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An Evaluation and Analysis of the Risk/Return Profile of Selected Banks

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SUMMARY

A study was undertaken into the current banking affairs of India. In the research study a study of the current affairs and news of the Indian banks that have appeared in the media and the banking news bulletins have been studied the features of the 4 Indian Banks have been studied and the analysis has been done of the data that has been collected. The results of the analysis and the findings have been recorded below to show the changing environment of the banking industry in India which is working towards improving the general Risk/Return profile of the country though the banking system. Suggestions for improvement and stability have been suggested and the scope for further studies has also been included in the paper. The purpose of undertaking the study had been to understand the economic situation of the Indian banking system in the current form economic conditions that Indian banks face in the global business environment and the impact that it might have on the risks that the Indian banks face and the profit return profile for the Indian banks in the country. The risks in banks are entirely dominated by the return and risk position in the banks whether they are public sector banks or private banks that are operating. The Credit risk can be divided in three categories the primary risks in banks take upn70% of the economic composition of the capital in the banks which the banks are required to keep from regulations enforced on banks and the 30% is divided and is taken up by market risk and operational risk. The market risk in a bank is the changes and the price fluctuation in the banking system and the operational control risks which is the failure to place strong internal controls and policies to deal with operation processes and problems. The paper analyzed the Indian banks both public sector and private from the view of Risk return profile. The few banks that have been studied are State bank of India, Punjab National Bank. Axis Bank, ICICI Bank and HDFC Bank. The findings and the results are provided below to show the current risk and return profile of these Indian Banks providing a view of the economic capital situation not only in these five banks but also in the flow of currency in the Indian economy. (Kumar,2007).

ABSTRACT

The study that was undertaken showed that here was a need to strategically mange the risk and the maximize the returns in all the five Indian banks that have been mentioned. This is due to the level of Non-Performing Assets (NPA) which is higher in the Indian banks in General and in these five banks in particular compared with the global bench mark for the level of Non-Performing assets that a bank should carry and what it needs to recover from the customers. The study also brought out the fact that there was a need for these banks because of the Reserve Bank regulations about the distribution if dividends by Indian banks to its shareholders. The other two reasons why a new strategic performance has to be created are because of the revision in the C.A.R norms and the new NPA levels permitted by the Reserve Bank of India. The latest Basel Records has created the need to make the credit risk management more strategic and efficient. The total advances of the banking sector have been Rs.112560 crores and 9.5% of these advances are bad advances or doubtful advances where the chances of retrieving the principal and the interest are highly unlikely. To primary indicators of credit risks in banks that provide figures that are fool proof are the Non-Performing Assets of banks and the Capital Adequacy Ratio of the banks. The stipulated CAR that the banks have to maintain provides a buffer against the credit losses from advances. The Reserve Bank Capital Adequacy Ratio of the Indian banks is 12% in 2015. This show that as of 2015 the level of Capital Adequacy Ratio that the banks need to keep is a minimum of 12% to create a buffer for the Indian banking industry against bad credit advances. As of march 31st the study indicated that the Gross Non Performing Assets in the Indian banking sector was 4.3% of the total assets. But the Crisil study indicates also that this is like to go upto 4.5% of the total assets which is better than the previous figures in 2006 of 9% of total Non-Performing Assets of the Indian banking industry. (Arora, 2014)

INTRODUCTION

The purpose of a banking industry is to be able to store the funds of the people and to provide a return for the funds being held in the bank. This is done by investing the people's money in projects through credit lines and advances and the income generated from it is what is paid as interest to the customers of the bank, as earnings to the other stakeholders of the bank and as dividends to the shareholders of the bank. While providing an advance to a customer the bank has to appraise the entire project before it advances the funds to ensure that the funs advanced can be paid back to the bank with the interest earning portion for which the bank is advancing the money. When these advances are not retuned and the interest payment is not made for whatever reasons these credit advances are considered to be bad debts ,bad advances or Non-Performing assets of the bank which sometimes have to written off the books when there is no hope of recovery.

