Global Financial Crisis and its impact on Indian Commercial Banks

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Abstract

Over time, the Indian banking industry has become more competitive and less concentrated. Gradual privatization and various reforms seem to have contributed to development of Indian financial sector. Today there is lot of competition in banking sector and banks are searching for and inventing other means of lending so that profits can be increased. Recent financial crisis has come along with many new challenges for the banking sector worldwide. Many lessons can be learnt from the crisis. The crisis can discourage many economies going for globalization. Banks need to strengthen their loans supervisory mechanism more strong. The cues from the market should be updated on regular basis so that corrective measures can be taken many times before, when it become worse. At the same time it is also very important that banks authorities know the exact picture of their banking operations. There should be no window dressing in reporting, which may likely to have a very devastating effect on the bank and economy once the real picture emerges suddenly at some point of time in future.

Keywords: Indian Commercial Banks, NPA, NPL, Financial crisis, Credit Risk

JLA Classification: G01, G21, G1

Introduction

Over time, the Indian banking industry has become more competitive and less concentrated. Gradual privatization and various reforms seem to have contributed to development of Indian financial sector. Today there is lot of competition in banking sector and banks are searching for and inventing other means of lending so that profits can be increased. This has also increased the risk exposures for the banks (Chandrasekhar, 2008). With implementation of financial deregulation, technology usage and opening up to global context has increased the complexity of business of commercial banks and their risk exposure (Rangarajan 2009). Product innovation and technological skill development have become the necessity of Indian banking system. In spite of the well grown finance sector, standing of Indian bank in the global arena is still not strong as the country's largest public sector bank, State Bank of India (SBI) was ranked 64th in the list of world's top 1000 banks. PNB and Bank of India were at 239 and 263 places respectively (Beniwal, 2009)

The global financial turmoil in 2008 caused many challenges to banking sector. The banks have to adopt different risk mitigating strategies to arrest the problems which may have induced from the financial sector collapse of United States. There was imminent fright that Indian banks' Non Performing Assets will go up as their portfolio will come under severe stress. Similarly there were apprehensions from every corner that Indian banks may also face problems on the line of US banks. The financial crisis has had its toll on export-related sectors like IT, textile and SMEs. The pressures on these sectors have direct impact on the asset quality of the banks. Risk management techniques suddenly have become the main operation of various banks.

Objectives:

This paper tries to study the impact that financial turmoil has on the Indian financial sector. The research work is based on the analysis of some important factors pertaining to banks. The study is basically analytical research which is based on the analysis of the different parameters for the past five years. The paper will further try to compare the performance of Public Sector Banks with the Private Sector Bank.

To achieve the above stated objective and after reviewing the related literature the study has been carried out in the following way:

Research Methodology:

The study has mainly used secondary data. Data belonging to the period 2004-05 to 2008-09 have been analyzed from the annual report of Reserve Bank of India. The results of the last financial year can generally be understood to provide the glimpse of impact of financial crisis which started in September 2008.

Data Analysis:

The statistical analysis for this study is descriptive. Mainly the time series analyses have been done over the period of the study. The trend patterns have been drawn for various dimensions of the study. Growth rate of different factors have also been calculated to know the impact of economic slowdown on the performance of banks.

Credit Growth: The financial crisis significantly influenced the outstanding credit in the last period of the study. Due to the deteriorating economic conditions and prevailing slowdown the growth in the outstanding credit has been much lower than what it used to be in the previous years. Table 1 shows the year wise growth rate of outstanding credit in percent.

Table1: Non-Food Gross Bank Credit (Scheduled Commercial Banks)

	March 19, 2004	March 18, 2005	March 31, 2006	March 31, 2007	March 28, 2008	March 29, 2009
Non-Food Gross Bank Credit (In Rs. Crore)	7,28,422	10,04,833	14,04,840	18,01,240	22,02,890	26,02,290
Percent Growth from the Previous Year (In Percent)	--	38	40	28	22	18

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Table 1 suggests that the credit off take has decreased with the slow down in the market. The outstanding credit as on March 29, 2009 is 260290 crore which is 18 percent higher to the previous year, while previous year's growth trend was 22 percent (FY08). Explaining the situation Sehgal (2009) states, "The Reserve Bank of India's latest data showed that the growth in credit offtake further slipped to 9.4% year-on-year on October 30 compared to 9.7% clocked, a week ago. Bank deposits are growing twice as fast as advances. The deposits growth stood at 19% on October 30, 2009. At the end of October 2008 credit growth had stood at 31% while the deposits growth was at 22%".

