

## **A Study Of Solvency Of SBI And ICICI**

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### **Abstract –**

In this study an attempt has been made to identify the comparative **Analysis of Solvency of SBI and ICICI Bank**. This research study is divided in six parts. First part includes the introduction and general scenario of Indian banking industry. The second part discusses the. conceptual and regulatory framework of Indian banking industry. Third part concludes the financial performance of SBI. The Fourth part deals with the financial performance of ICICI Bank. Fifth part deals with the comparative analysis and interpretation of SBI and ICICI Bank. Sixth, the present chapter deals with the Summary of major findings of the study, recommendations of this study. The Indian banking industry is passing through a phase of customers market. The customers have more choices in choosing their bank. The competition has been established within the bank operating in India.

State Bank of India is also concentrating at the top end of the market, on wholesale banking capabilities to provide India is growing mid / large Corporate with a complete array of products and services. It is consolidating its global treasury operations and entering into structured products and derivative instruments.

**ICICI** Bank is India's largest private sector bank with total consolidated assets of Rs. 11,242.81 billion (US\$ 172.5 billion) at March 31, 2018 and profit after tax of Rs. 67.77 billion (US\$ 1.0 billion) for the year ended March 31, 2018. ICICI Bank currently has a network of 4,874 Branches and 14,367 ATMs across India.

The **State Bank of India (SBI)** is an Indian multinational, public sector banking and financial services statutory body. It is a government corporation statutory body

headquartered in Mumbai, Maharashtra. SBI is ranked as 216th in the Fortune Global 500 list of the world's biggest corporations of 2018. It is the largest bank in India with a 23% market share in assets, besides a share of one-fourth of the total loan and deposits market.

Despite being the second largest bank in the country after SBI in terms of asset size, ICICI Bank lost its share of the banking sector's advances from 10.2% in FY07 to 8% in FY12. SBI is India's largest bank in the country with an asset size of over Rs.13 trillion. Although the bank's loan book is largely skewed towards corporate (large, mid and small) loans (50% of total advances in FY12), the retail side is also fast catching up.



As both the banks play a tremendous position in their respective sectors, there is a need to take a comparative view of the banking sector in terms of SBI and ICICI Bank. Hence,



**Keywords:** introduction, conceptual, regulatory framework, performance, comparative analysis and interpretation.

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## INTRODUCTION –

**Solvency** is the ability of a company to meet its long-term debts and financial obligations. **Solvency** is essential to staying in business as it demonstrates a company's ability to continue operations into the foreseeable future. ... A company that is insolvent will often enter bankruptcy.

**Solvency**, in finance or business, is the degree to which the current assets of an individual or entity exceed the current liabilities of that individual or entity.<sup>[1]</sup> Solvency can also be

described as the ability of a corporation to meet its long-term fixed expenses and to accomplish long-term expansion and growth.<sup>[2]</sup> This is best measured using the net liquid balance (NLB) formula. In this formula solvency is calculated by adding cash and cash equivalents to short-term investments, then subtracting notes payable.<sup>[3]</sup>

## Review of Research



## How it works (Example):

Solvency measures a company's ability to meet its financial obligations. Short-term solvency is often measured by the current ratio, which is calculated by dividing current assets by current liabilities.

Longer-term solvency is evaluated using the solvency ratio, which divides the company's net worth by its total assets.

A business can be insolvent but still profitable. For example, a company may borrow money to expand its operations and be unable to immediately repay its debt from existing assets. In this instance, the lender assumes cash flows will increase because of the business expansion and enable the company to comfortably meet payment obligations in the future.



## Why it Matters:

A company's solvency determines its ability to service debts and achieve long-term growth and profitability. A business that is completely insolvent is unable to pay its debts and will be forced into bankruptcy. Investors should examine all the financial statements of a company to make certain the business is solvent as well as profitable.

