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# Assessment of Earning Quality of Indian Commercial Banks

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**Abstract:** *Liberalisation, Privatisation and Globalisation has changed the ways of banking business in India and the banks are facing a challenge to improve their earnings on one hand and to serve the customers efficiently in innovative ways on the other hand. Earning quality is an important criterion for determining the efficiency of banks. Raising their earnings is one of the important ways by which a bank can vigorously expand its operation on sustained long term basis. The present study is concerned with assessing the earning quality of Indian commercial banks by computing related ratios and the study period is ten years. The banks are classified into three bank groups namely SBI group, Nationalised bank group and Private bank group and the secondary data is used to assess the earning quality of Indian commercial banks successfully.*

**Keywords:** *Burden, Spread, Interest income, Noninterest income, Working Fund.*

## Introduction

Globalisation is transforming every sector to vibrate on the concept of the survival of the fittest. The Indian banking sector also has to follow the same concept admist the entry of many foreign banks entering into the field of competition. For the survival and to compete, growth and reforms are necessary in the field of banking. Profitability leads the banks to meet out the forthcoming challenges. It is an important criterion to evaluate the overall efficiency of a bank group.

The earning quality of commercial bank is of great significance and its measurement is vitally important as it contributes not only to individual bank's earning but also it paves way for the economic development of the society as a whole. Commercial banks earnings are interest, discount, dividend income, commission, exchange charges and brokerage, fee on loans and other service charges. The earnings of a commercial bank is the result of the revenue and cost function. The revenue function shows the total income of the bank is derived from the services rendered by it and the cost function shows total expenses incurred on producing any services rendered by it.

Commercial bank's expenses are fixed in the short run. The bank's expenditure cannot be minimised by suspending operations or by reducing its working force. The expenses of the bank are not closely related with the volume of the business. The bank expenditure are interest on deposits and borrowings, salaries, allowances and other general expenses such as depreciation, stationery ,audit fee, law charges etc.

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The earning quality of a commercial bank depends on its maximising income and minimised operational expenditure. It is studied by computing profitability ratios, spread and burden related ratios.

**Statement of Problem**

Banking industry is pre-eminently a service-oriented industry. For survival and growth a bank has to be efficient and effective in utilisation of resources and provide excellent services to customers. Efficiency of any bank depends on its profitability and to earn income operating surplus must exceed operating expenses. So the relationship between the surplus and expenses are studied through ratios. Earning capacity of a bank has a great social relevance. Bank itself a socio economic institution contributes directly and indirectly to the social welfare and development of a country. Hence the paper focus on assessing the earning quality of banks through ratios analysis.

**Objectives**

The following are the objectives of the study:

1) To assess the earning quality of scheduled commercial banks in India
2) To offer suitable suggestions to improve the earning quality of commercial banks.

**Limitations**

The following are the main limitations of the study:

i) The study focuses only on certain computed ratios to assess the earning quality of banks while it is affected by number of factors.
ii) The study is based on secondary data as published in various publications of RBI and other reports.
iii) The study is confined only to a period of ten years.

**Methodology**

The study is based on secondary data. The RBI publications like, "Report on Trend and Progress of Banking in India", "Annual Reports of RBI", and "Reports on Currency and Finance" are the major sources for this study.

An analytical study of the Indian Banking Group is carried out for the period of ten years from 2004-2005 and 2013-2014. Forty six banks were identified from banking groups. The banks were categorized under three groups which include 6 banks belonging to SBI and its Associate group, 20 banks in nationalised bank group and 20 in Private Sector banks group.

**Hypothesis**

The increase in the earning quality has a direct and positive effect on the profitability of the banks.

**Concepts Used In the Study**

**Burden**

It is the excess of non-interest expenditure over non-interest income of the banks.

**Profit**

The excess of total revenue over total cost during a specific period of time, normally a year is called profit. It refers to the excess of income over expenditure and provisions in a given period of time.

