Int. Journal of Management and Development Studies 6(1): 01-06 (2017)
ISSN (Online): 2320-0685. ISSN (Print): 2321-1423
Impact Factor: 0.715

Impact of Financial Performance on Development of New Generation Banks

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Abstract: *The development of any bank depends on the extent to which its financial system efficiently and effectively mobilizes and allocates resources. There are a number of public, private banks and financial institutions that execute this function one of them is the new generation bank. New generation banks are the unique financial institutions that perform the special task of fostering the development of a nation, normally not undertaken by other banks. New generation banks are financial agencies that offer medium and long-term financial assistance and act as catalytic agents in promoting balanced growth of the country. The present study aimed that the impact of financial performance on development of new generation banks in Erode district.*

Keywords: Bank, Financial system, Execute, Agencies, Assistance.

Introduction

Finance is regarded as the life blood of a business it is one of the foundations of all kinds of economic activities. The justification is deemed to be financially sound if it is in a position to carry on its activity smoothly. Normally the main objective of any organization is to earn profit. Profit determines the financial position, Liquidity and solvency of the organization. It serves as a yardstick for judging the competence and efficiency of the management. Profit planning is therefore, a fundamental part of the overall management functions and is an important part of the total budgeting process. In recent years, there have been considerable pressures on the profitability of the banks and financial institutions, profitability is considered to be an index of financial health. The term profitability refers to an indication of the efficiency with which the operation of the business is carried on. Poor operational performance may indicate poor selling of bank products and hence poor profits. A lower profitability may rise due to lack of control over the expenses. Banking system occupies an important place in a nation's economy. A banking institution is indispensable in a modern society. It plays a pivotal role in the economic development of a country. Thus, economic development of a country depends upon the success of its banking industry and this success is determined to a large extent by understanding the needs and satisfaction of its customers. In the earlier societies functions of a bank were done by the corresponding institution dealing with loans and advances.

The banking and financial services sector is in a position to benefit most by leveraging technology and is a sector that has absorbed the technology to a great extent. Now-a-days a condition has reached in which this sector cannot survive without the support of information and communication technology. Banks, world over, have been effectively deploying information and communication technology as a strategic resource to achieve speed, efficiency, cost reduction,

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customer service and competitive advantage. Technology enabled banking services offer value to customers providing them with anywhere, anytime and anyway banking. Though these technological changes have been pioneered in India by new private sector and foreign banks, now such a situation has reached where even the traditional banks in the public sector and old private banks are increasingly pursuing technology-enabled services. All banks in India have realized in the post-liberalisation era that in order to remain competitive and provide the best services to their customers, they need to have the latest technology in place. Irrespective of their ownership status (public sector or private sector), almost all of them have given maximum importance to technological development and deployment. Banks and Financial Institutions are urged to generate sufficient revenue to meet the rising cost of funds. Profitability is a key result area where performance and results directly and virtually affect the survival. New generation banks play an important role in the economic development of every nation. They have control over the environment. They provide financial assistance to the small investors and develop their entrepreneur skill. Hence, the present study aimed that the impact of financial performance on development of new generation banks in Erode district.

Materials and Methods

Das (2010) made an attempt on the Indian banking industry with regard to financial liberalization and banking sector efficiency for a time period of 1980-2007. Using Stochastic approach and RBI data for 60 Indian commercial banks on the basis of empirical investigation, the study concludes that after financial liberalization there has been no significant change in the cost efficiency of the public sector banks and the domestic private sector banks are becoming more efficient in comparison to the public sector and the foreign banks. Ray and Das (2010) conducted a study on the distribution of cost and profit efficiency in the Indian Banking Industry for a time period of 1997-2003. Using nonparametric DEA methodology, nonparametric Kernel density estimation, the results of the study reveals that there is relatively high cost efficiency levels for Indian banks during the post reform period 1997-2003. There is no definite evidence that privatization enhances efficiency. Rayappan and Shunmughan (2009) made an attempt to review the progress of banking in Erode District by making an analysis of banking development of three sectors such as Public Sector, Private Sector and Co-operative Banks. These banks constitute the organized banking system of the District. The study concluded that Banking system of Erode District comprises of public sector, private sector and co-operative banks, with a wide network of branches spread all over the district. Canara bank with the highest number of branches in its fold (45) is the Lead bank of the district representing 35 rural branches, 7 semi urban branches and 3 urban branches.

