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PERFORMANCE OF PUBLIC SECTOR BANK WITH SPECIAL REFERENCE TO PUNJAB AND SIND BANK

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Abstract

The financial strength and operational efficiency of the Indian banks and financial institutions which were working in a highly protected and regulated environment were not measuring up to international standards. Several measures towards strengthening of supervision over banks were also introduced simultaneously. The more complex aspects of legal and accounting measures were ushered in subsequently when the basic tenets of the reforms were already in place. The Objectives of the study is to analyse the absolute financial performance of Punjab and sind bank since the Deregulation of the banking system. it is not as if there has been a clear trend towards improvement over the entire period – a clear trend is discernible only in the period, 1996- 97 to 1999 although even in this period net profit has tended to move both ways.

Keywords: Financial strength, operational efficiency, Indian banks and financial institutions, financial performance, Punjab and sind bank, Deregulation of the banking system, financial performance of Punjab and sind bank since the Deregulation of the banking system.

INTRODUCTION

Soon after independence, as India embarked upon planned economic growth, like any other country, it needed a strong and efficient financial system to meet the multifarious requirements of credit and development. To achieve this objective it adopted a mixed pattern of economic development and devised a financial system to support such development. The success it achieved, particularly in taking banking to the masses and making the banking system a potent vehicle for furthering public policy has few parallels in the world.

The financial strength and operational efficiency of the Indian banks and financial institutions which were working in a highly protected and regulated environment were not measuring up to international standards. The global and domestic developments called for corrections primarily with a view to strengthening the financial system and to bring it on par with institutions abroad. Hence, from 1992, a process of financial sector reforms, as a part of a broader programme of structured economic reforms was set in motion.

REFORMS AND AFTER

The financial sector reforms covered deregulation of policies, prescription of prudential norms based on internationally accepted practices in respect of capital adequacy, income recognition, asset classification and provisioning for impaired assets and introduction of competition in the banking sector. Several measures towards strengthening of supervision over banks were also introduced simultaneously.

The prudential norms were adopted in a phased manner from 1992-93 to make the transition less painful. Till adoption of the prudential norms, twenty-six out of twenty-seven public sector banks were reporting profits (UCO Bank was incurring losses from 1989-90). In the first post-reform year, i.e., 1992-93, the profitability of PSBs as a group turned negative with as many as twelve nationalised banks reporting net losses. The remaining seven nationalised banks could show only marginal profits between Rs. 4 crore and Rs. 38 crore. As on 31 March 1993, only one public sector bank had capital adequacy ratio of above 8 per cent. By March 1996, the outer time limit prescribed for attaining capital adequacy of 8 per cent, eight public sector banks were still short of the prescribed level. The NPAs of the banks aggregating Rs.39,253 crore as on 31 March 1993 brought the latent weaknesses in their asset portfolio out in the open.

REVIEW OF LITERATURE

K S Ramachandra Rao, Abhiman Das, Arvind Kumar Singh (2006) It is believed that the working capital support extended by commercial banks to small-scale industry is far from adequate. Although the SSI is a part of the priority sector, its share in total priority sector advances of all scheduled commercial banks has been falling consistently from around 39 per cent in 1992 to around 24 per cent in 2004. This paper examines the trends in sectoral allocation of bank credit to the SSI vis-à-vis the non-SSI sector in the post-reform period. The paper also makes an attempt to understand the variations in bank credit to the SSI sector across bank groups, and

also the influence of the size and performance of banks on credit to the SSI sector. The results indicate that the high incidence of bad loans arising out of SSI advances could be one of the reasons for the declining share of SSI loans of the commercial banks.

RAJARAM DASGUPTA2005 One of the reasons for the lacklustre performance of both public and private sector banks in extending credit to weaker sections is their high level of NPAs. While credit under the Swarnjayanti Gram Swarozgar Yojna scheme across states has been extended in proportion to the poor in the population, this is not so in the case of self help group (SHG) credit that has been growing at the rate of 120 per cent per annum. However, growth in SHG credit has been uneven. The southern states are seen as SHG-developed states while Bihar and Madhya Pradesh are among those characterised as SHG-backward. But besides the SHG model in extending credit to weaker sections, other different models exist for extending micro credit to the poor and weaker sections.

