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Impact of Global Recession on Public Sector Commercial Banks in India

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ABSTRACT: Banks act as important players in the financial markets. They play a vital role in the economy of a country. The Recession that began in December 2007 impacted the revenues and profitability of businesses worldwide. The Indian banking system is relatively insulated from the factors leading to the turmoil in the global banking industry. Our study is timely since it measures the recent performance of Indian banks after the global financial crisis. One of the mandates of financial sector reforms was to strengthen India's banking system. Performance refers to financial performance of banks which is measured by relevant accounting ratios. These can be measured through return on assets and return on equity. Efficiency refers to cost efficiency, which is the ability produce a given level of output at lower inputs. There is generally the review that Indian banking could withstand the global financial crisis.

KEYWORDS: Recession, Financial, Indian, Banking and Global.

I. INTRODUCTION

Banks act as important players in the financial markets. They play a vital role in the economy of a country. The Recession that began in December 2007 impacted the revenues and profitability of businesses worldwide. The Indian banking system is relatively insulated from the factors leading to the turmoil in the global banking industry. Our study is timely since it measures the recent performance of Indian banks after the global financial crisis. The financial sector reforms in 1990s paved for increasing efficiency through incorporating competition in the sector. One of the mandates of financial sector reforms was to strengthen India's banking system. After the financial sector reforms in 1990s, global financial crisis swept the global financial sector. As a result, the efficiency issue has again caught the attention. Indian banking is interesting because of diversity of bank ownership forms. Indian banks can be classified into four ownership groups: public sector banks, private sector banks, foreign banks and cooperative banks. The question that we address in this study is: what is the impact of global financial crisis on Indian banks. Performance refers to financial performance of banks which is measured by relevant accounting ratios. These can be measured through return on assets and return on equity. Efficiency refers to cost efficiency, which is the ability produce a given level of output at lower inputs. There is generally the review that Indian banking could withstand the global financial crisis. Several reasons such as effective regulation, banking environment may be attributable to it. In India, banking sector comprises of domestic banks .

The sub-prime crisis that emerged in the US housing market in the year 2007 resulted into a global financial crisis, leading to global financial recession. The financial landscape has significantly changed after the collapse of Lehman Brothers in September 2008. The impact of the crisis can be gauged from the sharp upward estimates of possible write-downs by banks and financial institutions from US\$500 billion in March 2008 to about US\$3.5 billion in October 2009. The crisis indicated that irrespective to the degree of globalisation of a country and soundness of its domestic policies, a financial sector could affect every economy. The crisis has impacted different economies differently. Every country has been affected by the crisis, although through different channels and to different degrees. The USA and Europe were at the epicenter of the crisis. In advanced economies, the crisis spread from financial sector to the real sector. In emerging economy, the transmission of external shocks to domestic vulnerability has typically been from the real sector to the financial sector. India has been affected by the crisis through the interplay between external shocks and domestic vulnerabilities by way of the financial, real and confidence channels. The Indian economy exhibited significant resilience in the backdrop of an intense global financial crisis. It witnessed moderation in GDP growth in 2008–2009 in comparison with the robust growth performance in the preceding five years. In the period during 2003–2008, the average GDP growth was not only the highest ever recorded in the India's past independence economic history, but also one of the highest in the world in the recent period. Nonetheless, the balance sheet of Public sector banks and their financial performance decelerated in the year 2008–2009. Although the growth of both the credit and deposits decelerated during 2008–2009 as compared to 2007–2008, they remained significantly positive. Deceleration in bank credit was observed in an intense manner in specific sectors. The Public sector banks in India showed considerable resilience against the backdrop of global financial crisis and its affects on Indian economy.

