

Financial Performance Evaluation of Public Sector Banks - A Conceptual Framework

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Introduction

Banking is the heart and soul of any business. The economy of the country mostly depends on the functioning of banking institutions. In India, the banking system is heavily depended on the public sector banks. Therefore, smooth functioning of public sector banks is important to achieve the economic efficiency. Public sector banks are the banks that are fully owned and operated by the central government of India. These banks are the integral part of the banking system. It accounts for nearly 75 per cent of the total banking business in India. State Bank of India, Punjab National Bank, Canara Bank, Bank of Baroda etc, are the examples of public sector banks.

Thus, public sector banks hold the major performance in the financial operations of our country. As our core research is financial performance evaluation of public sector banks, it is essential to study in brief about the Indian banking system and public sector banks.

Indian Banking System

In our nation, banking system is playing dominant role in building and developing the economy. It is deliberately practicing the methods of promoting the economy of our nation. It is playing an important role in the financing of agriculture, small and medium scale industries and export promotions. It is the facilitator of the growth and expansion of commerce and large scale industries. This system was deliberately designed to serve the citizens of India. It has gone through with many phases to design properly. Initially, the banks in India were established by the British. The first Indian bank was established in Madras¹ in the 1683. After that, the establishment of the Bank of Calcutta in 1806 marked the beginning of the modern banking era in India. Two more Presidential Banks namely Bank of Bombay and Bank of Madras were set up in 1840 and 1843 respectively.

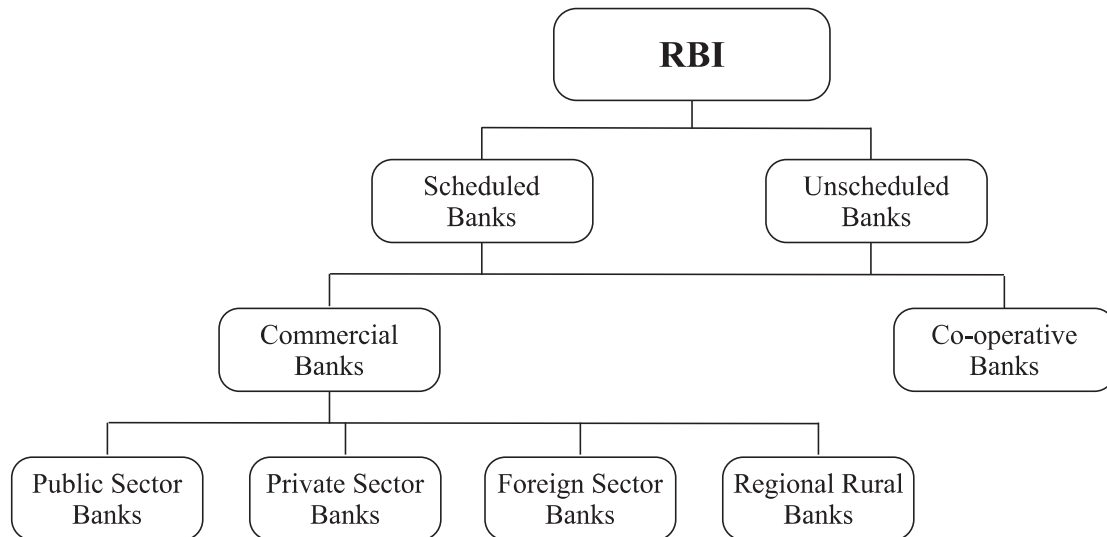
The major growth brought in the banking system by the Reserve Bank of India². It was established and started its operation since 1935. In 1948, it was nationalized, and became the India's central banking authority and an institution owned by the government of India. In 1949, the Banking Regulation Act was enacted to regulate, control, and inspect the banks in India. This act provided the rule that no new bank or branch of an existing bank may be opened without a license from the RBI, and no two banks could have common directors. With enactment of the Banking Regulation Act, the Indian banking system had undergone substantial changes structurally, geographically and functionally. Now, this system is serving in almost all segments of the market. Some of the key features of the Indian banking sector are as follows.

