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PROFITABILITY, PROBLEMS AND PROSPECTS OF INDIAN COMMERCIAL BANKS: A COMPARATIVE ASSESSMENT

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ABSTRACT

This piece of study is conducted to assess profitability, efficiency, problems and future prospects of Indian scheduled commercial banks. Nature of this study is descriptive and exploratory, and fully based on secondary data. Concerned data have been collected from data release of Reserve Bank of India (2021), statistical table relating to banks in India. Besides, various ratios have been taken into consideration in order to draw conclusions such as operating expenses, operating profit, Return on Assets and Return of Equity. A significant difference was assessed amongst three groups of banks in terms of profitability and efficiency. The foreign banks emerged as most efficient and profitable banks followed by private sector and public sector banks. Moreover, as far as problems are concerned, raising NPAs, increasing competition, new innovations and high transaction cost were major cause of concern, on the other hand banking deregulation and recent consolidation by government of India, and vibrant Indian economy can turn out to be game changer for public sector banks.

KEYWORDS: *Operating Expenses, Operating Profit, Return On Assets, Return On Equity And Prospects & Problems.*

INTRODUCTION

A bank is a financial institution which provides banking and various other financial services to their customers. Basically, two fundamental services are provided by banking financial institution viz. accepting deposits and sanctioning loans. But considering the present competitive global scenario, these institutions cannot be limited to their core activities. Hence, ATMs, internet and mobile banking have become the driving force in the banking industry. According to industry reports, the face of the Indian banking sector has tremendously changed over the years, now banks have reached to the masses with greater updated technology in order to facilitate multi-channel communication in organizational structure of banks and providing hassle-free services to its customers.

After era of nationalization and consolidation, banking facilities were taken to rural areas in order to extend the agenda of financial inclusion and baking services were largely shifted to agriculture sector. But nationalization led to the other problems such as excessive bureaucratization, red-tapism and disruptive tactics of trade unions. Consequently, major reforms were necessitated for the purpose of efficiency, profitability, growth and fulfilling the agenda of financial inclusion. Therefore, major reforms recommended by Narasimhum Committee had opened the doors for private and foreign banks in India, and this led to the greater competition, and high emphasis on efficiency and profitability amongst various groups of banks. Consequently, nationalized banks, which had dominated the banking sector, started feeling the heat of intense competition from private and foreign banks. Secondly, high transaction cost, poor profitability, alarming NPAs, and nexus amongst bank officials, corporates and politicians became major bottlenecks for this sector. In addition to this, external and internal challenges of global business has brought about new problems for the banking industry viz. new innovations and technology up-gradation has posed major challenges and opportunities also in front of scheduled commercial banks. Hence, to combat the challenges and reaping the benefits of opportunities is a tough task ahead for Indian banking sector. Therefore, this piece of paper is an attempt to examine the relative profitability, challenges and opportunity on the basis selected ratios of efficiency and profitability viz. cost of fund, intermediation cost, interest income, net interest margin, operating profit and return on assets and equity.

Historical Background

The bank of Indian known as first bank was established in 1786. After that East India Company established three presidential banks namely, Bank of Bengal (1809), Bank of Bombay (1840), and Bank of Madras (1843). The next bank was bank of Hindustan which was founded in 1870. Furthermore, Allahabad Bank was established in 1865 and this bank was fully owned by Indians. In 1921, all three presidency bank were merged to form a stronger financial institution which was known as Imperial Bank of India, but this bank remain limited to some functions of central banking prior to establishment of Reserve Bank of India in 1935. Subsequently, RBI was nationalized in 1949 under the banking regulation Act. Similarly, 1955, Imperial Bank of India was renamed as State Bank of India under the State Bank of India Act for the purpose of functioning as a principal agent of RBI to handle banking transaction all over the country. The Government of India had taken the following steps to regulate banking Institution in the country.

