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An analysis on the earnings & profitability and liquidity of HDFC bank

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Abstract
Camels analysis is used to evaluate a bank's overall performance and to monitor its compliance with laws and regulatory policies using CAMELS ratings. Camels analysis includes Capital adequacy, Asset quality, Management, Earnings, Liquidity and sensitivity to market risk. This study deals with the analysis of two components E-earnings & profitability and L- liquidity position of HDFC bank for the period of five financial years from 2012-13 to 2016-17. Earnings and profitability of banks reflects the ability to support present and future operations of the bank. HDFC bank has maintained stable and better earnings from different sources of its income. This study suggests that HDFC bank can utilize the assets in proper way to increase the income from return on assets. The performance of HDFC bank is sound in case of earnings and liquidity.

Keywords: HDFC, earnings, profitability, liquidity

Introduction

In 1980s CAMELS rating system was first introduced by US supervisory authorities as a system of rating for on- site examination for banking institutions. Under this system each banking institution is evaluated on the basis of five components relating to its operations and performance. These are capital adequacy, asset quality, management, earnings and liquidity. A sixth component, a bank's Sensitivity to market risk was added in 1997; hence the acronym was changed to CAMELS. These components reflect the financial performance, operating soundness and regulatory compliance of the banking institutions. Each component is rated from1 to 5 based on their performance as best and worst. This study is an analysis of earnings and liquidity of HDFC bank.

HDFC Bank

The Housing Development Finance Corporation Limited (HDFC) was the first bank to receive an 'in principle' approval from the Reserve Bank of India (RBI) to set up as a private sector bank in 1994. The HDFC bank was incorporated in August 1994 in the name of 'HDFC Bank Limited'. The register office of the bank is in Mumbai. The bank at present has 1725 branches and 3898 ATMs spread in 771 cities across India. The mission of HDFC bank is to be a" World-Class Indian Bank". The bank was established with the objective of building sound customer services all over India.

Review of Literature

Misra & Aspal (2013) [1] had seen the performance of State Bank group using CAMEL approach. The study revealed that SBBJ is at top in terms of capital adequacy ratios and have good asset quality but need to improve management skills. The SBP had adequate capital base but earning capacity is not good. Similarly, SBI had good liquidity position but need to asset quality. SBT had efficient management and good earnings ratio but need adequate capital base. At last SBM had good earning capacity but lack in liquidity rate.

Scope of the study

To analyse the performance and strength of HDFC bank using CAMELS analysis.

Objectives of the study
To identify and analyse the earnings & profitability and liquidity position of HDFC bank using CAMEL analysis.

Methodology
Period of study: The study covers the period of five financial years from 2012-13 to 2016-2017.

Data source: Secondary data has been considered for the study, which has been collected from the annual reports and audited financial statements of the banks.

Tools for analysis: CAMELS ratios are used as tools for analysis. In this study the ratios under earnings and liquidity are taken.

Earnings and Profitability
The quality of earning is very important aspect that determines the ability of a bank to earn consistently. It basically determines the profitability of bank and explains its growth in earnings in future. More specifically, this determines the capacity to absorb losses, finance its expansion, pay dividends to its shareholders, and build up an adequate level of capital. The following ratios are calculated in order assess the earnings and profitability of the bank.

Dividend Pay-out Ratio
Dividend payout ratio shows the percentage of profit shared with the shareholders. The more the ratio will increase the goodwill of the bank in the share market. It is calculated by dividing the dividend and net profit earned during respective years.