### Solvency Ratios vs. Liquidity Ratios: What's the Difference?

#### Solvency Ratios vs. Liquidity Ratios: An Overview

Solvency and liquidity are both terms that refer to an enterprise's state of financial health, but with some notable differences. Solvency refers to an enterprise's capacity to meet its long-term financial commitments. Liquidity refers to an enterprise's ability to pay short-term obligations; the term also refers to a company's capability to sell assets quickly to raise cash. A solvent company is one that owns more than it owes; in other words, it has a positive net worth and a manageable debt load. On the other hand, a company with adequate liquidity may have enough cash available to pay its bills, but it may be heading for financial disaster down the road.

Solvency and liquidity are equally important, and healthy companies are both solvent and possess adequate liquidity. A number of liquidity ratios and solvency ratios are used to measure a company's financial health, the most common of which are discussed below.

#### Liquidity Ratios

$$\text{Current ratio} = \text{Current assets} / \text{Current liabilities}$$

The current ratio measures a company's ability to pay off its current liabilities (payable within one year) with its current assets such as cash, accounts receivable, and inventories. The higher the ratio, the better the company's liquidity position.

**Quick ratio = (Current assets – Inventories) / Current liabilities**

**= (Cash and equivalents + Marketable securities + Accounts receivable) / Current liabilities**

The quick ratio measures a company's ability to meet its short-term obligations with its most liquid assets and therefore excludes inventories from its current assets. It is also known as the "acid-test ratio."

Days sales outstanding (DSO) = (Accounts receivable / Total credit sales) x Number of days in sales

DSO refers to the average number of days it takes a company to collect payment after it makes a sale. A higher DSO means that a company is taking unduly long to collect payment and is tying up capital in receivables. DSOs are generally calculated quarterly or annually.

### **Solvency Ratios**

**Debt to equity = Total debt / Total equity**

This ratio indicates the degree of financial leverage being used by the business and includes both short-term and long-term debt. A rising debt-to-equity ratio implies higher interest expenses, and beyond a certain point, it may affect a company's credit rating, making it more expensive to raise more debt.

**Debt to assets = Total debt / Total assets**

Another leverage measure, this ratio quantifies the percentage of a company's assets that have been financed with debt (short-term and long-term). A higher ratio indicates a greater degree of leverage, and consequently, financial risk.

Interest coverage ratio = Operating income (or EBIT) / Interest expense

This ratio measures the company's ability to meet the interest expense on its debt, which is equivalent to its earnings before interest and taxes (EBIT). The higher the ratio, the better the company's ability to cover its interest expense.

### **Solvency Ratios vs. Liquidity Ratios: Examples**

Let's use a couple of these liquidity and solvency ratios to demonstrate their effectiveness in assessing a company's financial condition.

Consider two companies, Liquids Inc. and Solvents Co., with the following assets and liabilities on their balance sheets (figures in millions of dollars). We assume that both companies operate in the same manufacturing sector, i.e., industrial glues and solvents.

| Balance Sheet (in millions of dollars) | Liquids Inc. | Solvents Co. |
|----------------------------------------|--------------|--------------|
| Cash                                   | \$5          | \$1          |
| Marketable securities                  | \$5          | \$2          |
| Accounts receivable                    | \$10         | \$2          |
| Inventories                            | \$10         | \$5          |
| Current assets (a)                     | \$30         | \$10         |
| Shareholders' equity                   | \$15         | \$40         |

In our example, we assume that "current liabilities" only consist of accounts payable and other liabilities, with no short-term debt. Since both companies are assumed to have only long-term debt, this is the only debt included in the solvency ratios shown below. If they did have short-term debt (which would show up in current liabilities), this would be added to long-term debt when computing the solvency ratios.

#### Liquids Inc.

$$\text{Current ratio} = \$30 / \$10 = 3.0$$

$$\text{Quick ratio} = (\$30 - \$10) / \$10 = 2.0$$

$$\text{Debt to equity} = \$50 / \$15 = 3.33$$

$$\text{Debt to assets} = \$50 / \$75 = 0.67$$

#### Solvents Co.

$$\text{Current ratio} = \$10 / \$25 = 0.40$$

$$\text{Quick ratio} = (\$10 - \$5) / \$25 = 0.20$$

$$\text{Debt to equity} = \$10 / \$40 = 0.25$$

$$\text{Debt to assets} = \$10 / \$75 = 0.13$$

We can draw a number of conclusions about the financial condition of these two companies from these ratios.