Further, the recent tight liquidity in the Indian market is also qualitatively different from the global liquidity crunch, which was caused by a crisis of confidence in banks lending to each other. While the main causes of global stress are less relevant here, Indian banks do face increased challenges due to domestic factors. The banking sector faces profitability pressures due to higher funding costs, mark-to-market requirements on investment portfolios, and asset quality pressures due to a slowing economy. CRISIL views the strong capitalization of Indian banks as a positive feature in the current environment. Indian banks' global exposure is relatively small, with International assets at about 6 per cent of the total assets. Even banks with international operations have less than 11 per cent of their total assets outside India. The reported investment exposure of Indian banks to distressed international financial institutions of about USD1 billion is also very small. The mark-to-market losses on this investment portfolio, will, therefore, have only a limited financial impact. Indian banks' dependence on international funding is also low.

II. REVIEW OF LITERATURE

Review of related literature makes the investigator fully aware with the previous work that has been done. It also provides an opportunity of gaining insight into the method, measures, subject and approaches employed.

Pradhan, Prashant (2009) in his article "business strategies for banks—how to emerge stronger from financial crisis" states that banks' strategies should be aimed at making themselves more flexible and resilient to emerging economic shocks. They should seize the extra ordinary opportunities arising out of uncertainties, taking advantage of new technologies and of the weaknesses of the competitors.

Saini & Singh, Arun Kumar (2014) studied the impact of global recession on financial performance of selected Indian public and private sector banks. SBI, the leading public sector bank and ICICI, the leading private sector bank was selected for the study. A period of six financial years 2005-06 to 2010-11 has been into consideration. Statistical tools like ratios and paired t-test has been used for testing the hypothesis. The selected parameters for analyzing the performance were operating profit, Return on long term funds, Return on Net worth, Return on Capital Employed, Dividend payout and Earnings per share. The study found that except 2nd and 4th factor there was impact of recession on SBI and except 2, 3 and 4th factor there was impact of recession on ICICI. The study concluded that the profitability of both the Indian banks is affected by recession or slowdown because majority of selected parameters were showing major changes in the pre and post-recession period.

Shaikh (2010) identified the impact of global financial crises on financial sector including the banking sector, equity markets, ECBs and remittances. The study concluded that the larger banks were not much affected by the crises because of their strong balance sheet and timely action by the government.

Mohanty (2010) commented about the impact of global financial crisis of 2008 on the Indian economy, he comments as the crisis showed that while increasing globalization and trade integration have brought enormous economic and financial benefits to the Emerging Market Economies (EMEs), they have also widened the channels through which a slowdown in economic activity in advanced economies could spread to the EMEs.

III. METHODOLOGY

The method used in this paper is descriptive-evaluative method. The study is mainly review based. It is purely supported by secondary source of data, i.e. books, journals, papers and articles and internet.



IV. RESULTS AND DISCUSSION

Table: 1
The efficiency scores of each of the banks

Banks	2007-08	2008-09	2009-10
Allahabad Bank	0.95	0.88	0.94
Andhra Bank	0.91	0.81	0.92
Bank of Baroda	0.85	0.86	0.93
Bank of India	0.96	1.00	0.91
Bank of Maharashtra	0.83	0.70	0.83
Canara Bank	0.91	0.85	0.98
Central Bank of India	0.84	0.73	0.83
Corporation Bank	0.95	1.00	0.94
Dena Bank	0.87	0.73	0.86
IDBI Bank	1.00	0.91	0.84
Indian Bank	0.87	0.81	1.00
Indian Overseas Bank	0.95	0.88	0.83
OBC	0.94	0.84	0.90
Punjab and Sind Bank	0.85	0.75	0.89
Punjab National Bank	0.88	0.85	0.98
Syndicate Bank	0.90	0.72	0.85
UCO Bank	0.86	0.78	0.85
Union Bank of India	1.00	0.82	0.92
United Bank of India	0.79	0.69	0.83
Vijaya Bank	0.91	0.82	0.86
State Bank of Bikaner and Jaipur	0.84	0.83	0.87
State Bank of Hyderabad	0.94	0.88	0.93
State Bank of India	0.86	0.87	0.87
State Bank of Indore	0.91	0.85	0.90
State Bank of Travancore	0.90	0.84	0.90