- i. It facilitates proper distribution of funds among various regions in India with the help of network of branches.
- ii. It provides safety and security to the saving of people. It encourages saving among the people for the future use.
- iii. It increases the mobility of capital that helps in increasing the productive capacity of the nation. It means banking system promotes the businesses through which the gross domestic product of our nation increases.
- iv. It plays a leading role in the economic development of the country by the mechanism of credit creation. Expansion of credit results in increase in investment, production and employment.
- v. Indian banking system provide many other services like issue of credit instruments, safe custody of valuables, collection of information regarding customers and transacting in foreign exchange which facilitate smooth trade in the country.

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Structure of Banking System in India

As this study is mainly related to the banking sector, there is a need to study the structure of banking system in India. It is necessary because in recent years the banking sector has grown tremendously. Further, every bank has their separate branches throughout the nation. Therefore, it is important to have depth assessment on the structure of banking system India. The following chart describes the structure of banking system in India.



Source: Indian Financial System, S.B. Deodhar, Aditi A. Abhyankar, H.P. House, 3rd Ed, 2005

Reserve Bank of India: Reserve Bank of India is the Central Bank of our country. It was established on 1st April 1935 accordance with the provisions of the Reserve Bank of India Act, 1934. It holds the apex position in the banking structure. RBI performs various developmental and promotional functions. It has given wide powers to supervise and control the banking structure.

Commercial Banks: Commercial banks are the institutions that accept deposit, makes business loans to general customers and businessman. These institutions run to make profit. They cater to the financial requirements of industries and various sectors like agriculture, rural development, etc. It includes public sector, private sector, foreign banks and regional rural banks.

Co-operative Banks: Co-operative banks were set up by passing a co-operative act in 1904. They are organised and managed on the principal of co-operation and mutual help. The main objective of co-operative bank is to provide rural credit. It plays an important role even today in rural financing. There are 196 cooperative banks in India.

Private Sector Banks: The private sector banks are owned and operated by the private shareholders. These are banks where greater parts of stake or equity shares are held by the private shareholders. In India, there are 21 banks in operation as private sector banks.

Foreign Banks: A foreign bank is the host bank of our country. It runs with the obligation of following the regulations of both its home and its host countries. The head office of these banks stays in abroad. Currently India has 46 foreign banks.

Regional Rural Banks (RRB): The government of India set up Regional Rural Banks (RRBs) on October 2, 1975. These banks provide credit to the weaker sections of the rural areas, particularly the small and marginal farmers, agricultural labourers, and small entrepreneurs. At present, there are 64 Regional Rural Banks in India.

Public Sector Banks: Public sector banks are the banks that are fully owned and operated by the central government of India. These banks are the integral part of the banking system. It accounts for nearly 75 per cent of the total banking business in India. State Bank of India, Punjab National Bank, Canara Bank, Bank of Baroda etc, are the examples of public sector banks.

Thus, public sector banks hold the major performance in the financial operations of our country. As our core research is on financial performance evaluation of public sector banks, it is essential to study in brief about the public sector banks.

Review of Literature:

Earlier many researchers have conducted various studies on financial performance evaluation in public sector banks and other allied aspects. Few important and noteworthy studies are presented and analysed here.