It is the *RBI's* observations on the period subsequent to *1990-96* that deserve to be carefully noted. The RBI says, "Developments in the subsequent period indicate that a majority of the public sector banks have been able to progress considerably towards the direction of passing the 'acid test' of achieving competitive efficiency. They have been actively engaged in overcoming the challenges of progressively conforming to the international best practices in various areas." The business press loves to hate PSBs. Perhaps it needs to ponder the reasoned assessment of a bank regulator whose credibility in the international markets is quite high.

METHODOLOGY

STATEMENT OF THE PROBLEM

The unique features of the progress in financial sector reforms may be of some interest. First, financial sector reforms were undertaken early in the reform cycle. Second, the reforms process was not driven by any banking crisis, nor was it the outcome of any external support package. Third, the design of the reforms was crafted through domestic expertise, taking on board the international experiences in this respect. Fourth, the reforms were carefully sequenced in respect to instruments and objectives. Thus, prudential norms and supervisory strengthening were introduced early in the reform cycle, followed by interest rate deregulation and gradually lowering of statutory pre-emptions. The more complex aspects of legal and accounting measures were ushered in subsequently when the basic tenets of the reforms were already in place.

OBJECTIVES

- To analyse the absolute financial performance of Punjab and sind bank since the Deregulation of the banking system

DEREGULATION OF BANKING SYSTEM

Has the performance of India's PSBs improved since the onset of financial deregulation in 1992-93? The question is important for more than one reason. It is important to know, first of all, whether the central objective of financial deregulation – improved efficiency – has been furthered. It is important also because improved efficiency is, to some extent, co-terminus with stability in the financial system, for hugely inefficient banks pose threats to the system.

Prudential norms were introduced for income recognition, asset classification, provisioning for delinquent loans and for capital adequacy. In order to reach the stipulated capital adequacy norms, substantial capital were provided by the Government to PSBs. Government pre-emption of banks' resources through statutory liquidity ratio (SLR) and cash reserve ratio (CRR) brought down in steps. Interest rates on the deposits and lending sides almost entirely were deregulated.

New private sector banks allowed promoting and encouraging competition. PSBs were encouraged to approach the public for raising resources. Recovery of debts due to banks and the Financial Institutions Act, 1993 was passed, and special recovery tribunals set up to facilitate quicker recovery of loan arrears. Bank lending norms liberalised and a loan system to ensure better control over credit introduced. Banks asked to set up asset liability management (ALM) systems. RBI guidelines issued for risk management systems in banks encompassing credit, market and operational risks. A credit information bureau being established to identify bad risks. Derivative products such as forward rate agreements (FRAs) and interest rate swaps (IRSs) introduced

NEED FOR THE STUDY

In 1908, leading figures such as Bhai Vir Singh, Sir Sunder Singh Majitha and Sardar Tarlochan Singh founded Punjab & Sind Bank to help the weaker section of the society in their economic endeavours to raise their standard of life.

Punjab and Sind bank was the one of the few banks in northern India who has honored the obligations of the migrating people from Pakistan. In spite of the fact that all its major branches were left in Pakistan and only a few branches were in India after partition.

In 1980 Punjab & Sind Bank was among six banks that the Government of India nationalized in the second wave of nationalizations. (The first wave had been in 1969 when the government nationalized the top 14 banks.)

At some point in the 1970s Punjab & Sind Bank established a branch in London. In 1991 Bank of Baroda acquired Punjab & Sind Bank's London branch.

ANALYSIS AND INTERPRETATION

I. Absolute Performance of Punjab and Sind Bank Since the Deregulation of the Banking System ;

Table 1 shows how the Punjab and Sind Bank performed in respect of five key performance indicators – interest spread, intermediation cost, non-performing assets, provisions and contingencies and net profit, all measured as a percentage of total assets over the period 1991-92, one year before financial deregulation was initiated, to 2006-07. Eyeballing the numbers, it should be evident that there has been an improvement in every one of these indicators in 2006-07over 1991-92 (1995-96 in the case of non-performing assets).