Suorce: Annual Reprt of R.B.I

As observed from the above Table 1, the mean efficiency for banks was 0.88 in the year 2008, 0.81 in the year 2009 and 0.89 in the year 2010. Research by Berger and Humphrey (1997) found the mean efficiency for European banks ranging from 0.55 to 0.95. In our study, efficiency for banks slipped to 0.81 in the year 2008–2009 from 0.88 in the year 2007–2008. This may be due to global financial crisis. The efficiency figures have reached the figure of 0.89, indicating the strength of Indian banking. In India, it is the real economy that got impacted first — on account of exports and the drying up of overseas finance for many firms. Banks are affected indirectly by the slowing down of the economy. The direct impact of the crisis on the Indian banking system has been small because Indian banks do not have big exposures to the subprime market. Indian banks are well placed to weather this impact. This is not a contrarian view. The RBI itself exudes optimism about the outlook for Indian banking in its latest Report on Trend and Progress in Banking. At a time when the financial system across the globe is engulfed in a deep crisis, the Indian banking system continues to show resilience. The underlying fundamentals of the Indian economy would continue to underpin the robust performance of the banking sector which remains profitable and well capitalized. There are good reasons for such optimism. First, unlike in the west where credit supply has collapsed, credit grew at 25% in 2007-08 and by 24% in the year to date. Banks may be expected to slow down credit growth in 2009-10 given the uncertainties in the environment. But growth of around 20% is still an impressive figure.

Secondly, spreads in the Indian banking system remain high in comparison with other banking systems, although they declined for the second year in succession. The net interest margin, an indirect measure of spread, was 2.4% in 2007-08. This is lower than the spread of around 2.8% we had until 2005-06. But volume growth today is higher than in most of the post-reform period. Higher volume growth should offset the decline in spread. Besides, banks have learnt to boost revenues through non-interest income. Thirdly, non-performing assets (NPAs) are at an all-time low. The ratio of net NPAs to net advances is down to 1%, down from 9% a decade ago. Fourthly, return on assets in the Indian banking system was 1% in 2007-08. This figure is a widely accepted benchmark for performance in banking. We must expect a rise in NPAs and higher provisions in 2008-09 and 2009-10. But banks stand to gain on their bond portfolios as interest rates fall. So any decline in return on assets should be small. Does this all sound too good to be true — the Indian banking system as an islet of tranquility in a sea of turbulence? One alarmist scenario is a

big collapse in property prices — remember, the rise in property prices here has been steeper than in the US or Europe. No fears. Housing loans are only around 10% of overall banking assets. Even if 20% of housing loans go bad, a figure we have seen in the subprime crisis, the maximum impact would be a rise in NPA/asset ratio to 3%. With an average capital adequacy ratio of 13%, banks are well placed to withstand an increase in NPAs of this order. But even this is unlikely because banks finance around 70% of the white component of housing loans. If we assume a black component of just 30% of the value of the property, banks are protected against a decline in property prices of 50% from their present levels.

There is always the danger of one or two weak players having serious problems. But we do have the capacity to contain systemic risk arising from such a situation. The broader lesson of the Indian banking system emerging relatively unscathed in the present crisis should not be ignored. Our unique approach to the issues of bank ownership and regulation, our reliance on home-grown solutions, has served us well. The need for caution is to be made on several fronts. However, there are two areas that do not receive the attention they merit. One is the need to improve the quality and performance of public sector bank boards. The RBI has laid down ‘fit and proper’ criteria for elected directors. It must extend these to all directors. It must also advise PSBs to increase the sitting fee from the disgraceful figure of Rs 5,000 — this pretence of austerity is not helping anybody. Another is the sharp rise in off-balance-sheet (OBS) assets in the banking system in recent years. For banks as a whole, OBS assets are 333% of balance sheets assets. The biggest exposures are among foreign banks (2,803%) and new private banks (302%). OBS items have proved the undoing of banks in the recent crisis.