Liquids Inc. has a high degree of liquidity. Based on its current ratio, it has \$3 of current assets for every dollar of current liabilities. Its quick ratio points to adequate liquidity even after excluding inventories, with \$2 in assets that can be converted rapidly to cash for every dollar of current liabilities. However, financial leverage based on its solvency ratios appears quite high. Debt exceeds equity by more than three times, while two-thirds of assets have been financed by debt. Note as well that close to half of non-current assets consist of intangible assets (such as goodwill and patents). As a result, the ratio of debt to tangible assets—calculated as  $(\$50/\$55)$ —is 0.91, which means that over 90 percent of tangible assets (plant and equipment, inventories, etc.) have been financed by borrowing. To summarize, Liquids Inc. has a comfortable liquidity position, but it has a dangerously high degree of leverage.

Solvents Co. is in a different position. The company's current ratio of 0.4 indicates an inadequate degree of liquidity with only 40 cents of current assets available to cover every

\$1 of current liabilities. The quick ratio suggests an even more dire liquidity position, with only 20 cents of liquid assets for every \$1 of current liabilities. But financial leverage appears to be at comfortable levels, with debt at only 25 percent of equity and only 13 percent of assets financed by debt. Even better, the company's asset base consists wholly of tangible assets, which means that Solvents Co.'s ratio of debt to tangible assets is about one-seventh that of Liquids Inc. (approximately 13 percent vs. 91 percent). Overall, Solvents Co. is in a dangerous liquidity situation, but it has a comfortable debt position.

[Important :-A liquidity crisis can arise even at healthy companies if circumstances arise that make it difficult for them to meet short-term obligations such as repaying their loans and paying their employees.]

The best example of such a far-reaching liquidity catastrophe in recent memory is the global credit crunch of 2007–09. Commercial paper—short-term debt that is issued by large companies to finance current assets and pay off current liabilities—played a central role in this financial crisis. A near-total freeze in the \$2 trillion U.S. commercial paper market made it exceedingly difficult for even the most solvent companies to raise short-term funds at that time and hastened the demise of giant corporations such as Lehman Brothers and General Motors Company (GM).

But unless the financial system is in a credit crunch, a company-specific liquidity crisis can be resolved relatively easily with a liquidity injection, as long as the company is solvent. This is because the company can pledge some assets if required to raise cash to tide over the liquidity squeeze. This route may not be available for a company that is technically insolvent since a liquidity crisis would exacerbate its financial situation and force it into bankruptcy.

Insolvency, however, indicates a more serious underlying problem that generally takes longer to work out, and it may necessitate major changes and radical restructuring of a company's operations. Management of a company faced with insolvency will have to make tough decisions to reduce debt, such as closing plants, selling off assets, and laying off employees.

Going back to the earlier example, although Solvents Co. has a looming cash crunch, its low degree of leverage gives it considerable "wiggle room." One available option is to open a secured credit line by using some of its non-current assets as collateral, thereby giving it access to ready cash to tide over the liquidity issue. Liquids Inc., while not facing an imminent problem, could soon find itself hampered by its huge debt load, and it may need to take steps to reduce debt as soon as possible.

## Special Considerations

The following points should be borne in mind when using solvency and liquidity ratios:

- **Get the Complete Financial Picture:** Use both sets of ratios, liquidity and solvency, to get the complete picture of a company's financial health, since making this

assessment on the basis of just one set of ratios may provide a misleading depiction of its finances.

- **Compare Apples to Apples:** These ratios vary widely from industry to industry, to ensure that you're comparing apples to apples. A comparison of financial ratios for two or more companies would only be meaningful if they operate in the same industry.
- **Evaluate the Trend:** Analyzing the trend of these ratios over time will enable you to see if the company's position is improving or deteriorating. Pay particular attention to negative outliers to check if they are the result of a one-time event or indicate a worsening of the company's fundamentals.

