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Are Public Sector Banks Deploying HR Cost Profitably? Overview of Decade Ending 2013-14

C. M. A. Rupali S. Gupte[1*] and S. U. Gawade[2]

[1]Research Scholar, Savitribai Phule Pune University, Pune, India; rupaligupte@hotmail.com
[2]Ex-Research Head, Sinhagad Institute of Management, Pune, India; sugawade@yahoo.co.in

Abstract

With the advent of Basel III and other global and internal challenges, Indian banks have to address several issues simultaneously. Capital shoring up, financial inclusion requirements, risk mitigation and NPA issues are some of them. The common underlying factor among all of these is achieving, maintaining, protecting and growing profitability. To ensure sustainable advantage in all areas, it is essential that banks make all efforts to use every resource at their disposal towards this purpose. Huma resource has always been a key factor in success and profitability of banks. It also represents a major part of operating cost. Profitable deployment of HR cost will ensure both operating and financial advantage. Public sector banks in India have faced several challenges with respect to HR cost. The demand for competitive salaries and growth of business has led to substantial rise in HR costs of public sector banks in recent years. However there is a need to see if the costs are being deployed profitably. Profitable deployment of any cost indicates more efficiency in use of resources and hence a move towards better profitability. With the help of the HCROI ratio and statistical techniques, the study tries to find out if they have moved towards more profitable deployment of HR cost in the decade ending 2013-14.

Keywords: Bank Profitability, HCROI, HR Cost, Student's t-test

1. Introduction

Banking represents a major part of economy and service sector of any country. A healthy and competitive banking sector is needed in economy to pool savings, provide liquidity and also avenues for investments[1]. Modern banking has extended in scope much beyond the traditional functions. It not only caters to specialized financial products, but also offers services in other financial activities like insurance, stockbroking, asset management and forex management as well as non-financial activities like real estate[5].

Banking sector, world-wide is facing several challenges due to disproportionate economic growth rates of nations, strongly interlinked economies, socio-political and environmental issues and rising threats of contagion. Indian banking sector has its own challenges along with the global issues. The necessity of increased financial inclusion is acknowledged and accepted by banks; however the looming threat of NPAS fuelled by disappointing growth trends of infrastructure sector and unstable agricultural economy is taking a toll of profitability of banks and eroding their capital base. Further, there are also the capital requirements and risk mitigation requirements under Basel III norms to be fulfilled by 2019.

In this situation, banks are facing an unprecedented pressure for evaluation, improvement and sustainment of performance. The scheduled commercial banks in India consist of Public sector banks, Private sector banks and Foreign banks. A Profitable banking sector is essential for the stability of the financial system[6]. However, today the banks are concerned with not only the overall profitability but also the profitability of each section, element and resource individually as well as conjoined.

** Author for correspondence*

Human resource is a key factor for any industry, but more so for service sector. In a key sector like banking, it can make a difference between success and failure. Along with the quality and efficiency implications, the cost implications of HR are also important. It contributes directly towards business and profitability growth. At the same time employee payments and provisions can form as high as 25 to 30% of total expenses of a bank. In order to ensure sustainable competitive advantage and to ensure better profitability, banks have to make sure that the cost of HR is spent as much effectively as possible. The study looks at the HR cost data of the decade ending 2013-14 to find out if there has been an improvement in the profitability of HR cost deployment of the banks. A decade is chosen in order to get a more detailed picture. The timespan is distinctly separated for further analysis by the subprime crisis, which has changed the working and efficiency of banking system as a whole. Section 2 consists of the conceptual framework found through literature review, Section 3 and 4 consist of Data & Methodology and Analysis respectively, followed by Observations and conclusion in Section 5 and End note in Section 6.

2. Literature Review

In research carried out with respect to European banks, Staikouras & Wood[11] observe that due to size differences, different banks also have different composition of salaries and wages. However, for all banks HR forms a key factor for success. The quantum and use of labour cost has both direct and indirect impact on profitability.

The annual survey by FICCI (2010) finds out that banks are increasingly beginning to recognize Human resources as a possible area of core competence, and seek to pursue and retain the best talent in the industry.

However the quantum and effectiveness of HR cost and the role of HR in public sector banks has always been a controversial area. Shirai[10] has noted strong trade unionism as a major reason for public sector banks' inability to reduce operating costs and hence improve profitability. In another survey by FICCI and BCG, Shah, et al.[9] find that public sector banks, entering in the decade of 2010 face a distinct disadvantage with respect to HR due to policies of past several decades. The salaries of employees of public sector banks are favourable as compared to private sector employees at entry level, but the picture reverses as they climb up in hierarchy (NDTV, 2015). This creates disparity in cost of HR and expected efficiency. The Report by Committee on HR issues in banking[2] also states improving as a major issue.

