Impact of Liberalization of the Banking Sector on the performance of State Bank of India

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Abstract

Banking is an integral part of our day-to-day lives and the economy. This research aims at studying for both pre and post liberations periods and the impact of the financial sector reforms on the various financial parameters. The study has been done with the help of secondary data collected in the form of various financial indicators of SBI's performance such as deposits, advances, profit, productivity, performance and efficiency ratios etc. over a span of 22 years, from Mar 1989 to Mar 2010. This period is divided into two parts to compare the performance of SBI before and after the financial reforms. Suitable statistical tools have been used to find out if liberalization has an impact on SBI's performance, areas of impact and no-impact identified.

Key words: *Banking, Liberalization, SBI, Reforms, Performance*

Background of the study

India is the largest country in South Asia with a huge financial system comprising of a variety of institutions and instruments. Even before our independence in 1947, India was having a well-developed financial sector. SBI is the largest commercial bank of India with a about 12000 branches and an extensive ATM network. The bank provides a range of products through its vast network in India and overseas. It enjoys a major market share in the deposits and advances portfolio of the entire Indian banking industry. As the part of Financial Reforms, Reserve Bank of India launched banking sector reforms in 1998, as per the recommendations made by the Narasimhan Committee on financial reforms, to create a more profitable, efficient and sound banking system. The changes brought about by the reforms included greater degree of operational autonomy, deregulation of interest rate system and free pricing of products, consolidation and restructuring of weak public sector banks, freedom to open new branches, improved credit delivery mechanism, legal reforms to expedite recovery of bank dues, etc. The banking sector was opened up for private and foreign banks. This created competition for the existing public sector banks and the State Bank of India which were enjoying a remarkable business share in the banking industry. This study is intended to compare the performance

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of State Bank of India before liberalization and after the reform process in terms of various parameters like deposits, advances, income (interest and others), expenditure (interest and others), net profit, profitability ratios, performance ratios, operational efficiency, staff productivity etc and identify areas of impact and no impact.

Need for the study

The strength of any economy can be measured by the soundness of its banking system. Commercial banks are the lifeline of an economy and a strong banking system is an important indicator of an economic strength of a nation. Banking has been a major industry in the financial sector of India touching the lives of every average Indian in some way or the other. The Indian banking system has been experiencing tremendous transformation over the past twenty years with the improvement in technology and communication media. The State Bank of India, being India's largest commercial bank has a major role to play in the Indian banking scenario. Hence, in the booming banking sector of India, the performance of SBI is of utmost interest and importance to all. It is also very relevant to study the pre and post liberalization performance of SBI, to analyze if the financial reforms have achieved their intended target.

Objectives

Since the main objective of the Banking sector in the performance period where social upliftment and social equality, post independence Indian banks spread their network at a fast pace to provide service to all corners of the country. Since Bank were guided with the motive of social upliftment and advancing to the weaker sections of economy, they could not function profitably and efficiently. Recognizing the need for liberalising, the Banking sector various reforms were introduced in the Indian financial sector to enhance its efficiency and productivity. A study on the impact of these reforms lays a base for future studies with respect to the effectiveness of these changes. On the basis of the financial indicators of SBI for the period 1989-2010, the study intends to compare its performance before and after liberalization in terms of various metrics like deposits, advances, income (interest and others), expenditure (interest and others), net profit, profitability ratios, performance ratios, operational efficiency, staff productivity etc.

Limitations of the study

- The study is based entirely on secondary information. Hence the limitations of secondary data are inbuilt.
- The findings are based on banking components like deposits, advances and performance and financial ratios of SBI. The influence of factors other than liberalization and privatization on the performance of SBI is out of the scope of this study.
- The financial data of SBI was available from Mar 1989 and hence the study has been done from Mar 1989 and not earlier.

Theoretical framework:

