TECHNIQUES TO MEASURE BANKING SECTOR PERFORMANCE

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ABSTRACT

The Reserve Bank of India (RBI) claims that India's banking system is adequately capitalised and regulated. The country's financial and economic conditions are significantly superior to those of any other country on the planet. The central government's position in the entire process must also be examined, since they play a critical role in the policy creation essential for the expansion of Indian banking. RBI introduced various schemes and programmes from time to time to reduce the NPA's and increase the profitability of banks. A bank's financial viability is jeopardised by high nonperforming assets (NPAs). Investing in such financial institutions is a terrible decision. However, banks must give loans to companies in order to strengthen the economy. This paper highlights the various techniques to measure the performance of Indian banks and also discusses the initiatives taken by Government and RBI to enhance the performance of banks.

KEYWORDS: Advance to Deposit Ratio, CASA Ratio, Equity Multiplier, Initiative, NPA, Net Interest Margin, Provisioning Coverage Ratio

INTRODUCTION

Innovative banking concepts such as payments and small finance banks have lately been introduced in the Indian banking market. The RBI's new policies may go a long way toward assisting the domestic banking industry's reform. The Reserve Bank of India (RBI) claims that India's banking system is adequately capitalised and regulated. The country's financial and economic conditions are significantly superior to those of any other country on the planet. According to credit, market, and liquidity risk analyses, Indian banks are generally robust and have fared well during the global slump.

For the rapidly expanding Indian banking industry, consolidation in the banking sector is critical in terms of mergers and acquisitions. This may be accomplished via lowering costs and increasing revenue. The crucial element here is to understand why we need to consolidate Indian banking and what challenges lie ahead. The central government's position in the entire process must also be examined, since they play a critical role in the policy creation essential for the expansion of Indian banking.

In addition to cooperative credit institutions, the Indian banking system includes 12 public sector banks, 22 private sector banks, 46 foreign banks, 56 regional rural banks, 1485 urban cooperative banks, and 96,000 rural cooperative banks. The total number of ATMs in India was 213,145 as of September 2021. Bank credit increased at a CAGR of 0.29 percent from FY16 to FY21. Total credit extended in FY21 reached US$ 1,487.60 billion. Deposits climbed at a CAGR of 12.38 percent from FY16 to FY21, reaching US$ 2.06 trillion in FY21. As of September 24, 2021, bank credit totalled Rs. 110.46 trillion (US$ 1.47 trillion), with credit to non-food businesses being Rs. 109.82 trillion (US$ 1.46 trillion).

As of November 3, 2021, the government's biggest financial inclusion campaign, the Pradhan Mantri Jan Dhan Yojana (PMJDY), has opened 43.81 crore bank accounts, with deposits in Jan Dhan bank accounts totaling >Rs. 1.48 trillion (US$ 19.89 billion). On November 9, 2021, RBI announced the commencement of 'HARBINGER 2021 - Innovation for Transformation,' a worldwide hackathon with the topic 'Smarter Digital Payments.' Kotak Mahindra Bank stated in November 2021 that it has finalised the purchase of a 9.98 percent share in KFin Technologies for Rs. 310 crore (US$ 41.62 million) for Rs. 310 crore (US$ 41.62 million). Small shops will be able to receive loans through Google Pay for Business in July 2021, thanks to a partnership with FlexiLoans, a digital lending platform for SMEs.