It is therefore necessary to have an accurate measurement of how effectively the HR cost is deployed by the banks. Various measures of HR profitability have been used by various researchers in studies related to HR efficiency and productivity as well as profitability. The most common among them are business per employee, profit per employee, HR cost per employee, employee cost to operating expenses, employee cost to total business, employee cost to total assets, staff cost as percentage to net income etc.[3, 7, 8]. While these measures are effective, they provide information about effectiveness of HR cost only subject to other factors like business growth and efficiency of other resources.

However, in order to understand profitability of HR cost deployment, the metric of HCROI (Human Capital Return-on-Investment) is used, which according to Fitz-Enz[4] is the ROI in terms of profits for monies spent on the employee pay and benefits. Viljoen[13] has also found it to be a measure adequately expressing the bottom line impact of human capital expenditure. The main advantage of the HCROI metric is that, it considers all revenue items and all other costs, including interest, as against HR cost. As a result it can be considered as an indication of both profitability per rupee of HR cost and overall efficiency of HR.

3. Data and Methodology

The study is carried out with respect to 26 public sector banks for the period ranging from 2004-05 to 2013-14. It gives us a wide span of 10 years. There are six banks from the SBI group and 19 from Other Public sector banks. Bank of Indore is omitted as it was merged with SBI in 2010. All the data is sourced from the official annual statistical publications of RBI.

The basic overview of banking sector reveals that during this period, the total banking business transacted by the selected banks increased by more than 400% over the decade. However the number of employees increased by only 10%. This fact is supported by the CAGR data of number of employees. Most banks have a very low to even negative CAGR of employee growth. The HR cost % on total cost has declined from 24% to 14% during the decade.

The significant ratios calculated for the purpose of evaluating efficiency and profitability of HR are:

Table 1. Summary statistics (2004-05 to 2013-14) (Rs.in Millions)

No.	Names Of Banks	Ratio	Min(Rs.)	Max(Rs.)	Avg(Rs.)	CAGR%
1	State Bank of India	BPE	354.63	1,586.35	944.07	18.11%
		CPE	13.90	53.79	31.01	16.23%
		PPE	5.35	14.65	9.57	11.34%
2	State Bank of Bikaner & Jaipur	BPE	290.42	1,296.02	777.56	18.08%
		CPE	12.33	57.29	31.79	18.61%
		PPE	3.98	13.21	8.47	9.12%
3	State Bank of Hyderabad	BPE	424.43	6,666.53	1,570.08	15.71%
		CPE	15.51	71.10	40.42	18.43%
		PPE	5.44	17.64	11.46	12.94%
4	State Bank of Mysore	BPE	283.81	1,288.23	783.34	18.30%
		CPE	11.52	53.14	30.70	18.51%
		PPE	4.49	12.27	8.12	9.63%
5	State Bank of Patiala	BPE	401.67	1,358.80	1,008.05	14.50%
		CPE	14.11	66.35	40.53	18.77%
		PPE	6.45	14.01	9.41	3.51%
6	State Bank of Travancore	BPE	400.35	1,499.42	878.29	15.80%
		CPE	13.65	73.36	36.09	20.54%
		PPE	5.79	10.94	8.27	5.45%
7	Allahabad Bank	BPE	397.03	1,783.07	1,047.05	18.16%
		CPE	15.29	74.89	38.85	19.31%
		PPE	4.94	17.82	10.74	15.33%
8	Andhra Bank	BPE	458.10	1,755.51	1,069.46	16.10%
		CPE	15.58	77.89	40.30	19.58%
		PPE	5.01	18.64	11.66	9.19%
9	Bank of Baroda	BPE	408.42	2,843.59	1,366.50	24.06%
		CPE	13.75	79.13	40.33	21.47%
		PPE	4.95	21.55	12.92	15.65%
10	Bank of India	BPE	507.16	2,610.39	1,348.92	19.97%
		CPE	13.56	80.15	40.34	21.82%
		PPE	3.46	19.98	11.48	21.52%
11	Bank of Maharashtra	BPE	355.48	1,694.88	854.65	18.95%
		CPE	15.38	79.62	35.51	19.84%
		PPE	2.60	14.93	7.44	16.02%
12	Canara Bank	BPE	453.32	2,213.11	1,195.33	19.26%
		CPE	13.78	85.93	41.53	22.55%
		PPE	5.44	15.92	10.05	12.64%
13	Central Bank of India	BPE	261.56	1,363.23	774.45	20.13%
		CPE	11.77	62.27	32.46	20.31%
		PPE	2.98	8.72	5.61	8.46%
14	Corporation Bank	BPE	580.32	2,651.67	1,440.66	18.39%
		CPE	17.52	111.82	51.94	22.87%
		PPE	8.42	20.68	14.62	8.23%
15	Dena bank	BPE	378.33	2,193.35	1,072.51	21.56%
		CPE	15.74	82.22	38.62	19.77%
		PPE	3.75	15.99	9.48	17.50%
16	IDBI Bank	BPE	2,661.50	4,019.80	3,347.75	4.69%
		CPE	64.50	154.51	116.99	10.19%
		PPE	7.97	36.74	21.60	18.51%

