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BRANCH PROFITABILITY

- Banking System in India is governed under the Banking Regulation Act, 1949 by the Reserve Bank of India which provide the regulatory framework for the supervision of banks in the country.

The development of the banking sector can be divided into three phases:

Phase I: The Early Phase during the period from 1770 to 1969

- During British rule, **the three Presidential banks** of India were established at Kolkata, Mumbai, and Chennai which merged as the **Imperial Bank of India in 1921.**

The Imperial Bank of India was later nationalized in 1955 and was named The State Bank of India, which is currently the largest Public Sector Bank.

Phase II: The Nationalisation Phase during the period from **1969 to 1991**

- In 1969, the Government of India decided to nationalize the banks under **the Banking Regulation Act, of 1949 during which 14 banks were nationalized.**
- In the year **1980, another 6 banks were nationalized taking the total to 20.**

Phase III: The Liberalization or the Banking Sector Reforms Phase from 1991 and continues to date

- In the final phase starting in the nineties, the Government set up the **Narasimham Committee to manage** the major reforms in the banking sector.
- During the period, **RBI gave out licenses to open private sector** banks in the country.

WHAT IS PROFIT?

- Profit is the money a business pulls in after accounting for all expenses.
- The three major types of profit are **gross profit, operating profit, and net profit-**-all of which can be found on the income statement.

GROSS PROFIT, OPERATING PROFIT, AND NET PROFIT

- The first level of profitability is **gross profit,** which is **sales minus the cost of goods sold**.

Gross Profit = Total Sales - Cost of Goods Sold

For example, if Company A has Rs. 1,00,00,000/- in sales and a COGS of Rs. 60,00,000/- it means the gross profit is Rs. 40,00,000.

Divide gross profit by sales for the gross profit margin, which is 40% (i.e., Rs. 40,00,000/- divided by Rs. 1,00,00,000/- multiplied by 100).

- The second level of profitability is **Operating Profit,** which is calculated by deducting **operating expenses from gross profit**. Gross profit looks at profitability after direct expenses, and operating profit looks at profitability after operating expenses.

These are things like selling, general, and administrative costs (SG&A).

Operating Profit = Gross Profit - Operating Expenses

- The third level of profit is **net profit**, which is the income left over after all expenses, including taxes and interest, have been paid.

  Net Profit = Operating Profit - Taxes & Interest

Difference between Profitability and Profit

Although the two terms are used interchangeably, profit and profitability are not the same.

PROFIT	PROFITABILITY
Interpretation by Businesses	
Profit is measured by the **total amount.**	Profitability can be interpreted in the form of **a percentage.**
Comparison of the Two	
Profit **cannot be compared** as it is not relative.	Profitability **can be measured by the use of ratios**.
Expression	
Profits are the **net gain** made after deducting all expenses.	Profitability is based on the extent to which a **business makes or earns its profits.**

TRADITIONAL MEASURES OF PROFITABILITY

- The traditional measures of the profitability of a business are primarily its **Return on Assets (ROA) and Return on Equity (ROE).**

Assets = Liabilities + Bank Capital (Owners' Equity)

- **THE ROA (RETURN ON ASSET)**

Return on Assets (ROA) is a type of **return on investment** (ROI) metric that measures **the profitability of a business in relation to its total assets.**

This ratio indicates how well a company is performing by comparing the profit (net income) it's generating to the capital it's invested in assets.

The higher the return, the more productive and efficient management is in utilizing economic resources.

RETURN ON EQUITY (ROE) FOR BANKS

This ratio provides information about the earnings, which the funds put in by the promoters/shareholders. The ratio can be worked out as under:

$$\text{ROE} = \frac{\textit{Net profit}}{\textit{Owned funds}} \times 100$$

Q. Net profit of a firm is 40. Its tangible net worth 400 and long-term liabilities 400. its return on equity is 10%

Why Efficiency matters for Bank Operations

- **Changes in customer preferences and expectations**, new competition, and new technologies are transforming the nature of banking.
- To **remain competitive**, banks need to invest in technology, marketing, automation, and self-service capabilities, and also must optimize their legacy investments in branches and traditional systems.

STRATEGIES FOR IMPROVING EFFICIENCIES OF BANKING

OPERATIONS

Following are the major strategic areas where today's banks are focusing their efforts.

Areas of improvement for better operating efficiencies

1. Business realignment

The basic premise of business realignment is to **exit business lines that have low margins** and **move instead into lines** that are inherently **more cost-effective and increase bank profitability**.

2. Channel optimization

The goal of **channel optimization is to assess the various ways customers interact with a bank** to create a **cost-effective** combination that is adapted to each bank's specific customer base.

3. Process costs

The goal is to improve the bank's efficiency ratio by **reducing the unit cost-to-value ratio of each activity or transaction** - such as the **cost of opening an account, creating a loan document package, or handling a specific type of transaction.**

4. Staff Productivity

productivity improvement is not dependent on technology alone. Some of the most significant opportunities involve using established performance management techniques, such as clearly defined **expectations and scorecards, improved motivation and rewards systems, and better training and supervision.**

5. Technology and automation

The goal is threefold:

1. To have **applications that allow customers to make transactions or obtain information on a self-service basis** without requiring employee efforts.

2. To **use technology to reduce the time employees spend on finding information**

3. To use **automated business rules and decision models** to move work more quickly and efficiently through processes

6. Vendor Management

- Vendor management is a term that describes the processes organizations use to manage their suppliers, who are also known as vendors.
- Vendor management includes activities such as selecting vendors, negotiating contracts, controlling costs, reducing vendor-related risks and ensuring service delivery.

