

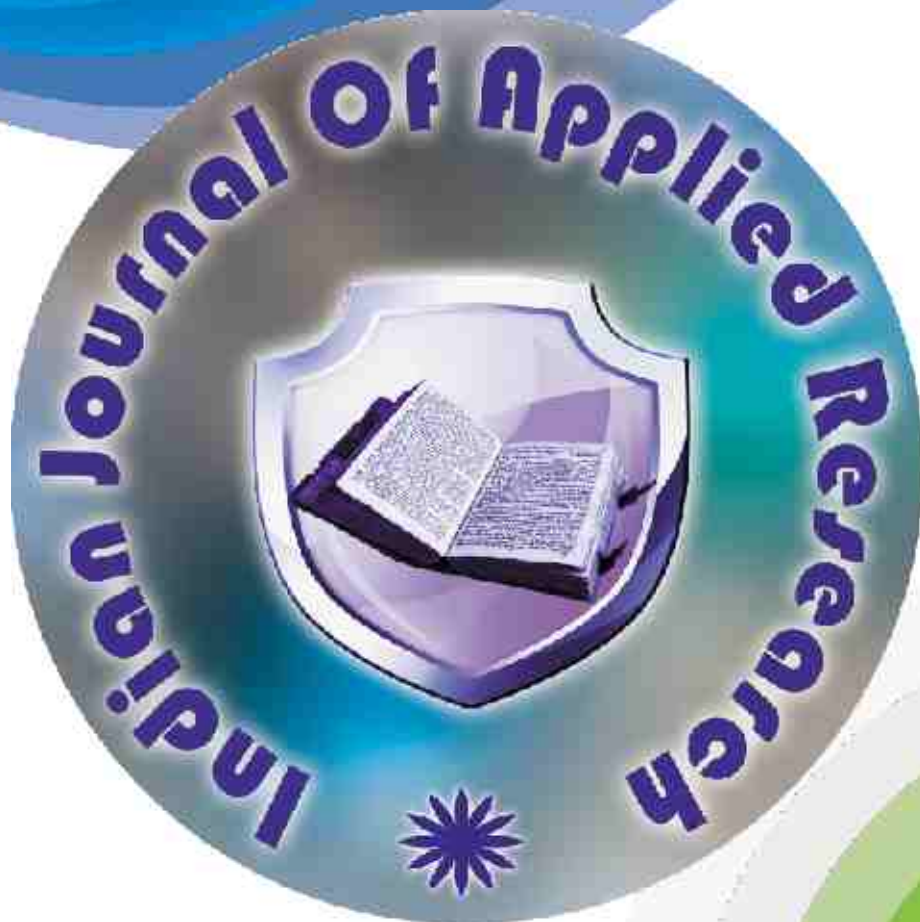
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Index