1949: Enactment of Banking Regulation Act

1955: Nationalization of State Bank of India

1959: Insurance Cover Extended to Deposits

1961: Nationalization of SBI’s Subsidiaries

1969: Nationalization 14 Major Banks

1971: Creation of Credit Guarantee Corporation

1975: Establishment of Regional Rural Banks

1980: Nationalization of Seven more Banks

Evaluation of Indian Banking Industry

Banking evaluation can be broadly categorized into four phases, which are as follows:

1st Phase: Pre Nationalization Phase (Prior to 1955)

2nd Phase: Era of Nationalization & Consolidation (1955- 1990)

3rd Phase: Indian Financial and Banking sector reforms and partial liberalization (1990 – 2004)

4th Phase: Period of Extensive Liberalizations (2004 onward)

REVIEW OF LITERATURE

Rahul Mathure (2021), this study was mainly concerned with analysis of performance of selected private and public sector banks. Under this study, it was concluded that private sector banks were better than public sector banks in terms of profitability and efficiency. **Dr. U. K. Pandey (2020),** this study was of the view that global competition and technological innovation has forced the Indian banks to review their policies and strategies. Besides, product differentiation by foreign banks was major differentiator between Indian and foreign banks. **Guruprasad, Pallav, Akash**

and Asish (2020), the study revealed that the banks have been progressive, but in case of any crisis in the financial system, it would not be easy for commercial banks to sustain their performance. **Prabhakar, Pooja, Rohit and Sweta (2020),** the study indicated significant difference of performance amongst scheduled commercial banks on the parameters selected under this study, but difference was not significant on return on equity. **Anita, Nidhi & Yadav (2018)**, recognized various challenges and prospects available for banking sector. ATMs, Debit card and net banking were major differentiator, which changed direction of banking sector, but still a lot was required to be done. Besides, policies and strategies required immediate correction. **Faozi, Eissa, Mosab & Najib (2018),** the result reveled that bank size, number of branches, assets management ratio, operating efficiency and leverage ratio were the most important bank specific determinants that affect the profitability of Indian commercial banks as measured by ROI. Besides, it was also revealed that ROE had a significant impact on bank size, assets management ratio, assets quality ratio and liquidity ratio. **Pallauvi and Sluja, R (2017),** assessed the profitability of scheduled commercial banks in India. Some parameters were selected in order examine profitability such as operating profit as percentage of working fund and net profit as percentage of total deposit and total income. **Dr. Javed&Qazi (2017),** this study discussed various challenges and opportunities such as, higher transaction cost, financial inclusion, global banking, intense competition, privacy & safety etc. Besides, product differentiation by foreign bank emerged as a major difference maker. **Malyalan. P. and Sirisha (2015),** examined the trend and progress on the basis of various parameters. This study found strong evidence that the private sector banks surpass the other groups of banks and got the highest position in all the parameters followed by foreign banks and public sector banks. **N.L. Sharma & S. Sharma (2015),** the study concluded that immediate action required on the Indian banking product and marketing strategies to serve the purpose of competitive age over the intense competition from national and global banks. **Dr. K. R. Manikayam (2014)**, this study found that banking companies have shifted their focus from product to customers. Product differentiation, innovation and technology up-gradation were major challenges. Besides, it was also found that level of consumer awareness was significantly higher and Internet banking, mobile banking and ATMs services emerged as larger differentiators. **Naser, A.V. (2014),** revealed that financial performance and employee efficiency of foreign banks is better than other commercial banks. Low profitability was a matter of great concern for public sector banks. **Bapat, D.M. (2013)**, assessed growth, profitability and productivity for Indian public sector banks, and significant difference was observed amongst the performance of three groups of banks. **Dr. K.A. Goyal & Joshi (2012)**, this study discussed many challenges and opportunities such as rural market, management of risk, employees and customer retention, environmental concern, social and ethical issues, global competition and technological innovation. **R.K. Uppal (2011),** found that public sector banks improved their financial performance, but many changes were required. Efficiency of new public sector banks were quite high, but foreign banks had an age. In addition to this, this study directed to public sector banks to focus on vision, value, innovation, leadership and social commitment in order convert challenges into opportunities.

Objectives

To cost of fund, operating expenses, return on assets, return on equity, net interest income and operating profit.

To review the comparative efficiency and profitability of different groups of scheduled commercial banks.

To assess the challenges and future prospects of Indian scheduled commercial banks.

