PDUAMT Business Review, Volume I, 2019, pp. 21-25

Comparison of ICICI's Performance between Pre and Post Basel II Norms Implementation

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Abstract

Banks play major role in the financial sector of each economy. They are the most important financial intermediaries and their activities have an impact on each sector of the economy. Banking in India has faced an enormous change after banking sector reforms and the implementation of Basel norms. Basel II is the second of the Basel Accords suggested on banking rules and parameters issued by the Basel Committee on Banking Supervision. The objective of this paper is to compare performance of ICICI before and after the implementation of Basel II norms. This performance has been measured with the help of four financial ratios i.e. cost- income ratio, return on equity, operating profit to total assets and credit-deposit ratio. Independent sample t test has been used to review the difference in selected ratios over the two periods. The result of the study shows that there is no significant improvement between the periods excepting the case of operating profit to total assets, which shows significant improvement between the periods.

Keywords: *Basel-II Norms, Cost-Income Ratio, Return on Equity, Operating Profit to Total Assets, Credit- Deposit Ratio*

JEL Classification: *G21, G28*

Introduction

Addressing the alleged shortcomings and structural weaknesses of Basel I accord, the Basel Committee proposed a new capital adequacy framework to replace 1988 Basel I Accord in June 1999. Basel II was mainly presented in June 2004 by BCBS, which became effective from March 2005. All banks operating in India necessitate to preserve minimum Capital Funds at 8% of Total Risk Weighted Assets. Banks necessitate disclosing their risk exposure etc. to the central bank. In India, all commercial banks have started implementing Basel II with effect from March 31, 2007 although a marginal extending beyond this date should not be ruled out in view of the latest indications on the state of preparedness. RBI report observed that foreign banks operating in India and Indian banks with presence abroad migrated to the Basel II framework with effect from March 31, 2008. All other scheduled commercial banks (except regional rural banks and local area banks) are expected to move around to the Revised Framework not later than by March 31, 2009 (Sarma, 2007). As compared to Basel I, Basel II is a much more comprehensive framework

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of banking supervision was fully implemented on April 2009 in India where banks are required to maintain a Capital to Risk Weighted Assets Ratio (CRAR) at 9%. It not only deals with the CRAR calculation but also has provisions for supervisory review and market discipline. In the present study, the performance of ICICI has been analyzed before and after the implementation of Basel II norms.

Review of Literature

Kumar and Sreeramulu (2008) measured the performance of Indian banks in terms of the employee's cost and productivity ratios for the period from 1997-2008. They inspected that the performance of modern banks was superior as compared to conventional banks.

Sitheswaran and Pradeep (2010) emphasized that the implementation of new Basel norms, enhanced transparency and disclosures, advanced corporate governance and deployment of highly developed technology might carry economic steadiness in banking sector.

Shanmugasundaram (2011) assessed the operational, efficiency and profitability variables of the public sector banks pre and post Basel I's perspective. These variables were scrutinized with the help of a few financial ratios. The performance of the public sector banks has been enhanced after the implementation of Basel I norms. The operational efficiency variables explicated humble improvement owing to enhanced profitability.

Khan et al. (2013) analyzed operational efficiency of selected Malaysian and Pakistani Islamic banks for the period 2006-2011. They studied that Malaysian Islamic banks were comparatively more proficient in forms of income-expense ratio and operating efficiency ratio, while Pakistani Islamic banks have admirable assets deployment latent.

Objective of the Study

The objective of this study is to compare performance of ICICI before and after the implementation of Basel II norms in respect of select parameters.

Hypothesis of the Study

There is no significant difference in performance parameters of ICICI in view of Basel II norms.

Research Methodology

The ICICI bank was taken as sample for the study. The present study covers a total period of 14 years starting from 2002-03 to 2015-16 divided into two sub-periods, *namely* pre-Basel II starting from 2002-03 to 2008-09 and post-Basel II norms from 2009-10 to 2015-16 (See Table 1). Independent sample T-test was used in order to see the differences in respect of selected parameters in the two periods. The parameters selected on the basis of the review of literature are Cost- Income Ratio (CIR), Return on Equity (ROE), Operating Profit to Total Assets (OPTA) and Credit- Deposit Ratio (CDR). The study uses only secondary data, which were collected from annual reports of RBI. SPSS20 software package and M.S. Excel were used for statistical analysis.