Methodology is a mode to systematically solve the research problems. It explains the various steps that are generally adopted by the researcher in studying the research problems along with the logic behind it. This study used both primary data and secondary data. For collecting primary data field survey technique was undertaken in the study. The researcher has collected first-hand information from one hundred employees of new generation banks in Erode district by means of using questionnaires. The respondents were selected on the basis of simple random sampling technique. Structural Equation Modeling method was employed for further analysis.

Results and Discussion

In structural equation modeling, the confirmatory factor model is imposed on the data. In this case, the purpose of structural equation modeling is twofold. First, it aims to obtain estimates of the parameters of the model, i.e. the factor loadings, the variances and covariances of the factor, and the residual error variances of the observed variables. The second purpose is to assess the fit of the model, i.e. to assess whether the model itself provides a good fit to the data.

Table 1: Manifest Variables and Latent Variable Considering for Measuring the Impact of Financial Performance on Development of New Generation Banks (Estimates)

Manifest Variables	Latent Variables
Return on investment	**Development of New Generation Banks**
Net income before taxes	
Increasing value of the firm	
Value added per employee	
Gross annual turnover	
Return on assets	

The research hypotheses have been defined on the basis of the factors regarding impact of financial performance on development of new generation banks.

H_1: There is no significant relationship between return on investment and the development of new generation banks.

H_2: There is no significant relationship between net income before taxes and the development of new generation banks.

H_3: There is no significant relationship between Increasing value of the firm and the development of new generation banks.

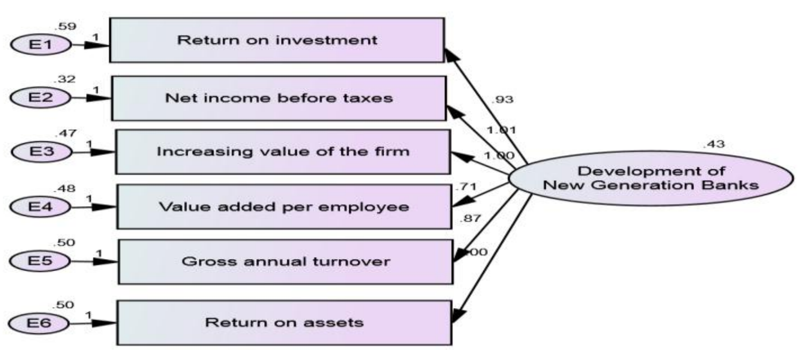
H_4: There is no significant relationship between Value added per employee and the development of new generation banks.

H_5: There is no significant relationship between Gross annual turnover and the development of new generation banks.

H_6: There is no significant relationship between Return on assets and the development of new generation banks.

To test the hypotheses Structural Equation Model was used and the output is presented in the form of path diagram. The sketch of the path diagram is given in the figure 4.1.

Figure 1: Path Diagram Indicating the Impact of Financial Performance on Development of New Generation Banks



(Note: Chi-square = 13.859, Degrees of freedom = 9 and Probability level = .127**)**

In the above path diagram, the values attached to one-way arrows / directional effects are regression coefficients. The regression coefficients and correlations measure the strength of the relations between the variables. A regression coefficient of 0.93 for return on investment indicates a strong relationship with the growth of new generation banks. A regression coefficient of 1.01 for net income before taxes indicates a strong relationship with the development of new generation banks. The factor ‘increasing value of a firm’ also is having a substantial relationship with the development of new generation banks with the regression coefficients of 1.00. A regression coefficient of 1.00 for the return on investments indicates a close relationship with the development of new generation banks. On the other hand, a regression coefficient of 0.87 for gross annual turnover and 0.71 for value added per employee indicates a strong relationship with the development of new generation banks. The analysis indicates that all the six factors namely return on investment, net income before taxes, increasing value of the firm, value added per employee, gross annual turnover and return on assets put together highly influenced the development of new generation banks. The researchers applied model fit indices to decide whether to accept this model or to fine tune the model further. The result of model fit test is presented in Table No. 2.