Banks have adopted cautious approach while disbursing credit to industries on the one hand and decreased credit requirement due to poor export demand on the other hand have been attributed for the decline in the growth percent. “The growth in infrastructure credit has slowed down due to moderated demand for credit after October 2008 reflecting the slowdown of the economy in general and industrial sector in particular," (Meena, 2009). Mallya (2009) says that continuing financial crisis will have negative impact on software sector, textile and SMEs. Such scenario will obviously impact asset quality of banks which in turn requires proper risk management mechanism to counter such challenges.

Table 2 has been drawn taking data of loans disbursed under the category Personal Loans. Last year sees lower amount of loan disbursed. The growth rate decline significantly in the year 2009 compared to the previous years. The percentage of personal loan to total non food credit also traverses a declining path. Banks have adopted a cautious approach due to financial uncertainty in the economy.

Table 2: Personal Loan (Scheduled Commercial Banks)

	March 18, 2005	**March 31, 2006**	**March 31, 2007**	**March 28, 2008**	**March 29, 2009**
Personal Loan (In Rs. Crores)	2,56,348	3,60,248	4,52,752	5,07,488	5,62,479
Percent Growth from the Previous Year (In Percent)	--	41	26	12	11
Percentage of total non food credit	25.5	25.6	25.1	23.0	21.6

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

CD Ratio: Overall there is decline in the CD ratio of all scheduled commercial banks. It is due to the lower credit offtake during the FY’09. All scheduled commercial banks credit deposit ratio is nearly 74 percent in the FY09 which was nearly 75 percent the previous financial year (Figure-1). Thus the CD ratio has declined but is still comfortable as they are lending roughly 70% of their deposits which is much better compared to the CD ratio during the period 1999-2002 which hovered around 50-60%. But there is more investment in government security which yields fewer returns (Sehgal, 2009).

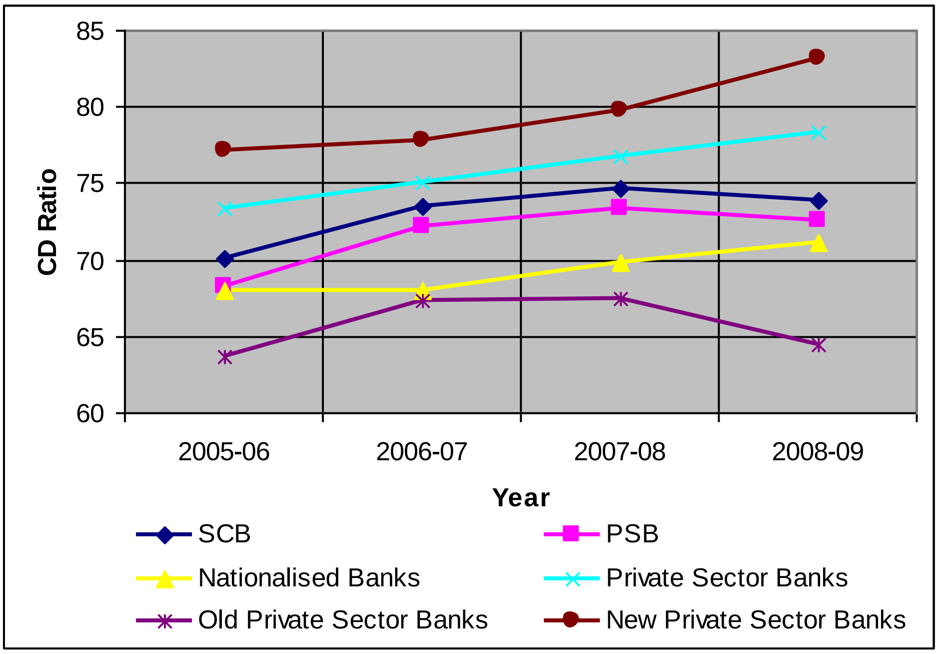

Figure 1: CD ratio of Indian Commercial banks

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Advances to Sensitive Sector: Advances to sensitive sector took backstage as economy was reeling under pressure. Mostly every bank categories refrained itself from involving much in such lending. The growth rate during the financial year 2008-09 for this sector was very meager and in most of the cases it was negative if compared with 2007-08. Table 3 compiles the data regarding advances to capital sector. It can be easily concluded from the table that there were sharp decline in the advances to the capital market category. Overall scheduled commercial banks witnessed negative growth during the financial year 2008-09 as compared to last year. The negative trend was mainly due to the poorer advances to capital market by private sector banks. There was sharp decline in the advances by private sector banks

