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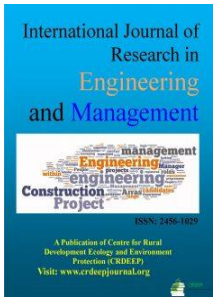

Full Length Research Paper

Profitability Analysis of the Nainital Bank Ltd., Uttarakhand (India)

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ABSTRACT

2019 and 2020 will be remembered as one of the difficult years for the Indian economy and Indian banking system. Even before the corona virus outbreak, the Indian economy was going through the worst phase. The gross domestic product (GDP) of India fell to 4.2 per cent in 2019-2020 which was lowest in the last 11-years. Bank deposits which grew by 10 percent in the year 2018-19 grew by 7.9 per cent, in 2019-20. Low bank deposits lead to contraction in the Bank credit growth rate to 6.1 percent in the year 2019-20, as compared to the 13.3 percent in the year 2018-19. This is a clear indication of condensing consumption demand. Given the uncertainties related to the intensity, spread, and duration of the pandemic, the recovery of Indian economy is expected to be weak in coming years due to which the credit growth in banks may slow down further in the coming years. With current changes and trends happening in the Indian banking industry especially the evaluation of the impact of stressed NPA's on the performance of banks becomes lot more significant. There is a necessity for studies on the performances of banks as it will reveal the recent trends and how they are functioning. Financial performance analysis and identification of their weakness and strength using financial performance indicators can contribute to management, shareholders, the public and the regulator as a whole. In order to analyse the profitability performance of the bank, certain ratios have been considered such as ROA, OPTWF, ROE, NIM and EPS. Such ratios as well as the components of profit of the bank have been further analysed through mean, coefficient of variation and compound annual growth rate.

Introduction

Financial system features a great role to play in economic development of a country. A well-functioning financial sector facilitates efficient intermediation of economic resources, which creates money within the economy however the years 2019 and 2020 will be remembered as one of the difficult years for the Indian economy and Indian banking system. Even before the corona virus outbreak, The Indian economy was going through the worst phase. The gross domestic product (GDP) of India fell to 4.2 per cent in 2019-2020 which was lowest mark in the last 11-years (The Hindu, 2020). According to National Statistical Office data, the manufacturing sector which grew by 5.7 per cent in the year 2018, grew merely by 0.03 per cent in FY 2019-20. The growth in the construction sector is deemed to have a spill over effect on several other industries, but construction sector too declined to 1.3 per cent in the year 2019-20 (Sahoo, 2020). Gross capital formation also remained low in FY 2019-20, which may be an effect of declining growth of bank deposits. Bank deposits which grew by 10 per cent in the year 2018-19 grew by 7.9 per cent, in 2019-20. Low bank deposits lead to contraction in the Bank credit growth rate to 6.1 per cent in the year 2019-20, as compared to the 13.3 percent in the year 2018-19. This is a clear indication of condensing consumption demand. Contraction in investment by 2.8 per cent and fall in exports by 3.6 per cent, lead to 4.2 per cent fall in real GDP of India in 2019-20, which is remarkably the lowest since 2008-09 when it was at 3.1 per cent (Affairs, 2019). The contraction in growth rate was a result of various factors such as decrease in demand and investments.

In the aftermath of Lockdown when the Indian economy was struggling with sharp decrease in economic activities the Reserve Bank of India, in an effort to boost the economy, resorted to decreasing the Repo Rate by 160 basis points in FY 2019-20 & again by 200 basis points up till May 2020 (Shetty, 2020). In the year 2019 the banking and financial services sector saw several measures to revive credit growth. The banking and financial services sector saw capital infusion, relaxation in norms related to leverage ratios, decrease in policy rates, and the merger of ten Public Sector Banks (PSBs). Given the uncertainties related to the intensity, spread, and duration of the pandemic, the Indian economy's recovery is expected to be weak in coming years due to which the credit growth in banks may slow down further in the coming years. Retail banking has played a crucial role in driving the overall growth in banking in the past, however retail banking which in turn was driven by housing and personal loans seems to deteriorate further. Vehicles and home loans portfolios of banks are expected to witness deterioration in asset quality. The Asset

quality of Banks will worsen as collections will be severely impacted given low economic recovery (PwC India, 2021). In the above scenario the evaluation of performance of banks on various parameters seems inevitable and crucial. With current changes and trends happening in the Indian banking industry especially the evaluation of the impact of stressed NPA's on the performance of banks becomes lot more significant.