This is the basic idea of the evaluation of risk /return in the all banks not just the Indian banks. The five banks that have been chosen for the risk/return study are State bank of India, Punjab National Bank, Axis Bank, ICICI Bank and HDFC Bank. The Return in banks is the earnings and the profits that are the income of the bank by which the banks pay dividends, salaries, pay taxes, the compulsory benefits and financial package to the employees for both union staff and non union staff. This is the income from which dividends are paid to the shareholders and incentives are provided for customer though various banking schemes and products. Therefore it is necessary to be able to understand the credit risk in the advances that the bank provides in relation to the retunes that the income from it provides a bank. The evaluation that is being undertaken is the Risk/Return evaluation of the 5 banks mentioned above. The study was undertaken to understand whether the theory on which the credit risk and return is based is still valid in today's economic concept of a global economy. (Bennett, 2015)

THE THEORY

The fundamental theory on which the credit risk and return is based is the concept that there needs to be an earning or a banking institution in order to create a currency flow throughout the economy so that the money is mobile and circulating in the market. If there is no money circulation then the condition of the banks are not good. The aim is to know the customers of the banks provide them the credit that need for projects and businesses and then reap the profit or earning income from it to pay the statutory interest rates levied for people's money being held in the banks. (Bennett, 2015) In order to be able to have a good earning capacity every Indian bank needs to ensure that it does not lend more that it capacity, it should had the buffer incase the advances extended turn into bad debts, they must also have system to monitor each advance that tell them if it is turning into a bad debt and what needs to be done. A bank that has a buffer level shows that the Non-Performing Assets levels are low and the income from the advances is high for the banks. This is the simple basic theory on which the credit risk and return concept in banking is based. (Phyl, 1997)

THE OBJECTIVES OF THE STUDY

The purpose of the study is to understand the economic condition of Indian and the strength of its banking industry. It is also aimed to find the level of credit exposure that the top 5 Indian banks in the country have in the market and what is the level of their nonperforming assets as against the value of the total assets of the bank.

The Methodology: The methodology that was used in the study was to take the financial figures of the credit advances of each bank individually and to compare them with the figures of the other four banks mentioned. The data as collected from the individual banks through their portals with their permission. The personal interviews with the top management provided reasons for the no performing results which will be placed in the results of the study paper. When all the figures were compiled an analysis was undertaken to understand from the results which of the five banks appears to have the best credit risk and return performance in view of the current economic situations that are prevalent in India. The analysis of the data is provided below.

State Bank of India: State Bank of India is a Public sector Bank that is listed in the following stock exchanges by the trading symbol that is given beside the stock exchange.NSE: SBIN,BSE: 500112,LSE: SBID,BSE SENSEX Constituent and CFX Nifty Constituent. The Share price as of 24th July 2015 = Rs.266.10. State Bank of India has all the banking products. The revenues of the bank as of 2015 areRs174,972.96 , The Profits of the bank as of March 31st 2015 are Rs13,101.89 ,Total assets of the bank areRs. 17,92,234.60 and the total equity of State Bank of India is $ 32 billion as of 2015. The owner is the Government of India and the number of employees that it employs is 223033 as of 2015. The total advances are Rs.1209828.72. The total Non-Performing assets of the Bank areNPARS., 56,725.34. The capital adequacy ratio is 12%.(Money Control,2015)

Punjab National Bank: Punjab National bank is the second largest bank in Indian bank and it is listed in the following stock exchanges with the following trading symbols listed beside it.BSE: 532461, NSE: PNB, CNX Nifty Constituent. The total income of the bank is Rs. 52,206.09 as of March 31st 2015. The total profit is Rs. 3,061.58 as at March 31st

2015. The total assets of the bank as of March 31st is Rs., 601,946.05 and the total equity of the bank is Rs. 82,93,970. The share price as of July 24th is Rs.139.20. The total numbers of employees as of March 31st 2015is 72,000 employees. The gross Non Performing Assets of the bank as of March 31st 2015 was Rs.25,694.86 Which is an 87% increase over 2014 Non Performing assets. (PNB,2015) The capital adequacy ratio of PNB is 12.89%.