Table 3: Lending to Capital Market

		2004-05	2005-06	2006-07	2007-08	2008-09
Scheduled Commercial Banks	Amount in Rs. Crore	15860.10	22303.16	35106.15	61638	55282
	Percent Variation	--	41	57	76	-10
Public Sector Banks	Amount in Rs. Crore	9390.18	13469.98	20620.85	31002	33202
	Percent Variation	--	43	53	50	7
Nationalised Banks	Amount in Rs. Crore	4888.28	8616.43	13922.38	19597	21582

	Percent Variation	--	76	62	41	10
Old Private Sector Banks	Amount in Rs. Crore	774.38	1049.21	1707.83	2539	2273
	Percent Variation	--	35	63	49	-10
New Private Sector Banks	Amount in Rs. Crore	3381.91	5282.42	8968.34	22729	13779
	Percent Variation	--	56	70	153	-39
SBI Group	Amount in Rs. Crore	2398.85	3375.22	4098.71	8429	8674
	Percent Variation	--	41	21	106	3

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Advances to Real Estate have also declined but the growth rate has been positive. Overall the scheduled commercial banks achieved only 15 percent growth rate in FY'09 compared to the 24 percent growth in the FY'08.

Table 4: Lending to Real Estate

		2004-05	**2005-06**	**2006-07**	**2007-08**	**2008-09**
Scheduled Commercial Banks	Amount in Rs. Crore	145604.00	262053.8	372874.2	456,858	524,228
	Percent Variation	--	80	42	23	15
Public Sector Banks	Amount in Rs. Crore	77313.10	158033.3	219784.8	283,425	334,305
	Percent Variation	--	104	39	29	18
Nationalised Banks	Amount in Rs. Crore	48125.99	101836.9	143631.9	181,926	219,566
	Percent Variation	--	112	41	27	21
Old Private Sector Banks	Amount in Rs. Crore	8640.70	12086.46	15566.4	18645	22212
	Percent Variation	--	40	29	20	19
New Private Sector Banks	Amount in Rs. Crore	43490.81	66980.22	104092.8	117457	123307
	Percent Variation	--	54	55	13	5
SBI Group	Amount in Rs. Crore	23244.27	46143.21	62325.21	85768	92945
	Percent Variation	--	99	35	38	8

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Indian banking sector is generally not much involved in advances to commodity sector and thus there is very little or no advances to this sector. Overall all scheduled commercial banks achieved negative growth rate in the year 2008-09 compared to the 91 percent growth in the year 2007-08 (Table 5). It is also visible that during the period of study, there is positive growth only during the FY'08; otherwise it has been negative for all the financial year during the period of study. The advances to this sector have varied widely across the various bank groups and there is no visible common trend. Only old private sector banks have the positive growth rate during the financial year 2008-09.

Table 5: Lending to Commodity Sector

		2004-05	2005-06	2006-07	2007-08	2008-09
Scheduled Commercial Banks	Amount in Rs. Crore	2366.49	1413.92	862.42	1644	897
	Percent Variation	--	-40	-39	91	-45
Public Sector Banks	Amount in Rs. Crore	1206.51	1227.54	351.15	734	–
	Percent Variation	--	2	-71	109	-100
Nationalised Banks	Amount in Rs. Crore	1206.51	1227.54	351.15	734	–
	Percent Variation	--	2	-71	109	-100
Old Private Sector Banks	Amount in Rs. Crore	98.83	154.74	500.91	809	897
	Percent Variation	--	57	224	62	11
New Private Sector Banks	Amount in Rs. Crore	1046.42	--	--	--	--
	Percent Variation	--	-100	--	--	--
SBI Group	Amount in Rs. Crore	--	--	--	--	--
	Percent Variation	--	--	--	--	--

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Table 6 shows the pattern of trend for the total advances to sensitive sector. The trend shows that various bank groups have marginal increase in their lending to this sector. Mostly all bank groups witnessed lower growth rate in the year 2008-09 compared to the year 2007-08. The various bank groups achieved positive growth rate except new private sector banks during the year 2008-09. This marginal positive growth can mainly be attributed to lending to real estate sector.