Research Methodology

Research Methodology includes the process of conducting research work. It explains nature and scope of study, methods of data collection and various statistical tools used for analyzing the data. This study is designed to be a descriptive and exploratory research, and thoroughly based on secondary data. All the scheduled commercial banks have been selected and categorized in three groups namely, Public Sector Banks, Private Sector Banks and Foreign Banks.For assessing profitability and efficiency, various ratios has been taken into consideration namely, cost of fund, operating expenses, interest income, net interest income, return of assets and return on equity. Besides, some factors have also been selected for examining challenges and opportunities after review of available studies. To meet the objectives of study, data have been collected for five years from 2016-17 to 2020-21, and this data was taken from data release of Reserve Bank of India (2021), Statistical Table Relating to Bank in India and various issues of RBI bulletins.

RESULT AND DISCUSSION

Various ratios like return on assets, return on equity, cost of fund and operating expenses etc. were calculated to analyze efficiency and profitability of scheduled commercial banks. Mean value and coefficient of variation has been used to make comparison amongst three groups of banks.

Table 1: Cost of Fund (In %)

Years	***Public Banks***	***Private Banks***	***Foreign Banks***
2020-21	4.24	4.48	2.54
2019-20	4.92	5.11	3.73
2018-19	4.99	5.4	3.61
2017-18	5.08	5.16	3.7
2016-17	5.62	5.76	4.24
Mean	*4.97*	*5.182*	*3.564*
S.D	*0.492544*	*0.469063*	*0.623242*
C.O.V	*9.91035*	*9.051773*	*17.48714*

Note: The data for tables 1 to 6 was collected from Reserve Banks of India (2021), statistical tables Relating to Banks in India, www.rbi.org.in/scripts/annulpublication.asp

Table 1 reveals the cost of fund, which refers to the cost of borrowings and cost of deposits. Mean value of this cost in case of public sector and private banks is 4.92 and 5.182 respectively, while mean value of foreign banks is comparatively very less (3.564). Besides, variation in the cost of foreign banks (17.48) is higher because cost of these banks has been reducing in successive years. Hence, foreign banks found most efficient followed by public sector banks and private banks.

Table 2: Operating Expenses (In %)

Years	**Public Banks**	**Private Banks**	**Foreign Banks**
2020-21	1.8	2.13	1.75
2019-20	1.84	2.28	1.86
2018-19	1.77	2.2	1.94
2017-18	1.66	2.19	2.13
1016-17	1.64	2.25	2.06
Mean	*1.742*	*2.21*	*1.948*
S.D	*0.087864*	*0.057879*	*0.152217*
C.O.V	*5.043831*	*2.618968*	*7.814012*

Table 2 shows operating expenses which are also known as intermediation cost, and this cost include rent, printing, lighting, stationary and advertisement etc. Operating cost of public sector banks is 1.74%, while same cost in case of private and foreign banks is comparatively high i.e. 2.21% and 1.94% respectively. Coefficient of variation is also manageable such as, 5.04% in case public sector banks, 2.61% in case of private banks and 7.81% in case of foreign banks. Expending less on operating expenses implied that PSB are less focused on customer services and maintenance of infrastructure etc.

Table 3: Net Interest Income (In %)			
Years	**Public Banks**	**Private Banks**	**Foreign Banks**
2020-21	2.45	3.58	3.3
2019-20	2.37	3.43	3.26
2018-19	2.33	3.26	3.23
2017-18	2.08	3.32	3.43
1016-17	2.12	3.38	3.38
Mean	*2.27*	*3.394*	*3.32*
S.D	*0.16171*	*0.121984*	*0.083367*
C.O.V	*7.123772*	*3.594096*	*2.511044*

Table 3 reveals Net Interest Income and if NII is positive, it means inflow of interest is greater than out of flow interest. Net interest income of private banks is the highest (3.39 %) closely followed by foreign banks (3.32%), but these earnings in case of public banks is comparatively very low (2.27%). Hence, it can be inferred from the above facts that quality of loans provided by PSB is not good, resulting in poor recovery of interest.

Table 4: Operating Profit (In %)			
Years	**Public Banks**	**Private Banks**	**Foreign Banks**
2020-21	1.75	2.99	2.98
2019-20	1.66	2.9	2.83
2018-19	1.51	2.54	2.78
2017-18	1.57	2.82	2.86
1016-17	1.68	3.02	3.25
Mean	*1.634*	*2.854*	*2.94*
S.D	*0.094499*	*0.192302*	*0.188282*
C.O.V	*5.783273*	*6.737976*	*6.40414*

Operating Profit is defined as total earnings less total expenses excluding provisions and contingencies. Foreign banks attained the highest operating profit (2.94 %) followed by private sector banks (2.85%) and public sectors banks (1.63%). Although, variation in the operating profit is the lowest in case of public sector banks (5.78%), but this variation is not substantial because COV in case of foreign banks and private banks is also not very high i.e. 6.40% and 6.73% respectively. Therefore, it is concluded that foreign banks and private banks are better than public sector banks in respect of operating profit.