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## The regulatory framework

### The need for regulation

A regulatory framework for the preparation of financial statements is necessary for a number of reasons:

- To ensure that the needs of the users of financial statements are met with at least a basic minimum of information.
- To ensure that all the information provided in the relevant economic arena is both comparable and consistent. Given the growth in multinational companies and global investment this arena is an increasing international one.
- To increase users' confidence in the financial reporting process.
- To regulate the behaviour of companies and directors towards their investors.

Financial reporting standards on their own would not be sufficient to achieve these aims. In addition there must be some legal and market-based regulation.

### National regulatory frameworks for financial reporting -

There are many elements to the regulatory environment of accounting. A typical regulatory structure includes:

- National financial reporting standards
- National law
- Market regulations

- Security exchange rules.

For example; the UK has its own national financial reporting authority, the Accounting Standards Board (part of the Financial Reporting Council) that issues financial reporting standards in the UK. The main piece of legislation affecting businesses in the UK is the Companies Act 2006. However, there are also many other pieces of UK, EU and even US legislation (such as the Sarbanes Oxley Act) that affect accountability in the UK. There are also numerous industry specific regulatory systems that affect accounting in the UK, for example; the Financial Services Authority, whose aim is to achieve public accountability of the financial services industry. Finally, there are regulations provided by the London Stock Exchange for companies whose shares are quoted on this market.

## Users of the Financial Statements

The main users (stakeholders) of financial statements are commonly grouped as follows:

- **Investors** and potential investors are interested in their potential profits and the security of their investment. Future profits may be estimated from the target company's past performance as shown in the income statement. The security of their investment will be revealed by the financial strength and solvency of the company as shown in the statement of financial position. The largest and most sophisticated groups of investors are the institutional investors, such as pension funds and unit trusts.
- **Employees** and trade union representatives need to know if an employer can offer secure employment and possible pay rises. They will also have a keen interest in the salaries and benefits enjoyed by senior management. Information about divisional profitability will also be useful if a part of the business is threatened with closure.
- **Lenders** need to know if they will be repaid. This will depend on the solvency of the company, which should be revealed by the statement of financial position. Long-term loans may also be backed by 'security' given by the business over specific assets. The value of these assets will be indicated in the statement of financial position.
- **Government** agencies need to know how the economy is performing in order to plan financial and industrial policies. The tax authorities also use financial statements as a basis for assessing the amount of tax payable by a business.
- **Suppliers** need to know if they will be paid. New suppliers may also require reassurance about the financial health of a business before agreeing to supply goods.
- **Customers** need to know that a company can continue to supply them into the future. This is especially true if the customer is dependent on a company for specialised supplies.
- **The public** may wish to assess the effect of the company on the economy, local environment and local community. Companies may contribute to their local economy and community through providing employment and business for local suppliers. Some companies also run corporate responsibility programmes through which they support

the environment, economy and community by, for example supporting recycling schemes.

Management and competitors would also use the financial statements of a business to make economic decisions. Management, however, would predominantly use monthly management accounts as their main source of financial information. It is also unlikely that a business would prepare financial statements for the purpose of aiding competitors!

## **Analysis and interpretation of financial statements:-**

Analysis and interpretation of financial statements means looking at the various parts of the financial statements, relating the parts to each other and to the picture as a whole, and determining if any meaningful and useful interpretation can be made out of this analysis.

All readers of financial statements, managers, owners, investors, and creditors, are interested in analyzing and interpreting the financial statements. However, what is of interest to one may be of less interest to another. For example, managers are very concerned about the internal operating efficiency of the organization and will look for indications that things are running smoothly, that operating goals are being met, and that the various departments are being managed as profitably as possible. Stockholders, on the other hand, are more interested in the net income and about future earnings and dividend prospects. In many cases, they would not be concerned about or be familiar with internal departmental results.

Creditors and investors other than stockholders might be interested in the net income but are even more interested in the debt-paying ability of the company. A company might have good earnings but, because of a shortage of cash, might not be able to meet its debt obligations.

An exhaustive coverage of the analysis and interpretation of financial statements is beyond the scope of this text. Therefore, this discussion will be confined to some of the more fundamental analysis techniques that lend themselves well to the hospitality industry. Also, comment will be confined to the two major financial statements: the balance sheet and the income statement. The analysis techniques illustrated are those that normally would be used by the operation's management.