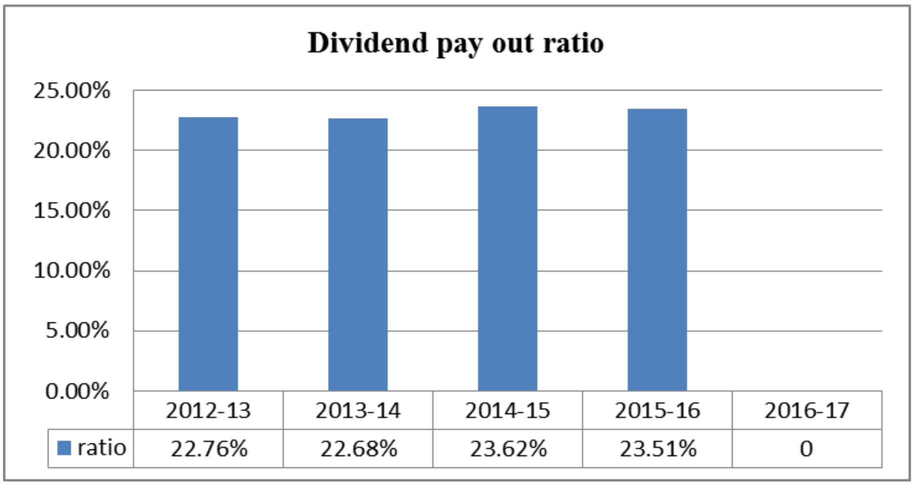

Chart 1.1

HDFC bank has shown fluctuations till 2015-16. The ratio increased from 22.76% in 2012-13 to 23.51% in 2015-16. The dividend information for the year 2016-17 is not available in the annual report of the bank. Thus the goodwill of the bank is maintained stable except in 2016-17.

Return on assets
Net profit to total asset indicates the efficiency of the banks in utilizing their assets in generating profits. A higher ratio indicates the better income generating capacity of the assets and better efficiency of management in future. It is calculated by dividing the net profit for every year and the total assets available in every year.

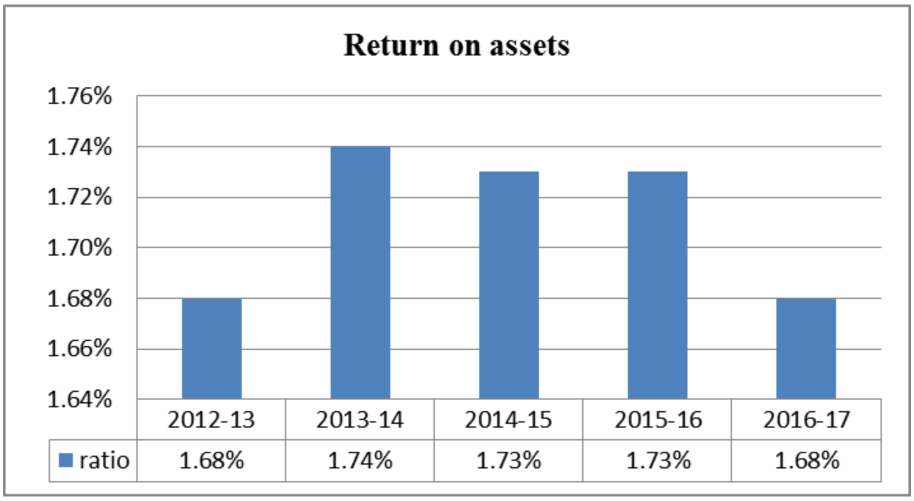

Chart 1.2

The ratio tells how profitable the bank can do with what it has. This ratio of HDFC bank revolves around 1.7% and thus shows a better capacity in generating income from company's assets.

Operating profit to average working fund ratio

This ratio determines the operating profits generated out of working fund employed. The better utilization of the funds will result in higher operating profits. The higher the ratio, the better it is. This ratio is calculated by dividing operating profit by average working fund.

