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www.skirec.org Email Id: skirec.org@gmail.com

Profitability among Public & Private Sectors Bank an Analysis

Dr Manohar Goel, Associate Professor,
Mukand Lal National College Yamuna Nagar (Haryana)

Abstract

Banking sector had played a revolutionary change towards the growth of our economy and henceforth it is the key indicator to analyze the level of development of any country. If the banking sector does not perform well agriculture, industry, trade activities all will be affected. Efficient banking system reflects a sound intermediation process and banks contribution towards economic growth. Profitability analysis of banks is essential for evaluating banks business life. Profitability is the capacity of an organization or firm to have benefits from their business activities. Profit is usually the reward of the entrepreneur. It acts as the performance measure of a business. Increasing profits attracts investors, expands the market and also enable a business to survive for a long period of time. Profit maximization is the main goal for business ventures and they spend countless hours and efforts to find out ways of reducing cost and increasing sales (Schreibfedar, 2006). Like all business banks receives profits by earning more than their expenses. Banks profits comes mainly from the interest charged on loans and the fees charged for the services it renders

Profitability of a bank is affected by both internal and external influences. This paper aims to examine the factors impacting profitability of banks particularly Indian banks. Information is collected using literature review from various sources like journals articles. Results shows that profitability of a bank is governed by internal factors such as its size, risk management methods, and costs. Inflation, interest rates, the money supply, and the gross domestic product are external factors that influence bank profitability. Numerous variables impact the profitability of banks. Internal determinants originate within the company, while external determinants originate outside the firm (market concentration, industry size and ownership, inflation, interest rates, money supply, and gross domestic product.

Keywords: *Profitability; Public Banks; Private sector Banks; India*

Introduction

Indian banking has changed due to reforms. The Reserve Bank of India has tightened margin limits to comply with Basel 3 criteria. Recent monetary policy moves have brought the Indian banking industry under investigation. The RBI raised interest rates to preserve the currency, raising bank funding costs. This might increase NPAs and reduce profits. Most public sector banks recently reported deteriorating asset quality. Internal and external influences affect a bank's profitability. Size, risk management, and costs impact a bank's profitability (Bodla&Verma 2006). External factors affect bank profitability: inflation, interest rates, money supply, and GDP (Athanasoglou et al., 2008). Economic growth depends on the banking industry. Banking helps the

economy by transferring public deposits into advances. A healthy banking system is essential for a nation's financial health and success. Understanding the factors that affect bank profitability helps identify successful initiatives and operational inefficiencies. Bank profitability depends on several things (Wanzenried, 2011). These factors can be categorised as internal determinants that originate within the company or external determinants that originate outside the firm (market concentration, industry size and ownership, inflation, interest rates, money supply, and GDP) (Athanasoglou et al., 2008). In light of the aforementioned, it's important to study internal and external factors that affect public and private bank profitability.The paper aims to study the factors affecting profitability of Indian banks.

Literature Review

Sahoo, & Majhi. (2014); in their study analyzes previous research on Indian commercial banks' non-performing assets (NPA). NPA is a global issue, not only in India. NPA is a red balloon for India's banking system. The inquiry aims to summarize the available literature on NPAs. The paper organizes available research into parts to analyze identification, growth and composition, drivers, financial ratios, recovery channels, financial sustainability, and other elements of NPA management of commercial banks. The literature reviews are based on a systematic review. The research papers and articles were chosen by searching keywords in the database's abstracts and conclusions. The systematic review procedure helps choose study articles. This research will help lenders analyze NPAs in new ways and academics and scholars perform exploratory research. The report explains research gaps in NPA management to add to the literature. A comprehensive NPA assessment can assist uncover issues and develop effective management.

Several epidemiological studies analyzed the relative performance determinants in various countries. (Almaqtari et al., 2018) reported that bank size, branch number, wealth management ratio, operational quality, and "leverage ratio are the most significant bank-specific factors that affect Indian commercial banks' profitability as measured by Return on assets". Among bank-specific characteristics, bank size, asset management ratio, asset quality ratio, and liquidity ratio were shown to positively affect ROE. Inflation, currency rate, interest rate, and demonization affected ROA for big banks. Saona (2016) found a link between multiple packets (e.g., "security trading, hedge funds, foreign exchange, insurance, etc.") and productivity, a negative correlation between revenue diversification (e.g., interests, taxes, fees, etc.) and competitiveness, and a link between capital structure and profit margins. Al-Homaidi, Tabash, and Ahmad (2019) discovered that the banking sector's history, CG details, corporate social transparency, business size, and age affect asset return. The banking sector's history, profitability statements, CEO remuneration data, corporate social reporting, zakat statistics, and bank size negatively affect ROE. Appropriate capital determines the equity-to-total-assets ratio. It determines capital power (Abel & Roux,2016). Al-Homaidi et al. (2017) observed that all bank-specific factors, barring branch count, affected competitiveness. All the primary banks considered in the study were revealed to have negative effects on Indian commercial bank profitability. Acaravci&Calim (2013) utilized total deposits to total assets as a deposit ratio metric. All external variables (GDP, currency rate, and interest rate) have a negative impact on the profitability of listed banks in India, except for the INF rate