1. **Manish Mittal and Arunna Dhademade (2005)** they found that higher profitability is the only major parameter for evaluating banking sector performance from the shareholders point of view. It is for the banks to strike a balance between commercial and social objectives. They found that public sector banks are less profitable than private sector banks, Foreign banks top the list in terms of net profitability. Private sector banks earn higher non-interest income than public sector banks, because these banks offer more and more fee based services to business houses or corporate sector. Thus there is urgent need for public sector banks to provide such services to stand in competition with private sector banks.
2. **Medhat Tarawneh (2006)** financial performance is a dependent variable and measured by Return on Assets (ROA) and the intent income size. The independent variables are the size of banks as measured by total assets of banks, assets management measured by asset utilization ratio (Operating income divided by total assets) operational efficiency measured by the operating efficiency ratio (total operating expenses divided by net income).
3. **Vasant desai (2007):** The Reserve Bank of India plays a very vital role. It is known as the banker's bank. The Reserve Bank of India is the head of all banks. All the money formulations of commercial banks are done under the Reserve Bank of India. The RBI performs all the typical functions of a good central bank as it is involved in planning the economy of the country. The main function is that the RBI should control their credit. It is mandatory for the Bank to maintain the external value of the rupee. Major function is that it should also control the currency.
4. **Hr. Machirajn international publishers (2009):** Efficiency can be considered from technical, economical or empirical considerations. Technical efficiency implies increase in output. In the case of banks defining inputs and output is difficult and hence certain ratios of costs to assets or operating revenues are used to measure banks efficiency. In the Indian context public sector banks accounts for a major portion of banking assets, it is necessary to evaluate the financial decisions of these banks and compare them with private sector banks to know the quality of financial decisions on its impact or performance of banks in terms of efficiency, profitability, competitiveness and other economic variables.
5. **DR.S. Gurusamy (2009):** One of the key elements of importance for shaping the financial system of a country is the pension fund. The fund contributes to the development of social security systems of a country is the pension fund. The fund contributes to the development of social security system of a country. A fund is established by private employers, governments, or unions for the payment of retirement benefits. Pension funds are designed to provide for poverty relief, consumption smoothing etc. Pension funds not only provide compensation for the loyal service rendered in the past, but in a broader significance. Works as a measure of socio- economic justice. Pension system refers to the framework of arrangement under which individuals gain specified entitlements to a regular income in retirement called pension.
6. **Dangwal and Kapoor (2010)** also undertook the study on financial performance of nationalized banks in India and assessed the growth index value of various parameters through overall profitability indices. They found that out of 19 banks, four banks had excellent performance, five banks had good performance and six banks had poor performance. Thus the performance of nationalized banks differ widely.
7. **Fernando Ferreng (2012)** it is generally agreed that recent economic crisis intensified worldwide competition among financial institution. This competition has direct impact on how bank deal with their customer and achieve its objectives performance evaluation of banks is the key function for improving banks performance. Banks profitability and success to a large extent depends on bank branch financial performance.
8. **Ramchandani Azhagasahi and Sandanvn Gejalakshmi (2012):** In their study found the impact of assets management operational efficiency and bank size on the financial performance of the public sector and private sector bank. The research revealed that bank with higher total capital deposits and total assets do not always mean that they have better financial performance. The overall banking sector is strongly influenced by assets utilization, Operational efficiency and interest income.
9. **Nutan Troke and P K Pachorkar (2012):** The study related that the private sector bank the percentage of other income in the total income is higher than public sector bank. Public sector bank depend on intent income for their efficiency and performance. The operational efficiency of private sector banks is better than public sector banks. Private sector bank use their assets quality better than public sector banks.
10. **Dr.Dhanabhakya & M.kavitha (2012)** in their research used some important ratio to analyses the financial performance of selected public sector banks such as ratio of advances to assets, ratio of capital to deposit, ratio of

capital to working fund, ratio of demand deposit to total deposit, credit deposit ratio, return on average net worth ratio, ratio of liquid assets to working fund etc. The ratio of advances to assets shows an increasing trend for most of the public sector bank. It shows aggressiveness of bank in lending which ultimately result in high profitability. The ratio of capital to deposit also indicates an increasing trend in the capital of banks. This ratio enables the bank to meet the contingencies of repayment of deposit. The ratio of capital to deposit in decline. The ratio capitals to working fund also indicate that the overall efficiency of the selected public sector banks are good. On the other hand the ratios of demand depart to total deposit is declining. This indicates better liquidity position of bank. The credit deposit ratio of most of the bank show an increasing trend. It shows that the profitability of the banks in government. The return on average net worth also shown an increasing trend.

