

**Relative Financial Performance of New Private Sector Banks in India**

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**Abstract**

*The policy of liberalization, globalization and privatization in 1990s was accompanied by new entrants in the Indian banking Industry. Government gave licenses to a small number of private banks which came to be known as New Generation tech-savvy banks. There arose large competitive pressures due to entry of new players in the Indian banking industry. The objective of the present paper is to examine the financial performance of new private sector banks in India. The study covers major private sector banks such as ICICI Bank, HDFC Bank, Axis Bank, Yes Bank, Kotak Mahindra Bank. To measure the profitability of banks in India, financial ratios are calculated such as Spread as percentage of working funds, Burden as percentage of working funds, Operating profit as percentage of working funds, Net profit as percentage of total income, Interest income as percentage of total income, Non-interest income as percentage of total income. The paper evaluates financial performance of private banks through overall profitability indices and on the basis of this study banks are classified into four categories- Excellent, Good, Fair and Poor performers. Statistical tools like average, standard deviation and coefficient of variation are used. The time period of the study is 5 years from 2007-08 to 2011-12. The study concludes that on basis of overall profitability HDFC Bank, Axis Bank and Kotak Mahindra Bank are the excellent performers and ICICI Bank and Yes Bank are the poor performers. The paper also makes recommendations to improve the financial performance of banks in India.*

**Keywords:** *Financial Performance, Private Banks, Profitability*

**Introduction**

Indian Banking sector is growing at rapid pace in co-ordination with global changes. Banks play a productive role in the economic growth of the country by following the proper mobilization and allocation of resources. Indian Banks has risen to such a height functionally and geographically that is unparalleled in the world. Banking sector reforms have brought sea changes in Indian banking industry. RBI's efforts to adopt international banking standards have forced the bank to shift the focus on profitability for survival. The policy of liberalization, globalization and privatization in 1990s was accompanied by new entrants in the Indian banking industry. Government gave licenses to a small number of private banks which came to be known as New Generation tech-savvy banks. There arose large competitive pressures due to entry of new players in the Indian banking industry.

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Profitability is very important criterion to evaluate the overall efficiency of a concern. The term 'profitability' is comprised of two words, 'profit' and 'ability'. The analysis of profitability is extremely important to management which is responsible of the ultimate success of the banks, to the state holders who are interested in adequate reforms and growth of the banks and to the long term creditors who are interested in the repayment of their debt and solvency of the bank. The present paper focuses on financial performance of major new private banks in India.

**Main Objectives of the study**

- To examine the financial performance of new private sector banks during the period from 2007-08 to 2011-12.
- To evaluate the financial performance of private sector banks in India and to appraise the profitability of these banks through overall profitability indices.
- To make recommendations to improve the financial performance of banks in India.

**Methodology & Database**

The study is secondary based and analytical in nature. The data is collected from publications of major private banks particularly annual reports of banks and publication of Reserve Bank of India such as Report on Trends and Progress of Banking in India. The study has taken into consideration following major private banks such as ICICI Bank, HDFC Bank, Axis Bank, Yes Bank, Kotak Mahindra Bank. To measure the profitability of banks in India, **financial ratios** are calculated which are as follows:

- Spread as percentage of working funds
- Burden as percentage of working funds
- Operating Profit as percentage of working funds
- Net Profit as percentage of total income
- Interest income as percentage of total income
- Non-interest income as percentage of total income

The time period of the study is 5 years from 2007-08 to 2011-12. The **statistical tools** are used in the study to analyze the data are average, standard deviation and coefficient of variation. For analyzing the performance of private banks, six **profitability indices** are calculated by using the following formula:

Profitability index =  $\frac{\text{Average ratio for the concerned private bank}}{\text{Average ratio for the aggregate of all the private banks}}$

Once the indices are obtained, their Average (X) and Standard deviation ( $\sigma$ ) are calculated.