Table 6: Lending to Total Sensitive Sector

		2004-05	2005-06	2006-07	2007-08	2008-09
Scheduled Commercial Banks	Amount in Rs. Crore	163831.14	285770.9	408842.8	520141	580407
	Percent Variation	--	74	43	27	12
Public Sector Banks	Amount in Rs. Crore	87909.69	172730	240756.8	315181	367507
	Percent Variation	--	96	39	31	17
Nationalised Banks	Amount in Rs. Crore	54220.78	111680.9	157905.5	202258	241148
	Percent Variation	--	106	41	28	19
Old Private Sector Banks	Amount in Rs. Crore	9513.91	13290.58	17775.14	21994	25382
	Percent Variation	--	40	34	24	15
New Private Sector Banks	Amount in Rs. Crore	47919.14	72262.64	113061.1	140186	137086
	Percent Variation	--	51	56	24	-2
SBI Group	Amount in Rs. Crore	25643.12	49518.43	66453.92	94197	101619
	Percent Variation	--	93	34	42	8

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Non Performing Asset: Non performing asset is one of the important factors for the determination of soundness of bank. It was fear throughout the financial year that the NPAs are bound to increase due to the economy slowdown. This apprehension proved true as there was significant increase in the GNPAs of Indian commercial banks.

Table 7: Gross Non Performing Asset (Scheduled Commercial Banks)

	2005-06	2006-07	2007-08	2008-09
Gross NPA(in Rs. Crore)	51885	50634	56668	70063
Variations over the previous year	--	-2	12	24
Gross Advances (in Rs. Crore)	1550449	2012506	2507885	3031587

Variations over the previous year	--	30	25	21
Gross NPA Ratio (%)	3.3	2.5	2.3	2.31

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

There is steep rise in gross non performing assets during the FY'09. The growth is bout 24% which is far greater than the trend of pervious years during this phase of study (Table 7). The asset quality of different bank groups has deteriorated during this period. It can be understood that economic slowdown affected the repayment capacity of industry, particularly Small and Medium Enterprises. The same observation has also been Harding (2009) as he says that bank will be under pressure due to this problem. There was dip in the demand for loan also as the growth in total advances declines during the FY'09. Thus economic slowdown has affected the asset quality of banks during this period.

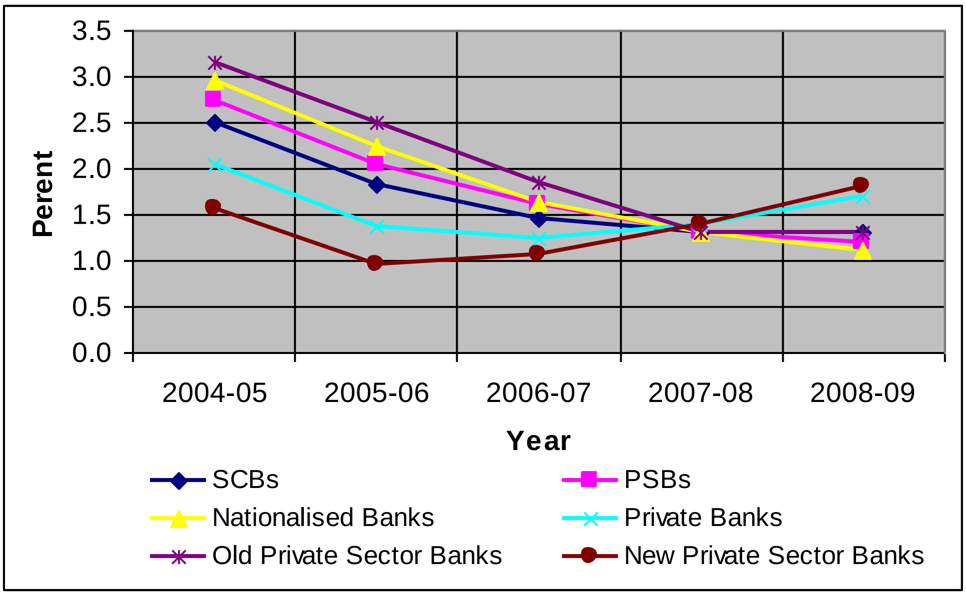

Figure2: GNPA to Total Asset of Indian Commercial Banks
Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

