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The analysis focuses on the earnings of state-owned commercial banks in India concerning high-risk investments.

Santosh Nair
Department of Commerce & Business Administration,
Gauhati University, Guwahati, India

Abstract

The current research looks at how asset risk affects the bottom lines of government-owned banks. The results reveal that asset risk significantly impacts commercial bankers' bottom lines. Net profits for commercial banks tend to decrease when asset risk is included. Twelve commercial banks are in the public sector, but only five have been chosen for their convenient locations. The years 2005-2006 through 2018-2019 are included in the analysis.

***Keywords**: Public sector banks, Liquidity concerns, Risk management, Regulatory framework, accounting practices, Technological developments, Solvency, Net profits*

Introduction

A risk is a situation in which the result is unknown or unexpected. It's a case of high hopes not being met. The term refers to the likelihood of an incredible shift in actual results relative to projections. Investment return result variability is another kind of risk. Risk, in the context of finance, refers to the potential for unfavourable effects due to uncertainty.

Private banks play a crucial role in the US monetary system as financial intermediaries, and their significance is reflected in the various risks they face. These risks include credit vulnerability, mortgage risk, price fluctuations, foreign exchange risk, and bankruptcy risk. The efficiency and viability of commercial banks are at risk if these dangers are not reduced.

Here we summarise the effect of various risk classes on the bottom lines of India's public and corporate banking sectors.

- Credit exposure risk, which refers to the potential of borrowers defaulting on loans, poses inherent challenges when granting loans. This risk arises from clients being unable or unwilling to fulfil their loan obligations, leading to increased provisions to account for higher loan defaults.

- Financial institutions face asset risk when clients struggle to make loan payments or when asset values experience fluctuations. Consequently, provisions must be set aside to address the growing number of loan defaults caused by these factors.

- The risk of interest rate fluctuations encompasses the possibility of unexpected and adverse shifts in market interest rates, which can decrease a company's Net Interest Income, Net Interest Margin, or market value. Banks are exposed to various interest rate risks, including Mismatch, Basis, and Embedded Options Risks.

- Currency exchange rate uncertainty introduces a new dimension to the risk profile of financial institutions. Banks are exposed to potential losses in adverse exchange rate scenarios, particularly when they hold releasing positions in spot or forward contracts or a combination of both.

- Liquidity concerns arise due to the reliance of commercial banks on prompt customer deposit payments and the availability of liquid resources to finance the expansion of their loan portfolios and other assets. Liquidity uncertainty arises from a mismatch between an organization's assets and accrued obligations and deposits.

Credit exposure risk, property risk, rate of interest variation risk, currency conversion risk, and liquidity issues are all potential threats to the profitability of India's government-owned corporate banks. To lessen the likelihood of negative outcomes for the financial wellness of banks, sound risk management procedures are required.

In India, the designated private banks are the primary holders of financial assets and play a crucial role in the country's monetary system. Their extensive branch network positions them as the largest banks in the nation. There are six distinct categories of regulated banks catering to businesses.

State-Owned Financial Institutions

The Government of India (GOI) has a significant stake in the country's public sector banks. There are 12 banks in India, with the public sector making up the biggest group.

Banking in the Commercial Sector:

Share capital in commercial banks is primarily provided by individuals and corporations. Between 1969 and 1980, these financial institutions narrowly escaped nationalization. Dhanlaxmi Bank. And Karur Vysya Bank Ltd., two of the oldest private banks in India, merged to become Centurion of PNB. There are now 22 privately owned banks under the country's regulatory framework.

Currency Exchange:

These banks are headquartered outside of India but serve the Indian market via entirely owned or locally operated branches. The RBI (Indian Central Bank) authorizes their operations there. Currently, 46 foreign banks are allowed to do business in India.

Institutions Serving Rural Areas on a Regional Basis:

Establishing these banks aims to provide access to banking services in rural areas. The federal government, an individual state government, and a public sector bank all possess equal shares. There are now 43 regional rural banks in operation in India.