**Profitability**

Profitability may be defined as the ability to earn a return from the investments made. It indicates the financial stability and greater the possibility of profit-earning the easier it is to attract capital investment. The profitability depends on the ability of the management o deal with overcoming risks and uncertainties through shifting them or hedging benefits, risks involved policy decision etc.

**Spread**

Spread is the difference between the interest earned and interest paid by the banks

**Working funds**

Total assets minus inter-bank adjustments is called working funds.

**ANALYSIS AND INTERPRETATION**

Earning Quality means the profitability of banks. The profitability of the banks is assessed by means of various ratios classified as the ratios related to spread and burden. Spread is the difference between interest incomes to interest expended. Burden is the difference between non-interest expenses to non- interest income. The ratios considered under this category are :

A) Spread Related Ratios:
   - i) Ratio of Interest Income to Working Fund
   - ii) Ratio of Interest Expended to Working Fund
   - iii) Ratio of spread to Working Fund

B) Burden Related Ratios:
   - i) Ratio of Non-Interest Income to Working Fund
   - ii) Ratio of Non-Interest Expenses to Working Fund
   - iii) Ratio of Burden to Working Fund

**Spread Related Ratios**

**Ratio of Interest Income to Working Fund**

The ratios of interest income to working fund for ten years for three bank groups reveal that the ratios of the highest consistency level in SBI group (CV.6.71%) followed by the Nationalised bank group (CV. 7.19%). The Private bank group shows the CV. of 11.65 percent with the lowest consistency level. The mean ratio of the Private bank group is the highest of 7.38 percent and least of 7.23 percent found in Nationalised bank group.

An insight into the SBI group ratios reveal that the ratios are recorded highest of 7.95 percent in the year 2013-14 and the least of 6.88 percent in the year 2010-11.

The ratios of Nationalised bank group shows the highest position of 8 percent found in 2011-12 and least level of 6.67 percent in 2004-05. The mean ratio is 7.23 percent.

Private bank group ratios show the highest of 8.37 percent found in the years 2012-13 and 2013-14 and the least of 6.14 percent found in the year 2004-05.

**Table 1: Ratio of Interest Income to Working Fund**

| Year | SBI Group | Nationalised Banks Group | Private Sector Banks Group |
|---|---|---|---|
| 2004-2005 | 7.03 | 6.67 | 6.14 |
| 2005-2006 | 7.14 | 6.71 | 6.16 |
| 2006-2007 | 7.00 | 6.85 | 6.87 |
| 2007-2008 | 7.06 | 7.11 | 7.55 |
| 2008-2009 | 6.99 | 7.42 | 8.28 |
| 2009-2010 | 6.95 | 6.88 | 7.20 |
| 2010-2011 | 6.88 | 6.95 | 6.93 |
| 2011-2012 | 8.12 | 8.00 | 7.95 |
| 2012-2013 | 7.93 | 7.99 | 8.37 |
| 2013-2014 | 7.95 | 7.73 | 8.37 |
| Mean | 7.30 | 7.23 | 7.38 |
| SD | 0.49 | 0.52 | 0.86 |
| CV | 6.71 | 7.19 | 11.65 |

**Source: Data computed and compiled from the various issues of statistical tables relating to banks in India (RBI).**

## Ratio of interest Expended to Working Fund

The ratio of interest expended to working fund for three bank group reveals that the ratios are more consistent for SBI group (CV. 10.65%) and the least consistency is found in Nationalised bank group (CV. 14.58%), whereas Private bank group shows also show similar level of consistency with CV. 14.25%.

