Financial Performance

Profits and Provisions

3.19 Profitability analysis of scheduled commercial banks (SCBs) revealed a decline in profits during 1998-99 (Tables 3.5 and 3.6). Substantial increase in provisions and contingencies by nearly 40 percent over the previous year led to significant decline in the net profits of public sector banks. Despite fairly significant decline in provisions and contingencies, the net profits of private sector banks also declined in 1998-99. In the case of foreign banks, the decline in provisions and contingencies contributed to higher net profits in 1998-99. For SCBs as a whole, provisions and contingencies increased by about 15 percent, and this contributed to a decline of 28.3 percent in their net profits. The operating profits of SCBs declined by 4.4 percent from Rs. 14,640 crore in 1997-98 to Rs. 13,992 crore in 1998-99. As can be seen from Table 3.6, operating profits of all bank groups except the public sector banks declined in 1998-99. Even in the case of public sector banks, operating profits of the State Bank of India (SBI) and its

TABLE 3.6

Variations in Profits of SCBs

(Rs. crore)

Banking-Group	Operating Profit	Provisions and Contingencies	Net Profit
1. Public Sector (i+ii)	303.8 (3.0)	2075.4(39.6)	-1771.6(-35.2)
(i) SBI & Associates	-84.3 (-1.8)	909.8(40.0)	-994.1 (-40.4)
(ii) Nationalised Banks	388.1(7.0)	1165.5 (39.2)	-777.5 (-30.3)
2. Private (Old)	-1.4(-26.9)	-159.7(-25.0)	-131.7(-29.8)
3. Private (New)	-55.3(-7.5)	-52.8(-15.5)	-2.5(-0.6)
4. Foreign	-604.9(-23.8)	-668.3(-34.9)	63.4(10.1)
Total	-647.8(-4.4)	1194.5(14.7)	-1842.3(-28.3)

Note : Figures in brackets show percentage change over the previous year.

TABLE 3.5

Working Results of Scheduled Commercial Banks for 1997-98 and 1998-99

	SBI Group		19 Nationalised Banks		27 Public Sector Banks		Foreign Banks		25 Old Pvt. Sector Banks		9 New Pvt. Sector Banks		All SCBs	
	1997-98	1998-99	1997-98	1998-99	1997-98	1998-99	1997-98	1998-99	1997-98	1998-99	1997-98	1998-99	1997-98	1998-99
A. Rupees Crore														
A. Income	24871	29349	42835	49518	67706	78867	8697	9719	6438	7361	3015	4131	85857	100078
i) Interest	21209	25126	37867	44348	59076	69474	6783	7857	5496	6498	2395	3541	73751	87370
ii) Other income	3662	4223	4968	5170	8630	9393	1914	1862	942	863	680	590	12106	12708
B. Expenditure	22412	27884	40265	47725	62677	75609	8068	9026	5996	7050	2616	3733	79354	95418
i) Interest Expended	13904	16983	26269	30857	40174	47840	4222	5201	4084	5088	1820	2777	50299	60905
ii) Intermediation cost	6235	7719	11025	12731	17259	20450	1931	2579	1272	1482	456	669	20917	25180
iii) Provisions and contingencies	2273	3182	2971	4137	5244	7319	1915	1246	640	480	340	287	8138	9333
C. Operating Profit	4732	4648	5541	5929	10274	10578	2545	1940	1082	791	740	684	14640	13992
D. Net Profit	2460	1466	2570	1792	5030	3258	630	693	443	311	400	397	6502	4660
E. Total Assets	232843	285904	416661	484417	649504	770321	65098	76623	54966	65423	25845	38531	795412	950898
B. Per Cent of Total Assets														
A. Income	10.68	10.27	10.28	10.22	10.42	10.24	13.36	12.68	11.71	11.25	11.90	10.72	10.79	10.52
i) Interest income	9.11	8.79	9.09	9.15	9.10	9.02	10.42	10.25	10.00	9.93	9.27	9.19	9.27	9.19
ii) other income	1.57	1.48	1.19	1.07	1.33	1.22	2.94	2.43	1.71	1.32	2.63	1.53	1.52	1.34
B. Expenditure	9.63	9.75	9.66	9.85	9.65	9.82	12.39	11.78	10.91	10.78	10.12	9.69	9.98	10.03
i) Interest Expended	5.97	5.94	6.30	6.37	6.19	6.21	6.49	6.79	7.43	7.78	7.04	7.21	6.32	6.40
ii) Intermediation cost	2.68	2.70	2.65	2.63	2.66	2.65	2.97	3.37	2.31	2.27	1.76	1.74	2.63	2.65
iii) Provisions and contingencies	0.98	1.11	0.71	0.85	0.81	0.95	2.94	1.63	1.16	0.73	1.32	0.74	1.02	0.98
C. Operating Profit	2.03	1.63	1.33	1.22	1.58	1.37	3.91	2.53	1.97	1.21	2.86	1.78	1.84	1.47
D. Net Profit	1.06	0.51	0.62	0.37	0.77	0.42	0.97	0.90	0.81	0.48	1.55	1.03	0.82	0.49