Table 5: Return on Assets (In %)			
Years	**Public Banks**	**Private Banks**	**Foreign Banks**
2020-21	0.28	1.17	1.56

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2019-20	-0.23	0.51	1.55
2018-19	-0.65	0.63	1.56
2017-18	-0.84	1.14	1.34
1016-17	-0.1	1.3	1.61
Mean	*-0.308*	*0.95*	*1.524*
S.D	*0.445836*	*0.354612*	*0.105499*
C.O.V	*-144.752*	*37.32763*	*6.922494*

Table 5 discloses return on assets. Public sector banks had negative rate of return i.e. -0.308 percent, while foreign banks achieved positive and the highest rate of return (1.524%) followed by private banks (0.95%). Consistency-wise analyzing, foreign banks maintained the highest stability in the profit because variations is minimum i.e. 6.92% and these banks exploited the assets better than any other sector of banks, while private sector banks found comparatively inconsistent, because variations is very high i.e. 37.32%, but better than public sector banks because variations in case of PSBs seems to be uncontrollable i.e. coefficient of variations is - 144.75 percent.

Table 6: Return of Equity (In %)			
Years	**Public Banks**	**Private Banks**	**Foreign Banks**
2020-21	4.67	10.33	9.2
2019-20	-4.16	3.3	8.76
2018-19	-11.44	5.45	8.77
2017-18	-14.62	10.12	7.16
1016-17	-2.05	11.87	9.12
Mean	*-5.52*	*8.214*	*8.602*
S.D	*7.674357*	*3.6491*	*0.830434*
C.O.V	*-139.028*	*44.42537*	*9.65396*

Table 6 shows return on equity, which refers to the net profit divided by capital including reserve and surplus, a profit left for equity share holders. Foreign banks retained the highest return on equity (8.60) followed by private sector banks (8.21) and public sector banks got the negative return on equity i.e. -5.52 percent and this amount to loss for equity share holders. Secondly, private sector banks revealed inconsistency on return for equity share holder, because COV is 44.42 percent, while it is very less in case of foreign banks i.e. 9.65 percent. Hence, foreign banks not only attained consistency, but also the highest return for equity shareholders.

By and large, foreign banks outperformed public sector banks and private sector banks on the parameters of profitability and efficiency. Although private banks had positive return on assets and equity, but not as good as foreign banks, public banks had negative return on assets and equity, which is major cause of concern for the government of the day.

Problems and Prospects

Considering profitability and consistency, public sector banks are very low as compare to foreign banks and private banks. Hence, public banks have been facing many challenges, but at the same time these banks can improve in future with available opportunities.

High Transaction Cost

A major problem for Indian banking industry is high level of transaction cost. As per reports, Indian banks can reduce transaction cost in the coming time by upto 50% per transaction with help of redesigning their process and system for the digital age. Indian banking sector needs to undergo substantial changes by reducing branch size and cost and by adopting new models of digital channels.

Security Breaches for customers and Employees

Security is a one of the major problems for online banking marketers. Since banking industry is highly dependent on online banking viz. mobile and ATMs and Web. Services are not fully immune security system. Hence, cyber security threats has become a major problem, cyber criminals simply needs to have certain personal information to get into the account of customers and employees steal their data money.

Customers & Employees Retention

In this competitive business world, retaining customers and employees, and meeting their expectations is very tough task ahead for public sector banks. Downfall in the morale of employees causes low revenue and due to close ties between staff and customers, loosing loyal employees means detaching valuable customers.

Increasing Competition

First and second generation reforms has triggered intense competition in the banking sector. Now, private and foreign banks have become major players and giving very tough competition to public sector banks, even their efficiency and profitability is better than public sector banks. Therefore, for survival and higher growth in highly competitive business environment, public sector banks need to focus on prompt and efficient customer services and designing customer friendly policies and procedure.