Though the study is based entirely on secondary data, a review of detailed literature on the banking sector in India, the need for financial reform and the impact of these reforms on the banking industry has provided a good base for further study in this direction. After Indian independence, The banking sector in India, was directed to to follow the philosophy of social equiality. This "Social" cause did not allow the banks to function with a profit making motive. Hence, to improve the efficiency and productivity of the Indian banking sector, reforms were introduced in the Indian financial sector through stages. (Santi Gopal Maji and Soma Dey, 2006). The past 20 years have seen the banking industry in India growing by leaps and bounds. The industry has been passing through an era of modernization and transformation, with a number of forces that are operating in the domestic and international front as well as acting as a major influencing force. The last decade has seen many positive developments in the Indian banking sector. The Reserve Bank of India (RBI), Ministry of Finance and related government and financial sector regulatory entities have made several notable efforts to improve regulation in this sector. The number of private sector banks and foreign banks in India has increased remarkably changing the structure in India. (Abdul Wahab, 2001) and Competition in the banking industry to attract the customers, thereby improving the performance and profitability of the existing public sector banks. Profit is the main motive for any business and there are a number of papers analyzing the performance of banks from the angle of profitability. Studies by Saveeta and Verma Sateesh (2001) Shravan Singh, (2001) and Reddy A Amarender, (2004) commonly reflect the increasing prominence of private sector banks and the decreasing importance of the public sector ones. The comparison of performance of public, private and foreign banks have also been undertaken by a lot of researchers, such as those of Ganesan P (2001), Das M R, (2002-03) and Gupta V and Jain P K (2003). These studies reflected the better performance of private sector banks compared to the public sector banks. A study by A Ramachandran and N Kavitha, 2007, provides an insight into the effect of the Earnings and Expenses factor on the profitability of banks and suggests a SWOT analysis for boosting the profitability. A comparison of productivity growth between pre- and post-liberalization periods shows that the average productivity growth in the post-liberalization period is higher than the average productivity growth in the pre-liberalization period. The results also suggest that, on an average, the productivity growth is mainly due to technological change than efficiency change (H P Mahesh and Meenakshi Rajeev (2007). Garima Malik`s study in 2008, has arrived at the conclusion that the entry of new private players has affected the performance of the old private sector banks. The research work by Ramakrishna Vyas and Aruna Dhade (2007), concludes that there is no impact of the entry of the new generation private sector banks on the performance of SBI. Most of the studies comparing the performance of the banks in different sectors throw a positive light on SBI. Santi Gopal Maji and Soma Dey (2006), see a high degree of positive association between productivity and profitability for achieving the target level of profitability by SBI. Papers by P. Janaki Ramudu and S Durga Rao (2006), revealed that SBI performed better in terms of Earnings per Share, Payout Ratio and its CAGR (Compound Annual Growth Rate) in majority of the parameters and was also higher than ICICI and HDFC. Barring EPS (Earnings Per Share) and DPS (Dividend per share), CAGR in all parameters of the State Bank of India was more than that of ICICI and HDFC. A comparative study by Manish Mittal and Aruna Dhade (2007), reflects that Indian banks especially the public sector banks and the old private sector banks are lagging far behind their competitors in terms of both productivity and profitability with the exception of the State bank of India and its associates.

Methodology:

A descriptive research design has been chosen for the present study. The design is intended to produce accurate description of variables relevant to the decisions being taken. The descriptive research includes surveys on bank performances, financial sector reforms and statistical data. The entire study is based on data collected from the secondary sources in the form of annual reports, ratio analysis reports, and profitability and performance reports.

Time period :

The study has been undertaken for a period of 22 years from Mar 1989 – Mar 2010. The liberalization process for Indian Economy was initiated in 1991-92, a period of 3 years has been earmarked for the reforms to set in and have a noticeable effect on SBI's performance. Hence 1989 – 1995 has been chosen for pre liberalization performance and 1996-2010 has been chosen for post liberalization performance. The study is based on the secondary data collected from articles and research papers published and available on the various websites.

Tools for Analysis

- Independent sample T Test has been performed on the variables and results interpreted.
- The profitability ratio of the bank is worked out as follows:

Profitability ratio = Spread ratio – Burden ratio

The ratios used for measuring the profitability of the bank are as:

- ✓ Interest earned ratio (r) = Total interest earned/Volume of business
- ✓ Interest paid ratio (p) = Total interest paid/ Volume of business
- ✓ Non-interest income ratio (n) =Total income–interest income/Volume of business
- ✓ Other operating expenses ratio(o)=Total expenses–interest expenses/

Volume of business

- ✓ Establishment expenses ratio (m) = Establishment expenses/ Volume of business

The following equations are derived from the above ratios:

- ✓ Spread ratio (s) = Interest earned ratio – Interest paid ratio (r-p)
- ✓ Burden ratio (b) = Other operating expenses ratio – Noninterest income ratio(o-n)

Return on assets, Profit margin, Net interest margin and Credit Deposit ratio have been considered for studying the operational efficiency of SBI.