## **COMPARATIVE HORIZONTAL ANALYSIS OF BALANCE SHEETS -**

A basic set of financial statements includes a balance sheet at a specific date and an income statement for the accounting period ended on that date. Some sets of financial statements may include a balance sheet and income statement for both the previous and current accounting periods. When prior and current period statements are provided, changes occurring between the two consecutive years or periods can be seen. However, these changes might not be as

obvious as you would expect. It is not easy to mentally compare the differences between two sets of figures, and it is extremely useful to have additional information available for analysis.

One method is to complete a comparative horizontal analysis of a balance sheet or an income statement. This technique requires at least two consecutive periods of information. The objective is to find and identify changes that have occurred over an accounting period. The difference in dollar value reported between the two statements for each line item, subtotal, or total of the statement is calculated and identified as a positive or negative dollar value change. The change, positive or negative, is divided by the prior period's dollar amount to determine the percentage change.

In comparative analysis, the terms absolute and relative change are sometimes used. An absolute change shows the dollar change from one period to the next. A relative change is the absolute change expressed as a percentage.

An absolute change may sometimes appear large (for example, \$10,000) but when compared to its base figure (e.g., \$1,000,000) represents a relative change of only 1%. By the same token, a relative change may seem high (e.g., 50%) but when compared to its base figure is quite small in absolute terms (for example, a \$50 base figure increasing to \$75). In terms of the total income statement, this \$25 change (even though it shows a relative increase of 50%) is insignificant. Therefore, when analyzing comparative statements, both the absolute and the relative changes should be looked at, and only those that exceed both acceptable norms should be of concern.

For example, absolute changes of concern might be established at \$10,000 and relative changes at 5%, and only those changes that exceeded both \$10,000 and 5% would be investigated. In this situation, the following changes would not be investigated:

- Above \$10,000 but below 5 percent
- Above 5 percent but below \$10,000
- Below \$10,000 and below 5 percent

## **COMMON-SIZE VERTICAL ANALYSIS OF BALANCE SHEETS**

Another technique used to analyze balance sheet information is to convert the statement to a common-size vertical analysis format. This method requires only one period of financial data. Common size means that total assets have a value of 100 percent and the numerical value of each item being converted represents a fractional part of total assets.

Since  $\text{Assets} = \text{Liabilities} + \text{Ownership Equity}$  and each side of the balance sheet has the same total value, every item in a balance sheet, subtotals, and totals, can be expressed as a percentage of total assets. Any subset of a balance sheet such as current assets, fixed assets, current liabilities, long-term liabilities, or ownership equity can be converted to a common-size vertical format and analyzed separately. Since each current liability is a part of total current liabilities, a common-size vertical analysis of current liabilities will express each individual current liability as a percentage of total

## COMPARATIVE HORIZONTAL ANALYSIS OF INCOME STATEMENTS

shows two consecutive annual income statements for a food department of a hotel. The same method that was used to analyze balance sheets is used for income statements. Line by line, find the numerical value change and divide the change by the prior year to find the percentage of change. The calculation to identify the percentage of change is as follows:

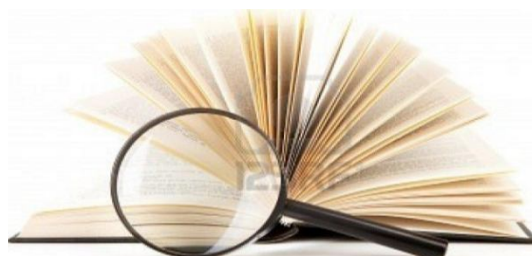
$$\begin{aligned} & (\text{Sales revenue 0004} - \text{Sales revenue 0003}) / \text{Sales Revenue 0003} = \% \text{ Change} \\ & (\$221,900 - \$201,600) / \$201,600 = \% \text{ Change} \\ & \$20,300 / \$201,600 = \underline{\underline{10.1\%}} \end{aligned}$$