Note : Number of foreign banks for 1997-98 and 1998-99 are 42 and 44 respectively.
Number of scheduled commercial banks for 1997-98 and 1998-99 are 103 and 105 respectively.

Associates registered a marginal decline of about 2 percent. The operating profits of nationalised banks, however, increased by 7 percent in 1998-99.

3.20 There have been changes in the net profit structure of various bank groups on account of increase in competition as well as diversification of activities. The share of State Bank of India and its seven Associated Banks (SBI Group) increased from 19.3 percent of total net profits of SCBs in 1991-92 to 31.5 percent in 1998-99, while the share of nationalised banks declined from 43.9 percent to 38.5 percent during this period. The share of foreign banks in the total net profit of SCBs also declined from 30.4 percent to 14.9 percent , whereas the combined share of old and new private sector banks increased from 6.4 percent to 15.2 percent during the same period.

Net Interest Income (Spread)

3.21 The net interest income or spread of nationalised banks registered a marginal increase from 2.78 percent of their total assets in 1997-98 to 2.79 percent in 1998-99. However, the corresponding proportion in respect of the SBI Group declined by 29 basis points from 3.14 percent to 2.85 percent during the same period. As a consequence, the net interest income of public sector banks, which account for more than 80 percent of total business of SCBs, declined by 10 basis points from 2.91 percent of total assets in 1997-98 to 2.81 percent in 1998-99. During this period, the net interest income of old private sector banks declined by 41 basis points from 2.57 percent of their total assets to 2.16 percent, while in the case of new private sector banks it declined by 25 basis points from 2.23 percent of total assets to 1.98 percent in the same period. As regards foreign banks, net interest income declined by 46 basis points from 3.93 percent of their total assets in 1997-98 to 3.47 percent in 1998-99. Nevertheless, it is significant to note that of the different bank groups, foreign banks group registered the maximum spread in 1998-99 at 3.47 percent, followed by the SBI Group at 2.85 percent, nationalised banks at 2.79 percent , old private sector banks at 2.16 percent and the new private sector banks at 1.98 percent as against 2.78 percent for all SCBs.

Non-Performing Advances

3.22 A non-performing asset (NPA) in India represents an advance that has not been serviced, as a result of “past dues” accumulating for 180 days and over. A distinction is also made in India between Gross NPAs and Net NPAs. In view of the time lag in recovery process and the detailed procedures and safeguards involved in regard to write-off, even after making provisions for advances considered as irrecoverable banks continue to hold such advances in their books. These are termed gross NPAs while provision-adjusted NPAs are termed as net NPAs. Net NPAs of SCBs declined marginally from 3.0 percent of their total assets as on March 31,1998 to 2.9 percent as on March 31,1999. The corresponding proportion in respect of public sector banks declined from 3.3 percent to 3.1 percent while it increased from 2.3 percent to 2.8 percent in respect of private sector banks during the same period. In the case of foreign banks net NPAs declined from 1 percent of their total assets as on March 31, 1998 to 0.8 percent as on March 31,1999. As the build-up of NPAs has been a major factor in the erosion of profitability of public sector banks in India, the Narasimham Committee (II) underscored the need to reduce the average level of net NPAs for all banks to 3 percent by 2002. The definitions of weak banks given by this Committee have internalized the concept of NPA. The Working Group on Restructuring Weak Public Sector Banks supplemented the above definitions by a combination of seven parameters covering solvency, earnings capacity and profitability (Box 3.4). The high level of NPAs of banks in India reflects the weak loan recovery mechanism. Data as on March 31, 1999 indicate that out of the total number of 21,781 cases involving a sum of Rs. 17,921 crore transferred to/filed with the Debt Recovery Tribunals (DRTs), the number of cases decided was 3,774 or 17.3 percent of the total, and they accounted for 10.0 percent of the total locked-up amount in the cases transferred to/filed with DRTs. The net NPAs of SCBs as a whole increased marginally from 7.3 percent of their net advances in 1997-98 to 7.5 percent in 1998-99. The net NPAs of public sector banks declined marginally from 8.2 percent to 8.1 percent whereas net NPAs of private sector banks increased significantly from 5.3 percent in to 6.9 percent during the same period. The net NPAs of foreign banks declined from 2.2 percent in 1997-98 to 2.0 percent in 1998-99. The gross NPAs of SCBs (sub-standard + doubtful + loss) increased from 14.4 percent of their gross advances in 1997-98 to 14.6 percent in 1998-99 (Table 3.7) . As regards different bank groups, gross NPAs of public sector banks declined marginally from 16.0 percent to 15.9 percent while gross NPAs of private sector banks increased significantly from 8.7 percent to 10.4 percent during the same period. The gross NPAs of foreign banks also rose from 6.4 percent to 7.0 percent in this period.