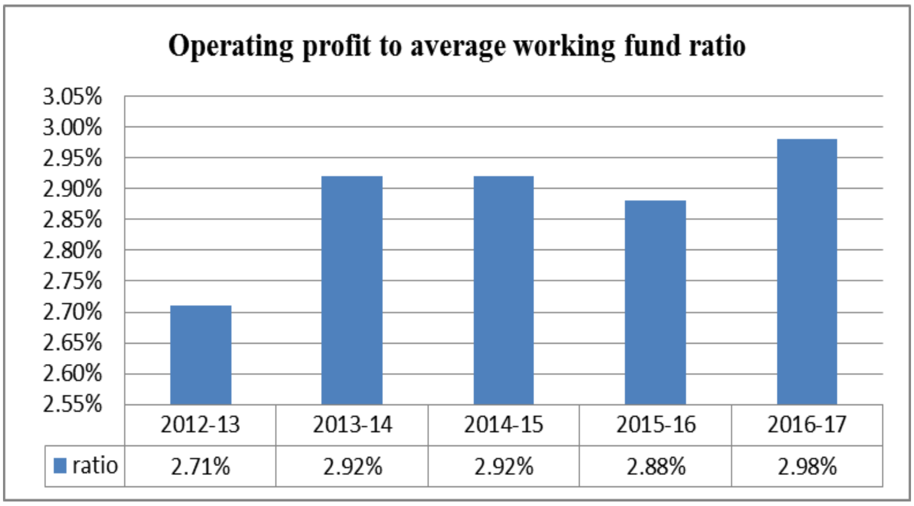

Chart 1.3

This ratio indicates how much a bank can earn from its operations net of operating expenses for every rupee spent on working funds. HDFC bank has utilized its employed working funds better in 2016-17 as against any other previous four years, thus the bank is performing well in 2016-17 compared to previous years.

Net Profit to Average Asset

Net profit to average asset indicates the efficiency of the banks in utilizing their assets in generating profits. A higher ratio indicates the better income generating capacity of the assets and better efficiency of management. It is arrived at by dividing the net profit by average assets, which is the average of total assets in the current year and previous year. Higher ratio indicates better earning potential in the future.

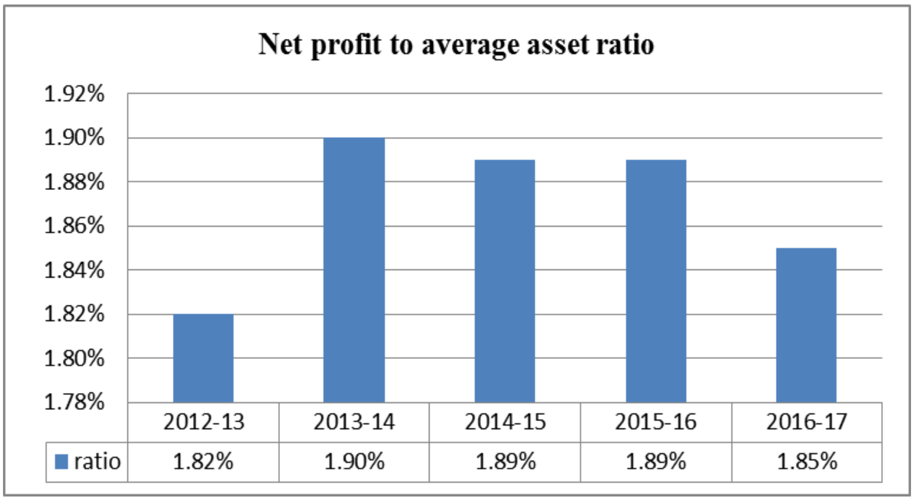

Chart 1.4

HDFC bank has shown fluctuations in this ratio by increasing from 1.82% in 2012-13 to 1.89% in 2015-16 and again reduced to 1.85% in 2016-17. The ratio is higher in 2013-14 indicating that the bank has used its assets efficiently to earn profit compared to other years.

Interest income to total income

The interest income to total income indicates the ability of the bank in generating income from its lending. In other words, this ratio measures the income from lending operations as a percentage of the total income generated by the bank in a year. Interest income includes income on advances, interest on deposits with the RBI, and dividend income.