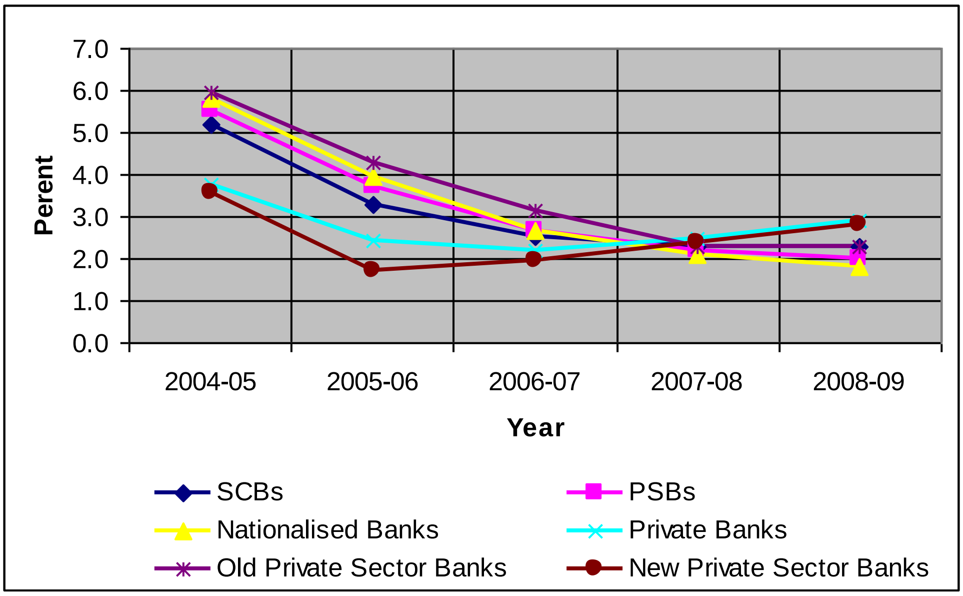

Figure3: GNPA to Total Advances of Indian Commercial Banks
Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Though there was significant increase in gross non performing asset, but GNPA to total asset ratio was under the control limit. Public sector banks have done far better than the private sector banks on this dimension (Figure 2). The conservative policies of state owned bank has proved beneficial for these banks. Similar scenario prevails for GNPA to total advances. Here also public sector banks proved to be better performer than the private Sector bank (Figure 3). There is visible upward trend with respect to private sector banks on these ratios. Public sector banks have been successful in controlling their GNPA to total advances around 2 percent. Private sector banks have their ratio more than 2 percent.

The net non performing asset to total asset and NNPA to total advances also presents the same trend as it is displayed for gross NPA. Here also public sector banks outperform private sector banks. State owned banks are somewhat able to maintain the same ratio values during the FY’09 as it is in FY’08. But private sector banks posses the increasing trend during the last period of study (Figure 4 & Figure 5)

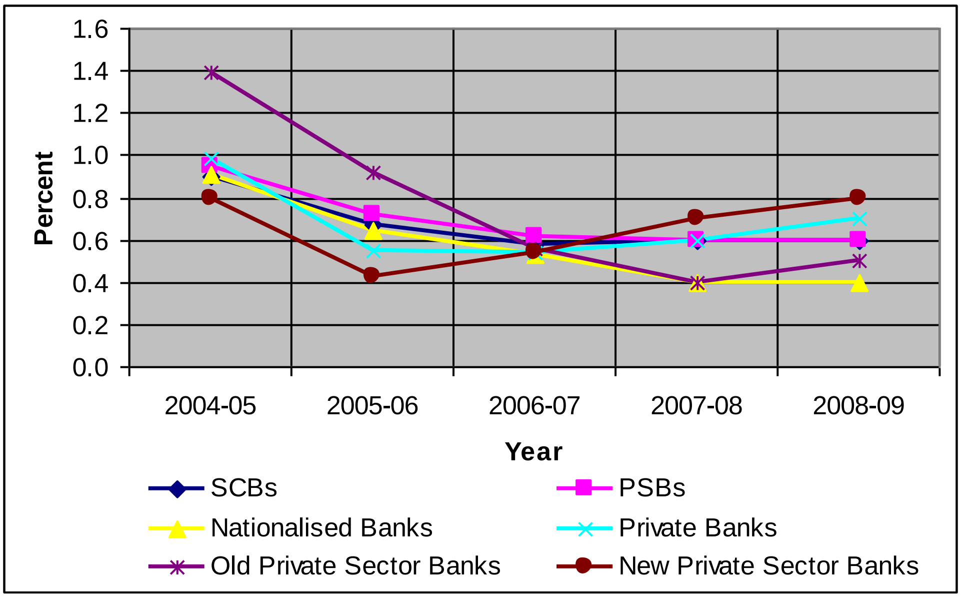

Figure 4: NNPA to Total Asset of Indian Commercial Banks
Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