The Indian banking system consists of 12 public sector banks, 22 private sector banks, 46 foreign banks, 43 regional rural banks, 1,484 urban cooperative banks and 96,000 rural cooperative banks, in addition to cooperative credit institutions (RBI report on banking). In a country like India, public sector banks have a grip over private sector banks in terms of size, geographical reach and access to low-cost deposits. Large size of business enables them to cater to the larger credit needs of corporate additionally as other sections of the society (Khan, 2019). Geographical reach through an oversized number of branches increases their access to low-cost deposits and lowers the portfolio risk through diversification. The access to low-cost deposits enables them to the company at competitive rates (Pathak, 2005:479). Though each and every bank irrespective of its size are important but the banks with a relatively smaller balance sheet will find it relatively more difficult to manage in the tough times coming ahead therefore the present study is focused on to analyse, the financial performances of banks with a relatively smaller balance sheet as compared to balance sheets of big banks such as ICICI and HDFC. For the purpose of this study the researcher has purposively selected 'The Nainital Bank Ltd.'

The Nainital Bank Limited was established in the year 1922 by Bharat Ratna Pt. Govind Ballabh Pant and few other prominent personalities of Nainital with an objective of catering to the banking needs of the people of the region. In the year 1973, Reserve Bank of India directed Bank of Baroda, a premier nationalized bank, to manage the affairs of the Nainital Bank Limited. At present Bank of Baroda holds 98.57% shareholding in the Nainital Bank Limited and remaining 1.43% shares are held by the public. The Bank is having 162 branches operating in five states i.e., Uttarakhand, Uttar Pradesh, Delhi, Haryana and Rajasthan. All the branches of the Bank are operating in CBS platform. Bank is also providing RTGS, NEFT, SMS Alerts, RuPay ATM cum Debit Card, NainiNet Internet Banking and Mobile Banking facilities to its customers. The total business of the Nainital Bank was Rs.11,441 crore, total Advances were Rs. 4,029 Crores and total Deposit were Rs. 7,412 Crores as on March 2021. The CASA Deposits of the bank registered a growth of 12.14 % and stood at Rs. 2,827 Crores on March 2021. The Operating profit of the Bank increased to Rs.118.25 crore registering a growth of 5.36% over previous FY whereas the Net NPA was 5.77% (Nainital Bank, 2021).

Objectives of the Study

Though there are various studies which have analysed the performances of banks in India however, there is still a necessity for further studies on the performances of banks as it will reveal the recent trends and how they are functioning. The study shall reveal the financial performance of bank. The financial performance defines potential of business, economic interest of the company management and reliability of present or future contractors. Therefore, financial performance analysis and identification of their weakness and strength using financial performance indicators can contribute to management, shareholders, the public and the regulator as a whole. The rationale of financial analysis is to diagnose the information contained in the financial statement so as to judge the future earning, ability to pay interest, profitability and dividend of the banks (The Economic Times, 2020). Furthermore, Profitability based analysis are considered to be robust and inclusive means to analyse the performance by evaluating the extent of operational efficiency as well as analysing the nuances of bank's diversifying earnings through non-interest income activities and administrative cost management. A robust performance management framework helps in bringing a proactive focused approach towards value addition and profitability that will ultimately lead to better future performance.

