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Bank Profitability in India: A Study of Public Sector Banks

Niharika

Ph.D. Research Scholar (UGC-SRF), Department of Economics, Panjab University, Chandigarh, India

Abstract

Bank profitability elucidates the financial ability and income earning capability of a financial institution. It is a pertinent parameter to gauge the financial health of a nation. In this context, the contemporaryresearch study aims to appraise and evaluate the performance of all the 27 Indian public sector banks on three major indicators of profitability, namely 'return on assets', 'return on equity' and 'cost of deposit' for a period of eight years i.e. from 2010 to 2017. The results exhibited that all public sector banks have experienced negative growth in regard to return on their assets and return on their equity during the undertaken time period. Out of all the public sector banks, IDBI and State Bank of Patiala registered the maximum negative growth with respect to return on assets and return on equity, respectively. Further, the Corporation Bank registered highest growth rate in context to cost of deposit during the undertaken years, thereby stipulating a reduction in the profits of a bank owing to higher cost of deposit ratio.

Keywords: *Bank Profitability, Public Sector Banks, Return on Assets, Return on Equity, Cost of Deposit.*

1. Introduction

Globally speaking, the financial sector has undergone major transformation over the years due to policy reforms in the regulatory frameworks as well as up-gradation in technology. The major change that was ushered in the Indian banking system was in the year 1969, when 14 major banks were nationalised followed by series of other policy changes such as introduction of lead bank scheme in 1969, priority sector lending and establishment of Regional Rural Banks (RRBs) in 1975 and finally the introduction of the structural changes in 1991, when on the recommendations of Narsimham Committee-I', the banking sector reforms were initiated (Ataullah, and Le, 2006). These reforms were mainly directed to create a competitive environment, thereby allowing admission of private players in the banking sector so as to improve the overall financial performance of the Indian banking system (Sathye, 2003). Financial performance of a bank can be gauged by a number of parameters such as profitability, solvency, liquidity, efficiency etc. Since, profitability is a prime parameter to ascertain and evaluate the financial health of a country,it has been observed that banks in the less developed financial markets tend to have larger profits and margins with costly and inefficient activities, while those in developed financial systems have tougher competition, efficient markets and lower profits (Demirguc-Kunt and Huizinga, 2000)

The main aim of the present study isto assess and evaluate the profitability of Indian public sector banks, which is paramount for economic growth as it reflects the financial ability and profit earning capability of a financial institution. Bank profitability, which is a significantly important dimension of financial health, can be measured by the following three indicators:

- **Return on Assets:** This indicator reflects the capability of a bank to generate income from bank's assets. It is positively related to the profit generating capacity of the banks in general.
- **Return on Equity:** This ratio computes the profits of a bank earned in comparison to the total amount of shareholder equity. It is also positively associated with the bank profitability.
- **Cost of Deposit:** It is the ratio of interest per deposit divided by the total deposits and is negatively related with the bank profitability.