Indian Banking sector challenged by domestic factors:

The reasons for tight liquidity conditions in the Indian market in recent weeks are quite different from the factors driving the global liquidity crisis. Some reasons include large selling by Foreign Institutional Investors (FIIs) and subsequent Reserve Bank of India (RBI) interventions in the foreign currency market, continuing growth in advances, and earlier increases in cash reserve ratio (CRR) to contain inflation. RBI’s recent initiatives, including the reduction in CRR by 150 basis points from October 11, 2008, cancellation of two auctions of government securities, and confidence-building communication, have already begun easing liquidity pressures. The strong capitalization of Indian banks, with an average Tier I capital adequacy ratio of above 8 per cent, is a positive feature in their credit risk profile. Nevertheless, Indian banks do face challenges in the current Indian economic environment, marked by a slower gross domestic product growth, depressed capital market conditions, and relatively high interest rate regime.

The profitability of Indian banks is expected to remain under pressure due to increased cost of borrowing, declining interest spreads, and lower fee income due to slowdown in retail lending. Profit levels are also likely to be impacted by mark-to-market provisions on investment portfolios and considerably lower profit on sale of investments, as compared with previous years. Moreover, those Indian banks considering accessing the capital markets for shoring up capital adequacy may be forced to curtail growth plans, if capital markets remain depressed. While these challenges will play out over the medium term, CRISIL expects the majority of Indian banks’ ratings to remain unaffected, as they continue to maintain healthy capitalization, enjoy strong system support and benefits of government ownership in the case of public sector banks.”Contradicting the general trends of the economy, the extension of non-food bank credit has grown faster in calendar year 2008 against the previous year. The same has been the case with regard to the flow of resources to the commercial sector, which includes non food bank credit, investment on shares/bonds/debentures and commercial paper issued by public/private sector companies. Despite this visible growth in credit extension by banks, there was a perception of decelerating credit growth to the Indian economy as a whole during 2008.

This slow down in credit extension could be primarily attributed to reduced flow of funds from non-bank sources such as financial institutions, NBFCs and resources mobilised from the capital markets and by way of external commercial borrowings — ADR, GDR, FCCB, foreign direct investments — and other forms of short-term credit. In fact, resource flow from these sources had dipped by over 30 per cent during 2008, while flow from the banking sector had increased by close to 30 per cent. The review of the Monetary Policy by the RBI for the third quarter of 2008-09 said: “There has been a noticeable variation in credit expansion across bank groups. Expansion of credit by public sector banks was much higher this year than in the previous year, while credit expansion by foreign and private sector banks was significantly lower.” This credit expansion by the banking sector was also reflected in the deep divergence in the pace of growth in deposits among the banks. It was only the public sector banks which could maintain the pace of growth in deposit accretion at 24.2 per cent. Deposit accretion in foreign banks fell sharply from 34 to 12 per cent and for private sector banks from 27 to 13 per cent. Backed by the steady pace of growth in deposits, the growth in public sector banks disbursement also grew quite significantly. Meanwhile, there was a deceleration in credit extension by foreign and private sector banks during 2008.

V. CONCLUSIONS

Indian banking is undergoing major transformation. The recent concern was the extent to which global financial crisis affected the Indian banking. The strength of Indian banking was reflected by the extent that it could withstand the global financial crisis. The study indicates that Indian banks, in general and Indian public sector banks, in particular, could withstand the global financial crisis. Although the efficiency scores reduced from the 2007–2008 to the year 2008–2009, the scores of 2009–2010 surpassed previous two years figures. The results of the analysis indicate that efficiency results of Indian public sector banks, in the year 2007–2008 are comparable to 2009–2010. The dip in efficiency was registered in the year dipped in the year 2008–2009. While comparing the mean efficiencies from the year 2007–2008 to the year 2009–2010. The outlook for the banking sector shows improvement in the year 2009–2010, given the broad based robust economic recovery in the last quarter of 2009–2010. The prudential norms adopted by the Indian banking system and the better regulatory framework in the country have helped the banking system remain stronger even during the global slowdown.

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