Scope and Methodology

The present study is based on secondary data collected from the annual reports of 'The Nainital Bank Ltd.'. The analysis of profitability of the bank is being carried out from 2016-17 to 2021-22. In order to analyse the profitability performance of the bank certain ratios have been considered such as Return on Assets, Return on Equity, Return on Investment, Earning per share. Such ratios as well as the components of profit of the bank have been further analysed through mean, coefficient of variation and compound annual growth rate. Further, the study used corelation matrix and all the calculation has been processed through MS Excel.

Results and Discussion

Profitability Analysis:

Profitability is defined as the ability of a bank or firm to generate earnings greater than its cost. When a bank or firm is profitable, the difference between the revenue and cost should be greater than zero. Profitability, which shareholders and managers focus on, is an important indicator of the financial institution's policies and decisions. In many previous studies, profitability is represented by various ratios. Most of them are going to seek how effective the bank management is in generating profit during a specific period. The most common ratios used in researches are Return on Assets (ROA), Operating Profit as percentage to Working Fund (OPTWF), Return on Equity (ROE), Net Interest Margin (NIM) and Earnings per Share (EPS). For these ratios, a higher positive value indicates better performance of the concern bank or other financial institution (Ayadi, 2019). However, a negative value of these ratios demonstrates that the bank is run at a loss.

Return on Average Assets (ROA):

Return on Assets is defined as a ratio to show the percentage which an organisation earns on its assets within a given year. It is the most commonly used benchmark for analysing the profitability because it measures the bank's return on investment in a format which can be easily compared with other institutions. It indicates the amount of profit a bank can generate on its assets. It is

measured by net income divided by average total assets. The net income and total assets are separately found in the annual income statement and the annual balance sheet. An increasing trend of Return on Assets ratio implies a higher asset-intensity as well as improving profitability of the bank and vice versa.

Table. 1. Return on Average Assets

Years	Return on Average Assets (ROAA)=Net Profit after Tax / Assets (%)	YoY Growth (%)
2016-17	0.73	
2017-18	0.63	-13.70
2018-19	0.33	-47.62
2019-20	-0.82	-348.48
2020-21	0.02	-102.44
Mean ($\bar{x}$)		0.18
SD (σ)		0.56
CAGR		-0.51

Data Source: Annual Report of 'The Nainital Bank Ltd.'

Historically, a Return on Assets ratio of 1% or more is considered satisfactory however this ratio may fluctuate due to prevailing economic times. According to Reserve Bank of India's (RBI), banks in India suffered from the weak asset quality and recorded their lowest return on assets since 2008 in FY18. Return on Assets ratio of banks in emerging market economies (EMEs) reflected mixed movements through 2017 and so far in 2018. The banks in developing economics as Russia, India and China suffered declines, in ROAs in 2017 and 2018 (Financial Express, 2020). The Return on Assets ratio of Nainital Bank during the past five years has not reached this mark.

The low Return on Assets ratio for Nainital Bank can be attributed to the prevailing economic times. Table 01 presents that during the study period, on an average, the 'The Nainital Bank Ltd.' has generated earnings of 0.18 percent on its average total assets with the variation of 0.56 percent in its annual performance. The bank earned highest returns from its assets in 2016-17 but its yearly growth performance was negative in all years of study. In 2019-20, the bank earned lowest return as well as its growth performance was also worst during the period. Negative Return on Assets ratio of Nainital bank implies that the bank's assets yielded negative returns in 2019-20.

Operating Profit as percentage to Working Fund (OPTWF): It measures the share of average of working fund earned by banks as lucre. As per the RBI guidelines, the typical working fund means the fortnightly average total of assets. The ratio is calculated by total operating profit divided by average working fund multiplied by hundred (S., 2006).

Table 2. Operating profits

Years	Operating Profit to Avg. Working Funds (%)	YoY Growth (%)
2016-17	1.66	----
2017-18	1.27	-23.49
2018-19	1.36	7.09
2019-20	1.31	-3.68
2020-21	1.42	8.40
Mean ($\bar{x}$)	1.40	
SD (σ)	0.14	
CAGR	-0.03	

Data Source: Annual Report of 'The Nainital Bank Ltd.'