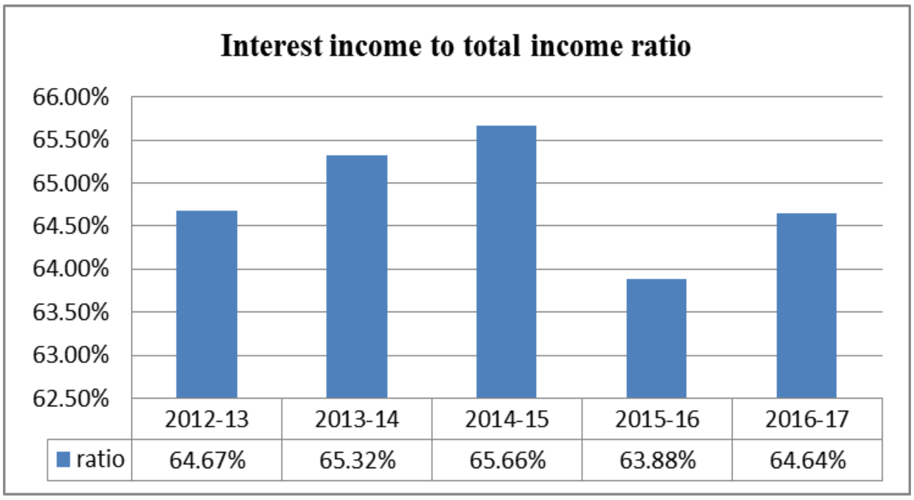

Chart 1.5

HDFC bank maintains a steady ratio of 63% to 66% in 2012-13-2016-17. The highest ratio was in 2014-15 as 65.66%. Thus it has a greater ability in generating income from interest.

Other income to total income ratio

The higher ratio indicates increasing proportion of fee-based income. The ratio is also influenced by gains on government securities, which fluctuates depending on interest rate movement in the economy. This ratio is calculated by dividing other income by total income in every year.

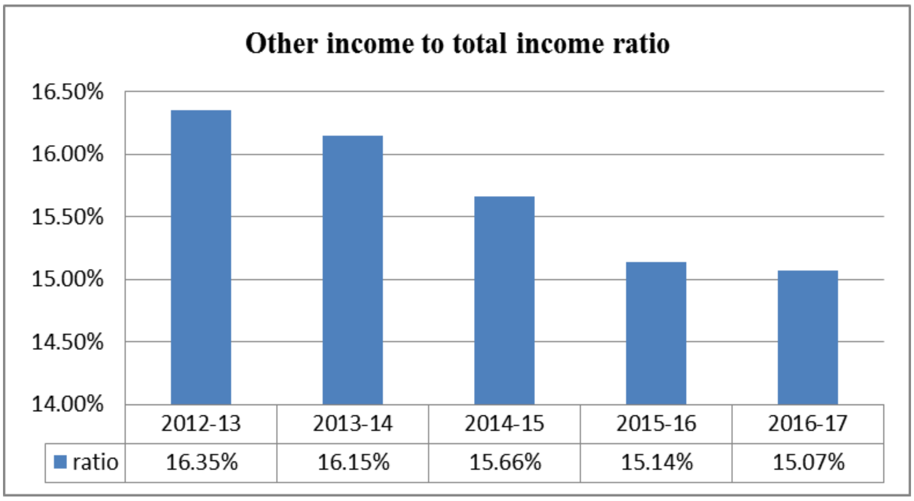

Chart 1.6

The ratio is also influenced by gains on government securities, which fluctuates depending on interest rate movement in the economy. The bank has shown decreasing trend in the ratio from 16.35% in 2012-13 to 15.07% in 2016-17. Thus this indicates that the bank's performance is satisfactory.

Liquidity

An adequate liquidity position refers to a situation, where institution can obtain sufficient funds, either by increasing liabilities or by converting its assets quickly at a reasonable cost. Risk of liquidity is a major threat to the image of the bank. So the bank has to take proper care of liquidity risk. The following ratios are used to measure the liquidity position of a bank.

Liquid asset to total asset ratio

Liquid assets include cash in hand, balance with the RBI, balance with other banks (both in India and abroad), and money at call and short notice. Total asset include the revaluations of all the assets. The proportion of liquid asset to total asset indicates the overall liquidity position of the bank.