The comparative horizontal analysis follows the same procedures to calculate the numerical change of each line item and the percentage that change represents. It matters not what financial information is being compared, as long as two consecutive operating periods of information are provided. The concept remains:

$$(\text{Period 2} - \text{Period 1}) = \$ \text{ Change} / \text{Period 1} = \% \text{ Change}$$

The other percentage change figures are calculated in the same way. Note that within each revenue area, except banquets, the revenue has increased, but total revenue has gone up only 2.1 percent. The reason for this relatively small increase in total revenue is that banquet revenue was down 7.7 percent over the year. Can the reasons be determined? Is the sales department not doing an effective job? Is there a new, competitive operation close by? Are prices too high? Even with the small total sales revenue increase, income has declined \$37,100, or 24.2 percent. This is a drastic change. With revenue up, all other factors being equal, income should also be up, not down.

## Literature Review :-



## Literature Review

Over the past decade the U.S. banking industry has undergone many changes, including the resolution of the savings and loan bailout, the rise of Internet banking, numerous mergers and acquisitions, and financial deregulation. Although all of these have had, or will have, a major impact on the banking sector, two of these factors could alter the underlying structure of the U.S. banking system. The first is the flurry of mergers and acquisitions that has occurred; the

second is the passage of the Gramm–Leach–Bliley Financial Services Modernization Act (Senate Bill 900) on November 12, 1999.

Like much of the industrialized economy, in the past few years the U.S. banking sector has experienced numerous mergers and acquisitions. Several mergers involved the country's largest banks, most notably the combinations of Citicorp and Travelers Group, Banc One and First Chicago, and NationsBank and BankAmerica. This consolidation trend has not been confined to the United States; there have been numerous mergers in such countries as Japan, France, and Germany, as well as crosscountry mergers such as that of Deutsche Bank and Bankers Trust (Table 1). Although in terms of dollar value mergers peaked in the United States in 1998, there continues to be considerable consolidation activity (Table 2). Its impact on the degree of competition and on the industry's structure both here and abroad is of concern to both economists and regulators.

The Financial Services Modernization Act, the other factor that could alter the industry's underlying structure, essentially repealed the Banking Act of 1933, more commonly called the Glass–Steagall Act. Glass–Steagall separated commercial banking, insurance, and investment banking into three distinct businesses that were prohibited from engaging in each other's activities. For example, banks could not offer insurance or underwrite securities. Although the legal barriers between these sectors had eroded over time, banks were still prevented from completely entering the other two businesses.<sup>1</sup> By lifting these statutory barriers, the new legislation could accelerate the merger of firms across the financial services industry (in contrast to the recent mergers within the banking sector). This could also lead to a less competitive financial and banking sector.

**Table 1**  
**Recent Merger Activity of World's Largest Banks**

|                                  | 1998 assets<br>(in billions of U.S. dollars) | Mergers and acquisitions                                         |
|----------------------------------|----------------------------------------------|------------------------------------------------------------------|
| Mizuho Financial Group           | 1,342,351                                    | Industrial Bank of Japan and Dai Ichi Kangyo and Fuji Bank*      |
| Sumitomo Bank/Sakura Bank        | 877,977                                      | Sumitomo Bank and Sakura Bank†                                   |
| Mitsubishi Tokyo Financial Group | 804,008                                      | Bank of Tokyo and Mitsubishi Bank and Mitsubishi Trust and Bank† |
| Deutsche Bank                    | 735,808                                      | Deutsche Bank and Bankers Trust                                  |
| Sanwa Bank/Tokai Bank            | 694,114                                      | Sanwa Bank and Tokai Bank†                                       |
| BNP Paribas                      | 692,713                                      | BNP and Paribas                                                  |
| United Bank of Switzerland       | 687,316                                      | Union Bank of Switzerland and Swiss Bank                         |
| Citigroup                        | 668,641                                      | Citicorp and Travelers Group                                     |
| Bank of America                  | 617,679                                      | NationsBank and BankAmerica                                      |
| HypoVereinsbank                  | 541,032                                      | Hypo-Bank and Bayerische Vereinsbank                             |

\* Scheduled for completion in 2002.

† Scheduled for completion in 2001.