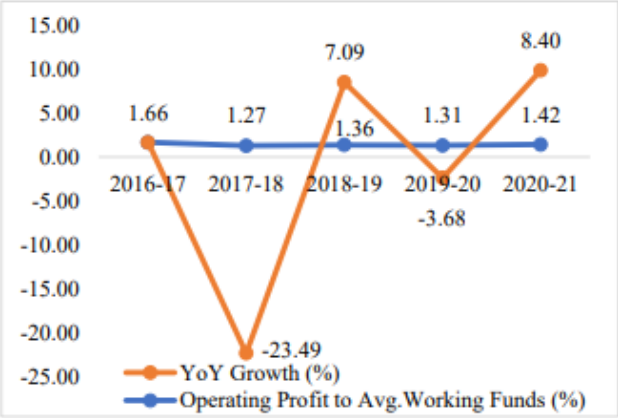


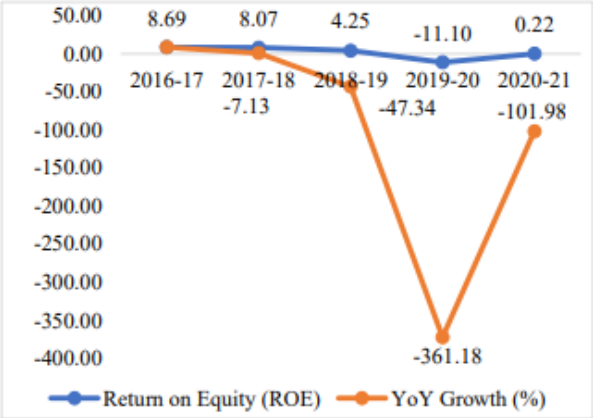
Table 02 shows that during the study period 'The Nainital Bank Ltd.' has been able to generate average of 1.40 percentage of its working fund with variation of 0.14 percent. The performance of the parameter is drastically fluctuated over the study period and resulted to CAGR of -0.03 percent. Thus, the profitability performance of the bank isn't consistent during the study period. The bank efficiently utilised its working fund in 2016-17 and performed poor in 2017-18 indicated by lowest ratio. However, its growth performance was excellent in 2020-21.

Return on Equity **(***ROE***):** While most companies focus on growth in earnings per share (EPS) the banking institutions emphasize on return on Equity. Banking institutions consider ROE as a much better metric in assessing the market value and growth of banking institutions. Capital base for banks being different than conventional companies is said to be a reason for this (Fuhrmann, 2017). Return on equity indicates how well a bank uses shareholder's investment fund to generate profit. In other words, it reflects a bank's efficiency at generating profits from every unit of shareholders' equity. It is calculated by dividing net profit by average shareholder's equity multiplied by hundred (Ayadi, 2019). Minimum capital requirements, as stipulated in Basel III has increased the amount of capital, banks have to maintain which has brought down the ROEs of banking institutions. Review of available literature suggests that on an average the ROEs of banking institutions have been decreasing following the reforms introduced in the banking sector after the depression of 2009 (Handa, 2017).

Table 3. Return on Equity (ROE)

Years	Return on Equity (ROE)=Net Profit after Tax / Equity (%)	YoY Growth (%)
2016-17	8.69	
2017-18	8.07	-7.13
2018-19	4.25	-47.34
2019-20	-11.10	-361.18
2020-21	0.22	-101.98
Mean ($\bar{x}$)	2.03	
SD (σ)	7.23	
CAGR	-0.52	

Data Source: Annual Report of 'The Nainital Bank Ltd.'



