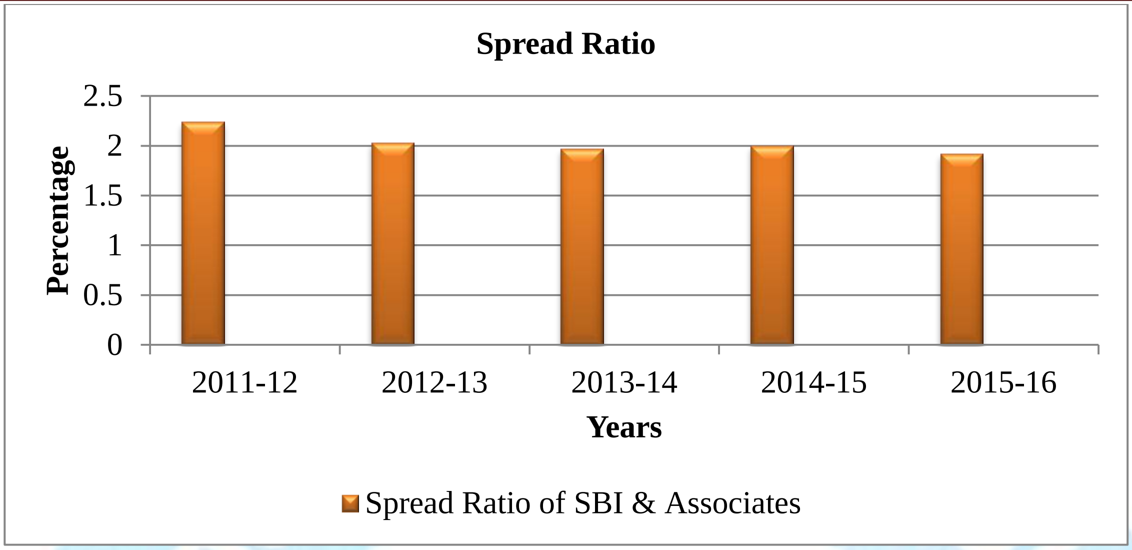

Figure 5 : Spread Ratio of SBI & Associates

(F) BURDEN RATIO (B)

This ratio shows the difference between operating expense and non-interest income of the bank. This ratio helps in determining more the bank is paying towards operating expenses than its non-interest income symbolically.

Burden Ratio

= Other Operating Expense Ratio – Non Interest Income Ratio

B = O – N

Table 6 shows the burden ratio of the SBI & its Associates. During the period from 2011-12 to 2015-16 the average burden ratio was .66 %. In year 2013-14 the growth rate was 10.29 percent. And then the performance was declined and growth rate was negative from 2014-2016.

Table 6 : Burden Ratio of the SBI & Associates

Year	Burden Ratio of the SBI & Associates (%)			
	Other Operating Expense Ratio (O)	Non-interest Income Ratio (N)	Burden Ratio (B)	% Growth
2011-12	01.81	01.15	00.66	-
2012-13	01.75	01.07	00.68	03.03
2013-14	01.85	01.10	00.75	10.29
2014-15	01.97	01.31	00.66	(-)12.00
2015-16	01.78	01.23	00.55	(-)16.67
Mean	01.832	01.172	**0.66**	

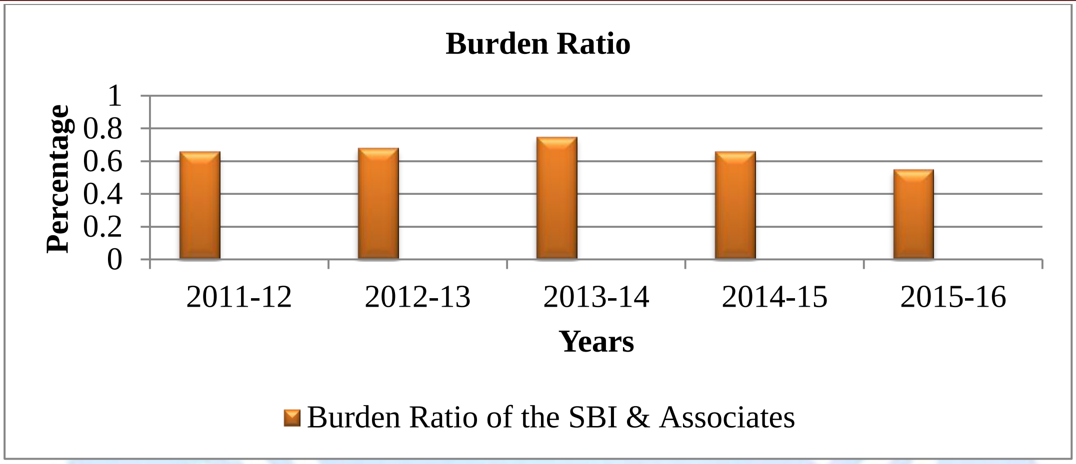

Figure 6 : Burden Ratio of the SBI & Associates

(G) Profitability

The profitability thus is defined as the difference the spread ratio and burden ratio. It shows the proportionate viability of income after repayment of burdens and is calculate as under