- ✓ Return on assets = ROA = Total income/Avg total assets
- ✓ Profit margin=Operating profit/Working funds
- ✓ Net interest margin=Net interest income/ Interest earned

Analysis and Discussions:-

The result of the T tests performed for the above-mentioned parameters is as below:

		F	Sig.	t	df	Sig. (2-tailed)	Std.Error Difference
Deposits	**Equal variances assumed**	8.574	.008	-3.393	20	.003	82601.77975
	Equal variances not assumed			-5.004	14.40	.000	56007.25611
Advances	**Equal variances assumed**	12.304	.002	-2.556	20	.019	70210.12833
	Equal variances not assumed			-3.785	14.13	.002	47422.88738
Interest Income	**Equal variances assumed**	5.399	.031	-3.486	20	.002	6928.70205
	Equal variances not assumed			-5.088	15.11	.000	4746.78516
Other Income	**Equal variances assumed**	5.310	.032	-4.226	20	.000	1407.53480
	Equal variances not assumed			-6.069	16.20	.000	980.05662
Total Income	**Equal variances assumed**	5.775	.026	-3.765	20	.001	7994.51448
	Equal variances not assumed			-5.498	15.09	.000	5474.50720

Expenditure		F	Sig.	t	df	Sig. (2-tailed)	Std.Error Difference
Interest Expenses	**Equal variances assumed**	4.941	.038	-3.611	20	.002	4370.32435
	Equal variances not assumed			-5.299	14.75	.000	2978.51652
Other Expenses	**Equal variances assumed**	9.181	.007	-3.982	20	.001	2713.75366
	Equal variances not assumed			-5.713	16.27	.000	1891.66484
Total Expenses	**Equal variances assumed**	5.328	.032	-3.811	20	.001	6977.08926
	Equal variances not assumed			-5.551	15.26	.000	4790.27330
Net Profit	**Equal variances assumed**	9.866	.005	-3.370	20	.003	1041.93459
	Equal variances not assumed			-4.970	14.40	.000	706.50027
Profitability Ratio	**Equal variances assumed**	0.030	.864	-7.059	20	.000	6.43583E-04
	Equal variances not assumed			-6.845	10.97	.000	6.63633E-04
Productivity							
Deposit per Employee	**Equal variances assumed**	10.70	.004	-3.230	20	.004	43.42642
	Equal variances not assumed			-4.775	14.24	.000	29.37858
Advance per Employee	**Equal variances assumed**	14.44	.001	-2.491	20	.022	36.54788
	Equal variances not assumed			-3.690	14.08	.002	24.66811
Business per Employee	**Equal variances assumed**	11.87	.003	-2.902	20	.009	79.70504
	Equal variances not assumed			-4.296	14.15	.001	53.84884
Profit per Employee	**Equal variances assumed**	17.83	.000	-3.279	20	.004	.30379
	Equal variances not assumed			-4.863	14.00	.000	.20482
Deposit per Employee	**Equal variances assumed**	11.31	.003	-4.086	20	.001	6.62539
	Equal variances not assumed			-6.003	14.68	.000	4.51044
Advance per	**Equal variances**	16.74	.001	-2.924	20	.008	5.77310

Branch	Assumed	F	Sig.	t	df	Sig. (2-tailed)	Std.Error Difference
	Equal variances not assumed			-4.324	14.20	.001	3.90325
Business per branch	**Equal variances assumed**	13.71	.001	-3.572	20	.002	12.30677
	Equal variances not assumed			-5.268	14.40	.000	8.34452
Operational Efficiency							
Return on Assets	**Equal variances assumed**	.004	.953	1.468	19	.159	.00636
	Equal variances not assumed			1.403	8.488	.196	.00665
Profit Margin	**Equal variances assumed**	9.733	.005	-4.632	20	.000	.33864
	Equal variances not assumed			-6.871	14.00	.000	.22831
Credit Deposit Ratio	**Equal variances assumed**	3.970	.060	1.713	20	.102	5.39744
	Equal variances not assumed			1.975	16.94	.065	4.68159
Net Interest Margin	**Equal variances assumed**	.452	.509	-.237	20	.815	6.14887
	Equal variances not assumed			-.294	19.42	.772	4.96641
Performance							
Growth Rate in deposits	**Equal variances assumed**	1.201	.287	-.414	19	.684	3.94739
	Equal variances not assumed			-.514	15.60	.614	3.17796
Growth rate in Advance	**Equal variances assumed**	.580	.456	-1.346	19	.194	5.28544
	Equal variances not assumed			-1.179	7.321	.275	6.03196
Growth Rate in net Profit	**Equal variances assumed**	1.344	.261	1.297	19	.210	20.41373
	Equal variances not assumed			1.049	6.543	.331	25.24033

Deposits - In the above table F& T values on Deposits are significant at less than 0.05. So, null hypothesis is rejected. There is a significant difference in the deposits of SBI before and after liberalization.

