A Comparative Study of Financial Decisions of Banks with Special Reference to Bank of India and HDFC Bank

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Abstract

Commercial banks are very crucial to economic growth of the nation for the services they provide such as financial mediation between savers and investors, credit creation and encouragement of capital accumulation. The health of the economy is the soundness of banking system. Banking as an activity involves acceptance of deposits and leading or investment of money. The importance of financial decision in bank performance is crucial because many of the factors that may lead to failure. The strategies and financial decisions that may drive to growth and profitability. The present study has been conducted to know the financial performance of HDFC Bank and Bank of India, the relationship between capital structure and banking performance and to study the relationship between financial decisions and corporate governance. The study is based on both primary and secondary data. The Current Ratio, Quick ratio, Credit deposit ratio, Yield on advances ratio and GNPA percentage to Gross advances ratios are used for this study. The study revealed that the current ratio of HDFC bank is greater than Bank of India. As far as the liquidity position is concerned, the HDFC bank has more liquid assets. The study revealed that HDFC has more credit deposit ratio which indicates that HDFC Bank creates more loan assets from its deposits as compared to Bank of India. The profit made from advances is more for HDFC bank when compared to Bank of India. The management of Non-Performing assets (NPA) is good for HDFC Bank because the Gross Non-Performing Assets to gross advances is less for HDFC Bank.

Key words:

Current Ratio, Quick ratio, Credit deposit ratio, Yield on advances ratio, Gross Non-Performing Assets, Percentage to Gross advances, Corporate Governance.

Introduction

Banking is one of the most regulated industries in the world. Among various regulatory measures, the regulation of bank capital is crucial due to the important role it plays in banks' soundness and risk-taking behavior, and its influence on the competitiveness of banks. In practice, a key aspect of capital regulation is the calculation of minimum regulatory capital, which is typically based on the credit risk of bank assets. Traditionally, the risk matrix was very simple in the sense that the risk weights were practically the same for bank loans of different risk. More recently, more risk-sensitive capital standards have been introduced, mainly because the low-sensitivity had arguable to severe market distortions as banks swapped low-risk assets against high-risk ones with more favorable risk weighting (regulatory arbitrage).

The private-sector banks in India represent part of the Indian banking sector that is made up of both private and public sector banks. The "private-sector banks" are banks where greater parts of stake or equity are held by the private shareholders and not by government.

Nationalized banks are also known as public sector banks. A nationalized bank is formed by taking a bank and its assets into the public ownership. The national government of the country holds the ownership of nationalized banks. In nationalized banks the government controls the bank. This could refer to taking control of the public shares, change in management and new corporate strategy.

HDFC Bank Limited is a banking company which is engaged in providing a range of banking and financial services. The Bank operates in four segments: treasury, retail banking, wholesale banking and other banking business. The treasury segment primarily consists of net interest earnings from the bank's investments portfolio, money market borrowing and lending, gains or losses on investment operations and on account of trading in foreign exchange and derivative contracts. The retail banking segment raises deposits from customers and makes loans and provides other services. The wholesale banking segment provides loans, non-fund facilities and transaction services to large corporates, emerging corporates, public sector units, government bodies, financial institutions and medium scale enterprises. The other banking business segment includes income from banking related activities, such as credit cards, debit cards and third party product distribution, primary dealership business.

The earlier holders of the Bank of India had failed and were no longer in existence. By the time a diverse group of Hindus, Muslims, Parsees, and Jews helped establish the present Bank of India in 1906 in Bombay. It was the first bank in India whose promoters aimed to serve all the communities of India. At the time, banks in India were either owned by Europeans and served mainly the interests of the European merchant houses, or by different communities and served the banking needs of their own community.

Statement of the Problem

Banking sector has a very important place in our Indian economy. Banking in India has been dominated by public sector banks since the 1969 when all major banks were nationalized by the Indian government. However, since liberalization in government banking policy in 1990s, old and new private sector banks have re-emerged. They have grown faster and bigger over the two decades since liberalization using the latest technology, providing contemporary innovations and monetary tools and techniques. Commercial banks are very crucial to economic growth of the nation for the services they provide such as financial mediation between savers and investors, credit creation and encouragement of capital accumulation. The health of the economy is the soundness of banking system. Banking as an activity involves acceptance of deposits and leading or investment of money. The importance of financial decision in bank performance is crucial because many of the factors that may lead to failure. The strategies and financial decisions that may drive to growth and profitability. The amount of the profit indicates the efficiency of the organization, the larger the profit higher the growth rate. The profitability depends on the effective utilization of funds to procure maximum profit for growth. In this context, it is highly relevant to examine the financial performance, the relationship between capital structure and banking performance and also the relationship between financial decisions and corporate governance of the banks.