SOURCES: 1999 Fortune Global 500; Dow Jones Interactive; Federal Reserve Board of Governors.

These two events, and the resulting consolidation, highlight the importance of understanding how this sector's structure (that is, the degree to which it is competitive) impacts various aspects of the economy and future economic growth. This, along with recent empirical work showing the importance of financial market development for economic growth, has generated

research aimed at determining the macroeconomic impact resulting from differences in the industrial organization of the banking system. There is no single, simple answer to this question. Thus, this article focuses on some of the theoretical research examining how the banking sector's underlying structure affects the economy and economic growth.

**Table 2**  
**Value of Recent U.S. Mergers**

|                       | <b>Acquired banks</b>             | <b>Assets of acquired banks<br/>(in billions of U.S. dollars)</b> |
|-----------------------|-----------------------------------|-------------------------------------------------------------------|
| <b>Total for 1998</b> |                                   | <b>1,016,565</b>                                                  |
| Largest mergers       |                                   |                                                                   |
| Travelers Group       | Citicorp                          | 310,897                                                           |
| NationsBank           | BankAmerica and Barnett           | 304,164                                                           |
| Bank One              | First Chicago and First Commerce  | 132,407                                                           |
| <b>Total for 1999</b> |                                   | <b>309,749</b>                                                    |
| Largest mergers       |                                   |                                                                   |
| Deutsche Bank         | Bankers Trust                     | 156,267                                                           |
| Fleet Financial       | BankBoston and Matewan Bancshares | 76,392                                                            |
| HSBC Holding          | Republic New York                 | 50,453                                                            |

NOTES: 1999 total is for mergers completed as of November 30. The HSBC/Republic merger is pending.

SOURCE: Federal Reserve Board of Governors.

## **AN OVERVIEW OF THE LITERATURE -**

Economists have long recognized that financial markets in general, and banks in particular, play a vital role in the efficient functioning and development of any economy.

Some of the recent research examining the relationship between banks, financial markets, and the macroeconomy have their origins in early work by Cameron (1967), Goldsmith (1969), McKinnon (1973), and Shaw (1973).

These authors highlight the fact that financial markets affect, and in turn are affected by, economic growth. They argue that well-developed financial markets are necessary for the overall economic advancement of less developed countries.

Townsend (1979) and Stiglitz and Weiss (1981) represent the next major work in this area. They developed some of the first banking-related models based on utility and profit maximization rather than on assumptions of the resulting behavior. Their models focus primarily on the part asymmetric information plays in the allocation of resources.

Much of the subsequent research in this area focuses on banks' and financial markets' role in helping overcome information gaps between borrowers and lenders.

With the work of Townsend and Stiglitz and Weiss as a foundation, Diamond (1984), Gale and Hellwig (1985), Boyd and Prescott (1986), and Williamson (1986, 1987) developed theoretical frameworks that model financial intermediaries more explicitly. Banks arise naturally in these models as a means for overcoming asymmetric information problems. The

particular form of this problem is that it is costly for lenders (or banks) to obtain information about borrowers and their projects. In these models, banks possess economies of scale with respect to gathering information and monitoring firms and thus are more efficient (or more cost-effective) than individual investors could be.

Until the early 1990s, most of the research focused primarily on a theoretical understanding of the relationship between banks and borrowers and justifying the existence of banks within the framework examined—that is, what services a bank could provide that individuals could not accomplish for themselves. However, in the 1990s theoretical and empirical research returned to the focus of the late 1960s and early 1970s, more closely examining the relationship between the financial sector and economic growth.

Recent empirical work on this relationship has established a strong, positive association between the development of a formal financial sector and an economy's level (or rate of growth) of real activity. King and Levine (1993b) establish that the banking sector's development is not only correlated with economic growth but is also a cause of long-term growth. Subsequent work has refined King and Levine and established that financial markets (defined more broadly than in their work) are a source of economic growth.