Advances - Similarly for advances F &T values are significant at less than 0.05. So, alternative hypothesis is accepted. There is a significant difference in the advances of SBI before and after liberalization.

Income - Again, test values are significant for all the three variables, at less than 0.05, indicating rejection of null hypothesis. Hence, there is a significant difference in the Interest income, Non Interest income and total income of SBI.

Expenses - F& T Values are significant for all the three variables, at less than 0.05, indicating rejection of null hypothesis. Hence, there is a significant difference in the Interest expenditure, Non-interest expenditure and hence, Total expenditure of SBI before and after liberalization.

Net Profit - F& T Values are significant for the net profit at less than 0.05, indicating rejection of null hypothesis. Hence, there is a significant difference in the net profit of SBI before and after liberalization.

Profitability ratio - For this also these two values are significant at less than 0.05, indicating rejection of null hypothesis. Hence, there is a significant difference in the profitability of SBI before and after liberalization.

Per Branch indicators - The values of F &T for the all the indicators of staff productivity sre significant at less than 0.05, indicating rejection of null hypothesis. Hence, there is a significant difference in the Staff Productivity of SBI before and after liberalization.

Operational efficiency - F&T values of profit margin are significant at less than 0.05, indicating rejection of null hypothesis. Hence, there is a significant difference in the profit margin of SBI before and after liberalization. For Credit – Deposit ratio, Return on assets and Net interest margin, these values are significant at a higher than 0.05 indicating an acceptance of the null hypothesis. And there is no significant difference in the Credit – Deposit ratio, Return on asset and Net interest margin of SBI before and after liberalization.

Performance of SBI - F&T values of all the three variables, namely, growth rate of advances, deposits and net profit, are significant at greater than 0.05, for which null hypothesis is rejection. Hence, there is a no significant difference in the growth rate of deposits, advances and net profit of SBI before and after liberalization.

Findings

The major happenings in the industry during this period, are well reflected in SBI's performance. The business levels and profit figures show a slow but steady upward trend after 1994,95, which can be attributed to the effect of the economic reforms, initiated in the 90s. Between 1994-95 and 2002-03, the growth in the banking industry was about 16.7%. SBI's growth during this period has been on similar scales. 1999 shows maximum growth rates in terms of deposits and advances. SBI has shown a profit margin for the first time in 1999.Though the pace of growth had gone up considerably after 2003, it was in line with the general economic boom which saw a huge increase in the size of population requiring Banking services. But SBI was losing its market share to other new generation private banks, especially ICICI. On account of the huge size of the bank, it could not offer customized products to its customers. Hence, the bank started shifting or to have parallel banking with other private banks. To keep pace with the technology savvy new banks and to maintain its share of the market, SBI went in for a major restructuring exercise in 2003 which included redesigning its branches, lean structures and technological up gradation. This explains the steep rise in staff productivity after 2003 & 2004. In 2004, there was a major exercise of recovery of advances and write off of NPAs by SBI which remained the almost constant for advance value between 2003 and 2004. The results of the t tests show that the Deposits, Advances, Income, Expenditure, Profitability ratio, Staff productivity and Profit Margin of SBI have been impacted by the liberalization of the banking sector. Variables such as the growth rate of deposits, advances, net profit, return on asset, credit-deposit ratio and net-interest margin of SBI did not have impacted by the liberalization and financial sector reforms. Hence, though SBI has taken general advantage of the increasing volume of business available to the banking industry, it needs to concentrate its focus on the bottom-line, namely, growth rate, return on asset, credit-deposit ratio and net interest margin that are the solid indicators of the operational efficiency and performance of the bank.

Conclusion

The study has been undertaken with the objective of finding out the impact of the economic reforms of 1990s on the performance of SBI. The financial indicators of SBI for a period of 22 years have been studied by dividing the period into two slots, pre liberalization and post liberalization periods. F & T – Tests have been used to analyze if the reforms had any impact on SBI's performance. The results show that there is a general increase in the volumes of business handled by the bank, its operated at almost the same margin of growth that has not improved on account of the reforms. The Efficiency ratios of the bank have also changed after the reforms which indicate that they have taken advantage of their huge base. The danger posed to SBI's market share on account of the tough competition from new private banks was the challenge for the giant. But the efforts over the past 4 years coupled with the global financial recession have put SBI on the road back to dominance. They are in the process of matching their technology, product line and customer service, with their competitors. With the advantage of maintaining the Indian government's accounts and its mammoth size, they will truly be the market leaders in its real sense in the days to come.

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