Axis Bank: The bank is a public bank that is listed in the following stock exchanges with the trading symbol provided next to it. NSE: AXIS BANK and BSE:532215. The share price of the bank as of July 24th 2015 is Rs.580.45The total revenue of the bank is as of March 31st 2015 was Rs. 43, 843.65. (Money Control, 2015) The net income of the bank as of March 31st 2015 was Rs. 2,310.54. The total assets of the bank are Rs. 3,83,244.89. The total equity of the bank is Rs. 38,220.49. The total number of employees that Axis bank employees are 37901.The total NPA value of the banks as of March 31st 2015 was Rs. 4,110.Capital Adequacy Ratio is 15.09% (Money Control, 2015)

ICICI Bank: The bank is a publicly listed company and is listed in the following stock exchanges with the trading symbol provided beside it.BSE: 532174, NSE: ICICIBANK, NYSE: IBN, BSE SENSEX Constituent, CNX Nifty Constituent. The revenue of the bank as at 2015 is $ 9.8 billion, net profits is $ 1.8 billion, the total assets of the bank are 103.4 billion and the total equity of the bank is $ 12.9 billion. The bank employs 67950 employees. Rs.301.40 is the share price of ICICI as of July 24th 2015. The total Non Performing Assets of the bank is Rs.6,325 crore. The Capital Adequacy Ratio of the bank is 17.02. (ICICI,2015)

HDFC Bank: HDFC is the last of the list of the top 5 banks and is a publicly listed bank in the following stock exchanges with the trading symbol given besides it, BSE: 500180, NSE: HDFCBANK, NYSE: HDB, BSE SENSEX Constituent, CNX Nifty Constituent. The share price of HDFC Bank as of July 24th 2015 is Rs.1106.60. The total assets of the bank are $92. 42 billion. The total equity of the bank is Rs 501,29,90. The net revenue of the bank is Rs. 10,215.92 The net profit of the bank is Rs. 2,326.52 which is one fifth increase so far over 2014 net profits. The total Non-Performing Assets of the bank was Rs.3,652.23 and the capital Adequacy Ratio of HDFC Bank is16. 79 (HDFC,2015).

Analysis: From the above details is evident that the two largest banks have very high credit exposures and the buffer for the total Nonperforming assets of the State Bank of India and Punjab National Bank are eating in the revenues of the bank. In comparison the ICICI , Axis and HDFC bank appear to be showing a better performance but one needs to take into account the size of State bank of India and Punjab National bank to understand that the level of exposure they have in the market are higher as they are owned by the Government of Indian and the successive governments can pressures the banks to lend in sectors that are non productive sectors in the interest of social welfare and community development. The most important ratio that emerges from all the ratios to understand the level of exposure of the banks is the capital adequacy ratio and the non-performing assets of a bank.

As compared to the international standards of 0.37% of exposure the Indian banks that have been studied which are the top performing banks in Indian banks in the Indian banking industry show that the banks have an exposure of at least thrice the internationally accepted value. What has also emerged from the study is that the credit exposure of the banks that have been studied are that each of the 5 banks have exceeded the reserve bank of India's set limits of 15% by suing the option of an additional 5% of the capital funds held in the banks. Most of the credit exposure in these 5 banks has been to reliance industries and the highest levels of nonperforming assets in the banks are the advances that have been made to 20 corporate houses. RBI is in the process of changing the guidelines of advances to the group entities if that is implemented the two banks from the list will be heavily impacted are ICICI and State Bank of India because the highest levels of advances that they have made are to group entities and the single largest entity that 4 out of 5 banks have given large advances to flouting the Reserve Bank of Indian is Reliance Industries.

The analysis also shows that the returns in the banks and the net profit posted in the current year in all the banks has shown high returns for all the banks except PNB whose nonperforming assets have increased by 87%. In the areas of the different types of risks that have been analyzed the effect of risk and revenue analysis has impacted the operational risks, the credit risks and the market risks. The evaluation result show that the performance risks and the CRM risks have shown no effect from the position of the credit and the return risks in a bank. The increase in risk exposure has increased and the banks are even flouting norms to extend advances because of the fierce competition in the banking industry today in India. In order to decrease the level of risk the banks that have been studied show that the four stages of the credit risk analysis y having set standards and reportings in place, by evaluating the concentration position, the level of exposure and the types of contemporary exposure that are involved in the advances process creating internal guidelines and increase the use of performance based compensation packages. The five banks showed variances in the relationship between the risk and the capital advances and the efficiency was different for all the banks. This is one of the reasons why the performance levels of all the banks are different despite being subjected to the same norms in the banking system by regulation.(Money Control, 2015).