On the basis of performance indices, the study seeks to **classify** Private sector banks into four categories:

- a) Excellent Performance level includes the banks lying at the top 25 percent areas of the normal distribution i.e. where index value is greater than  $(X+0.6745\sigma)$
- b) Good performance level includes the banks whose growth index score lies between 50 to 75 percent areas of the normal distribution i.e. where index value is between  $X$  to  $(X+0.6745\sigma)$
- c) Fair Performance category includes those banks where index lies between 25 to 50 percent area under normal curve i.e. where index value is between  $(X-0.6745\sigma)$  to  $X$
- d) Poor category comprises the banks which show their index lying at the bottom 25 area of the normal distribution i.e. where index value lies below  $(X-0.6745\sigma)$

Value of  $0.6745\sigma$  refers to the standard normal distribution which divides the distribution at 25 percent and 75 percent respectively. For expenditure index as in case of burden index, the performance levels had been reversed. This is because these are expenses for the bank and lower the volume, higher the performance measured in terms of profitability. MS Excel is used to calculate the values.

### **Analysis & Interpretation**

Following ratios are calculated to assess the financial performance of major private banks in India.

**Spread as percentage of working funds:** Interest spread is the difference between interest earned and interest paid by the banks. Working funds refers total resources of the bank. The ratio of spread as percentage of working funds is a measure of operating profitability of banks. Higher value of this ratio is better. Table 1 shows spread as percentage of working funds.

HDFC Bank had the maximum ratio during 2007-08 (3.93%), Kotak Mahindra Bank during 2008-09 (6.51%), 2009-10 (5.52%), 2010-11 (4.12%) and 2011-12 (3.83%). For ICICI Bank, Axis Bank, Yes Bank, the ratio increased during 2011-12 as compared to 2007-08 whereas for HDFC Bank and Kotak Mahindra Bank, the ratio has decreased over the period of time.

Bank-wise analysis shows maximum average ratio for Kotak Mahindra Bank (4.86%) followed by HDFC Bank (3.83%), and minimum average ratio for ICICI Bank (2.05%), Yes Bank (2.13%) and Axis Bank (2.63%) respectively. Maximum variations in the ratio are witnessed by Kotak Mahindra Bank (23.04%) and minimum variation is observed by Yes Bank (3.92%).

Year-wise, the average ratio of five new private sector banks was highest during 2008-09 (3.46%) and lowest during 2007-08 (2.88%). The average bank spread ratio increased from 2.88% (2007-08) to 3.23% (2009-10) and then declined to 2.95% in 2011-12.

Maximum variability was observed during the year 2008-09 (54.3%) and minimum variation during 2011-12 (25.8%). Table 4.1 reveals that HDFC Bank and Kotak Mahindra Bank achieved higher ratio over the average bank ratio for all the years.

**Table1: Spread as percentage of working funds**

Year/Bank	ICICI Bank	HDFC Bank	Axis Bank	Yes Bank	Kotak Mahindra Bank	Average	S.D.	C.V. (%)
<b>2007-08</b>	1.82	3.93	2.36	1.98	4.32	2.88	1.16	40.2
<b>2008-09</b>	2.02	4.04	2.49	2.22	6.51	3.46	1.88	54.3
<b>2009-10</b>	1.93	3.76	2.77	2.16	5.52	3.23	1.46	45.2
<b>2010-11</b>	2.22	3.80	2.70	2.11	4.12	2.99	0.92	30.8
<b>2011-12</b>	2.27	3.64	2.81	2.19	3.83	2.95	0.76	25.8
<b>Average</b>	2.05	3.83	2.63	2.13	4.86	3.10		
<b>S.D.</b>	0.19	0.15	0.19	0.09	1.12			
<b>C.V. (%)</b>	<b>9.27</b>	3.92	7.22	4.23	23.04			

Source: Calculated values

**Burden as percentage of working funds:** Burden refers to the difference between non-interest expenditure and non-interest income of a bank. From the profitability angle of the banks, this ratio is considered to be very important. To enhance the profitability, the banks should always try to reduce this ratio. Table 2 shows burden as percentage of working fund. ICICI Bank has lowest ratio during 2007-08 (0.78%); Yes Bank during 2007-08 (0.81%). ICICI Bank and Yes Bank could achieve a lower burden ratio then the average ratio for all the years.

Bank-wise analysis shows the lowest average ratio for Yes Bank (0.86%) and ICICI Bank (0.98%) respectively and maximum average burden ratio for Kotak Mahindra Bank (3.15%) and HDFC Bank (2.49%) respectively. Thus Yes Bank was at better position and Kotak Mahindra Bank at worst position with respect to burden ratio for the period under study. Maximum variation and least consistency in the ratio was found in case of Kotak Mahindra Bank (26.98%), ICICI Bank (20.41%) respectively. Minimum variation and maximum consistency was observed for Yes Bank (3.49%), Axis Bank (3.76%) and HDFC Bank (11.24%) respectively.