However, it is not as if there has been a clear trend towards improvement over the entire period – a clear trend is discernible only in the period, 1996- 97 to 1999-2000 (which, perhaps explains why the RBI's evaluation has been confined to this period), although even in this period net profit has tended to move both ways. In the initial years, we see ups and downs in all indicators as Punjab and sind bank struggled to come to grips with deregulation.

In the more recent period, the interest spread has increased, which is a sign of improved efficiency in the system. So have intermediation cost, non-performing assets and provisions. Profitability too has not improved over the initial period. Instead the bank has experienced loss from 1992-93 till 1995-96. Profitability has sharply improved from 1996-97

Incidentally, the failure to account for such items, which really do not have a bearing on operational efficiency, or for one-off items such as VRS charges often leads to incorrect perceptions of performance at Punjab and sind bank The picture is not very different when one leaves out the SBI group, which is the better managed component of PSBs. At the 19 nationalised banks too, one finds an improvement in the indicators, with a clear trend in most indicators in the most recent period. The net profit to asset ratio of 0.57and 0.99 is more to the figure of 0.5, which must be regarded as healthy, As there is a great deal of talk about the 'poor health' of PSBs, it is worth comparing the profitability of PSBs with that ofbanks elsewhere. As per data provided by the Bank for International Settlements [BIS 1999], return on assets, defined as profit *before* tax, ranged from –0.08 to 1.07 in the Euro area in 2006 with most countries hovering around the 0.5 mark even on a pre-tax basis. In the Scandinavian countries, return on assets was in the range of 0.9 to 0.95, again on a pre-tax basis. In the UK, returns were higher at 1.19, while Japan recorded a miserable –0.74. The only outliers were US banks (1.42) and Australia (1.39). The return of assets at Punjab and Sind Bank thus does not compare unfavourably with that of banks elsewhere. As the weak banks have been hobbled in their operations pending recapitalisation by government for several years now, it would be more appropriate to evaluate the performance of both Punjab and Sind Bank in the nationalised bank category. It is not possible to compute averages for Punjab and Sind Bank minus the weak years of bank using published data but it is fair to suggest that if we did so the net profit to total assets ratio of the nationalised bank too would move from 0.99 to close to 0.50. The point has been made by some that nine out of 19 nationalised banks showed losses in 2000-01 (eight in 1999-2000) after adjustment of interest on Recapitalisation Bonds, that is, the bonds in which the banks invested the recapitalisation funds they received from government. The implication is that the aggregate profitability numbers for this category are deceptive. There are two ways of responding to this contention. A purely accounting response would be that if the equity provided to the banks is to be used in the denominator in computing return on assets, then it is only appropriate that the relevant income also be included in the numerator. But if we wish to move away from scoring points in accounting terms, we could argue that at least the banks could have raised capital when they needed it had they been allowed or enabled to do so; perhaps, they might have had to under-price their issues, but they could have raised capital all the same. Had they raised capital on their own, they might have invested the proceeds in higher return avenues such as loans instead of in bonds yielding around 10 per cent. So, the profits of the nine banks in question, it could be argued, are understated by adding interest on recapitalisation bonds. Either way, there is little reason to evaluate the banks' performance by excluding such interest.

What exactly has driven the improvement in profitability over the period 1992- 2007 for Punjab and Sind Bank as a whole?

TABLE 1
KEY PERFORMANCE INDICATORS FOR PUNJAB AND SIND BANK

years (As Per Cent of Total Assets)	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Interest spread	2.68	0.64	1.78	2.26	2.15	2.60	2.63	2.38	2.35	2.51	2.30	2.67	3.29	3.64	3.31	3.49
Intermediation cost	3.18	3.32	2.89	2.61	3.06	3.06	2.80	2.57	2.82	2.98	2.77	2.85	3.99	3.63	2.54	2.38
Non-performing assets NA	NA	NA	NA	NA	2.15	2.60	2.63	2.38	2.35	2.51	2.30	2.67	3.29	3.64	3.31	3.49
Provisions and contingencies	0.29	3.22	3.52	0.76	1.94	0.48	0.39	0.29	0.31	0.67	1.02	1.91	0.94	2.09	0.84	1.16
Net profit	0.02	-5.05	-3.65	-.12	-1.83	0.26	0.72	0.57	0.52	0.10	0.17	0.03	0.06	-0.45	0.57	0.99