Objectives of the study

1. To know the financial performance of HDFC Bank and Bank of India.
2. To know the relationship between capital structure and banking performance.
3. To study the relationship between financial decisions and corporate governance.

Research Methodology:

In this study an attempt has been made to evaluate and compare the financial performance of HDFC Bank and Bank of India. The study is based on both primary and secondary data.

The following ratios are used for this study.

1. Current Ratio
2. Quick ratio
3. Credit deposit ratio
4. Yield on advances ratio
5. GNPA percentage to Gross advances.

Review of Literature

Adieus et al., (2013) noted that the financing decision is concerned with the raising of funds that finance assets. Funds should be adequate to procure the assets necessary for operation. At the same time, if the funds are more than required, the excess would remain unutilized making no contribution to output but adding to the financing cost, thereby considerably eroding profitability. In other words, the financing decision should ensure optimum capitalization. The major sources of long-term capital are shares and debentures. Funds can also be obtained in the form of term loans and leases, as the latter serves as an alternative to borrowing. If sufficient funds are not raised domestically, they are obtained from sources abroad. Financial strategy consists of three interrelated kinds of decisions: investment, funding and working capital decisions

Robert Higgins (2007) noted that most of the thoughtful individuals and some investment bankers know that all investing financial decisions involve risk as well as return. Business investment require the expenditure of a known sum of money today, in anticipation of uncertain future benefits. Risk itself is a fundamental determinant of investment value. If two investments promise the same expected returns, but having differing risks, most of us will prefer the low risk alternative. As a result, risk reduces investment value.

Zuberi describes corporate governance as a set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are the shareholders, management and the board of directors. Other stakeholders include employees, customers, creditors, suppliers, government and the community at large. An important theme of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problem. Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation and commitment to the organization.

Prasanna Chandra (2012**)** tries to differentiate the corporate governance in the private and public sectors based on their features. In private sector, there are three broad categories of shareholders, viz promoters, financial institutions and individual investors. Family managed companies show greater vigor. Public sector enterprises are constrained by various regulations.

Kr. Paul (2012) describes the Term Lending guidelines by RBI. Importance is given to deferred payment exports, industries where output is meant for export, industries with short gestation period, agricultural sector, industries in industrially backward areas and SSIs with investments up to Rs. 25,000.

Kr. Paul and Chandrani Paul (2012) state that before granting term loans, the financial institutions conduct the feasibility study on the following aspects – technical feasibility, economic feasibility, commercial feasibility, financial feasibility and managerial competence.

Shekhar and Lekshmy Shekhar (2013) identified the measures to contain the level of NPAs as i) Debt Recovery Tribunals (DRTs), (ii) Lok Adalats (People's Court), (iii) Asset Reconstruction Companies (ARCs), (iv) Corporate Debt Restructuring (CDR) mechanism and (v) Recovery camps.

Parasuraman (2012) recognized financial ratios as summary drawn from the financial statements in such a way that they were capable of being interpreted easily. However, the use of ratios was also fraught with certain limitations and would never be a substitute for a full valuation exercise.

King (2012**)** identified ratio analysis as an important technique which was widely used for interpreting financial statements. The technique served as a tool for assessing the current and long-term financial soundness of a business. It was also used to analyze various aspects of operating efficiency and level of profitability.

Results and Discussion

The present research paper is an effort to make a comparative study between the growth rate in Bank of India and HDFC Bank. For this purpose, the data relating to both the banks for a period of 10 years, i.e., from 2004 to 2014 have been collected. The main parameters used for analysing the growth are Net profit growth, Net assets growth, ROA (Return on Assets) and NPA.

Table 1 Current Ratio

	2013	2014	2015	2016	2017
BOI	0.25	0.24	0.23	0.23	0.24
HDFC	0.54	0.60	.58	1.04	0.74

Source: Compiled from Published data

Low values for the current ratio (values less than 1) indicate that a firm may have difficulty meeting current obligations. However, an investor should also take note of a company's operating cash flow in order to get a better sense of its liquidity. A low current ratio can often be supported by a strong operating cash flow. Cash is a current asset. So, spending more cash will automatically reduce the current ratio. The companies can use cash for several purposes. The cash can be used for the acquisition of fixed assets rather than using project finance. The company can also look at paying off the entire or a proportion of the long-term debt. Another effective use of cash is to pay more dividends. This will keep the investors happy as well as reduce the current ratio (Table 1).