| Sr. No | Title | Author | Subject | Page. No. |
|--------|--|--|------------------|-----------|
| 1. | Assay Of Triphenylmethane Reductase Enzyme And PCR-Based Identification Of TMR Gene In Enterobacter Asbriae Strain XJUHX-4TM | Tina Mukherjee, Mounita Bhandari, Manas Das | Biotechnology | 1-2 |
| 2. | An Analysis Of Growth Of Credit Card Industry | Dr. A. Vinayagamoorthy, K. Senthikumar | Commerce | 3-5 |
| 3. | Impact Of Pre-Merger And Post Merger On Financial Performance (With Reference To Private Sector Banks) | Dr. Shital Vekariya | Commerce | 6-8 |
| 4. | Relativity On Climate And Competencies In Human Resource Development With Reference To Neyveli Lignite Corporation Ltd, | S. Jayakumar. Dr. R. Ramachandran | Commerce | 9-11 |
| 5. | Human Resource Outsourcing: A Strategy For Gaining Competitive Advantage | Dr. Santosh M. Singh | Commerce | 12-13 |
| 6. | Relationship Between EVA And ROI And MVA (A Case Study Of Ten Manufacturing Industries In India) | Dr. Shivani Gupta | Commerce | 14-15 |
| 7. | Modeling The Traits Of An Effective Teacher At Higher Education | Dr. Haridayal Sharma | Commerce | 16-17 |
| 8. | Mahatma Gandhi National Rural Employment Guarantee Act (Mgnrega): Issues And Challenges | Dr. Mohd. Ashraf Ali, Mushtaq Ahmad | Commerce | 18-20 |
| 9. | Standardisation And Grading | Viram. J. Vala, Dr. Vijay Kumar Soni | Commerce | 21-22 |
| 10. | Profitability Of Selected Information Technology Companies In India | Dr. M. Jegadeeshwaran, C. Udaya | Commerce | 23-25 |
| 11. | Emerging Trends In The Indian Media And Entertainment Industry | Dr Mahalaxmi Krishnan | Commerce | 26-27 |
| 12. | Inventory Management Strategies And Control Techniques: An Empirical Investigation Of Small Scale Industries | Vipul Chalotra, Neetu Andotra | Commerce | 28-30 |
| 13. | A Study On Performance Indicators Of Commercial Banks | Dr. G. Ganesan, P. Parthasarathy | Commerce | 31-33 |
| 14. | Improved Approaches To Coreference Resolution In Machine Learning | Kuldeep Singh Raghuwanshi, Ashwini Kumar Verma | Computer Science | 34-37 |
| 15. | Security Issues & Controls In Cloud Computing | V. Naga Lakshmi | Computer Science | 38-40 |
| 16. | Human Development Index Of De-Notified Nomadic Castes In Maharashtra Division: A Study Of Jalna And Aurangabad Districts | Dr. Ashok Pawar | Economics | 41-43 |
| 17. | Public Private Partnership In Rural & Urban Projects In India | Dr. Ashok S. Pawar, Dr. Shankar B. Ambhore | Economics | 44-45 |
| 18. | Populace Insight On Development In Public Health Sector Of India Subsequent To Functioning Of National Rural Health Mission | Krishnakant Sharma | Economics | 46-49 |
| 19. | Problems Of Rural Women Entrepreneurs In India: A Conceptual Overview | C. Jeyasri Usha N Devi, Dr. A. Sankaran | Economics | 50-52 |
| 20. | Poverty Of Banjara And Vanjari Communities In India | Tidke Atish S., Dr. Pawar Ashok S. | Economics | 53-54 |
| 21. | India And China: Economic Reforms And WTO | Dr. Surinder Kumar Singla, Dr. Kulwinder Singh | Economics | 55- 56 |
| 22. | Implementing Life Skill Education Strategies In Teaching – Learning Process | R. Kalaiselvi, Dr. A. Palanisamy, Dr. A R. Saravanakumar | Education | 57-59 |