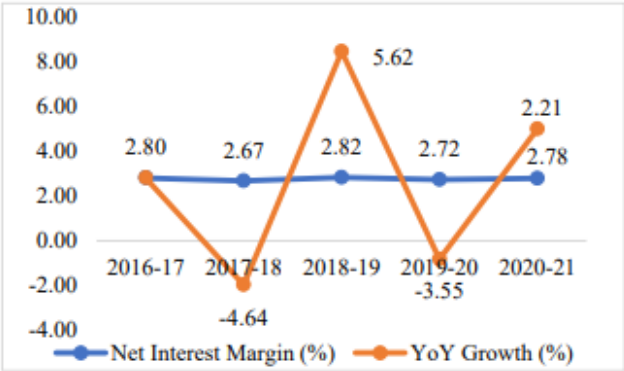
Since the introduction of Basel III, the ROEs of banks have remained between 5% and 10%, however the ROE of Nainital bank (except for the year 2016-17 and 2017-18) seems to be far from the industry average. Table 03 depicts that during the study period, on an average, the 'The Nainital Bank Ltd.' has not been able to utilise the shareholder's equity efficiently and have provided a return on equity of mere 2.03 percent with the variation of 7.23 percent in its yearly performance. The low return on equity may be attributed to the impacts of BASEL III norms. Moreover, ROE is considered to be higher for bigger banks which may be another reason of low Returns on Equity for Nainital Bank (Bhagat, 2017). The compound annual growth performance of the parameter figured to -0.52 percent.

Net Interest Margin (NIM): may be a popular profitability ratio utilized by banks, which helps them determine the success of firms in investing compared to the expenses on the identical investments and is calculated as Investment income minus interest expenses (this step is brought up as netting) divided by the common earning assets (Choudhry, 2018). For example, suppose a bank pays 5% on its deposits, and charges 7% on advances implying a 2% difference in the interest margin. A positive net interest margin shows that the bank has been efficient with its investments, while a negative margin indicates that the bank has not made effective investment decisions. The net profitability of a bank would increase with an increase in the numbers of deposits and advances over time. Monetary policies (which largely impacts the changes in the interest rates) set by central banks may have a major effect on the net interest margins of a bank. These decrees play a pivotal role in regulating savings and credit demand. Consumers are more likely to borrow money and fewer likely to save lots of it when interest rates are low.

Table 4. Net Interest Margin (NIM)

Years	Net Interest Margin (%)	YoY Growth (%)
2016-17	2.80	
2017-18	2.67	-4.64
2018-19	2.82	5.62
2019-20	2.72	-3.55
2020-21	2.78	2.21
Mean ($\bar{x}$)	2.76	
SD (σ)	0.06	
CAGR	0.00	

Data Source: Annual Report of 'The Nainital Bank Ltd.'



Around the onset of the reform process in 1992, the NIM of Indian banks was around 3.9 per cent however the recent data illustrates that average data for Net interest margin statistic in all banks across India was approximately 2.35 percent in the fiscal year 2017, which was down by 2.45 percent in the fiscal year 2015. The data for the Nainital Bank illustrates that the share of Net Interest margin is close to the industry average. Table 04 provides that on an average, the Nainital Bank could generate 2.76 percent of its investments with the variation of 0.06 percent in its yearly performance. Past literature on banks suggests that net interest margin would be higher for banks which have high low-cost deposits or high lending rates however on comparing the lending rates of Nainital bank with other banks it seems that there is no significant difference between the lending rates therefore low-cost deposits may be considered to be a probable reason of satisfactory Net Interest margin of Nainital Bank.