In addition, a theoretical literature exploring the nature of the correlation between the banking sector and economic growth has developed. It suggests that the financial system could impact real economic performance by affecting the composition of savings (Bencivenga and Smith 1991), providing information (Greenwood and Jovanovic 1990), and affecting the scope for credit rationing (Bencivenga and Smith 1993; Boyd and Smith 1997, 1998).<sup>7</sup> However, most of the theoretical literature on the relationship between intermediation and growth considers an economy with a competitive banking system. As a practical matter, economies display substantial variation in the competitive environment of their banking systems.

**Table 3**  
**Structure of the Banking Industry**  
**at Year-End 1998**

|                | Concentration in the<br>banking industry<br>(percent) |
|----------------|-------------------------------------------------------|
| China          | 70                                                    |
| India          | 42                                                    |
| Hong Kong      | 29                                                    |
| Korea          | 50                                                    |
| Malaysia       | 40                                                    |
| Philippines    | 60                                                    |
| Singapore      | 39                                                    |
| Thailand       | 62                                                    |
| Argentina      | 38                                                    |
| Brazil         | 52                                                    |
| Chile          | 47                                                    |
| Colombia       | 53                                                    |
| Mexico         | 68                                                    |
| Peru           | 67                                                    |
| Venezuela      | 56                                                    |
| Czech Republic | 66                                                    |
| Hungary        | 57                                                    |
| Poland         | 43                                                    |
| Russia         | 42                                                    |
| Israel         | 87                                                    |
| Saudi Arabia   | 66                                                    |
| South Africa   | 81                                                    |
| Australia      | 69                                                    |
| Germany        | 17                                                    |
| Japan          | 22                                                    |
| United States  | 35                                                    |

Table 3 provides an approximate measure—concentration ratios—for the degree of competition within various countries' banking sectors. Ascertaining the actual level of competitiveness within the industry is extremely difficult. Consequently, concentration ratio (the fraction of the banking market served by the largest four or five banks) are often used as a proxy to measure competitiveness. It should be noted that these ratios are an imperfect measure, as even if the largest banks control most of the market, they still might compete fiercely among themselves.

As a result of these differences, more recent theoretical research has begun examining the banking sector's market structure along two lines. The first, characterized by Krasa and Villamil (1992) and Winton (1995), examines the optimal size, number, and capitalization of banks. Although these studies deal somewhat with bank structure, they focus primarily on the optimal

The second line of research focuses on comparing economies that are identical except for the structure of the banking system. These models examine the impact bank structure has on some particular aspect of the economy. Thus, they assume a particular market structure (either competitive banks or a monopoly bank), as opposed to ascertaining the optimal bank size and number. It is this line of research that this article explores.

## **Methodology, Findings and Conclusion -**

On the basis of study of financial performance, based on the parameters like interest income, net interest income, Noninterest income, Interest expanded, Operating expenses, Credit Deposit Ratio, Investment deposit ratio, cash deposit ratio and Total debt to owners fund. It can be concluded very safely that the study of last five years i.e. from 2012 to 2016 HDFC Bank has performed much better than ICICI, SBI, UNION and we conclude that the HDFC bank have much better growth prospects as compared to other banks.

Interest income, Net-interest income and operating expenses of HDFC were highest, among ICICI, SBI and Union bank followed by during the period of study. ICICI bank performed well than other banks in non-interest income, credit deposit, investment deposit and cash deposit. In the public banks the SBI and UNION banks only performed well in cash and interest expanded during the study period. The HDFC bank performs well in net interest income which means the difference between the revenue that is generated from banks assets and the expenses associated with paying out its liabilities. The ICICI bank performs well in non –interest income which means the bank and creditor income derived primarily from fees including deposits and transaction fees, insufficient funds fees, annual fees, monthly fees services charges inactivity fees check and deposits slip fees and so on while again the HDFC bank is good in total operating expenses which means the total of cost of goods sold, office and administrative expenses and selling and distribution expenses. The overall performance of ICICI bank is good than other banks in solvency which included the parameters of Credit Deposit Ratio, Investment deposit ratio, cash deposit ratio, Total debt to owners fund during the study period. The public banks (SBI, UNION) needs more improvement in these areas to increases there efficiency. Hence, the overall performance of HDFC bank is good on comparing the other banks including all the parameters during the whole study period.

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