Capital Adequacy

3.23 Capital to Risk-Weighted Assets Ratio (CRAR) reflects the financial viability of commercial banks. As on March 31,1999, CRAR of public sector banks as a whole was 11.2 percent, which was marginally lower than the level of 11.5 percent attained as on March 31,1998.However, all public sector banks except one have achieved CRAR of 9 percent as on March 31,1999. As per the prudential norms, SCBs are required to achieve CRAR of 9 percent by March 31,2000. A number of banks have entered the capital market to satisfy the capital adequacy norm. Till end-March, 1999, 8 public sector banks raised capital through equity issues from the new issues market. In fact, Government is encouraging public sector banks to raise capital through public issues. To facilitate this, they have been allowed to write off accumulated losses against paid up capital so as to enable them to have higher earnings per share. The growing presence of commercial banks in the capital market is reflected in the increase in the number of banks listed on recognised stock exchanges from 6 SCBs in 1994-95 to 28 SCBs in 1998-99. As at end-March, 1999, the shares of 8 public sector banks and 17 private sector banks were listed for secondary market trading on the National Stock Exchange (NSE).

TABLE 3.7

Classification of Loan Assets of SCBs

(percentage distribution of total loan assets)

Asset	Public	Private	Foreign	SCBs
Standard				
1997-98	84.0	91.3	93.6	85.6
1998-99	84.1	89.6	93.0	85.4
Sub-standard				
1997-98	5.1	4.8	3.9	4.9
1998-99	4.9	6.0	3.6	4.9
Doubtful				
1997-98	9.1	2.9	0.8	7.7
1998-99	9.0	3.6	1.5	7.8
Loss				
1997-98	1.9	1.0	1.7	1.8
1998-99	2.0	0.9	1.9	1.9
Total				
1997-98	100.0	100.0	100.0	100.0
(Rs. crore)	(284971)	(36753)	(30972)	(352696)
1998-99	100.0	100.0	100.0	100.0
(Rs. crore)	(325328)	(44492)	(31433)	(401253)

Note : Due to rounding, total may not add up to 100.

Bank Supervision and Regulation

3.24 The term of the Board for Financial Supervision (BFS) in the RBI, which is the supervisory authority for banks, AIFIs, and NBFCs, has been extended upto March 27, 2000 or till the reconstitution of the Central Board of RBI, whichever is earlier. The main supervisory issues addressed by BFS relate to on-site and off-site supervision of banks, AIFIs and NBFCs, and registration and prudential norms of NBFCs. The on-site supervision system for banks is on an annual cycle and is based on the ‘CAMELS’ model. It focuses on core assessments in accordance with the statutory mandate, *i.e.*, solvency, liquidity, operational soundness and management prudence. Banks are rated on the basis of this assessment. In view of the recent trends towards financial integration, globalisation and technological upgradation, it has become necessary for supervisors to supplement on-site supervision with off-site surveillance. The aim is to capture ‘early warning signals’ from off-site monitoring which would avert financial crisis of the nature of the East Asian or Latin American crisis. The off-site monitoring system consists of 12 returns on capital adequacy, asset quality, large credit and concentration, connected lending, earnings and risk exposures (namely, currency, liquidity and interest rate risks). These efforts are further supplemented by an in-depth analysis of the secondary market movements of listed scrips, which serve as an indicator of public confidence in financial performance of banks. In order to enable banks to manage the