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The Credit Worthiness Analysis: The evaluation of the credit analysis is an overall analysis that represents the credit worthiness to make advance to such customers. From the study of the level of advances the degree of exposure it appears that even though the formats of credit analysis is good there are several relaxations that are made depending upon who the credit client is. This has been show above with the example of Reliance Industries who have nonperforming assets in all the above banks. What appears from the figures provided above is that none of the banks have tried to decrease the level of exposure to the customers who have defaulted whether they are large single entities or they are large corporate houses, however it has been seen that the banks have been aggressively trying to collect the dues of nonperforming assets of individual customer in the hope of closing the gap. (NDTV Profits, 2015).

Credit Rating: The credit rating of State bank of India and Punjab National bank is Baa3 which is an upward change that Moody has made from stable to positive. The credit ratings of ICICI Bank, Axis Bank and HDFC Bank have been downgraded to Baa3/--3 mainly due the decreased level of government for these three banks.

The credit ratings have a direct impact of the credit risk, the market risk, and the operational risk of the banks. With the downgrading that Moody has done as of April 2015, it is evident that despite high share prices the investors will be wary to invest in banks that have less support from the government owing mainly to the repeated manner in which the regulation are flouted to provide credit advances to favoured clients leading to long standing NPAs which are an outcome of public funds being used for advances as mentioned earlier in the paper and creating losses in public money. (NDTV Profits, 2015)

The illustrations provided below are the comparison between Axis Bank, HDFC Bank and Punjab National Bank using HSBC as the neutral indicator for the performances. In illustration 2 the net performance comparison between ICICI, HDFC and Axis Bank has been illustrated to explain why the credit ratings of the three institutions have been downgraded in April 2015.

In illustration3 the State Bank of India advances have been illustrated in order to explain why with the sheer size of their operations the credit advances are reasonable and the CAR ratio rate is 12%.Illustration 4 shows the key indicators of performance of Punjab National Bank.

Comparative Analysis

As on Mar 09. Rs in crs

Particulars	Axis	HDFC	PNB	HSBC
Deposits	117,374.11	142,811.58	209,760.50	49,970.27
Advances	81,556.77	98,883.05	154,702.99	27,588.68
Share Capital	359.01	425.38	315.30	4,499.16
Net worth	10,214.80	15,052.73	14,653.63	11,214.3
Book Value	284.53	344.44	416.74	-
Interest earned	10,835.49	16,332.26	19,326.16	6,326.9
Interest expenditure	7,149.27	8,911.10	12,295.30	2,661
Net profit	1,815.36	2,244.94	3,090.8	12,91.2
Net NPAs	0.35%	1.49%	0.17%	1.42%
Total Assets	147,722.06	183,270.78	246,918.62	94,620.3
Return on Assets	1.44%	1.10%	1.15%	1.51%

Illustration 1

All indicators and ratios center around the Non-performing assets of a bank in India. The rate of nonperforming assets shows that the credit risks involved in the banking industry are high and the rating of 2015 show that investor confidence in three out of the 4 top most banks in the India being studied is low. The study also shows that the investor

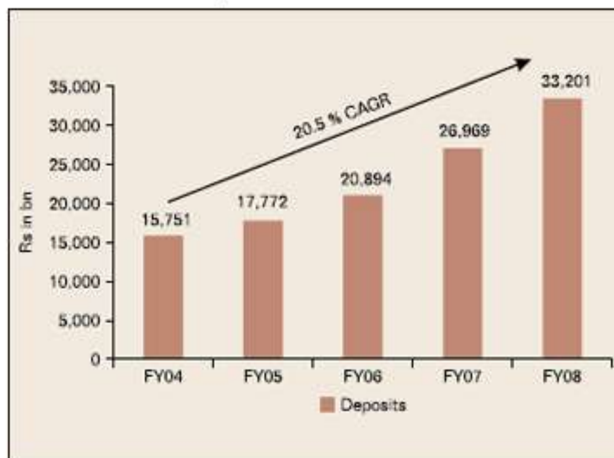
confidence is low not because of the customer relations, or the market risks or even the operational risks but it is the key factor of credit risks and returns that have impacted the top 5 banks of the country. Another reason that has emerged is that the credit appraisal relaxations are not being done according to the credit worthiness of the client whether it is a single independent entity or whether it is a group entity. Many requirements are being waived because of the name of the entity in the market even though the financial performance is doubtful or bad. In the case of the banks that have been studied , none of the top 5 banks have made an attempt to recover the large loan given to single corporate houses and this has had a major impact on their quality of advances and the level of credit risks. (Roy,2015)