High level of NPAs

Non-performing assets has been great cause of concern for banking sector. A level of NPAs means high probability of credit default, resulting in poor quality assets and stress on profitability. Although, as on march 2020, gross non-performing and net non-performing assets reduced to 8.2 and 2.8 percent respectively from 9.1 and 3.7,percent in 2019. Recent financial stability reports released by RBI indicated that GNPA ratio likely to go up from 7.5% in Sep. 2020 to 14.8% by Sep. 2021. In nutshell, poor assets quality is major threat for the survival of banks.

Untouched Rural Market

Banking in India is supposed to be good in terms of product range; supply and it reach to remote areas of this country. But rural India still remains a big challenge especially for private and foreign banks. Although, advent of internet and mobile banking has resolved this problem to a greater extent, especially during COVID-2019, but still a lot remain to be done.

Innovation and Technological Advancement

Information and communication technology has become central point in the development of banking and financial services. Most of banking analyst considers adoption of technological changes is very important factor for public sector banks and with help of updated and innovative technology, this sector of banks can compete with foreign and private sector banks. Delivery of performance, and offering convenience to the retail customer and operating efficiency will improve to greater extent.

Prospects for Public Sector Banks

As Indian banking sector has gone through many problems and challenges as discussed above, but on the other hand, many opportunities are also there to be exploited in order to have a sustainable rate of growth, efficiency and profitability. The biggest opportunity for public sector banks is the Indian consumer. Demographic change in terms of income level and cultural change such as lifestyle aspirations has changed the profile of Indian consumers; it will turn out to be a game changer for this sector. The Indian consumers are full of expectations to achieve new heights at younger age of their life and it will lead to growing demand for competitive and sophisticated retain banking services. The demand for wide range of product and services has been raising viz. the consumer need loan to finance their house, car and property. Besides, many consumers are also looking for an exclusive retirement plan, long terms investment plan to finance their child's higher education and a life insurance policy etc. This kind of consumer exists not only in metro cities of this country, but across all the cities, towns and villages. In addition to this, Indian market has many more opportunities for this sector such as:

Offering innovative product

Door to door service approach

Managerial excellence

Merger & acquisition

A growing economy

Banking deregulation

Increases client borrowing

An increase in number of borrowing

An increase in money supply

After going through many problems and prospects, it can be suggested that the public sector banks need to set aggressive target, recognize and reward progress made by employees in order to motivate them for further progress. Besides, these banks should energize and invigorate others, adopt and welcome new changes instead of getting frightened or paralyzed and see the changes as an opportunity not a threat. Secondly, these banks should have a mindset that drive quality, cost and speed for a competitive advantage and this can be achieved by assimilating new technological changes and exploiting available opportunities mentioned above.

CONCLUSION

After detailed and inclusive analysis, the following inferences have been drawn by the researcher.

- After three categories of banks, foreign banks stood out to be the most efficient banking institutions because they outperformed public and private sector banks on the parameter of cost namely, cost of fund which includes cost of deposit and cost of borrowings. Secondly, public sector banks performed better than private sector banks since cost of deposit in case public sector banks were comparatively lower. Thus, private sector banks found least efficient in terms of cost of fund.
- Although the cost wise, private sector banks were not good enough, but the Net interest Income was highest, which amounts to very efficient management of loan and investment portfolios. Besides, public sector banks were lagging behind private and foreign banks in the management of loan and investment portfolios.
- The operating profit which is better parameter to judge the profitability was the highest in case of foreign banks followed by private sector banks public sector banks, because operating profit deduct all the expenditures from the total earnings of a bank.
- Return on assets was also the highest in case of foreign banks followed by private sector banks and it turned out be negative in case of public sector banks and negative return amounts

inefficient utilizations of resources. Hence, public sector banks need to focus on how to exploit the available resources in order to get positive return on assets.

- Return for the equity share holders was also negative in case of public sector banks and the highest for the shareholders of foreign banks followed by private sector banks.
- By and large, poor profitability was a major cause of concern for the public sector banks and their survival will be challenged in the coming days if they do not improve their loan and investment portfolios.
- Indian public sector banks have been undergoing through many problems namely, increasing NPAs, regulatory problems, global competition, technological advancement and sinking market share and high transaction cost etc. On the other hand, this sector of banks can reap the benefits of innovative products, banking deregulation, merger and consolidation, managerial excellence and vibrant economy etc.

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