**Table 2: Ratio of Interest Expended To Working Fund**

| Year | SBI Group | Nationalised Banks Group | Private Sector Banks Group |
|---|---|---|---|
| 2004-2005 | 3.96 | 3.84 | 3.80 |
| 2005-2006 | 4.06 | 3.97 | 3.76 |
| 2006-2007 | 4.05 | 4.26 | 4.42 |
| 2007-2008 | 4.79 | 5.04 | 5.16 |
| 2008-2009 | 4.84 | 5.30 | 5.54 |
| 2009-2010 | 4.70 | 4.82 | 4.45 |
| 2010-2011 | 4.20 | 4.45 | 4.09 |
| 2011-2012 | 5.02 | 5.62 | 5.13 |
| 2012-2013 | 5.16 | 5.75 | 5.38 |
| 2013-2014 | 5.23 | 5.60 | 5.26 |
| Mean | 4.60 | 4.87 | 4.70 |
| SD | 0.49 | 0.71 | 0.67 |
| CV | 10.65 | 14.58 | 14.25 |

**Source: Data computed and compiled from the various issues of statistical tables relating to banks in India (RBI).**

SBI group ratios reveal that the interest expended to working fund with highest proportion of 5.23 percent in the year 2013-14 and the least proportion of 3.96 percent found in 2004-05. The mean ratio is 4.60 which is the least than other two groups.

Nationalised bank group ratios indicate the highest level of 5.75 percent in the year 2012-13 and least level of 3.84 percent found in 2004-05. The mean ratio is the highest of 4.87 percent than other two groups.

Private bank group ratios highest level of 5.54 percent found in 2008-09 and least of 3.80 percent found in 2004-05. The mean ratio is 4.70 percent.

### Ratio of Spread to Working Fund

The spread to working fund ratios for ten years shows the highest consistency level with minimum variability (CV.13.01%) found in SBI group, and maximum variability with minimum consistency found in Private bank group (CV.17.69%)

**Table 3: Ratio of Spread to Working Fund**

| Year | SBI Group | Nationalised Banks Group | Private Sector Banks Group |
|---|---|---|---|
| 2004-2005 | 3.06 | 2.83 | 1.49 |
| 2005-2006 | 3.08 | 2.73 | 2.40 |
| 2006-2007 | 2.80 | 2.58 | 2.45 |
| 2007-2008 | 2.27 | 2.07 | 2.39 |
| 2008-2009 | 2.15 | 2.12 | 2.74 |
| 2009-2010 | 2.25 | 2.06 | 2.75 |
| 2010-2011 | 2.68 | 2.50 | 2.84 |
| 2011-2012 | 3.09 | 2.38 | 2.82 |
| 2012-2013 | 2.77 | 2.24 | 2.98 |
| 2013-2014 | 2.72 | 2.13 | 3.11 |
| Mean | 2.69 | 2.36 | 2.60 |
| SD | 0.35 | 0.28 | 0.46 |
| CV | 13.01 | 11.86 | 17.69 |

**Source: Data computed and compiled from the various issues of statistical tables relating to banks in India (RBI).**

An insight into the SBI group indicates that the ratio of 3.09 percent being highest level found in the year 2011-12 and least level of 2.15 percent in the year 2008-09. The mean is 2.69 percent, the highest than other groups.

On analysing the Nationalised bank group it reveals that the highest ratio of 2.83 percent found in 2004-05 and the least ratio of 2.06 percent found in 2009-10. The mean ratio is 2.36 percent.

The ratios of Private bank group shows that the highest level of 3.11 percent found in 2013-14 and lowest level of 1.49 percent found in 2004-05. The mean ratio shows 2.60 percent.

### Burden Related Ratios

### Ratio of Non-Interest Income to Working Fund

The table showing the ratios of non-interest income to working fund for three bank groups for ten years reveal that the ratios are more consistent in Private bank group (CV.9.49%). The SBI group shows the CV. of 16.10% and the least level of consistency with CV. 16.10% is found in Nationalised bank group.

SBI group ratios reveal that the proportion of non-interest income to working fund is found highest of 1.51 percent in the year 2012-13 and least of 0.96 percent in 2012-13 with a mean ratio of 1.18 percent.

Nationalised bank group ratio indicates that the highest ratio of 1.27 percent found in the year 2004-05 and least of 0.75 percent in the year 2013-14. The mean ratio is 0.92 percent.