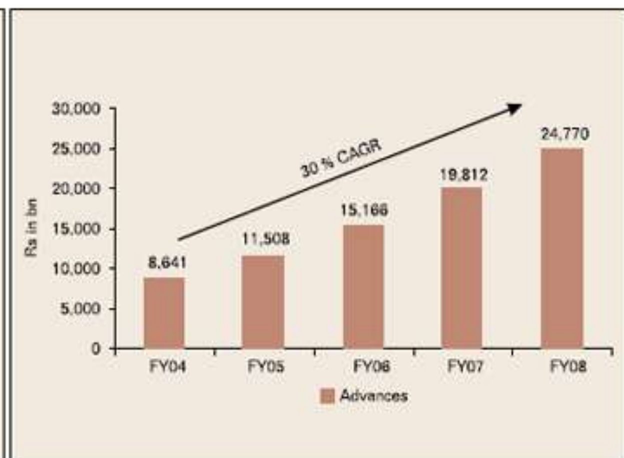
Comparison

Particulars	AXIS BANK	HDFC BANK	ICICI BANK
Net profits	Rs 4218 Cr	Rs 5247 Cr	Rs 7643 Cr
Current account and savings account(CASA) ratio	42 %	48.4 %	43.5 %
Net non performing assets	0.25 %	0.20 %	0.62 %
Capital adequacy ratio (CAR)	13.66 %	16.5 %	18.52 %
Provision coverage ratio (PCR)	80.91 %	82.4 %	80.4 %

Comparison of Axis Bank, ICICI Bank and HDFC bank and the credit risk levels

Illustration 2





State Bank of India Advances and CAGR percentages

Illustration 3

The PNB advances

Illustration 4

KEY PERFORMANCE INDICATORS (KPI)			
QUARTER	MARCH 2015	MARCH 2014	DIFFERENCE (%)
REVENUE	11,650.52	11,101.33	4.95%
NII	3792	4002	-5.3%
NET PROFIT	306.56	806.35	-61.9%
EPS	6.77	17.82	-62%
GROSS NPA	6.55%	5.25%	-
NET NPA	4.06%	2.85%	-
SIGNIFICANT METRICS			
BOOK VALUE	198.28	P/BV	0.74
EPS (TTM)	19.20	P/E RATIO	7.63

Recommendations: The suggestions that can make the credit system stronger is to add the following suggestions into the organization credit appraisal structure:

1. The customers who are not repaying their advances despite having the capability should not be extended further advance even if it the largest business house in the country.
2. The book review of all advances should be done on weekly level in order to know the level of exposure by the week so that at the end of every month the maximum possible repayment of advances has been collected.
3. The credit appraisal process needs to be made more stringent and no relaxations should be made on the name and reputation of the corporation only, but relaxations should be made only if the performance levels meet a set criteria of credit worthiness
4. The audit system of the credit advances should be done regularly and all the weaknesses need to be addressed, no internal auditor should clear any questionable advance as appropriate and should immediately ask for a corrective action to be taken before putting the internals system to the 'clear' level.

Scope for Further Studies: The scope for further studies in this subject is open in the areas of finding a more efficient models of credit advances where it is possible to be able to create a phase system of advances and the incremental approved amount being provided only after the result are seen in the implementation. This process can be changed and or modified internally depending upon the success of the model in credit risks and return figures and performance the modification could be standardized to improve the level of Non Performing Assets which is the key limitation and concern in Credit risk and returns in the Indian banks. This condition exists in all the developing economies.

CONCLUSION

A study was undertaken into the risk and returns of Indian banks and a review and evaluation has been done in the credit risk segment of the top 5 Indian banks in India. India is showing good growth as a developing country and this is being reflected in the strength of the five top most banks in the Indian banking system. What goes to the credit of the county is that the top 2 banks in the country are owned by the Government of India. The credit risk is the most important area and the advances that are made by the any bank creates the profit s or the losses and needs to be evaluated and monitored in a more efficient manner to ensure that the Indian banks improve their credit performance and the credit ratings. When Moody downgrades, investors don't invest and if investors don't invest then the bank does have the confidence of the public, the government, or the stock exchange. Even if the corporate house is large and the advance is large the banks should ensure that the corporate house to which advances are being made fits the credit criteria and the credit criteria should be designed to suit the corporate house or entity seeking a line of credit.

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