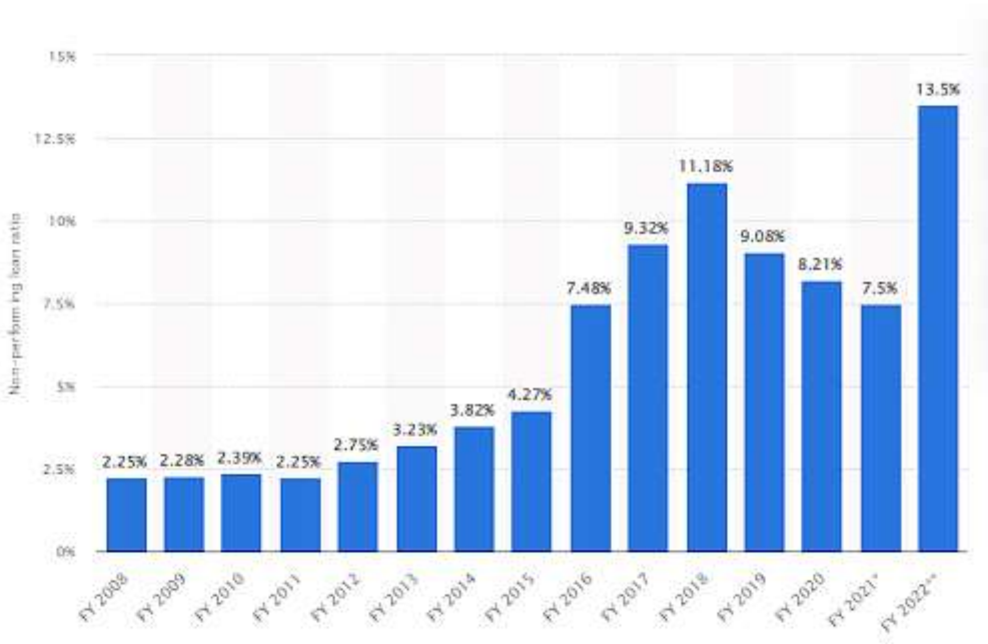
INITITATIVES BY GOVERNEMENT

The RBI introduced the 'RBI Retail Direct Scheme' for retail investors in November 2021, with the goal of increasing retail involvement in government securities. As part of its risk mitigation efforts, the RBI issued new auto debit guidelines with a mandatory additional factor of authentication (AFA) from October 1, 2021, to increase the safety and security of card transactions. The Central Banks of India and Singapore stated in September 2021 that they will integrate their digital payment systems by July 2022 to allow for quick and low-cost fund transactions. Prime Minister Narendra Modi unveiled e-RUPI, a person- and purpose-specific digital payment solution, in August 2021. A QR code or SMS string-based e-voucher issued to the beneficiary's cell phone is known as e-RUPI. Users of this one-time payment option will be able to redeem the voucher at the service provider without the need of a card, digital payment app, or online banking. The government plans to disinvest IDBI Bank and privatise two public sector banks, according to the Union Budget 2021-22. The government completed successfully consolidation, culminating in an eight-fold decrease in the number of public sector banks.

INDIA'S NON-PERFORMING ASSETS PROBLEM

Since FY 2018, the NPA has been dropping due to several actions by the Reserve Bank of India and the national government, including the Insolvency and Bankruptcy Code, the repeal of past policies like as the 5:25 rule, and so on. The country was projected to suffer an increase in bad debts as a result of the coronavirus (COVID-19) pandemic and shutdown. Based on the September 2020 value, the Reserve Bank of India anticipated three possibilities for the fiscal year 2022 till September 2021. The GNPA-ratio would reach 13.5 percent in the baseline scenario, a new record. For investors, high NPAs constitute a warning indicator. It implies that the bank in question is not viable. This has an immediate impact on the banks' cash flow and profitability in the future.

If these nonperforming assets (NPAs) had been paid on schedule, the banks would have had more capital. The banks might have taken advantage of this to offer additional loans. In reality, if the percentage of nonperforming assets (NPAs) continues to rise, banks will need to make greater provision. Funds set aside as a reserve might have come from the bank's future profits, which could have otherwise been utilised to ensure steady expansion. In other words, a high NPA prevents future income creation.



DEALING WITH NPA'S

A bank's financial viability is jeopardised by high nonperforming assets (NPAs). Investing in such financial institutions is a terrible decision. However, banks must give loans to companies in order to strengthen the economy. As a result, they are vulnerable to NPAs. However, NPA is only one element to consider when assessing a bank's asset quality. Before purchasing a bank stock, you must evaluate a number of variables. Analysing NPA in isolation isn't going to cut it. Other elements to consider are capital adequacy ratio, liquidity coverage, and qualitative analysis.

Non-performing assets (NPAs) cost banks money. Banks are required by RBI regulations to retain a 'provision' for nonperforming assets. Provision refers to funds set aside from a bank's 'net profit.' If the NPAs become uncollectible (loss asset), they are written off by subtracting the provision.

• Sub-Standard Assets: These are loans that have been non-performing for less than a year. Banks must set aside a quarter-million dollars for these nonperforming assets (NPAs).

