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Performance Evaluation of Commercial Banks in the Indian Banking Industry

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Abstract

Bank regulation is crucial due to the systemic risks highly leveraged banking organizations face. Since the 2008 financial crisis, countries have focused on strengthening financial institutions and restoring economic security. In the Indian finance industry, globalization, intense competition, and new challenges have heightened the importance of regulation. A performance evaluation model is invaluable to driving organizational success, aligning objectives with strategy, and effectively tracking and sharing information. Traditional evaluation methods primarily focus on financial outcomes, but in today's fast-paced and competitive economy, long-term viability must be considered alongside financial success. As a service industry, banking relies on tangible and intangible factors to enhance productivity. The Balanced Scorecard, a performance measurement method, incorporates the outcomes of both measurable and unmeasurable aspects.

Keywords: Commercial banks, Balanced Scorecard, Balanced Scorecard, Financial crisis, Regulation framework, Competition, Asset categorization, Long-term objectives

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Introduction

The Crucial Role of Banks in the Financial Sector: A Key Pillar of Economic Stability

The financial system is integral to a country's economic growth and serves as the engine that drives progress. The success or failure of banks directly impacts all industries within a nation. Banks provide crucial financing to businesses across sectors, serving as a barometer for the state of the economy. Developing countries prioritize strengthening their banking sector to achieve economic expansion and poverty reduction goals. Scholarly research has consistently shown that improving financial institutions significantly contributes to economic growth. Financial institutions act as intermediaries, connecting savers and investors to provide essential funding to businesses. The banking and insurance industry accounts for 6% of India's GDP, with the overall service sector contributing around 52%. The service industry's share of GDP has been steadily increasing, and India's financial services industry is predicted to rank among the world's most enormous by 2025. India's monetary system relies heavily on its banking sector, which serves the country's financial, societal, political, and topographical needs. Indigenous financiers in the 18th century met the financial demands of the business community in India, laying the groundwork for the modern banking system.

Before Nationalisation (Before 1955)

- The initial stage of development before nationalization.
- The period preceding the state taking control of banks.
- The formative phase of the banking system in India.

Consolidation and Nationalisation (1955-1990)

- Stage characterized by the nationalization of banks.
- Focus on consolidating the banking sector.

- State intervention and control over banking institutions.

Liberalisation and Reform of the Indian Monetary and Financial Services Industry (1990-2004)

- Implementation of reforms and changes in the financial and banking sectors.
- Partial liberalization of the industry.
- Introduction of new policies to promote growth and efficiency.

Increased Liberalisation Stage (From 2004 Onward)

- Phase marked by a higher degree of liberalization.
- Continued reforms and opening up of the banking sector.
- Emphasis on enhancing competition and attracting foreign investment.

Each phase represents a distinct period in the development and transformation of the Indian Banking system, reflecting changes in policies, regulations, and the overall economic environment.

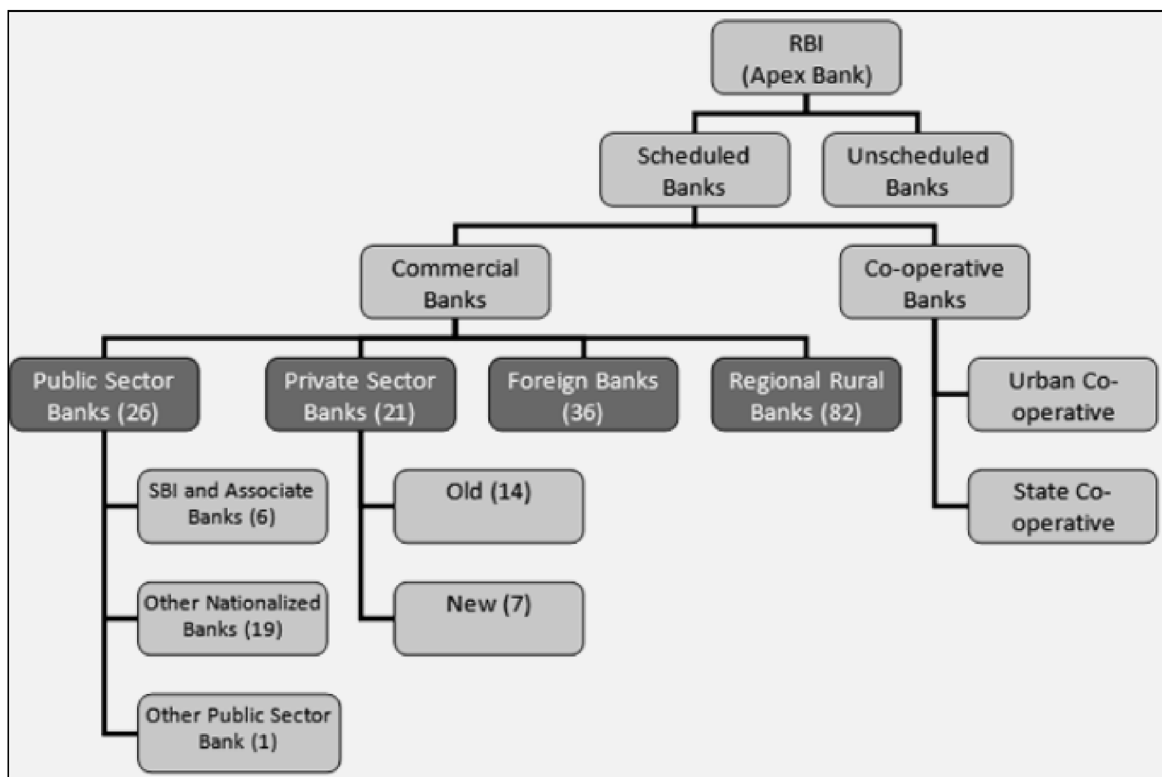

Fig 1: Indian Financial System

India's Regulation Framework

In its early years, the Reserve Bank of India (RBI) lacked the authority to effectively control and monitor banks, such as performing audits and inspections, identifying unsound practices, and providing solutions. Requiring the blessing of the Central Bank of India, new financial institutions sprung up. Therefore, several banks sprung up nationwide with numerous branches but few resources.