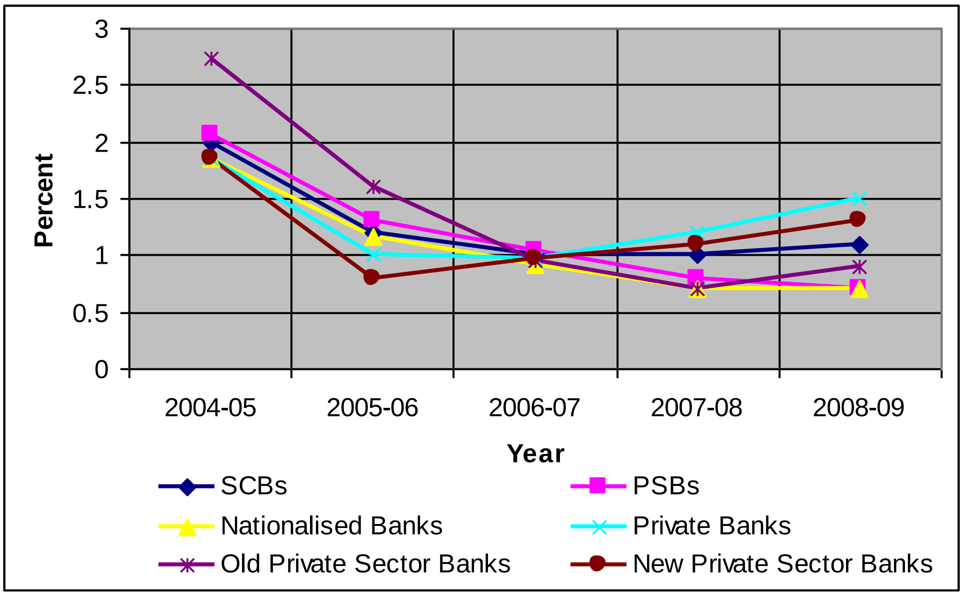

Figure 5: NNPA to Total Advances of Indian Commercial Banks
Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Profit: Various bank groups have shown superior growth in their operating profit during the FY'09. It is also visible that it is approximately identical growth in the operating profit of different bank groups. Table 8 compiles the data of growth in operating profit for the period 2006 to 2009.

Table 8: Growth in Operating Profit (Scheduled Commercial Banks)

Variations in Percent	**2006**	**2007**	**2008**	**2009**
SCBs	7	21	27	33
PSBs	-2	12	18	33
Nationalised Banks	-4	24	15	33
Old Private Sector Bank	1	34	19	33
New Private Sector Banks	38	42	46	25
State Bank Group	-2	-5	22	34

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Though operating profit is quite healthy for various bank groups, but net profit in the FY'09 has declined compared to the FY'08 (Table 9).

Table 9: Growth in Net Profit (Scheduled Commercial Banks)

Variations in Percent	**2006**	**2007**	**2008**	**2009**
SCBs	17	27	37	24
PSBs	7	22	32	29
Nationalised Banks	6	29	30	28
Old Private Sector Bank	99	30	76	22
New Private Sector Banks	33	30	41	12
State Bank Group	5	10	37	32

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Net Interest Income: Net interest margin for different bank categories have improved during the year 2008-09. Low credit demand resulted in the southward revision of the interest rate on deposits which improved the interest margin. Table 9 suggests that every bank category has improved their net interest margin. The growth in NII is hovering about 25 percent for all bank categories in the FY09. Overall liquidity in the Indian banking sector is quite healthy due to low cost healthy deposits.

Table 10: Net Interest Income Trend (Scheduled Commercial Banks)

Variations in Percent	**2006**	**2007**	**2008**	**2009**
SCBs	17	14	13	25
PSBs	11	8	3	25
Nationalised Banks	11	14	0	25
Old Private Sector Bank	15	7	5	28
New Private Sector Banks	50	28	45	24
State Bank Group	11	-2	8	21

Source: *Report on trend and Progress of Banking in India, Various Issues; RBI*

Findings and Conclusions:

Economy slowdown does have impact on the overall performance of the banks, but the impact has reasonably been under control. Credit growth has declined during the period as the banks have adopted a cautious approach. Banks restricted the disbursal of advances for personal loans. There is sharp increase in gross non performing asset but their ratios with respect to total asset and total advances have still been under control.