| | | | | |
|-----|--|--|---------------------------|---------|
| 23. | Utilisation Of Modern Technology By The Teachers In Pupil Processing Organisation | Dr. P.Paul Devanesan, Dr A. Selvan | Education | 60-61 |
| 24. | Impact Of Vocational Training On Students | K.Sudha Rani, G.Umapathi, Dr. T. Ananda, | Education | 62-63 |
| 25. | A Study On Emotional Intelligence Of Secondary School Teachers | Dr. Umme Kulsum, Prathima H.P. | Education | 64-66 |
| 26. | The Efficiency Of Feedback Strategy Of Homework On The Development Of 10th Grade EFL Writing Skill In Al-Karak Educational Directorate | Majid Al- Khataybeh, Areej Al-Shourafa` | noitacudE | 67-74 |
| 27. | Perspectives Of Stress Management In Education System | M. Meenakshisundaram, G. P. Raja, Dr. A R. Saravanakumar | Education | 75-76 |
| 28. | Attention Regulation Of Meditators And Non-Meditators Of Class IX | G. Madhavi Kanakadurga, Dr. D. Vasanta Kumari, | Education | 77-78 |
| 29. | Role Of Psychoeducation In Teaching – Learning Process | Dr. A R. Saravanakumar, Dr. A. Balu, Dr. S. Subbiah | Education | 79-80 |
| 30. | Microcontroller Driven RGB Led System For Tristimulus Surface Colorimetry | T. N. Ghorude, A. D. Shaligram | Electronics | 81-83 |
| 31. | Pmgsy And Rural Roads Development In India: Economic, Financial And Maintenance Issues | K.C. Manjunath | Engineering | 84-86 |
| 32. | Routing Packets On A Chip. | Naren V Tikare | Engineering | 87-89 |
| 33. | Finding The Nearest Neighbors In Biological Databases | Er. Pankaj Bhambri, Dr. O.P. Gupta, Er. Franky Goyal | Engineering | 90-92 |
| 34. | Factors Affecting The Sustainability Of The Asphalt Roads: A Case Study Of Irbid Inner Ring Road, Jordan | Eng. Nasr Ahmad Dr. Mihai Iliescu | Engineering | 93-94 |
| 35. | Physical And Chemical Testing Of Compounded PVC | Sapna Dabade, Dr. Dheeraj Mandloi, Deepak Khare | Engineering | 95-96 |
| 36. | Impact Of Organic Farming On Yield Of Some Common Crops- A Case Study. | Namrata D. Awandekar | Environmental Science | 97 |
| 37. | Hydrogeologic Settings Of The North And South Brahmaputra Plains In Upper Assam: A Comparative Study | Dr. Uttam Goswami | Geology | 98-100 |
| 38. | To Study Staffing Pattern In Rajasthan Public Healthcare Delivery System. | Dr. Ashwin G. Modi, Sushman Sharma | Healthcare | 101-105 |
| 39. | Work And Health: A Situational Analysis Of Factory Workers | Dr. S. S. Vijayanchali, Dr. E. Arumuga Gandhi | Home Science | 106-108 |
| 40. | Performance Of Camel Kid Hair: Acrylic Blended Yarn And Knitted Fabric | Suman Pant, Anjali Sharma | Home Science | 109-110 |
| 41. | Impact Of Holistic Nutrition Education Package On Diabetes Mellitus Control In Middle Aged Women | Dr. Anjali Rajwade | Home Science | 111-112 |
| 42. | Assessment Of Relationship Between Ida And Personal Hygiene, Nutritional Knowledge And Dietary Practices In Adolescent Girls | Dr. Anjali Rajwade | Home Science | 113-114 |
| 43. | Employee Attrition And Retention In Private Insurance Sector– A HRM Challenge | Dr. J. Senthil Vel Murugan, S.Bala Murugan | Human Resource Management | 115-117 |
| 44. | A Study On Impact Of Unionism On Industrial Relations In Manufacturing Sector | Jaya Ahuja | Industrial Relations | 118-120 |