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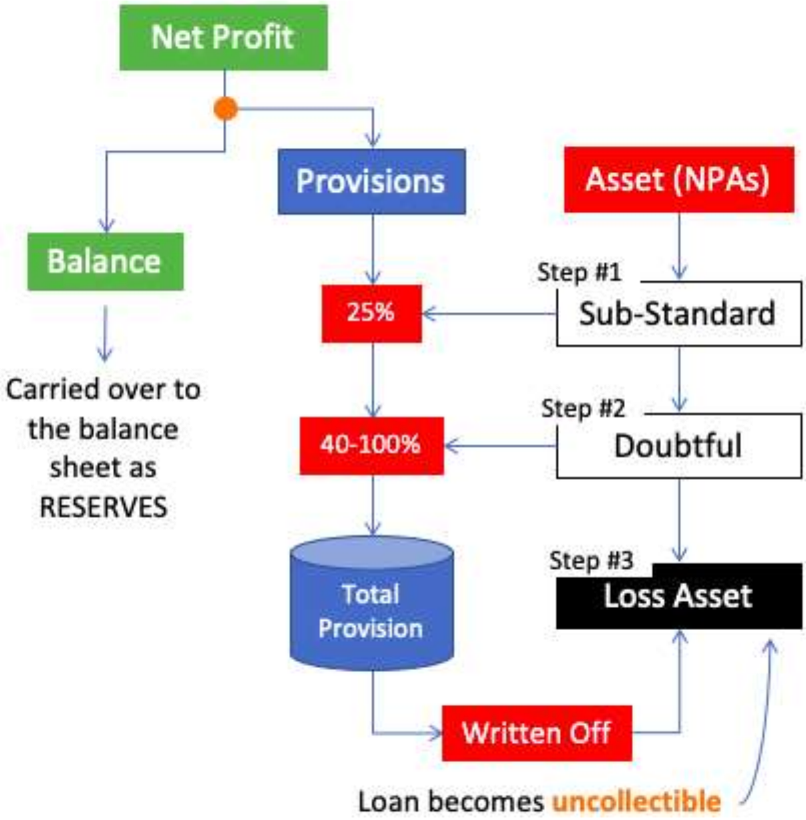
• Doubtful Assets: These are debts that have been non-performing for at least a year. Banks must set aside 100% of the unsecured component and 40% of the secured portion for certain nonperforming assets. After the third year, a 100 percent contingency for the full outstanding debt must be preserved.

• Loss Assets: These are non-performing assets (NPAs) that the bank has deemed "uncollectable." The auditors and, if required, the RBI have additionally validated the information. Banks must set up a 100 percent provision for these nonperforming assets. Learn more about the NPA categorization system.



1. Net NPA

The fraction of the GNPA for which no provisions have been made, stated as a percentage, is known as net NPA. It may also be seen of as a future risk of loss for which banks may be obliged to set aside funds, decreasing their profits even further. The lower the GNPA and NNPA numbers are, the safer the bank is. Now that we know what GNPA and NNPA are, let's look at how these two figures affect Indian banks.

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BANKS	GNPA (%)		NNPA (%)	
	Last 1-Yr	10-Yr Avg	Last 1-Yr	10-Yr Avg
HDFCB	1.33	0.40	1.12	0.31
ICICI	5.64	1.25	5.93	2.30
Kotak	2.29	0.71	2.08	0.87
Axis	4.06	1.12	3.58	1.73
IndusInd	2.73	0.69	1.43	0.53
Bandhan (7Yr)	7.05	3.51	1.98	0.87
IDBI	28.26	1.97	18.30	6.15
Yes	17.14	8.77	4.43	1.84
AU Small (5Yr)	4.34	2.18	2.41	1.36
Federal	2.89	1.31	2.92	1.10
City Union	4.17	2.29	2.26	1.32
RBL	4.44	2.12	1.59	0.77
Ujjivan Small (4Yr)	0.98	0.20	1.49	0.94
SBI	6.41	2.23	6.20	5.59
BOB	10.05	3.13	6.74	2.72

More Greens (the lot looks better)

In terms of GNPA and NNPA, HDFC Bank appears to be the best of the 15 banks analysed. IndusInd Bank and Kotak Mahindra Bank are the next two banks on the list. SSCustomers and businesses will place more trust in a bank with a low GNPA and NNPA. More retail savings accounts will be created in such banks' branches. Companies will open current accounts with these banks to demonstrate their trust in them. As a result, such banks' CASA ratios will skyrocket.