17	Indian Bank	BPE	273.80	1,747.30	885.52	22.87%
		CPE	11.51	73.01	35.26	22.79%
		PPE	4.18	18.51	11.43	14.84%
18	Indian Overseas Bank	BPE	342.27	1,676.54	943.47	19.31%
		CPE	13.35	73.75	38.16	20.91%
		PPE	5.57	14.13	9.42	9.70%
19	Oriental bank of commerce	BPE	575.00	2,127.12	1,374.70	15.64%
		CPE	19.53	88.97	53.31	18.35%
		PPE	7.97	22.00	13.77	11.19%
20	Punjab & Sind Bank	BPE	234.19	1,781.30	931.47	25.29%
		CPE	12.07	89.06	43.44	23.90%
		PPE	2.68	12.50	7.74	14.95%
21	Punjab National Bank	BPE	354.17	1,726.61	970.20	19.25%
		CPE	13.25	61.83	33.48	18.66%
		PPE	4.12	19.33	11.72	18.73%
22	Syndicate Bank	BPE	440.81	1,813.19	1,025.14	17.02%
		CPE	13.40	61.57	34.91	18.46%
		PPE	4.09	13.39	8.20	14.03%
23	UCO Bank	BPE	360.99	1,756.51	988.40	19.22%
		CPE	12.98	60.60	36.22	18.68%
		PPE	3.11	20.49	8.47	22.20%
24	Union Bank of India	BPE	551.04	2,355.97	1,360.94	17.04%
		CPE	16.23	84.76	42.10	20.16%
		PPE	5.43	17.04	11.69	11.55%
25	United Bank of India	BPE	223.46	1,209.29	710.39	20.64%
		CPE	10.99	62.95	31.35	21.41%
		PPE	2.92	13.32	7.26	14.49%
26	Vijaya Bank	BPE	433.14	1,737.41	989.95	16.69%
		CPE	14.34	81.84	42.82	21.35%
		PPE	5.78	10.39	7.87	2.59%

Source: Annual Statistical Tables of RBI

* BPE - Business Per Employee
**CPE - Cost Per Employee
***PPE- Profit Per Employee

- Business per employee (Deposits+ Advances+ Off balance sheet activities/No. of employees)
- Cost per employee (Total expenses/No. of employees)
- Profit per employee (Operating Profit/ No. of employees)

Note: Operating profit is taken instead of PAT as it is a more significant item in relation to operations.

To understand whether this decrease in HR cost has affected profitability of deployment of HR, a more effective measure of Human Capital Return On Investment (HCROI) is therefore used. It is calculated as follows using the Fitz-Enz formula

$$HCROI = \frac{\text{Revenue - (Expenses - HR Cost)}}{\text{HR Cost}}$$

It can be seen that there are mixed results regarding HCROI. Almost equal numbers of banks show both decline and rise in HCROI from beginning to the end of the period. In order to understand the overall performance of the ratio better, the period is divided in two time spans, pre and post the sub-prime crisis. Means are found out for both the periods. As the metric in question is a ratio, Geometric mean is found out to be suitable.

The means are then subjected to Student's t-test for equality of means (One tailed). The study aims to find out whether or not the HR cost is being deployed more profitably over the period. As 19 out of 26 banks show higher GM of HCROI in the later period, it is expected that over the decade the HR cost is being deployed more profitably leading to better which should lead to average of HCROI being higher in the second part of the period. Therefore, the Null Hypothesis of the study is