| | | | | |
|-----|---|--|------------------------|---------|
| 45. | Augmentation Of India's Foreign Exchange Reserve: An Analysis | Dr.S P.Mathiraj, Ar.Annadurai | International Business | 121-123 |
| 46. | Films – A Techno Literary Art Form | Dr. Dipti Mehta | Literature | 124-125 |
| 47. | Indirect Models Of Reading To Develop Descriptive Writing | Dr. K. Madhavi | Literature | 126-128 |
| 48. | Ramkrishna Mishra Ke Upanaso Me Rajnetaik Chetavni | Dr. Sanjay Rathod, Dilip Jhadav | Literature | 129 |
| 49. | Hindi Kavita Me Nari Jivan Ka Badla Swarup | Dr. Sanjay Rathod | Literature | 130 |
| 50. | Impact Of IPL Sponsorship On Consumer Buying Behavior With Reference To Nagpur City | Chandrima Das | Management | 131-135 |
| 51. | Crowd Sourcing –A New Management Mantra | Devi Premnath, Dr. C. Nateson | Management | 136-137 |
| 52. | Small Scale Industries In India: An Evaluation Of Productivity In The Post-Liberalized Scenario | Dr. Gaurav Lodha, | Management | 138-139 |
| 53. | Comparative Analysis Of Milk Products With Respect To Its Competitors With Special Reference To Karnataka Milk Federation (KMF) – At Dharwada City, Karnataka, India | Dr. N. Ramanjaneyalu | Management | 140-143 |
| 54. | A Study On Work Stress In Women Employees In Coimbatore District | R. Maheswari, N. Brindha | Management | 144-145 |
| 55. | Accounting For Carbon Credits | Dr. Gaurav Lodha | Management | 146-148 |
| 56. | A Literature Review On The Relationship Between Training (As A Core Responsibility Of HRM) And Firm Performance. | Priya Sharma, Dr. S. L. Gupta | Management | 149-152 |
| 57. | A Study On Agricultural Marketing Practices And Constraints With Special Reference To Paddy / Rice. | CM Maran, Dr Raja Pranmalai | Management | 153-156 |
| 58. | Performance Of Share Price Of Indian Public Sector Banks And Private Sector Banks - Comparative Study | V. Prabakaran, D. Lakshmi Prabha | Management | 157-158 |
| 59. | Intuitionistic Fuzzy Primary And Semiprimary Ideal | Dr. M.Palanivelrajan, S.Nandakumar | Mathematics | 159-160 |
| 60. | Significance Of Umbilical Artery Velocimetry In Perinatal Outcome Of Fetuses With Intrauterine Growth Retardation. | Dr G S Shekhawat | Medical Science | 161-163 |
| 61. | Large Adult Sacrococcygeal Teratoma: A Case Report And Review Of Literature. | Dr.Yavalkar Pa, Dr. Naik Am. | Medical Science | 164-165 |
| 62. | Epidural Steroid In Low Back Ache | Dr. B. L. Khajotia, Dr. Neelam Meena | Medical Science | 166-167 |
| 63. | A Comparative Study Of Second Trimester MTP With Use Of Vaginal Misoprostol And Extra Amniotic Instillation Of Ethacridine Lactate. | Dr. Ketaki Junnare, Dr. Sameer Darawade, Dr. Priyamvada Shah, Dr. Swati Mali. | Medical Science | 168-169 |
| 64. | A Novel Surgical Approach For Treatment Of Sui –TVT Obturator Tape | Dr. Ketaki Junnare, Dr. Durga Karne, Dr Neelesh Risbud. | Medical Science | 170-171 |
| 65. | Advantage Of Fallopian Tube Sperm Perfusion Over Intra-Uterine Insemination When Used In Combination With Ovarian Stimulation For The Treatment Of Unexplained Infertility. | Dr G S Shekhawat, Dr Pushpalata Naphade | Medical Science | 172-175 |

| | | | | |
|-----|---|---|--------------------|---------|
| 66. | "Bilateral Sertoli-Leydig Cell Tumor In Postmenopausal Female" A Case Report | Dr. Priyamvada Shah, Dr. Ketakijunnare, Dr. DurgaKarne | Medical Science | 176-178 |
| 67. | Pretreatment With Ephedrine For Prevention Of Pain Associated With Propofol Injection. | Dr. Kavita U Adate, Dr. Jyoti A. Solanki | Medical Science | 179-181 |
| 68. | Does The Structured Teaching Programme Influence The Knowledge About Physical Wellbeing Of School Children? A Quasi Experimental Study. | Dr. S. Valliammal, Dr. Ramachandra, Raja Sudhakar | Nursing | 182-184 |
| 69. | An Approach For Information Retrieval For Bookstores Using Formal Ontology | Sumit Jain, C.S.Bhatia | Ontology | 185-187 |
| 70. | Analgesic Activity Of Anacardium Occidentale | A. Devadoss, C. Aparna, K. Parimala, D. Sukumar | Organic Chemistry | 188-190 |
| 71. | Behaviourism : Science Or Metaphysics | Dr. Jatinder Kumar Sharma | Philosophy | 191-193 |
| 72. | Multi-Dimensional Perspectives Of Obesity And Its Management | S. Dhanaraj, Dr. A. Palanisamy | Physical Education | 194-196 |
| 73. | Refractive Index, Density, Excess Molar Volume, Excess Molar Refraction For Liquid Mixtures (Ethyl Ethanoate + Benzene Derivatives) At Different Temperatures | Sheeraz Akbar, Mahendra Kumar | Physics | 197-199 |
| 74. | Refractive Indices, Densities And Excess Properties For Liquid Mixtures (Cetane + Alkanols) At Different Temperatures | Sheeraz Akbar, Mahendra Kumar | Physics | 200-202 |
| 75. | Capacity Building For Effective Local Governance: Indian Perspectives | Dr. Pralhad Chengte | Political Science | 203-205 |
| 76. | Psychological Well-Being: A Study Of Non-Institutionalized Aged | Dr. Pankaj S. Suvera | Psychology | 206-208 |
| 77. | Women Empowerment Through N R E G S (With Reference To State Of West Bengal) | Dilip Kumar Karak | Social Sciences | 209-211 |
| 78. | Effect Of Selected Yogic, Aerobic And Laughter Exercises On Blood Pressure Of High School Boys | Dr.Manjappa.P, Dr.Shivarama Reddy. M | Sports | 212-216 |
| 79. | Association Study Between Lead And Copper Accumulation At Different Physiological Systems Of Goat By Application Of Canonical Correlation And Canonical Correspondence Analyses | Partha Karmakar, Debasis Mazumdar, Seema Sarkar (Mondal), Sougata Karmakar | Statistics | 217-219 |
| 80. | Development Of Silver -Silica Nanocomposite For Novel Humidity Sensing Application | Surender Duhan | Technology | 220-221 |