Al-homaidi et al. (2017) discovered that management size, management diligence, audit committee size, and institutional ownership affect ROA, but board composition, audit committee composition, audit committee diligence, and firm age do not. Return on assets and company age impact the liquidity of Indian listed businesses, according to Al- Studies in Economics and Business Relations3homaidi et al. Exports or imports were studied for 37 Indian commercial banks. Size of company, asset quality, liquidity, asset management, and net interest margin effect ROA. Adequate capital, deposits, "quality of operations, GDP, and inflation rate" negatively affect ROA. The data also imply that capital sufficiency, bank size, operational efficiency, GDP, and inflation affect ROE (Al-homaidi et al. 2017). Yahya, Akhtar, &Mosab (2017) evaluated the influence of political instability, macroeconomic, and internal indicators on Islamic banks in Yemen. The data suggests that operational efficiency and financial risk are negatively associated with ROA and ROE. Capital adequacy has a negative, marginal association with ROA and ROE. The paper also illustrates that asset size, wealth management, funding, and reserves affect banks' financial performance. GDP, inflation, and political insecurity have boosted Yemeni company values. To determine if bank-specific and external factors affect financial institution profitability in chosen nations and regions. The data suggests that larger organizations with stronger management have higher asset returns. Value/originality (Masood & Ashraf, 2012). AL-Omar& AL-Mutairi (2008) discovered that equity ratio, loan-asset ratio, operational expense ratio, and total assets explain 67% of asset return (ROA). Internal variables (excluding borrowing costs) and economic indicators (except unemployment) affect company liquidity. Size, deposits, productivity, capital adequacy, GDP, and inflation were considered. Bank size and GDP were shown to reduce bank liquidity. Deposits, productivity, capital adequacy, and inflation boosted bank liquidity (Singh & Sharma, 2016).

Results & Discussion

After India's economic liberalization, Indian banks face competition. Public and private banks have had varying 10-year performances. Stressed assets nearly increased from 5.7% in FY08 to 10.2% in 2014. India's economy began changing in 1991 based on Narasinhan's proposals. The improvements opened the door for new private and multinational banks. This boosted competitiveness and efficiency. A decade after reform, sectoral changes continued. Lesser players were merged. National support was needed to create international norms like Basel II. Early 2000s saw a more stable yet competitive banking sector. The industry had different-owned enterprises. They competed and cooperated to boost India's economy.

Multiple factors, including bank-specific traits, industry-specific factors, and macroeconomic ones, impact profitability. The analysis found that Ghanaian banks have remained profitable during the previous decade, including the 2008 global financial crisis. Prior to the global financial crisis, only two bank-specific factors and one industry-specific variable impacted the profitability of banks, namely capital and reserve to total assets, noninterest income to gross revenue, and bank deposits. During these years of global financial crisis, bank profitability was impacted by all macroeconomic variables, one bank-specific variable, and one industry-specific variable, namely the annual real Gross Domestic Product (GDP) growth rate, the annual average base lending rate, the annual rate of inflation, the annual growth rate of money in circulation, and the ratio of non-interest income to gross income. Sharma and Gounter (2008) investigated the factors of bank

profitability in PICs (Pacific Island Countries) and found that certain banks remained robust and profitable during the global financial crisis. The data suggest that bank size, annual loan growth, liquidity, yearly deposit growth, operational efficiency, market concentration, annual real Gross domestic product (GDP), and annual inflation rate have no discernable impact on profitability.