Improvements in India's banking industry
In 1991, the Narasimham Committee's proposals for reforming the banking system were implemented.

The Indian government made real market structural changes, necessitating corresponding banking sector reforms. The financial sector reforms of the first phase of the reform era occurred between 1992 and 1998, while the changes of the second phase occurred after 1998. Before 1991, when liberalization began, the Indian banking system was dominated by state-run institutions and subject to strict controls. Low financial base, low profitability, poor asset quality, a lack of competitors among banks, and similar problems plagued the banking system. In April 1992, the Reserve Bank of India (RBI) introduced several prudential requirements concerning revenue recognition, asset categorization, and capital sufficiency to improve the banking sector. The most notable changes include capital adequacy ratio, asset categorization and provisioning, monetary policy liberalization, and lowering of statutory pre-emptions (RBA's SLR and CRR rates). Banks' ability to withstand financial shocks is evaluated by comparing their capital to their risk-weighted lending exposure.

The lowest acceptable ratio, according to international regulations, is 8%.

This ratio guarantees that the bank has sufficient capital to weather losses from nonperforming assets without going under. The purpose of these regulations is to safeguard depositors' support and strengthen the economy as a whole. The term "asset segmentation" describes categorizing the assets of a banking institution or the loans extended by a bank according to the assessed risk of recovery. This ongoing procedure allows the bank to continually track the quality of its portfolio of loans and take corrective measures if necessary. Additionally, banks must set aside money to cover the cost of poor loans they issue. After banks were nationalized, competition in the banking industry dried up since RBI regulations forbade establishment of private banks.

Strategies for Evaluating Financial Institutions
There are many ways in which financial institutions' success may be evaluated. Traditional ratios, parametric models, non-parametric methods, and combined structures for assessing performance are the four broad classes identified by Ferreira et al. Since it is easy to understand and apply and uses terms familiar to consumers and investors, the standard ratios approach has won widespread favour and widespread adoption. Parametric models, often known as models of economics, conduct independent evaluations but need accurate descriptions of the factors that may be challenging. As a result, these techniques have a low adoption rate. The DEA methodology is among the most popular and effective non-parametric approaches—photo 2. Below are a few examples of KPIs used to evaluate performance in each angle. Several KPIs must be revised when applied to a service business like a bank. The BSC connects the four lenses and the overarching business strategy.

Fig 2: A few examples of KPIs used to evaluate productivity in each angle are provided below.

Problem Statement:
The current evaluation of banks' performance in India primarily relies on monetary metrics, which may not provide a comprehensive understanding of their proper financial health and prospects. Financial ratios are trailing indicators and do not account for the inherent risks in the modern banking business. There is a need for a performance assessment model that considers all aspects of banks' infrastructure and procedures.

Purpose of the Research:
The globalization of banks and the evolving financial landscape necessitate an evaluation of banks based on their sustainability, global issues, competitive climate, and risk management. The assessment should be forward-looking, incorporating indicators that capture immediate and future financial benefits. Non-monetary indicators should also be included in the evaluation systems.

Approaches to Research:
The primary purpose of this research is to assess the effectiveness of India's commercial banks via the balance sheet approach. The study uses various perspectives to probe the elements most critical to success. The buyer Development and Growth and Business Process primary data are gathered from customers and bank staff. The Financial institutions' financial outlook is analyzed using supplementary data from publicly accessible annual reports.

Research Objectives:
The primary purpose of the research project is to investigate the viability of using the Balanced Assessment as a tool for monitoring the efficiency of bankers and regulatory institutions. The study focuses on the period from 2009 to 2015 and aims to evaluate the performance of selected financial institutions. The research includes ten banks, comprising six public and four private institutions. Data is collected from customers and employees at multiple bank branches in Bangalore to analyze the

perspectives of Customers, Staff Learning and Development, and Internal systems in the Balanced Scorecard framework. The Financial Outlook is determined by analyzing the annual accounts of the banks for the specified period.

Conclusion

This study demonstrates the value of using the Balanced Scorecard's several criteria in assessing India's financial institutions. It highlights the limitations of using monetary metrics alone for examination since they can only reveal trends in the past. The current regulatory standards in India do not adequately evaluate financial metrics or manage risks. The assessment methods often overlook banks' competitive strategies to ensure long-term viability. By implementing the Balanced Scorecard, banks can adopt a new approach to evaluating success, considering customer focus and innovative approaches to overcome challenges and stay ahead of the competition. Banks can use the Balanced Scorecard to benchmark their efforts with long-term objectives. Embracing the Balanced Scorecard would redefine performance evaluation in the banking industry.

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