Note: NA - not available.
Source: For tables, RBI report on Trend and Progress in Banking in India, 2007-2008

TABLE 2
CHANGE IN PROFITABILITY IN 2006-07 RELATIVE TO 1992-93

As Per Cent of Total Assets	Change over 1992-93
Interest spread	0.8156
Intermediation cost	-0.8013
Provisions and contingencies	0.8683
Net profit	0.9746

Source: COMPUTED

It is useful to compare the last year, 2006-07, with the first year of deregulation, 1992-93. Table 2 presents the break-up of the components of profitability in both cases. The individual components presented in the table would not add up to the net profit figure because items such as 'other income' and 'tax' are absent. Nevertheless, we can judge how the key components of profitability have behaved. Comparing, first, 2006-07 with 1992- 93, finding that there is an improvement in net profit as a percentage of total profits of 0.9746 percentage points. This is a huge increase in spread – entirely to be expected in the wake of deregulation – which has been offset by a decline in intermediation cost and, more significantly, by a increase in provisions and contingencies as the level of non-performing assets came down. When we compare 2006-07 with 1992-93, the first year of deregulation, the picture changes somewhat. There is a bigger jump in profitability, 0.9746 percentage points. An increase in spread has contributed to this jump. Provisions increased substantially – understandable since these were very large in the first two years of deregulation when banks' balance sheets were being cleaned up – and a decline in intermediation cost. Putting together the pictures for the

two years, three points are worth making. First, relative to deregulation, there has been an improvement in efficiency in the banking system as a whole by the increase in interest spread. Two, even an increase in provisions has driven the increase in profitability. Thirdly, when we consider only the deregulation period, an increase in spreads has also contributed to improved profitability. In other words, the spread took a big knock at the onset of deregulation but has looked up since although it has stayed below the pre-deregulation level. The recovery in spreads over the deregulation period is worth remarking because, in general, the decline in spreads that follows deregulation is not only steep but hard to reverse. Typically, banks respond to the squeeze on spreads and hence on profitability by taking on bigger risks, and this ultimately destabilises the banking system. In India, the decline in spreads has been contained. By giving banks more time to get their acts together, this factor has contributed to stability in banking. The decline in spreads has been contained because disintermediation, which typically accompanies financial deregulation, has been aborted in the Indian context. Companies are unable to use the capital market as an alternative to banks; hence the downward pressure on loan yields is less than it might have been if the capital market had taken off. More importantly, perhaps, deposit growth has not been threatened because depositors are reluctant to desert banks in favour of capital market instruments, given their experience with the stock market.

Bank deposits as a proportion of GDP have risen from 40.3 per cent of GDP in 1990- 91 to 41.7 per cent in 1999-2000; a stronger indicator of aborted disintermediation is the decline in the ratio of shares and debentures in saving of the household sector from 14.3 per cent in 1990-91 to 2.5 per cent in 1999-2000, the last year for which RBI data is available [RBI 2007].

CONCLUSION

Financial sector reform is a continuous process that needs to be in tune with the emerging macroeconomic realities and the state of maturity of institutions and markets, mindful of financial stability. In this changing milieu, there are several areas which are being addressed now. The first issue pertains to capital account convertibility. In view of the rapid changes that have taken place over the last few years and the growing integration of the Indian economy with the world economy, the RBI has recently set up a Committee comprising eminent policymakers, financial sector experts and academia to suggest roadmap forfuller capital account convertibility.

The Committee is required to, in this context, examine the implications of fuller capital account convertibility on monetary and exchange rate management, financial markets and financial system. An important issue, specifically relating to the banking sector, is consolidation. Despite the liberalisation process, the structure of the Indian banking system has continued without much change though development finance institutions were merged with banks. The consolidation process within the banking system in recent years has primarily been confined to a few mergers in the privatesector segment induced by financial position of the banks. Some mergers may take place in future for compliance with minimum net worth requirement or norms on diversified ownership. The RBI has created an enabling environment by laying down guidelines on mergers and acquisitions.

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