



## Methods of measuring the efficiency of commercial banks

Pradeep<sup>1</sup>, Parveen Kumar<sup>2</sup>

<sup>1</sup> Lecturer in Commerce, GSSS Kohla, Gohana, Sonapat, Haryana, India

<sup>2</sup> Lecturer in Economics, GSSS Garhi Ujale Kha, Gohana, Sonipat, Haryana, India

### Abstract

Efficiency analysis is essential for the evaluation of bank's performance. To estimate bank's efficiency we can apply different methods. Analysis of financial indicators is the most popular efficiency analysis method in banks, but the number of financial indicators can be really big and make the interpretation of the results more difficult. This method has become increasingly popular in measuring bank efficiency in the countries with developing banking systems.

The main aim of this article is to present the results of efficiency analysis computed by the classical index of balance sheet characteristics.

**Keywords:** bank efficiency, efficiency analysis, SCBs

### Introduction

The intensive and continuously increasing competition in the financial services market creates a need for an access to information that would allow evaluating commercial and banks operation in this market. Such evaluation are really essential to both band owner and customers who expert high level financial profit.

To estimate band efficiency we can use different methods. This method can be classified in various ways one of them distinguishes

The traditional method of financial indices based on balance sheet analysis.

Parametric methods based on the knowledge of production function.

Non-parametric methods that do not required inch knowledge.

For the purpose of the present research the traditional method of financial indices was chosen to evaluate bands efficiency.

The parametric method was omitted as it requires defining the relation between inputs and performance and also data are long periods of time. The method based on balance sheet characteristic indexes has monopolized the banding practice.

The aim of this article is to present the results of efficiency analysis computed by traditional method. The analysis was arrived out in schedule commercial banks operating in India. The period of efficiency analysis cove the year 2008-2012.

### Current position of banking in India

As per RBI's data for 2012. 173 commercial banks were functioning in India on March 31, 2012. Out of these 169 were scheduled commercial banks (SCBs), 82Reginal Rural Banks and 4non scheduled commercial banks. 101261 offices (including the branch offices and administrative offices) were working on March 31, 2012. Out of these 36130 were in rural areas, 25931 in semi urban areas, 20321 in urban areas and 18879 in metro-Politian cities. Maximum number of bank offices were in Uttar Pradesh (12121) followed by

Maharashtra (9635) and Andhra Pradesh (8422). Delhi's share in bank deposits was highest (11.1%) followed by Uttar Pradesh (7%) and Karnataka (6.7%). In bank credit Delhi's share was 13.6% followed by Maharashtra (9.7%) and Andhra Pradesh (7.9%).

### Efficiency Analysis By The Method of Financial Indicators

Efficiency analysis in essential for the evaluation of banks performance financial indicators are still an important analytical instrument, and the band's owners and potential customers use them to compare and evaluation the performance of bands That in why bands need to pay particular attention to the value of the traditional indicators if they want to create a positive image and to be perceived positively by general public.

These indication can be divided into four group;-

- profitability rates
- Margin rate
- Weighted
- Employment efficiency rates.

The efficiency indicators may be analyzed from different aspects in the case of time as a criterion, we study the dynamic of ratios, which allows to check whether the efficiency improves and deteriorates a given period of time. If we consider a group of band's efficiency to average values of the group the band financial reports such as balance shuts profit and loss accounts or less frequently cash-flow accounts are used to assess the efficiency indicators.

The first group of the indicators is profitability rates. The mart common ones in this group are:

- Return on assets (ROA), presented as a ratio of financial result and a bank's assets;
- Return on equity (ROA)-a ratio of financial result to a band's own fund;
- Return on tale (ROS) - a ratio of financial result to a

- band's income;
- Costs ratio (C/I)-a ratio of costs to incomes.

The ROA, ROE and ROS ratios, which are universally applied in financial analysis allow to evaluate the efficiency of band's performance within a given period of time and in comparison to other market players so, their significance for management in of comparative nature.