Year-wise, the average burden ratio which was 1.79 percent in 2007-08 increased to 2.12 percent in 2008-09 and declined to 1.47 percent in 2011-12. This indicates that new private banks in order to increase their profitability reduced burden ratio. The burden ratio was more consistent during 2011-12 (42.86%) and 2010-11 (49.07%) whereas less consistency was observed during 2008-09 (67.92%), 2007-08 (64.25%) and 2009-10 (61.88%) respectively.

**Table 2: Burden as percentage of working funds**

Year/Bank	ICICI Bank	HDFC Bank	Axis Bank	Yes Bank	Kotak Mahindra Bank	Average	S.D.	C.V. (%)
2007-08	0.78	2.73	1.38	0.81	3.29	1.79	1.15	64.25
2008-09	1.32	2.82	1.27	0.88	4.33	2.12	1.44	67.92
2009-10	0.94	2.44	1.38	0.85	3.46	1.81	1.12	61.88
2010-11	0.95	2.39	1.31	0.88	2.52	1.61	0.79	49.07
2011-12	0.90	2.11	1.32	0.87	2.17	1.47	0.63	42.86
Average	0.98	2.49	1.33	0.86	3.15	1.76		
S.D.	0.20	0.28	0.05	0.03	0.85			
C.V. (%)	20.41	11.24	3.76	3.49	26.98			

Source: Calculated values

**Operating Profit as percentage of working funds:** Operating profit denotes the difference between the interest spread and burden. Net profit is obtained by deducting provisions and contingencies from operating profit. This ratio indicates operating profit per unit of working funds. Higher value of this ratio indicates better profitability and lower ratio shows lower profitability of the bank. Table 3 shows operating profit as percentage of working funds. Kotak Mahindra had the maximum ratio during 2009-10 (3.97%) and Axis Bank during 2008-09 (2.95%), 2010-11 (3.17%), 2011-12 (2.19%), HDFC Bank during 2007-08 (2.83%).

Bank-wise Analysis of the ratio reveals average ratio is highest in case of Axis Bank (3.02%) followed by Kotak Mahindra Bank (2.93%) and HDFC Bank (2.79%), Yes Bank (2.62%) and lowest in case of ICICI Bank (2.13%). Year-wise analysis shows maximum average ratio during 2009-10 (3.17%) and minimum during 2007-08 (2.39%). In terms of variability, 2011-12 (11.11%) was most consistent and 2009-10 (19.87%) was least consistent.

**Table 3: Operating Profit as percentage of working funds**

Year/Bank	ICICI Bank	HDFC Bank	Axis Bank	Yes Bank	Kotak Mahindra bank	Average	S.D.	C.V. (%)
2007-08	1.99	2.83	2.57	2.06	2.51	2.39	0.36	15.06
2008-09	1.96	2.83	2.95	2.75	2.54	2.61	0.39	14.94
2009-10	2.28	2.89	3.48	3.24	3.97	3.17	0.63	19.87
2010-11	2.23	2.79	3.17	2.58	2.86	2.73	0.35	12.82
2011-12	2.19	2.65	2.94	2.48	2.79	2.61	0.29	11.11
Average	2.13	2.79	3.02	2.62	2.93	2.69		
S.D.	0.15	0.09	0.33	0.43	0.59			
C.V. (%)	7.04	3.23	10.93	16.41	20.14			

Source: Calculated values

**Net Profit as percentage of total income:** The ratio of net profit as percentage of total income reflects the income generating capacity of the banks. This ratio indicates as to what percentage of total income is being earned by a bank as net profit. Total income includes both interest and non-interest income. Higher ratio indicates higher profitability and lower ratio indicates lower profitability. Table 4 shows net profit as percentage of total income.

The ratio witnessed wide variations and gradual increase over the years for all banks. In case of ICICI Bank ratio in 2007-08 (10.49%) which increased in 2011-12 (15.75%), ratio of HDFC Bank also increased from 12.83% (2007-08) to 15.88% (2011-12), Axis Bank ratio increased from 12.17% (2007-08) to 15.47% (2011-12), Yes Bank from 12.01% (2007-08) to 13.64% (2011-12) and Kotak Mahindra Bank from 9.80% (2007-08) to 15.16% (2011-12).