A Study On Performance Indicators Of Commercial Banks

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ABSTRACT

The purpose of this paper is to study the performance indicators of the commercial bank and to analyze their relationship with the banks. The study is based on the performance indicators of the banks from research papers, articles, and journals and published reports. The parameters identified during performance indicators have been classified under five categories are, Spread Ratio, Spread Related Ratio, Burden Ratio, Burden Related Ratio, and Profitability Ratio. This study will be useful for policymakers in formulating future policies, bank customers in taking their decisions about the selection of bank and the bankers for taking their management decisions in a better way.

Keywords : Commercial Banks, Indicators, Spread, Burden, Profitability

Introduction

The banking sectors play an important role in providing financial intermediation and economic acceleration by converting deposits into productive investments. The performance of the banking sector is a subject that has received a lot of attention from researchers. In this cut throat competitive era, an efficient management of banking operations requires up-to-date knowledge of all those factors on which the bank's profit and efficiency depends. Thus it is very much relevant to identify the parameters which may affect the performance of banks directly or indirectly, long run or in short run to provide a true picture of the financial and non financial health of the banks. In this paper we have made an attempt to identify the key parameters which must be considered while measuring the performance of the commercial banks. This study will be useful for policymakers for comparing the performance of different banks and in formulating future policies. It will also be relevant for bank customers in taking their decisions about the selection of bank and the bankers for taking their management decisions in a better way.

Review of Literature

- 1) Ranjan Mujarjee (2007) Carried out a study on "An overview of pre and post M&A deals" with the objective of analyzing the need for the attention of professional in finance, law, strategy etc. the study revealed the danger areas and pit falls of the integration process and due diligence.
- 2) Dr. K. Srinivas (2010) the study concluded on "Pre and Post Merger Performance of Merged Banks in India A Select Study" with the objective of analyzing the financial performance of spread ratios, burden ratios, profitability ratios, liquidity ratios, solvency ratios, and asset quality ratios need for the attention of professional in finance.
- 3) Dr. N. Bharathi (2010) the study analyzed on "Profitability Performance of New Private Sector Banks An Empirical Study" with the objective of analyzing the profitability performance of spread ratios, spread related ratios, burden ratios, burden related ratios, profitability ratios, correlation,

and regression for the attention of professional in finance.

4) Jyoti Saluja, Dr.Rajinder kaur (2010) the study analyzed on "Profitability Performance of Public Sector Banks in India" with the objective of analyzing the profitability and factors responsible for good or poor profitability performance of mean, standard deviation, co-efficient of variation and profitability ratios used.

Objectives

- 1) To identify the parameters for measuring the financial performance of commercial banks (Spread Ratio, Spread Related Ratio, Burden Ratio, Burden Related Ratio, and Profitability Ratio).

Research Methodology

The study has been done on the basis of related to performance indicators of banks. Around so many research papers have been studied to identify the performance indicators discussed. On the basis of their characteristics and relation to performance of bank, the performance indicators have been categorized into five categories namely; Spread Ratio, Spread Related Ratio, Burden Ratio, Burden Related Ratio, and Profitability Ratio. Then each indicator has been discussed in detail to analyze its relationship with the performance of banks.