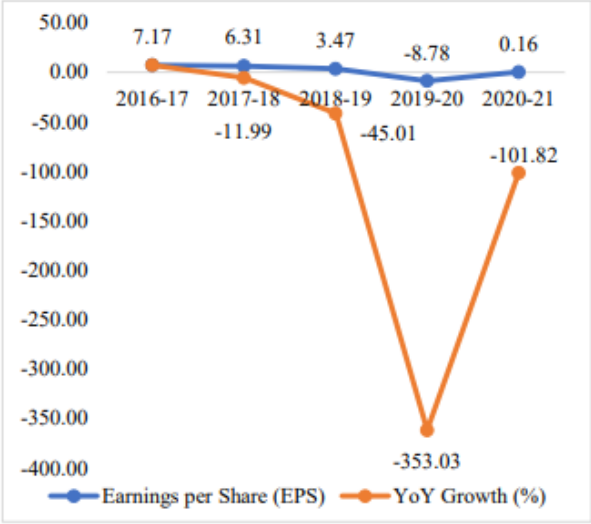
Earnings per Share (EPS): Earnings per share (EPS) represents bank's profit per outstanding share. Earnings per share are an indicator of profitability. It is calculated by multiplying the net profit after tax with weighted average total number of outstanding equity shares (Padmalatha, 2011). A high EPS will indicate that the bank profitable and has enough profits available for distribution to shareholders.

Table 05 reveals that during the study period, on an average, the Nainital Bank has been able to generate per share earnings of 1.67 with a variation of 5.77 in its yearly performance. The EPS was highest in 2016-17 with the 7.17 and lowest -8.78 in 2019-20. Besides, during the study period, the compound annual growth performance of the parameter was -0.53 percent.

Table 5. Earnings per share (EPS)

Years	Earnings per Share (EPS)=net profit after tax /total number of equity shares (`)	YoY Growth (%)
2016-17	7.17	
2017-18	6.31	-11.99
2018-19	3.47	-45.01
2019-20	-8.78	-353.03
2020-21	0.16	-101.82
Mean ($\bar{x}$)	1.67	
SD (σ)	5.77	
CAGR	-0.53	

Data Source: Annual Report of 'The Nainital Bank Ltd.'



The relationship between the return on assets and other selected indicators of profitability is also being analysed using the coefficient of correlation. For the purpose of calculation return on assets is taken as dependant variable whereas the other selected indicators of profitability are taken as independent variable. The coefficient of correlation may take values between -1 and 1. A positive value will indicate a direct correlation between the return on Assets and selected ratios of profitability, while the negative ones would imply an inverse relationship. A value near to 1 would indicate strong relationship whereas a value less than 0.70 will indicate a weak relationship.

Table 06. Correlation Matrix

Correlation between	Return on Average Assets	Operating Profit to Avg. Working Funds	Return on Equity	Net Interest Margin	Earnings per Share
Return on Average Assets	1.0000				
Operating Profit to Avg. Working Funds	0.4315	1.0000			
Return on Equity	0.9992	0.4030	1.0000		
Net Interest Margin	0.1771	0.6247	0.1726	1.0000	
Earnings per Share	0.9996	0.4197	0.9998	0.1869	1.0000

The table 06 imply that the correlation coefficient between return on assets and return on equity have a high positive relationship implying return on assets are largely affected by changes in return on equity. Return on equity is further directly dependant on net profits after tax implying that an increase in net profit after tax will increase the return on assets of Nainital Bank. Similarly high positive relationship is observed between EPS and Return on Assets of Nainital bank. The low value of correlation implies that the net interest margin does not have a direct relationship with increase in return on assets however it is evident that the net profit margin is an important aspect which will affect the net profits after tax which in turn has a high positive relationship with return on assets. Similarly, the other selected measures of profitability have low levels of Pearson correlation coefficient.

Summary and Conclusion

The main emphasis of the present paper is to assess the profitability performance of 'The Nainital Bank Ltd.' for the period of five years i.e., from 2016-17 to 2021-22. The study has considered five parameters for measuring the performance such as ROA, OPTWF, ROE, NIM and EPS. The analysis of the study reveals that the profitability performance measured by the different parameters fluctuated throughout the study period and the study also concluded that the return on assets of Nainital bank is largely dependent on return on equity and earnings per share of Nainital Bank.

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