Profitability = Spread – Burden

P = S – B

Table 7 shows the profitability of SBI & Associates from the period 2011-12 to 2015-16. The negative growth was registered in the year 2012-13 to 2013-14. The growth rate in the year 2014-15 was 9.84%.

Table 7 : Profitability of SBI & Associates

Year	Profitability of SBI & Associates (%)			
	Spread ratio (S)	Burden ratio (B)	Profitability (P)	% Growth
2011-12	02.24	00.66	01.58	-
2012-13	02.03	00.68	01.35	(-)14.55
2013-14	01.97	00.75	01.22	(-)09.63
2014-15	02.00	00.66	01.34	09.84
2015-16	01.92	00.55	01.37	02.24
Average	**02.032**	**00.66**	**1.372**	

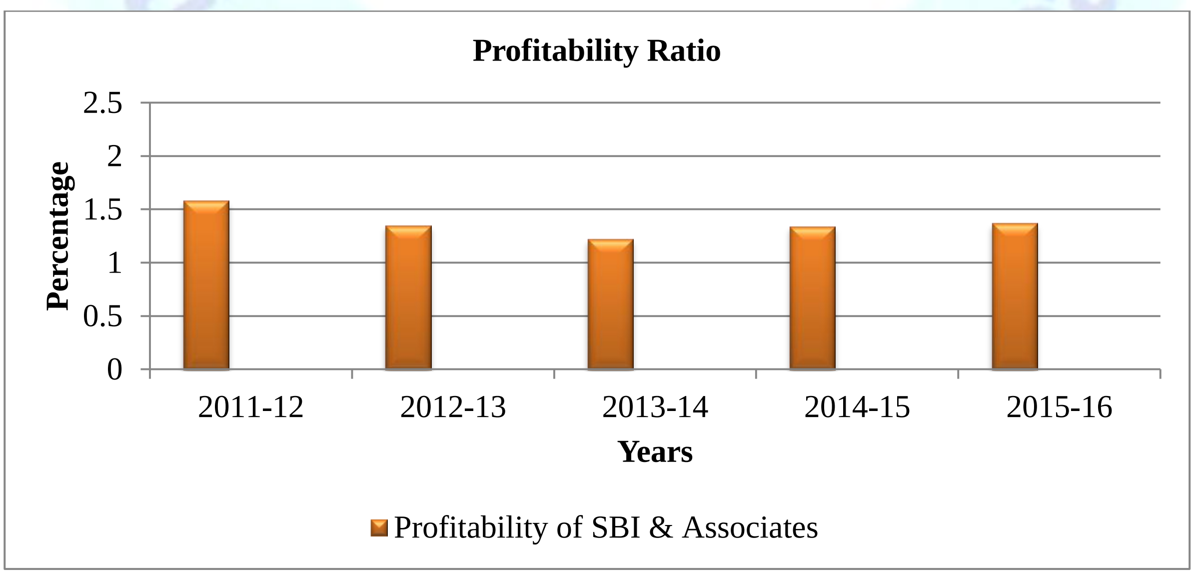

Figure 7 : Profitability of SBI & Associates

Summary and Conclusion

SBI is India's largest commercial bank. It has a vast domestic network of more than 16000 branches (approximately 14 percent of all bank branches) and commands one fifth of deposits and loans of all scheduled commercial banks in India. The implementation of LPG policy by the government has led to economic changes that enhanced competition in the economic environment. The way banks work has shifted from traditional banking to modern banking with the implementation of e-banking. The above results state that bank still has to improve its profitability aspect which is clearly reflected in above results. Overall the profitability situation is satisfactory but still SBI need to gear itself to adopt to complex environment. In order to stay competitive in the complex environment SBI has to follow more customer centric approach and should give much importance. Thus bank today in order to have better profitability has to adopt more dynamic and flexible approach in its policies.

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