Data Analysis

It is good practice, once we have entered data, to test for normality of distribution. In this way, we can be sure that our data have achieved an important assumption for parametric testing. Kolmogorov-Smirnov test is a more suitable test of normality of distribution. These types of tests essentially test data for goodness of fit against pre-calculated normally distributed values.

Table 2 shows that p values of the selected variables greater than 0.05 except cost to income ratio for pre-Basel II period. Thus, the null hypothesis, i.e., performance parameters are not different from a normal distribution, is accepted and it is concluded that the data are normally distributed and have fulfilled the requirement of parametric test.

Table 2: Result of Normality Test

Parameters	Period	Test of normality	
		Kolmogorov-Smirnov	**p value**
CIR	Pre -Basel II	0.309	0.042
	Post -Basel II	0.187	0.200*
ROE	Pre -Basel II	0139	0.200*
	Post -Basel II	0.150	0.200*
OPTA	Pre -Basel II	0.206	0.200*
	Post -Basel II	0.214	0.200*
CDR	Pre -Basel II	0.300	0.056
	Post -Basel II	0.191	0.200*

Note: * indicates significant at 5 % level
Source: Computed

Since the data are normally distributed as evident from the result of normality test, the parametric test i.e. Independent sample T-test is employed in order to test the null hypothesis of not significant difference between mean performances of ICICI in respect of selected parameters in view of Basel II norms. Table 3 provides the comparative performance of ICICI in respect of selected parameters for the pre and post Basel period. The Independent sample T-test evaluates the difference of means of the respective parameters between pre and post Basel II period. It is found that the p values of CIR, CDR, and ROE are greater than 0.05. Thus the null hypothesis is accepted and it is concluded that there is a minor change in the mean values of these parameters during the post Basel II period. In other words, it can be stated that the performance of the bank with regard to cost efficiency, return to shareholders and asset quality is not significantly different between the two periods. On the other hand, a major increment is observed in the mean value of OPTA after the implementation of Basel II norms, as its p value is less than 0.05.

This result has confirmed the rejection of null hypothesis and hence, it is concluded that there is an improvement in respect of earning operating profit relative to total assets during the Basel II period.

Table 3: Comparative Performance of ICICI between Pre and Post Basel II period

Parameters	**Period**	**Descriptive statistics**		**Independent Samples Test**		
		Mean	**S.D.**	**t value**	**p value**	**Remarks**
CIR	Pre -Basel II	42.57	3.552	2.140	0.054	> 0.05, No Significant difference
	Post-Basel II	38.86	2.911			
ROE	Pre -Basel II	14.87	4.521	1.642	0.127	> 0.05, No Significant difference
	Post-Basel II	11.70	2.380			
OPTA	Pre -Basel II	2.109	0.199	-3.691	0.006	< 0.05 Significant difference
	Post-Basel II	2.780	0.438			
CDR	Pre -Basel II	94.163	8.560	-1.384	0.192	> 0.05, No Significant difference
	Post-Basel II	99.517	5.610			

Source: Computed

Conclusion

The above said results of the study conclude that after Basel II implementation, ICICI Bank's performance has improved in case of OPTA. This shows a considerable enrichment in this ratio. But no significance change was found in case of CIR, ROE and CDR. There is a possibility that after implementation of Basel III, the bank performance will improve if banks' risks are reviewed appropriately.

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Appendix I: Pre & Post Basel II Description of Key Ratios of ICICI

Parameters	Pre- Basel II							Post- Basel II						
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
CIR	49.88	42.85	42.2	39.9	40.2	40.4	43.4	37	41.9	42.9	40.5	38.2	36.8	34.7
ROE	17.38	20.93	18.86	14.33	13.17	11.63	7.80	7.96	9.65	11.20	13.10	14.02	14.55	11.43
OPTA	2.44	2.04	2.02	1.86	1.97	2.14	2.29	2.62	2.35	2.32	2.57	2.93	3.18	3.49
CDR	110.61	91.17	91.57	88.54	84.97	92.30	99.98	89.70	95.91	99.31	99.19	102.05	107.18	103.28

Source: Compiled from various issues of RBI's Annual Publications

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