Return on assets (ROA) and return on equity (ROE) are used as proxies to quantify the profitability of Indian banks, whereas bank size, assets quality, capital sufficiency, liquidity, operating efficiency, deposits, leverage, assets management, and the number of branches is employed as bank-specific indicators. In addition, as independent variables, a set of macroeconomic drivers, including gross domestic product, inflation rate, interest rate, exchange rate, financial crisis, and demonetization, are utilized. The results indicated that bank size, the number of branches, the assets management ratio, operational efficiency, and leverage ratio are the most influential bank-specific factors influencing the ROA profitability of Indian commercial banks. In addition, the results indicate that, among the bank-specific factors, bank size, assets management ratio, assets quality ratio, and liquidity ratio have a considerable positive influence on ROE. Regarding macroeconomic variables, the results indicate that the inflation rate, currency rate, interest rate, and demonization have a substantial effect on ROA. In the case of ROE, however, the data indicate that all macroeconomic drivers, with the exception of demonization, have a considerable influence on the profitability of the bank as assessed by ROE(Figure 1.1)

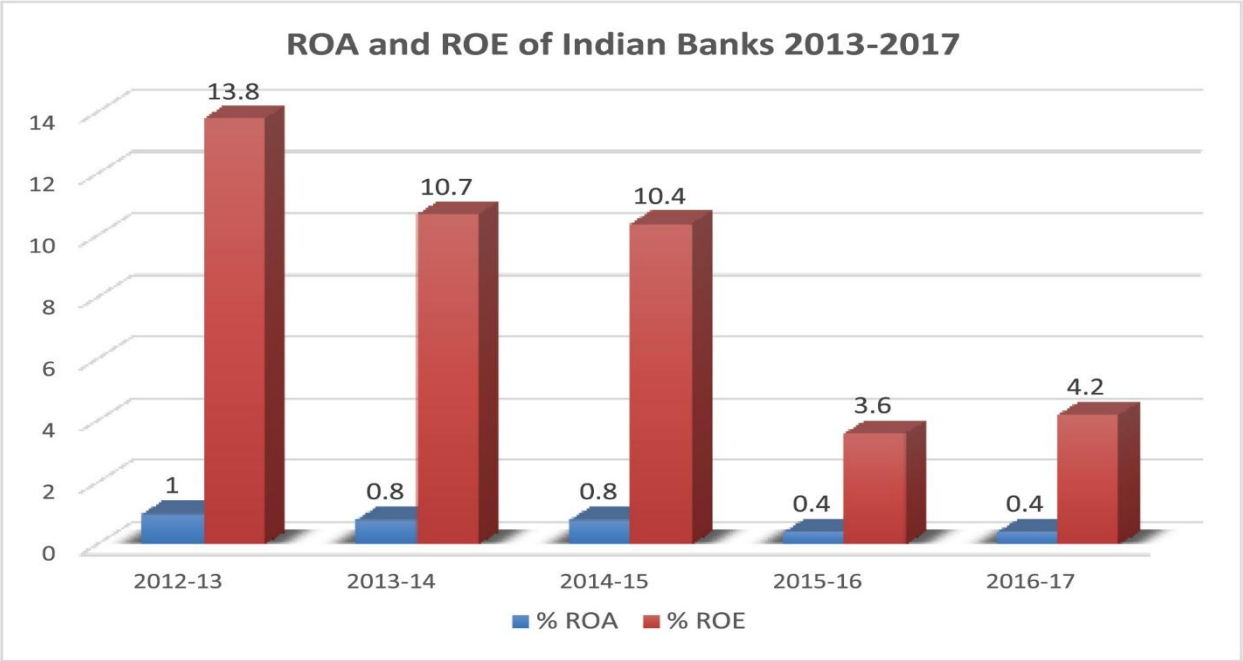

Figure 1.1: ROA & ROE of Indian Banks 2013-2017

Source: Almaqtari, F. A., Al-Homaidi, E. A., Tabash, M. I., & Farhan, N. H. (2019). The determinants of profitability of Indian commercial banks: A panel data approach. *International Journal of Finance & Economics*, *24*(1), 168-185.

Conclusion

Liberalization, privatization, and globalization policies of the early 1990s changed the Indian banking system. These policy changes have rationalized India's banking sector through new private banks, asset quality criteria, and interest rate deregulation. Indian banks introduced Core Banking System to improve customer service. Private sector banks in India use profitability analysis for profit planning and budgeting. There are few research on private commercial banks in emerging nations, according to a study. In India, private, public, and combination studies have been done. None of the papers quantified and evaluated new and existing private sector banks in India. Few studies have used pooled panel cross-section data to compare fixed and random effects. Profitability has been utilized in few research (Return on asset). Due to the researcher's belief that there is a knowledge gap regarding the profitability performance of private sector banks in India, particularly new and established private sector banks, an empirical analysis of the profitability anddeterminants of profitability of private sector banks in India was necessary. Profitability performance of a major bank affects its financial health and the economy. If profitability increases, it means the company is developing with the appropriate plan and future rewards and prospects.

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