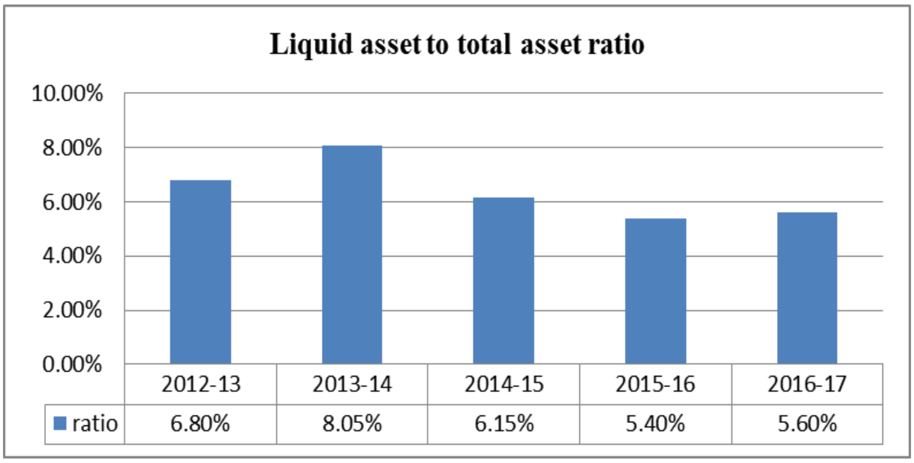

Chart 2.1

HDFC bank maintained a higher proportion of liquid assets in 2013-14. It relatively reduced in the recent years to 5.6% in 2016-17. Though there are fluctuations in the ratio the bank has maintained a better liquidity position.

Government securities to total asset ratio

Government Securities are the most liquid and safe investments. This ratio measures the government securities as a proportion of total assets. Banks invest in government securities primarily to meet their SLR requirements, which are around 25% of net demand and time liabilities.

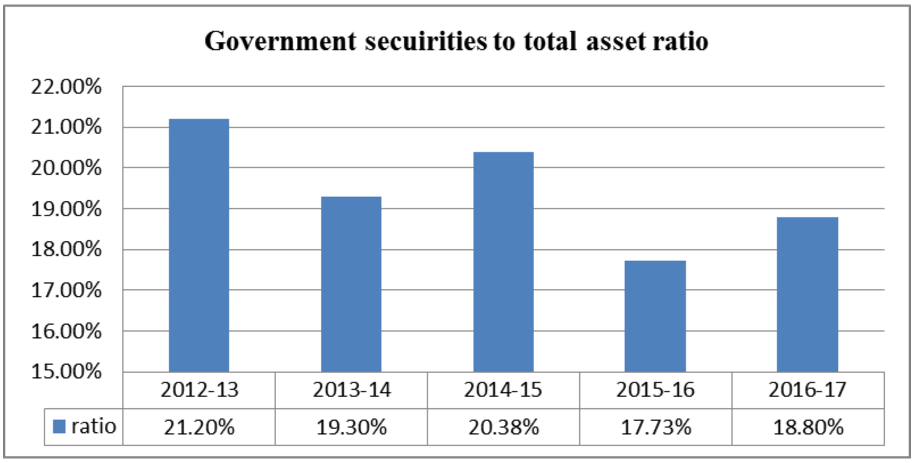

Chart 2.2

HDFC bank has been cautious enough to invest fairly 18% to 21% of its assets in government securities every year. Thus the bank has the highest investment of 21.2% in the year 2012-13. Lastly in the year 2016-17 this ratio has been reduced to 18.8%.

Liquid assets to demand deposit ratio

This ratio measures the ability of a bank to meet the demand from deposits in a particular year out of liquid assets. Demand deposits offer high liquidity to the depositor and hence banks have to invest these assets in a highly liquid form.