BOX 3.4

Major Recommendations of the Working Group on Restructuring of Weak Public Sector Banks

Keeping in view the urgent need to revive the weak banks, the Reserve Bank of India set up a Working Group in February, 1999 under the Chairmanship of Shri M.S. Verma to suggest measures for the revival of weak public sector banks in India. The major recommendations/points of the Working Group, which submitted its Report in October, 1999, are listed below :—

- Seven parameters covering three areas have been identified; these are (i) Solvency (capital adequacy ratio and coverage ratio), (ii) Earning Capacity (return on assets and net interest margin) and (iii) Profitability (ratio of operating profit to average working funds, ratio of cost to income and ratio of staff cost to net interest income + all other income).
- The definitions/tests provided by the Committee on Banking Sector Reforms (CBSR) should be supplemented by performance analysis based on the seven parameters cited above for identifying weakness in banks in future.
- The seven parameters can also be used to evolve benchmarks for competitive level of performance by public sector banks; to begin with these benchmarks maybe set at the median levels of ratios pertaining to the 24 public sector banks (excluding the three identified weak banks, viz. Indian Bank, UCO Bank and United Bank of India).
- Narrow banking cannot by itself be adopted as a long-term restructuring strategy.
- Closure involves many negative externalities affecting depositors, borrowers and employees, and should not be exercised unless all other options are exhausted.
- Comprehensive restructuring can succeed but calls for firm and decisive actions in exercise of hard options. The Government, management and employee unions must agree upon every important condition of the proposed restructuring programme before it is begun.
- Restructuring of weak banks should be a two-stage operation; stage one involves operational, organisational and financial restructuring aimed at restoring competitive efficiency; stage two covers options of privatisation and/or merger.
- Operational restructuring essentially involves building up capabilities to launch new products, attract new customers, improve credit culture, secure higher fee-based earnings, sell foreign branches (Indian Bank and UCO Bank) to prospective buyers including other public sector banks, and pull out from the subsidiaries (Indian Bank), establish a common networking and processing facility in the field of technology, etc.
- The action programme for handling of NPAs should cover honouring of Government guarantees, better use of compromises for reduction of NPAs based on recommendations of the Settlement Advisory Committees, transfer of NPAs to ARF managed by an independent AMC,etc.
- To begin with, ARF may restrict itself to the NPAs of the three identified weak banks; the fund needed for ARF is to be provided by the Government; ARF should focus on relatively larger NPAs (Rs. 50 lakh and above).
- A 30 – 35 percent reduction in staff cost required in the three identified weak banks to enable them to reach the median level of ratio of staff cost to operating income.
- In order to control staff cost, the three identified weak banks should adopt a VRS covering at least 25 percent of the staff strength; for the three banks taken together, the estimated cost of VRS ranges from Rs. 1100 to Rs. 1200 crore.
- The organisational restructuring includes delayering of the decision making process relating to credit, rationalisation of branch network, etc.
- Financial restructuring involves efforts to maintain a CAR well above the minimum required level, further recapitalisation subject to strict conditionalities relating to operational and organisational restructuring of the recipient bank, etc.
- System restructuring may include setting up of an independent agency under a special Act of Parliament to approve bank-specific restructuring programmes, initiate their implementation and monitor their progress. Such an agency may be designated as the Financial Restructuring Authority (FRA).
- The existing legal provisions, which are out of line with the present day realities, need to be amended and new enactments relating to bankruptcy, foreclosures, etc. made.
- For speeding up the recovery process, a mechanism should be worked out to make DRTs more effective.

risks associated with asset-liability mismatches, detailed Guidelines on Asset-Liability Management and Risk Management Systems have been issued by RBI. The RBI has also recently renewed the existing supervisory framework in India in relation to the BASLE core principles which are the minimum requirements for effective banking supervision laid down by the BASLE Committee on Banking Supervision. Steps are being taken to bridge the gaps which are mainly in the area of Risk Management, Consolidated Supervision, Inter-agency Cooperation and Cross Border Supervision.