Over the period of study 2007-08 to 2011-12, Axis Bank has highest average ratio (14.82%) followed by HDFC Bank (14.22%), Yes Bank (13.98%) and Kotak Mahindra Bank (12.83%). Lowest average ratio is observed in ICICI Bank (11.09%). In terms of variability, the ratio is more consistent for Yes Bank (13.38%), Axis Bank (13.97%), HDFC Bank (14.22%) and less consistent in case ICICI Bank (42.02%) and Kotak Mahindra Bank (27.90%).

Year-wise Analysis shows Axis Bank has highest ratio during 2010-11 (17.12%) and 2008-09 (13.21%) and 2009-10 (16.22%), HDFC Bank during 2007-08 (12.83%) and 2011-12 (15.88%). The average ratio gradually improved over the period with maximum 16.23% during 2010-11 and lowest during 2008-09 (10.13%). In terms of variability, highest variation and less consistency is observed during 2008-09 (32.68%) and lowest variation and more consistency is observed during 2010-11 (3.69%).

**Table 4: Net Profit as percentage of total income**

<b>Year/Bank</b>	<b>ICICI Bank</b>	<b>HDFC Bank</b>	<b>Axis Bank</b>	<b>Yes Bank</b>	<b>Kotak Mahindra Bank</b>	<b>Average</b>	<b>S.D.</b>	<b>C.V. (%)</b>
<b>2007-08</b>	10.49	12.83	12.17	12.01	9.80	11.46	1.26	10.99
<b>2008-09</b>	5.27	11.44	13.21	12.46	8.27	10.13	3.31	32.68
<b>2009-10</b>	8.13	14.76	16.14	16.22	14.45	13.94	3.34	23.96
<b>2010-11</b>	15.79	16.18	17.12	15.59	16.46	16.23	0.60	3.69
<b>2011-12</b>	15.75	15.88	15.47	13.64	15.16	15.18	0.90	5.93
<b>Average</b>	11.09	14.22	14.82	13.98	12.83	13.39		
<b>S.D.</b>	4.66	2.03	2.07	1.87	3.58			
<b>C.V. (%)</b>	42.02	14.28	13.97	13.38	27.90			

Source: Calculated values

**Interest Income as percentage of total income:** Interest income in banks refer to fund based income. Interest earned includes interest or discount on deposits, income on investments, balance

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with RBI and other banks and other income. This ratio is indicator of profitability of banks. Higher ratio is indicator of higher profitability of banks. Table 5 shows Interest Income as percentage of total income.

Highest ratio was observed in case of Kotak Mahindra Bank in 2007-08 (84.55%), 2008-09 (91.80%), 2009-10 (83.82%), Yes Bank has highest ratio during 2010-11 (86.46%) and in 2011-12 (88.04%)

Bank-wise Analysis show maximum average ratio for Kotak Mahindra Bank (86.16%), followed by Yes Bank (83.19%), HDFC Bank (82.35%), Axis Bank (77.99%) and minimum in case of ICICI Bank (69.24%). The ratio is more consistent for HDFC Bank (1.45%), Axis Bank (2.96%), Kotak Mahindra Bank (3.82%), Yes Bank (4.77%) and least consistent for ICICI Bank (21.74%).

Year-wise analysis shows highest ratio during 2011-12 (84.04%) and lowest in 2009-10 (74.09%). In terms of variability, maximum variability and less consistency is observed during 2009-10 (18.36%) and minimum variability and more consistency is observed in 2007-08.

**Table 5: Interest Income as percentage of total income**

Year/Bank	ICICI Bank	HDFC Bank	Axis Bank	Yes Bank	Kotak Mahindra Bank	Average	S.D.	C.V. (%)
<b>2007-08</b>	77.75	81.58	79.59	78.71	84.55	80.44	2.69	3.34
<b>2008-09</b>	56.51	83.23	78.90	82.08	91.80	78.50	13.2	16.82
<b>2009-10</b>	50.59	80.94	74.68	80.46	83.82	74.09	13.6	18.36
<b>2010-11</b>	79.62	82.13	76.59	86.46	84.29	81.82	3.87	4.73
<b>2011-12</b>	81.72	83.88	80.23	88.04	86.35	84.04	3.21	3.82
<b>Average</b>	69.24	82.35	77.99	83.19	86.16	79.79		
<b>S.D.</b>	15.05	1.19	2.31	3.97	3.29			
<b>C.V. (%)</b>	21.74	1.45	2.96	4.77	3.82			