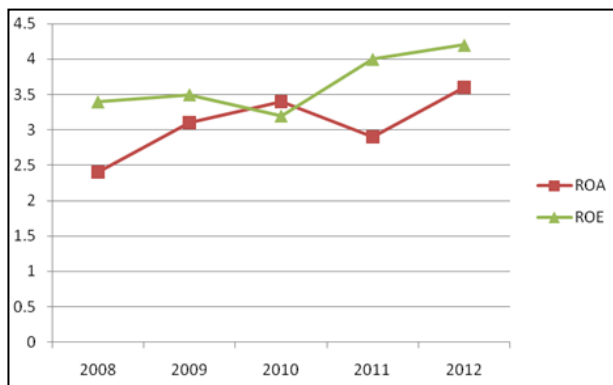


Fig 1

Chart I presents the value of ROA and ROE ratios obtained by scheduled commercial bands (SCBs) in India in 2008-2012. The values of both indicators, increasing since 2008 Show an improvement in the profit ability is scheduled commercial banks in the last few years.

Another group of efficiency indicators are margin rates. Two basic rates of time group are based on interest margin;

- Net interest margin-a ratio of interest results to assets;
- Interest spread which can be interpreted as a difference between the average interest- bearing assets and the average expense of interest-bearing liabilities.

The additional margin rates that show the income and expense of band's activities could also be applied although it is not necessary to use all the margin indicators to evaluate the financial conditional or efficiency of a bank.

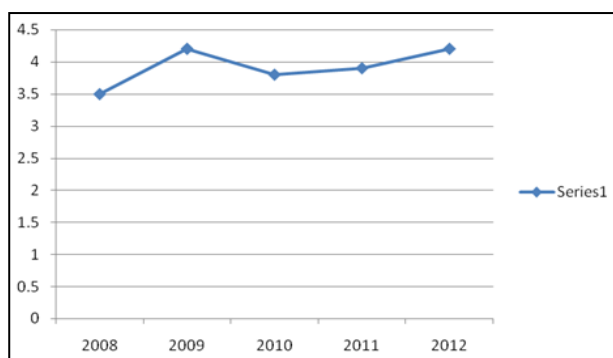


Fig 2

Chart-2 presents the basic indicators of this group i.e the net interest margin in scheduled commercial banks in 2008-2012. After the period of a visible decline the net interest margin is constant in commercial bands in the last years.

The next group of financial measured applied in efficiency

analysis are weighted result rates:

- The result rate changed with reserve which is shown as a difference between the building up and dissolution of reserves, and the achieved result.
- The result rate changed with operating costs be the ratio of operating cost to the result.

If the result rate changed with reserves shows a positive value i.e if a banks builds up more reserves than dissolves it can be said that building up reserves changes the band's result, i.e decrease its level.

The result following from both definitions can be interpreted in various ways. The clearest interpretation is provided by applying the result of banding activity in this case the indication show the percentage of the result used to cover the operating costs or the reserves balance.

The last group of measures constitutes the employment efficiency rates. The most frequently used ones are:

- The rates presented are a ratio of assets to a number of employers.
- The rate presented as a ratio of a result to a number of employers.
- These indicators show the average balance sum and the result produced by one full time employee of a bank

**Concluding remarks**

The results achieved by the classical method of financial indicators of financial analysis, i.e. return on equity (ROE) and employment efficiency rate.

The main advantages of the method of financial indicators are;

- Simplicity and easiness of application,
- Universality of application,
- Obtained measures are absolute values and thus can be used for evaluations, comparisons, rankings, etc.
- Availability of data.

Financial indicators can be used by all those interested in evaluating a bank's performance- banking supervision, owners, management or customers.

This method of financial indicators has certain drawbacks. The basic one is a vast number of the indictors used. In banking practice, a few hundreds of such factors are used. Applying so many measurements does not give the whole picture of the situation since particulars indicators provide only fragmentary information.

**References**

- Bhattacharya A, Lovell CAK, Sahay P. The impact of liberalization on the productive efficiency of Indian commercial banks, *European Journal of Operational Research*. 1997; 98:332-345.
- Janki B. Unleashing Employee Productivity: Need for a Paradigm Shift, *Indian Banking Association Bulletin*. 2002; 24:7-9.
- Ram Mohan TT, Raj SC. Productivity and efficiency at Public and Private sector banks in India, working Paper, *Indian Institute of Management, Ahmadabad*, 2003.
- Sathye M. Privatization performance and efficiency: A study of Indian Banks, *Vikalpa*. 2005; 30:7-16.