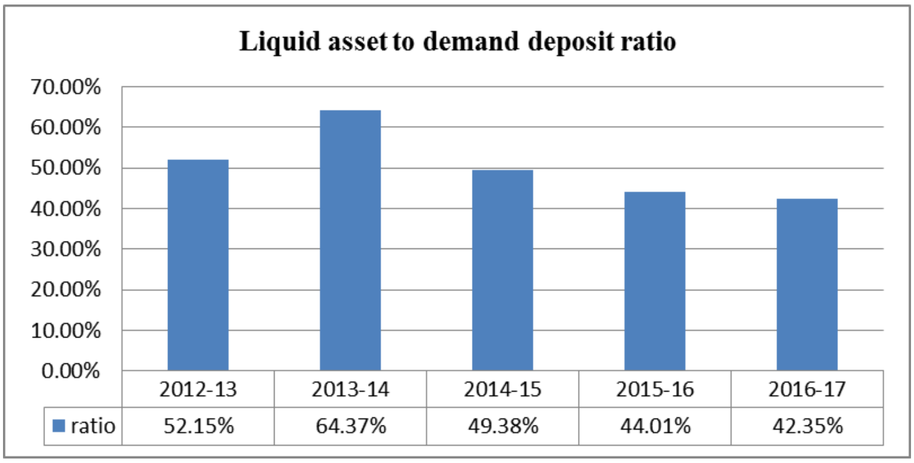

Chart 2.3

HDFC bank has not maintained adequate liquid assets to meet from deposits. There is decreasing trend in ratios from 2012-13-2017 as 52.15% in 2012-13 to 42.35% in 2016-17.

2.4 Liquid asset to total deposit ratio

This ratio measures the liquidity available to the deposits of a bank. Total deposits include demand deposits, savings deposits, term deposits and deposits of other financial institutions. Liquid assets include cash in hand, balance with the RBI, balance with other banks (both in India and abroad), and money at call and short notice.

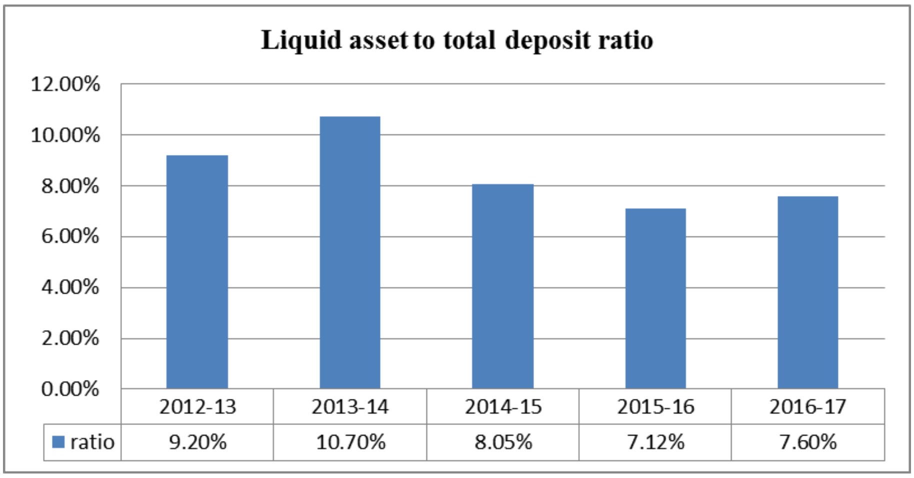

Chart 2.4

HDFC bank had a higher proportion in 2014; this then declined to 8.05% in 2015 and further reduced to 7.6% in 2017 thus showing fluctuations in its potential to meet deposits out of liquid assets.

Findings

Earnings and profitability

- Though the bank has shown increasing trend in dividend payment till 2015-16 there was no dividend in 2016-17.
- The bank has better capacity in generating income from company assets in spite of fluctuations.
- The bank has efficiently used the working funds in 2016-17 compared to all other years.
- The bank shows efficient utilization of assets in generating profits in the year 2013-14 (1.9%).
- The bank has greater ability in generating income from interest from 2012-13 to 2016-17.
- The bank has shown decreasing trend in generating other income.

Liquidity

- The liquid assets ratio is reduced in 2016-17 compared to other years.
- The investment in government securities in 2012-13 is high and it has been declined in the following years.
- HDFC bank has shown a decreasing trend in the ratio of liquid assets to demand deposits.
- The bank had higher proportion of ratio in 2013-14 which is 10.7% compared other years.

Suggestions

- HDFC bank can utilize the assets in proper way to increase the income from return on assets.
- The bank must improve its liquidity position in all years.
- The bank can increase the income from other sources excluding interest income.

Conclusion

CAMEL approach is significant to assess the performance, strength and give necessary suggestions to improve the performance of the bank. In this study the performance of HDFC bank was analysed based on two major components of camel analysis i.e., earnings and liquidity is analysed. Thus it is understood that the profitability and the liquidity position of HDFC bank is sound in the study period i.e 2012-13 to 2016-17. Further the bank can make some improvements to achieve the better liquidity position in future years.

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