Table 2 Quick Ratio

	2013	2014	2015	2016	2017
BOI	9.26	10.15	7.5	9.9	7.3
HDFC	7.84	8.55	12.69	14.59	11.19

Source: Compiled from Published data

The higher the quick ratio, the better the company's liquidity position. However, too high a quick ratio may indicate that the company has too much cash sitting in its reserves. It may also mean that the company has a high accounts receivables, indicating that the company may be having problems collecting on its account receivables (Table 2).

Table 3 Credit Deposit Ratio

	2013	2014	2015	2016	2017
BOI	76.88	76.86	76.60	72.85	68.91
HDFC	80.14	81.79	81.71	83.20	85.64

Source: Compiled from Published data

Credit-deposit ratio is the proportion of loan-assets created by banks from the deposits received. The higher the ratio, the higher the loan-assets created from deposits and vice-versa. Lack of business environment, poor law and order in the past years, poor credit absorption capacity of the state, and delay in government run mechanism has created obstacles in way of credit deployment by commercial banks. As the credit deposit ratio increases, the bank's ability to create loan advances from deposits increases. Generally, CD ratio above 50% is considered good. In that sense, both the banks have a good ratio (Table 3).

Table 4 Yield on Advances Ratio

	2013	2014	2015	2016	2017
BOI	11.03	10.23	10.81	11.64	10.72
HDFC	14.63	13.58	13.26	12.96	12.50

Source: Compiled from Published data

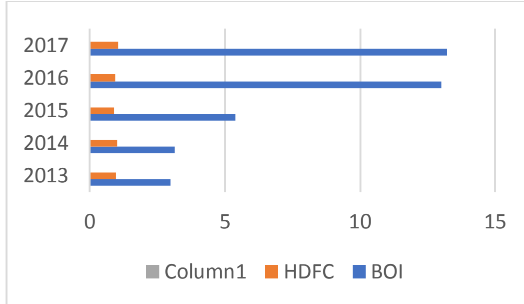
The ratio gives the average lending rate of the portfolio. High yield on advances is an indication that the entity is into financing riskier assets and may see asset quality issues. It also indicates whether the pricing of the loan is in line with underlying risk. Yield on advances ratio is more for HDFC Bank when compared to Bank of India. It indicates that HDFC finances more risky assets than BOI, which could be one of the reasons for higher profitability of HDFC Bank (Table 4).

Table 5 GNPA Percentage to Gross advances

	2013	2014	2015	2016	2017
BOI	2.99	3.15	5.39	13.0	13.22
HDFC	0.97	1	0.90	0.94	1.05

Source: Compiled from Published data

The Gross NPA to loans (advances) ratio is used as a measure of the overall quality of the bank's loan book. NPAs are those assets for which interest is overdue for more than 90 days (or 3 months). Net NPAs are calculated by reducing cumulative balance of provisions outstanding at a period end from gross NPAs. Higher ratio reflects rising bad quality of loans (Table 5).



Source: Compiled from Published data

Figure 1 Graph Showing Gnpa to Gross Advances

The Gross NPA ratio is higher for BOI which indicates the bad quality of loans. This may be due to the investment of their deposits in safe assets (Figure 1).

Conclusion

NPA is always a major cause of concern for banks. Unlike private sector bank, public sector bank cannot bend the rules for aiming only profit. Various strict measures are being taken at all level so as to crush NPA, OTS, Adalat, Restructuring are few to name. Third party products are also being promoted as a tie up between bank and insurance or investment companies. Shares also ensure additional income for the banks and help in improving profit margin. As a conclusion it can be mentioned that while private sector banks strive to increase their profitability, the public sector banks aim at increased service which may affect their profitability. To survive and attain sustainable growth levels in competitive business environment, good Corporate Governance practices must be effectively implemented and enforced preferably by self-regulation and voluntary adoption of ethical code of business conduct and if necessary, through relevant regulatory laws and rules framed by the Government or regulators such as RBI, SEBI etc. A Corporate Governance Policy should serve as an effective instrument to ensure greater accountability on the part of the Boards of Directors to the stakeholders. Bank of India is committed to ensure highest level of corporate governance in its business dealing.

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