11. **Debashish Sur (2012):** A financial statement is a collection of data organized interims of some laid down accounting procedures. Financial statements are blue print of the working or performance of any organization. The users of financial statements are direct users and indirect users. The direct users are Owners of business, Management, Creditors, Tax authorities, Customers etc. Indirect users are Stock exchanges, Financial analysis, Trade associations, Competitors, Financial press, General public etc.
12. **Ravinder Kaur (May 2012):** A comparative study of SBI and ICICI Bank, the author has written an International Multidisciplinary Research Journal. Due to globalization, banking sector has developed a lot. The banking sector in India has very large network. One of the popular banks is the State Bank of India. The SBI has over 16,000 branches over a wide range of banking. The main objective of study is to examine the financial performance of SBI and ICICI Bank. SBI is a public sector bank and ICICI bank is a private sector bank . Ratio analysis was applied to analyze and to compare the trends in banking business and financial performance.
13. **Dr. Anurag B Singh and Ms.Priyanka Tandon (2012):** The researcher has mentioned the importance of the banking sector in the economic development of the country. In India banking system is featured by large network of Bank branches, serving many kinds of financial services of the people. The research Methodology used by there is a comparative analysis of both the banks based on the mean and compound growth rate (CGR). The study is based on secondary data collected from magazines, journals & other published documents. Which was a limitation since it's difficult to prove the geniuses of the data.
14. **Pawankumar Avdhanam and Srinivas Kolluru, Ramkrishne Fonnd, (2013):** in their study that state bank group other than SBI home finance has performed better throughout the period of study. Though there was a decline in PAT for the year 2000-01 but then there was continuous rise in PAT. Most public sector banks have performed better over year.
15. **Vasant Desai, (2013):** The performance of a bank can be assessed in there broad dimension viz. business development, customer service and housekeeping. The resources that a branch has are manpower, premises, planning, system procedure, organizational structure and general administration. The efficiency of a branch would be measured by the extent which it has balanced between three parameters
16. **William George A J and Dr. Manoj P K (2013):** This research paper is a study of the modern management philosophy of customer relationship management (CRM) which deals with the maintenance of a sound relationship with the customers. The study is carried out in the Kerala based commercial banks. Also this study compares the CRM between the public and private sector banks of the same region. Kerala has been very conducive and of great benefit for the development of banking sector. The Indian banking sector is undergoing many changes and the banks are facing many challenges. Customers switch banks and go to other banks where they find better services and thus the find it difficult to retain their old customers.
17. **MS. Foiza (2013):** The development of electronic commerce is growing at a fast pace because of advancing global infrastructure. To meet these demands businesses need innovative ways to create value such as different IT infrastructure, different enterprise architectures and different ways of thinking about doing business. By adopting technology in banks it has established the use of different technology tools in banking. Which enables bank to reduce transaction cost, saving money and also saving time's E-Banking refers to deploying banking services over electronic and communication networks directly to customers. Internet banking provides benefits such as cost saving reaches new segment of population, efficiency, enhancement of the banks reputation and better customer service.
18. **Cheenu Goel, Chitwan Bhutani Rekhi, (2013)** The commercial banking system provides a large portion of the medium of exchange of a given country and is the primary instruments through which monetary policy is implemented. Commercial banks make the productive utilization of idle finds and thus assist the society to produce wealth. Berry, Kehoe and Lindgreen's study (1980) revealed that the most frustrating aspects of bank marketing were lack of management support, lack of interdepartmental co- operation, crisis management and government intrusion. It shows that during the earlier period there was not much focus on marketing of financial services. There

was hardly any marketing done by banks but after 1991 there are tremendous changes in the banking sector in India competition among banks emerged due to entry of private sector banks and foreign banks.