Source: Calculated values

**Non-Interest Income as percentage of total income:** Non-interest income is also known as other income is second as well as last component of the total income of a bank. Non-interest income of bank represents income earned by way of commission, brokerage, service charges and other miscellaneous receipts. From the viewpoint of profitability, non-interest income of bank is considered as an important factor. This ratio indicates percentage of fee based income in total income and hence greater profitability. Thus banks must give much emphasis to increase the non-interest income as to have the higher profitability. Table 6 shows non-interest income as percentage of total income. The ratio was highest for ICICI Bank during 2007-08 (22.25%), 2008-09 (43.49%), 2009-10 (49.41%), Axis Bank during 2010-11 (23.41%) and 2011-12 (19.77%).

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Bank-wise analysis of the ratio reveals maximum average ratio (30.76%) for ICICI Bank followed by Axis Bank (21.99%), HDFC Bank (17.65%), Yes Bank (16.81%) and minimum ratio for Kotak Mahindra Bank (13.83%). In terms of variability, more variation and less consistency is observed in ICICI Bank (47.27%) and least variation in ratio for HDFC Bank (6.74%).

Year-wise analysis shows average was highest in 2009-2010 (27.49%) and lowest in 2011-12 (15.96%). In terms of variability, greater variation and less consistency is observed in 2008-09 (61.38%) and less variation and more consistency was observed during 2007-08 (13.75%)

**Table 6: Non-Interest Income as percentage of total income**

Year/Bank	ICICI Bank	HDFC Bank	Axis Bank	Yes Bank	Kotak Mahindra Bank	Average	S.D.	C.V. (%)
<b>2007-08</b>	22.25	18.42	20.40	21.29	15.45	19.56	2.69	13.75
<b>2008-09</b>	43.49	16.77	21.09	17.92	8.19	21.49	13.19	61.38
<b>2009-10</b>	49.41	19.06	25.32	19.54	16.18	27.49	13.55	49.29
<b>2010-11</b>	20.38	17.87	23.41	13.36	15.70	18.14	3.93	21.66
<b>2011-12</b>	18.28	16.12	19.77	11.96	13.65	15.96	3.21	20.11
<b>Average</b>	30.76	17.65	21.99	16.81	13.83	20.21		
<b>S.D.</b>	14.54	1.19	2.31	4.01	3.29			
<b>C.V. (%)</b>	47.27	6.74	10.50	23.85	23.79			

Source: Calculated values

**Table 7: Table showing Indices of Profitability Performance**

Bank/Ratio	Spread as % of working funds	Burden as % of working funds	Operating Profit as % of working funds	Net Profit as % of total income	Interest Income as % of total income	Non-Interest Income as % of total income
<b>ICICI Bank</b>	0.66 P	0.55 P	0.79 P	0.83 P	0.87 P	1.52 E
<b>HDFC Bank</b>	1.24 E	1.41 E	1.04 G	1.06 G	1.03 G	0.87 F
<b>Axis Bank</b>	0.84 F	0.75 F	1.12 E	1.11 E	0.98 F	1.09 G
<b>Yes Bank</b>	0.68 P	0.49 P	0.97 P	1.04 G	1.04 G	0.83 F
<b>Kotak Mahindra Bank</b>	1.56 E	1.79 E	1.09 E	0.96 F	1.08 E	0.68 P
<b>Average</b>	0.97	0.99	1.00	1.00	1.00	0.99
<b>S.D.</b>	0.39	0.57	0.13	0.11	0.08	0.33

Source: Calculated values

## **Conclusions**

It can be concluded that HDFC Bank, Axis Bank and Kotak Mahindra Bank are the excellent performers and Yes Bank and ICICI Bank are poor performers on basis of overall profitability.

## **Suggestions**

Following suggestions are made to improve the profitability of the banks:

- Banks should enhance fee based income and reduce dependence on interest income in order to increase profitability.
- Banks should grow in size and should introduce diversified and sophisticated products to meet the needs of modern society.
- Profitability of banks is largely affected by high operating costs. High labour productivity, updated technology and employment of low cost funds help in controlling operating costs and ensure financial viability of banks.

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