7. Product Bundling and Relationship Pricing

Banks need to think beyond a 'one-size-fits-all' strategy to cater to customers' increasing demand.

Bundle pricing is a business strategy where **companies group several products together into a bundle** and **sell them at a single price,** rather than attribute individual prices to each item.

Relationship pricing is the pricing of services offered to a customer based on the **total business that the customer conducts or could potentially conduct**.

8. Sophisticated customer segmentation

It is classified based on - **tenure with the bank, number of accounts, balances of accounts and loans, frequency of interaction with the bank, channel preferences along with psychographic** (values, attitudes, lifestyles), behavioral (usage rate, price sensitivity, brand loyalty, and benefits sought) and demographic variables (occupation, income, and family status).

9. Real-time cross-selling/up-selling

Upselling is the practice of encouraging customers to purchase a comparable higher-end product than the one in question, while cross-selling invites customers to buy related or complementary items.

10. Automating Customer Care

Expanding customer **self-service, case management, dispute management, and event-based decision-making can be perceived as better customer care,** while lowering operational costs and increasing effectiveness.

FACTORS AFFECTING THE PROFITABILITY OF BANKS IN INDIA

- ***Macroeconomic factors***-The profitability of banks responds positively to **GDP growth and negatively, to the inflation growth rate.**
- ***Industry Specific Factors***-**NPAs have the most adverse impact on the profitability of banks.** They reduce profitability due to an **increase in operating costs** and a **decline in their interest margins**.
- ***Other Bank-Specific Factors***-
  - There exists a positive relationship between **deposits and profitability** as the more deposits a bank collects, the higher will be the **availability of funds for generating loans** and for other profitable uses such as investments.
  - **Non-interest income of the bank consisting of commission income, service charges, and fees, guarantee fees, net profit from the sale of investment securities, and foreign exchange profit** is another factor in determining the **bank's profitability**.

STEPS TO IMPROVE BRANCH PROFITABILITY

1. Focus on balancing profit, growth, and risk: The best-performing banks' balance the **three principal drivers** of franchise **value profit, growth, and risk** to maximize performance and build a sustainable earnings stream.

2. Assess the strategy fit and unique role for each branch in the network*: The* approach results in setting goals that some branches cannot achieve and goals that may not be aggressive enough for other branches.

3. Analyse the current customer base for each branch: Banks that increase wallet share among customers can also improve retention rates.

4. Identify your best new prospect (potential customers) opportunities: To attract new customers, banks should take a more data-driven, proactive approach. To begin the process, branch officials should focus on two things:

(i) Which types of customers currently gravitate to the branch and

(ii) Which specific segments should the bank target and pursue as prospects?

5. Analyse the competition: Understanding the **strengths and weaknesses of the competitor** helps branches to develop effective business plans and leverage competitive intelligence into true business advantages.

6. Set specific goals by branch for business and consumer markets:

The **controlling office** will be equipped with the information needed to establish **branch-specific goals and incentive compensation** plans tied to those customer segments.

7. Execute effective marketing campaigns to drive customer origination, retention, and expansion: To attract new customers and **sell more products to existing customers** requires that banks not only establish **unique goals for each branch but also adopt a more demanding sales culture.**

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8. Redefine the bank model of the future: **Branch strategy should be evolving constantly**, and it should be an **ongoing process** for banks to assess the current position and determine how effectively staff members are contributing toward maximizing value.

The branches should also ensure to focus on the following steps too to improve profitability.

1. Relentless focus on NPA reduction: Each branch must focus on recovery to increase revenue and profit.

2. More quality loans: Banks primarily earn by interest income. So, more quality loans, more interest income. The credit deposit ratio should be around 70%.

3. Focus on non-interest income: Branches need to focus on **cross-selling different products** like insurance, mutual funds, Demat Accounts, Government Tax Collection, non-fund business (Guarantee/ LC, etc.), Commission/ exchange on various services, etc.

4. Low-cost deposit: Low-cost Deposit viz. Current Deposit and Savings Deposit Accounts (CASA) are a vital component of deposits in all banks and these i.e., Current Accounts Savings Accounts (CASA) Deposits are very important performance indicators for Banks.

5. Holding Minimum Cash Balance: The cash holding limit should normally be less than 1% of the branch deposit.

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6. Cost Management: Close management of costs can drive branch profitability. However, cost-cutting at the expense of the quality of the bank's products and services is not desirable at all.

7. Good Customer Relationship: This requires utmost focus and attention continuously to acquire new customers, increase the customer base and retain the customers to increase profitability.

8. Courteous behavior by Branch Head: The branch head is not only the leader but also a sort of guardian to the branch staff. He requires them to be nice and appreciative to them and they will do wonders for the branch.

ESSENTIAL FACTORS TO MAKE CONTINUOUS IMPROVEMENT IN PROFITABILITY

- **Locating areas in your business that could be improved** or made more efficient, e.g., general business processes or administration
- Using **key performance indicators** (KPIs) to analyze your **strengths and weaknesses**, e.g., rising costs or falling sales
- **Assessing your general business costs**, e.g., overheads, how discounted deals with loyal r customers affect your profits, how productive your staff are
- **Reviewing your areas of business waste and reduce them**, e.g., power supply costs
- **Regularly reviewing the pricing of your products**

- Improving your **profitability through your best customers** - use up-selling, cross-selling, and diversifying techniques to improve your profit margins