Financial Performance Indicators

Spread Ratios

Spread is the difference between interest earned (on loan and advances) and interest paid (on deposit and borrowing) by the banks. These ratios play a major role in determining the profitability of the banks. It is the net amount available to the banks for meeting their operating and managerial expenses. In order to analyze the profitability performance, it becomes imperative to study the magnitude of this spread and its components i.e., interest earned and interest paid in relation to working fund of the banks. Hence, the following ratios are calculated for the present research study.

Interest income to working fund

Interest earning refers to the return on pure banking business i.e., its traditional business. The interest income includes interest and discount earned on advances, income from investment made by a commercial bank and other interest income. The ratio of interest income as percentage of working fund is an indicator of the rate at which a bank earns income by lending funds.

$$\frac{\text{Interest income}}{\text{Working fund}}$$

Working fund = Current Assets - Current Liabilities

Interest expenses to working fund

The ratio of Interest expenditure to working fund represents relationship of the cost of funds to the working fund for the banks. The major ingredients of interest paid consist of interest paid on deposit, borrowing and other interest expenditure. This ratio is an indicator of the rate at which a bank incurs expenditure on borrowed funds from public as well as other borrowings.

$$\frac{\text{Interest Expenses}}{\text{Working fund}}$$

Spread to working fund

The ratio of spread as percentage of working fund is one of the important indicators to determine the profitability of banks. It is calculated as the difference between the first two ratios viz., interest income to working fund and interest expenses to working fund. This ratio provides a cushion for meeting the expenses of management and administration.

$$\frac{\text{Spread}}{\text{Working fund}}$$

Spread Related Ratio

Interest earned and interests paid are the main ingredients of spread ratios. But the magnitude of the changes in the contents of interest earned and interest paid are much important to analyze the spread ratios in a more imperative way. So, the following further ratios are considered relevant to analyze the spread.

Interest income to total income

The profitability of a bank mainly depends on the interest income. If the proportion of interest income is more, then the banks can easily cope with the non interest expenditure. In an average about 88% of the total income should be from interest income. Hence utmost care should be taken to raise the interest income to improve the profitability of business.

$$\frac{\text{Interest Income}}{\text{Total Income}}$$

Interest expenses to total expenses

The major position of the total expenditure constitutes only interest expenditure. It consists of interest on deposits, inter bank fund and borrowings. The interest expenses as proportion of total expenses indicates the level of interest expenses in total expenses.

$$\frac{\text{Interest Expenses}}{\text{Total Expenses}}$$

Interest deposits to total expenses

Total deposit of a bank consists of demand deposits, time deposits and saving deposits. All these deposit have different rates of interest subject to the period of deposit made by the customers. The cost of deposit is one of the main expenses which ultimately reduce the profitability of the bank.

$$\frac{\text{Interest Deposits}}{\text{Total Expenses}}$$

Burden Ratios

Burden is defined as the difference between non-interest expenditure and non-interest income of the banks. It represents non-interest expenditure that are covered by non-

interest income. It is an important factor in determining the profitability of the banks. Because, in the present day, apart from the traditional activities, the banks are taking up core banking activities like ATM, credit card etc.

Non-interest expenditure to working fund

Non-interest expenditure of commercial bank generally includes man power expenditure like salary, allowances, provident fund etc., and other operating expenses. Increase in the expenditure reduces the profitability of the bank.

$$\frac{\text{Non-Interest Expenses}}{\text{Working fund}}$$

Non-interest income to working fund

Non-interest income of banks represents income earned by way of commission exchange, brokerage, service charge and minor receipts which generally play a minor role in meeting the non-interest expenditure. The increased ratio of non-interest income reduces the burden of a bank and improves the profitability.

$$\frac{\text{Non-Interest Income}}{\text{Working fund}}$$

Burden to working fund

It is the difference between the percentage of non-interest income to working fund and the percentage of non interest expenses to working fund. It is the balance of non interest income over the non-interest expenditure of a bank.

$$\frac{\text{Burden}}{\text{Working fund}}$$

Burden Related Ratios

The sub-items involved in the non interest expenditure and non-interest income are the main cause for the changes in the respective variables which ultimately affect the burden ratios. Hence, to probe further into the sub elements of non-interest expenses and non-interest incomes are studied.