19. **E. Gordon and K. Natrajan (2014):** The economic development of any country depends on the existence of a well-organized financial system. It includes financial markets and financial institutions which support the system. Financial system provides the intermediation between savings and investment and promotes faster economic development.
20. **Garimachoudhary (2014):** used network of banks, productivity of banks, capital adequacy ratio, growth of banks as an indicator of measuring banks performance. The study related that private sector banks have expanded faster than public sector banks. The capital adequacy of new private sector banks is above RBI minimum requirements. However the assets base of public sector banks raise faster than private sector banks.
21. **Dr. (Mrs.) Anita (2014):** It is very important for the customer to spend some of their time in banks to avail all services. Relationship marketing should be emphasized on the co-operate staff members and special training should be provided also private banks are ahead of public banks in the strategic intent. Also in order to keep the customer satisfied the infrastructure of the banks decor sitting facility are adequate also overall improvement of the banks is necessary by making the customers available with the latest technology and services. Naloni studied the service quality model for customers in PSB's she stated that the entry of new private sector banks has led to improve customer service and products.
22. **Renu Bagoria (2014):** The main objective of this paper is to make a comparative study between private sector banks and public sector banks and the adoption of various services provided by this bank. The different services provided by these banks are M-Banking, Net banking, ATM, etc. One of the services provided by the bank i.e. Mobile banking helps us to conduct numerous financial transactions through mobile phone or personal digital assistant (pda). Data analysis had been made in private sector banks like ICICI Bank, INDUSIND Bank, HDFC Bank, Axis Bank and public sector banks like SBI Bank, SBBJ, IDBI and OBC Bank. These banks also provide Mobile Banking service. The overall study showed that the transaction of Mobile banking through public sector bank is higher than private sector.
23. **Neetu sharma, dr. Richa choudhary, dr.harsh purohit (2014):** Banking institution try to spread Green environment product by way of Finance to those Industries which make "Green Product" Eg : Automobile Industry give more importance to battery bike or solar car etc. Green banking is an umbrella that makes bank sustainable in Economic, environment & Social dimensions. Green banking is making technological improvement in banking sector. It is a smart way of thinking with a vision of future sustainability. Green banking is still a major issue & can take an important for development of our country India. The environmental friendly activities such as using energy efficient alliance, implement green data centers help in improving their operational efficiency as well as cost saving factor for a long run.
24. **AlpeshGajera (2015):** in his research article an financial performance evaluation of private and public sector banks found that there in significance difference in the financial performance of these banks and private sector banks are performed better than public sector banks in respect of capital adequacy ratio and financial performance.

Public Sector Banks

The public sector banks are working under the control of central government. In these banks, the central government holds the majority of shares. It means more than 50 percent shares are held by the government and the rest are held by private parties or individuals. The activities, ownership and operations of these banks remain with the government. At present, there are 12 banks are running as the public sector banks. Among these banks, State Bank of India is the largest bank in India with the huge capital investment and area of expansion. Thus, the performance of the public sector banks is very high. It carries more than 75 per cent of the nation's currency in circulation. It has been playing vital role in the growth and development of our country. However, this sector is suffering with some limitations. These limitations act as the barriers to the performance of this sector.

Public sector in the banking industry emerged with the nationalization of Imperial Bank of India (1921) and creating the State Bank of India (1955) as a part of integrated scheme of rural credit proposed by the All India Rural Credit Survey Committee (1951). The Bank is unique in several respects and it enjoys a position of preeminence as the agent of RBI wherever RBI has no branches. It is the single largest bank in the country with large international presence, with a network of 48 overseas offices spread over 28 countries covering all the time zones. One of the objectives of establishing the SBI was to provide extensive banking facilities in rural areas by opening as a first step 400 branches within a period of 5 years from July 1, 1955. In 1959, eight banking companies functioning in formerly princely states were acquired by the SBI, which later came to be known as Associate Banks. Later, two of the subsidiary banks, viz., the State Bank of Bikaner and

Jaipur were merged to form the State Bank of Bikaner and Jaipur, thus form eight banks in the SBI group then making banks in the state bank group.

The Public sector in the Indian banking got widened with two rounds of nationalization—first in July 1969 of 14 major private sector banks each with deposits of Rs. 50 crore or more, and thereafter in April 1980, 6 more banks with deposits of not less than Rs. 2 Crore each. It resulted in the creation of public sector banking with a market share of 76.87 per cent in deposits and 72.92 per cent of assets in the banking industry at the end of March 2003. With the merger of 'New Bank of India' with 'Punjab National Bank' in 1993, the number of nationalized banks became 19 and the number of public sector banks 27. The number of branches of public sector banks, which was 6,669 in June 1969, increased to 41874 by March 1990 and again to 46,752 by March 30, 2003. The public sector banks thus came to occupy a predominant position in the Indian banking scene. It is however, important to note that there has been a steady decline in the share of PSB's in the total assets of SCB's during the latter - half of 1990s. While their share was 84.5 per cent at the end of March 1996, it declined to 81.7 per cent in 1998 and further to 81 per cent in 1999.

At present, there are 12 banks are running as the public sector banks. Among these banks, State Bank of India is the largest bank in India with the huge capital investment and area of expansion. This sector is experiencing an impressive growth since the 1990. However, to judge the performance of any bank there is a need of evaluation. For the purpose of evaluation there are number of parameters. One important among them is the evaluation of financial performance.