Private bank group ratio is recorded highest of 1.81 percent in 2007-08 and lowest of 1.42 percent in 2005-06. The mean ratio is 1.58 percent.

**Table 4: Ratio of Non-Interest Income to Working Fund**

| Year | SBI Group | Nationalised Banks Group | Private Sector Banks Group |
|---|---|---|---|
| 2004-2005 | 1.51 | 1.27 | 1.49 |
| 2005-2006 | 1.38 | 0.94 | 1.42 |
| 2006-2007 | 0.97 | 0.80 | 1.49 |
| 2007-2008 | 1.18 | 1.04 | 1.81 |
| 2008-2009 | 1.26 | 1.05 | 1.75 |
| 2009-2010 | 1.30 | 1.01 | 1.78 |
| 2010-2011 | 1.21 | 0.78 | 1.47 |
| 2011-2012 | 1.01 | 0.76 | 1.48 |
| 2012-2013 | 0.96 | 0.76 | 1.50 |
| 2013-2014 | 0.98 | 0.75 | 1.57 |
| Mean | 1.18 | 0.92 | 1.58 |
| SD | 0.19 | 0.17 | 0.15 |
| CV | 16.10 | 18.48 | 9.49 |

**Source: Data computed and compiled from the various issues of statistical tables relating to banks in India (RBI).**

## Ratio of Non-Interest Expenses to Working Fund

The ratio of non-interest expenses to working fund for ten years for three bank group shows that the highest level of consistency in Private bank group ratios (CV. 2.93%) and least level of consistency in Nationalised bank group (CV.16.99%). The mean ratio is found least of 1.53 percent in Nationalised bank group followed by SBI group of 1.89 percent and Private bank group mean is 2.05 percent.

SBI group ratios for ten years reveal that the highest level of 2.28 percent found in the year 2005-06 and least level of 1.57 percent found in 2008-09.

Nationalised bank group ratios indicate the highest level of 2.02 percent in 2004-05 and least of 1.32 percent in 2012-13.

Private bank group position shows that he highest of 2.16 percent found in 2007-08 and least of 1.97 percent found in 2010-11.

**Table 5: Ratio of Non-Interest Expenses to Working Fund**

| Year | SBI Group | Nationalised Banks Group | Private Sector Banks Group |
|---|---|---|---|
| 2004-2005 | 2.14 | 2.02 | 2.01 |
| 2005-2006 | 2.28 | 1.93 | 2.11 |
| 2006-2007 | 2.00 | 1.67 | 2.06 |
| 2007-2008 | 1.70 | 1.48 | 2.16 |
| 2008-2009 | 1.57 | 1.41 | 2.12 |
| 2009-2010 | 1.79 | 1.35 | 1.99 |
| 2010-2011 | 1.83 | 1.46 | 1.97 |
| 2011-2012 | 1.85 | 1.35 | 2.01 |
| 2012-2013 | 1.80 | 1.32 | 2.03 |
| 2013-2014 | 1.95 | 1.33 | 2.06 |
| Mean | 1.89 | 1.53 | 2.05 |
| SD | 0.21 | 0.26 | 0.06 |
| CV | 11.11 | 16.99 | 2.93 |

**Source: Data computed and compiled from the various issues of statistical tables relating to banks in India (RBI).**

## Ratio of Burden to Working Fund

The ratios of burden to working fund of three bank groups for ten years reveals that the ratios of Private bank group shows the highest level of consistency with the CV. of 27.05 percent, whereas the SBI group and Nationalised bank group shows more variability and least consistency with CV. of 32.39 percent and CV. 50 percent respectively.