Non-interest income to income

Non-interest income is the additional income contributing to the profitability of the banks. This income is earned by the banks from its core business. If the proportion of non-interest income is more than the banks can easily utilize this amount to meet the non-interest expenditure and the excess will be contributing to the profitability.

$$\frac{\text{Non-Interest Income}}{\text{Income}}$$

Establishment expenses to the total expenses

Establishment expenses implies the expenses met by the banks towards its employees i.e., pay and allowance, P.F, contingencies etc. the effect on profitability of establishment expenses may be analyzed by calculating the establishment expenses as percentage to total expenses.

$$\frac{\text{Establishment Expenses}}{\text{Total Expenses}}$$

Operating expenses to the total expenses

Operating expenses include all expenses except interest expenses. It consists of the payments and provision for employees, rent, taxes, lighting, printing and stationary, advertising and publicity, depreciation on banks property, director fees and allowances, auditors fees and expenses, legal charges, post and telegraphic expenses, repairs and maintenance, insurance and other expenses etc. It gives the proportion of operating expenses to total expenses. More of these expenses lead to reduction in profitability.

$$\frac{\text{Operating Expenses}}{\text{Total Expenses}}$$

Burden to total income

The term burden refers to non-interest expenditure not covered by non-interest income. So, efficient management of burden is necessary to improve the profitability of the banks. The ratio of burden to total income indicates the proportion of burden to total income.

$$\frac{\text{Burden}}{\text{Total Income}}$$

Profitability Ratios

To analyze the profitability of the banks, the relationship between the earnings and the funds used is analyzed. So, the ratio indicates the efficiency with which a bank deploys its total resources to maximize its profit. So the present study seeks to analyze the profitability with the help of the following ratios.

Gross Profit to working fund

Ratio of gross profit / loss to working fund shows the gross margin obtained on services provided by the banks in relation to working fund. This ratio is helped to judge the efficiency of the banks. A high ratio is a sign of good management of the bank as it reflects the cost of providing services by the banks and relatively a low ratio is undesirable.

$$\frac{\text{Gross Profit}}{\text{Working fund}}$$

Gross Profit to total deposit

The ratio of gross profit to total deposits explains the gross return available for the deposits of the bank. The ratio portrays the quality of the earning capacity of the bank. Highest ratio refers to the good earning capacity of the bank.

$$\frac{\text{Gross Profit}}{\text{Total Deposit}}$$

Net profit / loss to total income

Net profit / loss is the return on the investment made by any organization. It is the measure of efficiency of the organization. The ratio net profit / loss to total income indicate the proportion of net / profit / loss towards total income of the bank. It shows the percentage of total income available as profit to the organization.

$$\frac{\text{Net Profit}}{\text{Total Income}}$$

Net profit / loss to total deposit

Net profit refers to revenue left to owners after meeting all the expenses and taxes. It implies the efficiency of the banks. The

ratio of net profit / loss to total deposit gives a picture of the extent of return on the total deposit committed by the banks. Deposits are the main Sources of the bank for its lending purposes. This ratio indicates the efficiency of the banks in employing the deposits. Higher the ratio would be better for the organization if the banks earn profit and vice versa.

$$\frac{\text{Net Profit}}{\text{Total Deposit}}$$

Net profit / loss to working fund

It is one of popular analytical tools to determine the banks profitability. Net profit is the balance of revenue available after meeting all its expenses and provision for contingencies and working fund refers to the total of balance sheet items.

$$\frac{\text{Net Profit}}{\text{Working Fund}}$$

Conclusion

The discussion in the paper have clearly indicates the various performance indicators which may affect the profitability of the commercial banks. The relevance of the study is that one can find almost all the important indicators with their brief description which affects the performance and profitability of the banks. Besides all, the impact of each indicator and their relationship with the performance of the bank has also been provided in the study which can help the research people to take decision about which indicators they can choose for further studies. The findings in research paper with relation to the performance indicators would surely provide a basis for the model formulation in any research related to the profitability or performance of the banks.

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