There was sharp decline in the lending to the sensitive sector. Mostly every bank categories abstained itself from exposing much to the sensitive sector. It was only the real estate sector under the sensitive sector which saw some kind of positive growth during the period 2008-09. Though there were some pressure on the banking operation, still the banks' performance when analysed with respect to profits is reasonably good. Operating profit has significantly increased in the last year of study but the provisioning and other expenses have reduced the net profit of different bank categories. There is positive but lower growth in net profit in FY'09 compared to the FY'08.

Worsening asset quality and the amount of restructured loans were the main concern in the Financial Year 2009. Slow down in the economy, problems emerging globally in the banking sector contributed towards the increase in gross Non Performing Loans in 2008-09 (22.5 percent) from 11.9 percent in 2007-08 (Business Standard, 23 November 2009, p-1).

Saha (2009) observing the poor conditions of Indian Financial Institutions says that Capital Adequacy Ratio of banks like Federal Bank (18.47), Corporation Bank (18.8), YES Bank (17.25) and ICICI Bank (17.69) are twice more than the stipulated limit of 9 percent. Reasons behind this is primarily due to low cost of fund and low credit growth.

Comparing the performance of private sector banks and state owned bank it can be said that public sector banks have done better than their private sector counterparts. Public sector bank being under the continuous supervision of government is generally adopting the cautious approach. This philosophy comes really handy in the economic conditions of the likes of that in 2008. These banks generally exercise cautious approach in disbursing retail loans. On the other hand private sector banks play aggressively in the market and in the process expose themselves to the various risks.

It can also be concluded that state owned banks managed their portfolio and policies in much better and effective way than the private sector banks. Public sector banks effected the changes in the prime lending rate more judiciously than the private sector banks thus maintaining the profits. Clearly, the turn in the economy has seemingly worked to the advantage of the PSBs. Private banks need to be stringent in their risk management practices to reduce NPAs going forward," (Mehta, 2009)

Thus far Indian commercial banks have preformed reasonably well in the financial turmoil of 2008. The credit may be given to the somewhat conservative approach of the Indian commercial banks especially public sector banks. Rangarajan (2009) putting the reason says that this happened as Indian banks were not exposed to toxic assets. Ahya (2009) while stating caution for banks says that banks need to be very careful with pricing in the risk for the different products.

Mohan (2009) suggests ten regulatory lessons that can be learnt from the sub-prime crisis are: Higher capital Requirement, Revisiting Basel II Capital Norms, Re-design of Performance Incentives, Widening Gambit of Central Bank Regulation, Tread Warily on Foreign Bank Entry, Prudential Limits on Securitization, addressing Liquidity Risk, Regulations of Derivative Contract, Risk Management is a Board Function too, Board Composition Matters

Indian policymakers have begun the groundwork for a new architecture to strengthen the country's financial system, to preclude the possibility of a Lehman Brothers-type collapse of a big Indian financial institution. The High Level Co-ordination Committee on Financial Markets (HLCCFM), which has representation from all financial regulators and finance secretary, is readying a paper that will outline the mechanism to ensure financial stability in the country (The Economic Times, 12 Nov. 2009, p-9). Risk management system has to be strengthened and effective. The survival and profitability of banks will also hinge on fee based income and diversified earning profiles. This is particularly important for public sector banks. On these lines many public sector banks have started recruiting sales personnel to sell investment products. In the past couple of months PSU banks such as State Bank of India Canara Bank and Bank of Baroda have beefed up their sales team to focus on selling investment product (Vasudevan et. al., 2009).

Recent financial crisis has come along with many new challenges for the banking sector worldwide. Many lessons can be learnt from the crisis. The crisis can discourage many economies going for globalization. Banks need to strengthen their loans supervisory mechanism more strong. The cues from the market should be updated on regular basis so that corrective measures can be taken many times before, when it become worse. At the same time it is also very important that banks authorities know the exact picture of their banking operations. There should be no window dressing in reporting, which may likely to have a very devastating effect on the bank and economy once the real picture emerges suddenly at some point of time in future.

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