2. CASA RATIO

Banks' business plan is to acquire low-cost deposits and then lend the money to borrowers at a higher rate of interest. To begin collecting deposits, the bank must first entice individuals and businesses to create bank accounts in its locations. Banks will receive deposits from account holders after the account is established. SThere are four distinct types of deposits: Current account, savings account, fixed deposit, and recurring deposit are the four types of accounts. The current account is the only one of these four deposit kinds that pays no interest. The savings account pays a low interest rate of 3% to 4% per year. Higher interest rates are available on fixed and recurring deposits.

The CASA Ratio should be as high as possible. As investors, we must seek for banks who are constantly boosting their CASA ratio. A higher CASA ratio suggests that the bank has a less expensive funding source (deposits). A cheaper source of funding means the bank's Net Interest Margins (NIM) - a measure of profitability – will be greater.

3. PROVISIONING COVERAGE RATIO

It's a ratio that shows how much of the Gross NPA (GNPA) has already been safeguarded by the bank's "Provisions." It is attractive for investment because of its high PCR, ROA/ROE, and NIM. The PCR is the ratio of the bank's overall provisions to its gross nonperforming assets. The balance sheet may be used to calculate both provisions and gross NPAs. A PCR of 90% indicates that the bank covers 90% of all Gross NPAs with 'provisions.' Only 10% of the population is uninsured.

4. ADVANCE TO DEPOSIT RATIO

Banks collect deposits from account holders and issue them as loans (Advances) to people/companies who need them. A bank that collected Rs.100 crore in deposit, and issues Rs.90 crore as loans will have an A/D ratio of 0.9. The lower is the ADR the safer is the bank. But low ADR will also adversely impact the bank's NIM and hence returns (ROA and ROE). So, it is necessary for banks to keep a balance between 'low ADR' and 'high NIM.'

5. EQUITY MULTIPLIER RATIO

If we will see the balance sheet of a bank, it will have two components as a *source of funds*: equity and deposits. The **equity** component is also called shareholders funds (net worth). It consists of share capital and reserves.

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Deposits are funds parked in the various current accounts, savings accounts, FD's, and RD's of the bank. A sum of equity and deposits is the **total capital** available with the bank to do business. The ratio between total capital and total equity is called Equity Multiplier (EM = Total Capital / Total Equity). As a rule of thumb, if the equity multiplier of a bank crosses 15, the bank may be considered risky.

6. NET INTEREST MARGIN

The primary business of banks and financial organisations is to collect interest (on loans) and pay interest on deposits. If we look at the bank's P&L account, we can see that "interest" is the largest source of income. In the previous five years, HDFC Bank has earned an average of 84 percent of its "total income" as "interest."

Similarly, the average interest paid by HDFC Bank during the previous five years was 54 percent of the entire expenditure. As a result, banks and financial institutions are better appraised for profitability by a ratio called net interest margin, which is the key component on the revenue and cost side (NIM).

PROMPT REMEDIAL ACTION

The PCA framework was created by the RBI in 2002 as a structured early-intervention tool for banks that had become undercapitalized or unstable owing to a loss of profitability. Its purpose is to solve the issue of non-performing assets (NPAs) in India's banking sector.

The framework was reviewed in 2017 in response to the suggestions of the Financial Stability and Development Council's working group on Resolution Regimes for Financial Institutions in India and the Financial Sector Legislative Reforms Commission. If a bank is in crisis, PCA is expected to warn the regulator, as well as investors and depositors. The purpose is to prevent issues from reaching crisis proportions. PCA helps RBI monitor banks' key sperformance indicators and take remedial measures to restore a bank's financial health.

CONCLUSION

High NPAs endanger the financial health of a bank. Investing in such banks is a bad idea. But in order to improve the economy, it is necessary for banks to provide loans to businesses. This makes them prone to risk of NPAs. However, NPA is just one important factor to understand bank's asset quality. There are multiple factors which you need to consider before buying a bank stock. Analysing NPA in isolation will not suffice. Capital adequacy ratio, Liquidity coverage, Qualitative analysis are few other factors you need to analyse. To save your time, we have written a detailed guide explaining every fundamental factor one needs to check before investing in banks.

PSBs subscribe to government bonds, which are subsequently funnelled back to banks as capital via the bond method. The government profits since its obligation is confined to the interest component solely, whereas PSBs obtain much-needed revenue while earning interest on bonds. So far, the government has invested over Rs 2.70 lakh crore on these bonds. The expected capital for PSBs ranges from Rs 25,000 crore to Rs 50,000 crore, however the actual amount is contingent on a variety of variables like regulatory forbearance, NPA projections, bad bank, and the privatisation of PSBs that were not involved in the consolidation process.

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