Financial Performance of Public Sector Banks

Over a period of time, the financial health of PSBs is continually to deteriorate resulting in decline in their efficiency. Since so many obligations, economic and social, are imposed on PSBs, it was thought, that their performance should not be judged merely in terms of profits. Since 1969, PSBs began to play a large and dominant supplementary role to the government programmes in alleviating poverty, employment creation and generation of fresh resources for development.

They have been highly successful in achieving their principal objective of deposit and loan expansion. Their participation in priority sector lending is highly commendable: In June 1969, on the eve of nationalization the share of priority sector in total credit of SCBs was mere 14 per cent (Rs. 504 crore). By March 2002, with the massive involvement of PSBs their outstanding lending to priority sector had climbed up to Rs. 1, 71,185.26 crore. As a per cent of net bank credit the same was 43.1 per cent as against the mandated 40 per cent. In terms of profitability, the SBI group has recorded a steady rise in net profits from Rs. 244 crore in 1991-92 to Rs. 2,222 crore in 2000-01 and Rs. 4,512 crore in 2002-03. In the case of 19 nationalized banks, profitability has always been low.

During 1992-93 and 1993-94 these banks actually posted huge losses to the tune of Rs. 3,513 crore and Rs. 4,705 crore respectively. It is possible to defend the low profitability by 'referring to their commitment to social obligations imposed by the Government: as for instance opening rural branches in large numbers, financing poverty alleviation programmes at concessional rates of interest, priority sector lending to the extent of 40 per cent huge NPAs, etc. As a result of their involvement in social~ banking and other factors such as directed investment, the state of health of these banks left much to be desired. The net profit as a per cent of Total assets became 0.99 per cent in 1992-93 and 1.1 per cent in 1993-94. Similarly, the net profit as a per cent of Total assets of 19 nationalized banks was 1.71 per cent in 1992-93 and 9.8 per cent in 1993-94. Prior to reform period, profitability was not considered as the million objectives of PSBs. The return on assets of PSBs does not compare unfavorably with that of banks elsewhere. As per data provided by the Bank for International Settlements (BIS) 1999, return on assets defined as profit before tax moved from 0.08 to 1.07 in Euro area in 1998 with most countries covering around the 0.5 mark even on free tax basis.

The banking system in India is facing the major problem of increasing non-performing assets. As per the latest statistics the total NPAs in India is more than 10 lakh crores. It includes 8.95 lakh crores in public sector banks and 1.26 lakh crores in private sector. In India, there are three main sectors in which the scheduled commercial banks are functioning. They are public sector, private sector and foreign banks. In each sector, the gross non-performing assets are increasing every year during the period of our study i.e., from 2009 to 2018. The increase is reported much higher in public sector banks as compared to private sector and foreign banks. The government, to recover the NPAs from the defaulters, has evolved the recovery mechanism in our country. They are lok adalats, DRT, SARFAESI Act etc. The recovery of the amount of these agencies is not satisfactory. It has shown declining trend. The same trend is found in the context of sector wise net NPAs. In comparison of net NPAs, the public sector banks recorded high growth whereas private sector banks and foreign banks the growth rate is insignificant. The return on assets of three sectors is also showing the decreasing trend. Such decrease is mainly due to the decline in the profitability of the public sector banks. At the end, we can say that the public sector banks have failed to prevent and control NPAs. To this crisis, the government control and interferences, corruption, indifferent attitude of the bank officials can be considered as the key factors. During the same period, private and foreign banks could effectively prevent and control the NPAs. It is because of RBI guidance, effective management and committed employees of the banks.

Conclusion

The public sector banks are the heart and soul of Indian banking system. It operates more than 70 per cent of money circulation in India. However, the public sector banks should focus on improving the liquidity position in order to meet out its current obligations. The failure of having sufficient liquidity will result in the loss of creditor's confidence. The earning quality of the bank can be improved by increasing the net and operating profits through their efficient technology. The credit policy used by the bank can further be improvised so that foreclosures can be reduced. The creditworthiness of the banks can further be improved by having a proper internal audit team.

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