Table 2: Model Fit Indices of Impact of Financial Performance on Development of New Generation Banks

No.	Test Factor	Calculated Value	Acceptable Value
1	GFI (Goodness-of-fit-index)	0.958	>=0.90 and above satisfactory fit 0.80 to <0.9 acceptable fit (Hair et al.2006)
2	AGFI(Adjusted goodness-of-fit-index)	0.902	
3	CFI(Comparative fit index)	0.972	
4	NFI (Normed fit index)	0.925	
5	TLI (Tucker-Lewis index)	0.953	
6	RMSEA (Root mean square error of approximation)	0.074	0.08 or less would indicate a close fit of the model

The table 2 indicates that the model fit indices of factors influencing the selecting a plant in industrial locality. The Goodness of fit index (GFI) score is 0.958, adjusted goodness of fit index (AGFI) score is 0.902, comparative fit index (CFI) score is 0.972, normed fit index (NFI) score is 0.925, Trucker Lewis index (TLI) score is 0.953. The root mean Squared Error of Approximation (RMSEA) secured 0.074 that indicates that the model is a close fit with a reasonable error of approximation. From the analysis, it is inferred that all the six variables selected for the analysis are well fit and it proves that all these variables clearly indicates their relationship with development of new generation banks in the study area.

Table 3: Variance-Covariance Matrix of Estimates

Factor	1	2	3	4	5	6
1	.031					
2	.014	.027				
3	.014	.015	.030			
4	.010	.011	.011	.022		
5	.012	.013	.013	.009	.027	
6	-.012	-.014	-.013	-.009	-.011	.015

Table 4: Regression Weights for Considering Financial Performance on Development of New Generation Banks

Measured Variable		Latent Variable	Estimate	S.E.	C.R.	P
Return on investment	<---	Development of New Generation Banks	.926	.175	5.293	Significant at 1% level
Net income before taxes	<---	Development of New Generation Banks	1.015	.163	6.232	Significant at 1% level
Increasing value of the firm	<---	Development of New Generation Banks	.999	.173	5.793	Significant at 1% level
Value added per employee	<---	Development of New Generation Banks	.710	.147	4.823	Significant at 1% level
Gross annual turnover	<---	Development of New Generation Banks	.868	.163	5.330	Significant at 1% level
Return on assets	<---	Development of New Generation Banks	1.000			

From the result shown in table 4, it is noted that estimates of the coefficient of net income before taxes and increasing value of the firm which affected the growth of new generation banks and it indicates that both factors are highly influenced the development of new generation banks. Further, the analysis indicated that all the variables are having positive relationship with the development of new generation banks and significant at 1% level.

Table 5: Inversion of Correlation Matrix

	Return on investment	Net income before taxes	Increasing value of the firm	Value added per employee	Gross annual turnover	Return on assets
Return on investment	1.584	-.686	-.397	-.169	.116	.011
Net income before taxes	-.686	1.947	-.132	-.282	-.344	-.421
Increasing value of the firm	-.397	-.132	1.748	.049	-.504	-.513
Value added per employee	-.169	-.282	.049	1.378	-.273	-.257
Gross annual turnover	.116	-.344	-.504	-.273	1.552	-.155
Return on assets	.011	-.421	-.513	-.257	-.155	1.650

The above table shows the inversion of correlation between the variables. From the analysis, it is inferred that all the six variables selected for the analysis are well fit and it proves that all these variables clearly indicates their relationship with development of new generation banks in the study area.

Suggestions and Conclusion

Banks and Financial Institutions are urged to create adequate revenue to meet the rising cost of funds. Profitability is a key result area where performance and results directly and virtually affect the survival. New Generation Banks play a vital role in the economic development of every nation. They have control over the environment. They provide financial assistance to the small investors and develop their entrepreneur skill. It is noted from the analysis that all the selected New Generation Banks are depending more on debt funds. It will create more interest burden, which will affect the profitability position. Hence it is suggested for all the selected New Generation Banks should reduce its dependence on debt and they must create adequate margin of safety to their creditors. The enormous amount of finance required for all economic development could not be met by government itself. Now India has been successful at developing a large financial sector, and one of the largest capital markets in the developing world. In this context, the concept of new generation banking came into the picture with the objective of mobilizing resources from the internal and exterior sources besides government. The Indian financial system has undergone a notable transformation over the last six decades and now comprises an inspiring network of financial institutions mainly in the public and co-operative sectors – financial markets and a wide range of financial instruments. The system has become more sophisticated in response to the varied needs of the country.

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