Microlending Institutions:

These financial institutions are tailored to the needs of specific groups, such as microbusinesses, craftspeople, and small farmers. They aim to increase access to banking services in underserved areas of the nation. These financial institutions must have a minimum capitalization of Rs. 200 crores. India has ten smaller financial institutions that the government officially recognizes.

Credit Unions:

These community banks are committed to widening the financial safety net and increasing the number of people with access to banking amenities. They are, however, barred from offering banking products like credit and loan cards. There are now two operational planned payment banks.

Scheduled cooperative banks exist in India alongside commercial banks. These financial institutions rely on mutual aid and provide various financing options. The banking requirements of people in rural areas are their primary focus. The number of cooperative banks in India is extensive, with 53 in metropolitan areas, 34 in the state, and 352 at the district levels.

Literature assessment

Al-Homaidi et al. (2019) conducted a study on 37 industrial banks in India, examining the impact of variables such as GDP, falling purchasing power, borrowing expenses rate, and currency conversion rate on accounting practices from 2008 to 2017. Their findings indicated that while GDP and loan costs had limited effects on profitability, transition size and price inflation played significant roles.

From 2008 to 2010, Al-Musali and Ku Ismail (2016) investigated rational reserve management in the Gulf Regional Council banks, revealing a strong correlation between reasonable capital execution and banking performance metrics across all GCC countries.

According to an analysis of 22 banks in Nigeria business lenders conducted by Daniyan-Bagudu et al. (2017), greater liquidity was connected with improved output and customer confidence in the financial sector.

Using a random impact model, Elshaday et al. (2018) examined the connections between the Central African Republic, the Chartered Institute of bank features, and the effectiveness of eight independent banks in the Ethiopian finance market from 2007 to 2016.

Over five years, from 2012 to 2017, Haabazoka (2019) analyzed the effect of technological developments on the lending standards of 19 banking institutions in Zambia. The results showed that the banks' KPIs improved when they adopted technological advances, especially in digital banking services.

The effect of salary increases on the Vietnam Bank for Industry's bottom line from 2007 to 2017 was studied by Luu et al. (2019). Their research showed that wage increases considerably influenced productivity. However, the effect was not constant across all banking organizations. The results were good for state-owned and commercial banks but detrimental for national non-state companies.

Palmalai and Saminathan (2016) analyzed India's public sector, private sector, and international banks using the CAMEL model. Their research revealed that public-sector banks lagged behind their private-sector counterparts. While there were areas where personal and global banks were on par, international banks generally outperformed government and private banks.

Methodology:

This study aims to analyze how Indian public sector commercial banks calculate the risk of their assets. There are twelve government-owned banks in India, and PNB, SBI, UCO, IOB, and UBI were chosen. These financial institutions were selected from around India. Descriptive research techniques were used in the study, which gathered data from 2005–2006 through 2018–2019.

Outcome and Discussion:

The findings demonstrate varying levels of asset risk among public-sector commercial banks. The research reveals a gradual increase in asset risk, which raises concerns. Asset risk negatively affects bank profitability, emphasizing the need for attention. Banks can mitigate the risk by tightening lending standards and conducting thorough due diligence. Reducing loan defaults and asset deterioration can minimize the need to set aside significant loss provisions. Higher interest rates on loans can also enhance banks' net interest margins. Recovering funds from nonperforming loans poses substantial challenges for financial institutions.

Conclusion:

The overall analysis of the examined banks highlights poor recovery efforts. During the period under review, they witnessed a significant surge in defaults, resulting in heightened asset risk for financial institutions. Urgent action is required to ensure banks' solvency due to the adverse impact of asset risk on profitability. To increase profits, banks should employ innovative strategies to recover funds from dormant, lost, and written-off accounts. Approving loans only after comprehensive due diligence, including assessing applicants' credit history, creditworthiness, and collateral condition, can enhance banks' ability to recover funds in case of default.

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