**Table 6: Ratio of Burden to Working Fund**

| Year | SBI Group | Nationalised Banks Group | Private Sector Banks Group |
|---|---|---|---|
| 2004-2005 | 0.63 | 0.75 | 0.53 |
| 2005-2006 | 0.90 | 0.99 | 0.69 |
| 2006-2007 | 1.02 | 0.87 | 0.56 |
| 2007-2008 | 0.52 | 0.43 | 0.35 |
| 2008-2009 | 0.31 | 0.36 | 0.37 |
| 2009-2010 | 0.49 | 0.34 | 0.21 |
| 2010-2011 | 0.62 | 1.50 | 0.49 |
| 2011-2012 | 0.84 | 0.58 | 0.53 |
| 2012-2013 | 0.84 | 0.57 | 0.54 |
| 2013-2014 | 0.97 | 0.58 | 0.49 |
| Mean | 0.71 | 0.70 | 0.48 |
| SD | 0.23 | 0.35 | 0.13 |
| CV | 32.39 | 50.00 | 27.08 |

**Source: Data computed and compiled from the various issues of statistical tables relating to banks in India (RBI).**

The ratios of burden to working fund for SBI group for ten years reveal that the ratios are at the highest level of 102 percent in the year 2006-07 and least level of 0.31 percent in the year 2008-09. The mean of the ratio is 0.71 percent.

The ratios of Nationalised bank group indicates the highest level of 0.99 percent in the year 2005-06 and he least level of 0.34 percent in 2009-10. The mean of the ratio is 0.70 percent

The ratios of Private bank group highest level of 0.69 percent found in 2005-06 and lowest level of 0.21 percent in 2009-10. The mean of the ratio is 0.48 percent.

## Findings

1. The ratio of interest income to working fund reveals that the Private bank group interest income is the highest with the mean ratio of 7.38 percent. The mean proportion of interest income of SBI group and the Nationalised bank group are 7.30 and 7.23 percent respectively. The SBI group ratios are the most consistent (CV. 6.71%) than other bank groups.
2. Interest expended to working fund ratios are found highest in Nationalised bank group with mean of 4.87 percent and it is least of 4.60 percent in SBI group.
3. The highest ratio of spread to working fund of 3.11 percent in 2013-14 and least of 1.49 percent in 2004-05 is found in Private bank group, which indicate that the private bank group have increased their interest income and decreased their expenses in recent years.

The SBI group ratio is 2.69 percent and Nationalised bank group is 2.36 percent. The spread ratio is consistent in Nationalised bank group.

4. Highest mean of non-interest income to working fund of 1.58 percent is found in Private bank group and least of 0.92 percent found in Nationalised bank group.
5. Non-interest expenses to working fund ratio reveals that the proportion of non-interest expenses of 1.53 percent is found in Nationalised bank group and the highest of 2.05 percent is Private bank group.
6. The ratio of burden to working fund of the three bank group indicate that the mean of SBI group and Nationalised bank group show a mean of 0.71 and 0.70 with little variation. The Private bank group have the least mean of 0.48 percent and the ratios are the most consistent than other groups.
7. The Private bank group ratios indicate that the earning capacity of them have increased in recent years as their interest and interest income have increased in recent years than the SBI and Nationalised bank group. The SBI group ratios reveal that the earning capacity is increasing gradually. The Nationalised bank group indicate increase in earning capacity increases at the least level than other groups. The highest level of variability is seen in Private bank group and the ratios of SBI group are more consistent.

**Suggestions**

1. Reducing burden and enhancing spread strategies are ideal.
2. Banks may reduce establishment expenditure by adopting innovative banking techniques.
3. Banks may concentrate on other specialised services to enhance non-interest income.
4. Enhancing the customer base by rendering efficient and quality services may increase their earnings.

**Conclusion**

Indian commercial banks the barometers of the Indian economy play a key role in the up liftment of the country. Earning quality of various commercial banks indicates the current climate of the economy and it foretells its future. The study reveals that the earning quality of all the Indian Commercial banks increased in recent years. The Private sector banks earn more interest and noninterest income than the nationalised commercial banks. The Nationalised banks have to improve their earning quality as its role is inevitable in the improvement of the priority sectors.

All the banks should strive to earn more profits as the competition is increasing due to the entry of foreign banks. Altogether the earning capacities of all the banks are in the pace of success.

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