Table 2. Human capital return on investment

No.	Names	04_05	05_06	06_07	07_08	08_09	09_10	10_11	11_12	12_13	13_14	GM 04-05 To 08-09	GM 09-10 To 13-14
1	SBI	259%	239%	226%	268%	284%	244%	267%	286%	269%	243%	**254%**	**261%**
2	SBBJ	276%	197%	242%	248%	294%	280%	238%	282%	273%	231%	**249%**	**260%**
3	SBH	280%	239%	304%	311%	336%	386%	323%	330%	297%	277%	**292%**	**321%**
4	SBM	237%	248%	248%	268%	270%	324%	314%	271%	308%	249%	**254%**	**292%**
5	SBP	390%	297%	297%	303%	317%	361%	300%	311%	249%	212%	**319%**	**282%**
6	SBT	338%	266%	273%	271%	317%	258%	268%	259%	253%	214%	**292%**	**250%**
7	ALLB	237%	250%	277%	314%	318%	352%	296%	306%	270%	279%	**277%**	**299%**
8	ANDB	284%	243%	270%	307%	306%	320%	319%	345%	315%	300%	**281%**	**319%**
9	BOB	267%	226%	247%	254%	283%	310%	339%	387%	361%	324%	**255%**	**343%**
10	BOI	216%	228%	248%	323%	382%	305%	255%	318%	338%	311%	**273%**	**304%**
11	BOM	206%	186%	232%	239%	237%	224%	174%	236%	281%	226%	**219%**	**226%**
12	CAN	287%	268%	281%	278%	311%	331%	306%	300%	281%	285%	**285%**	**300%**
13	CEN	226%	194%	208%	204%	213%	233%	187%	212%	210%	192%	**209%**	**206%**
14	CORP	428%	362%	401%	392%	441%	438%	385%	413%	407%	355%	**404%**	**399%**
15	DEN	191%	269%	265%	285%	255%	264%	278%	314%	320%	277%	**251%**	**290%**
16	IDBI	329%	351%	420%	440%	342%	460%	505%	449%	455%	481%	**374%**	**470%**
17	IND	250%	216%	255%	272%	278%	327%	347%	333%	255%	251%	**253%**	**300%**
18	IND OS	277%	251%	268%	311%	298%	206%	264%	270%	270%	269%	**280%**	**255%**
19	ORI	411%	338%	349%	322%	317%	349%	409%	331%	334%	348%	**346%**	**353%**
20	P & S	156%	174%	225%	229%	237%	266%	234%	191%	221%	194%	**202%**	**220%**
21	PNB	199%	238%	254%	263%	295%	335%	303%	325%	292%	275%	**248%**	**305%**
22	SYN	206%	197%	255%	258%	249%	240%	255%	277%	258%	260%	**232%**	**258%**
23	UCO	198%	187%	213%	207%	220%	261%	282%	303%	341%	419%	**205%**	**317%**
24	UNI	295%	269%	329%	405%	368%	370%	266%	312%	303%	258%	**330%**	**299%**
25	UNIT	239%	202%	229%	173%	203%	232%	285%	305%	320%	303%	**208%**	**287%**
26	VIJ	351%	267%	277%	263%	250%	250%	204%	266%	232%	206%	**280%**	**230%**

H0 : The Average HCROI of the second part of the decade is more than the Average HCROI of the first part of the decade.

Therefore, the Alternative hypothesis is - *H1: There is no significant difference in the Average HCROI of both parts of the decade.*

As a result the t-test null hypothesis; H_a0 = There is no significant difference between the group of means of the two period

The alternate hypothesis is H_a1= The group of means of the first part of the decade are significantly lesser than the group of means of the second part. The rejection of test null hypothesis will indicate acceptance of the ultimate hypothesis

4. Analysis

The Business per Employee and Cost per employee for all banks shows a high CAGR. However this does not necessarily mean that HR cost is being deployed more profitably over the period. The high CAGR can be due to the disproportionate increase in the total value of business as compared to the number of employees over the period.

Inspite of high CAGR of CPE in case of all banks, the positive profit per employee CAGR shows that the available human resource and the spending there on are able to sustain the business growth and ensure profit improvement. However, this does not tell us about the overall period and whether the HC cost deployment has become more profitable over the period

Table 3. T values

t (Observed value)	-1.484
t (Critical value)	-1.675
p-value (Left-tailed)	0.072

The HCROI of banks present a mixed picture. As a result the t-test is carried out to differentiate between the ratios between two time spans. The results are as follows (Table 3: at 5% Confidence level)

As the computed p-value is greater than the significance level alpha=0.05, one cannot reject the null hypothesis H_a0. Which implies the rejection of the ultimate hypothesis of the study.

5. Conclusion

- The Business growth of Public sector banks for the decade ending 2013-14 is not matched by the growth in employee numbers. Even though the total costs have shown sufficient growth, the HR cost growth does not form a major part of the overall cost growth. In fact, the ratio of HR cost to total cost shows a decrease from 24% to 14% over the decade.
- All the ratios for evaluating the performance pf employees in terms of business and profit show a rising trend and positive growth rates, but they may not give the real picture as the growth in employee numbers is lesser than the business and profit growth.
- HCROI is a better metric as it considers the profitability net of all other costs except for the HR costs and hence removes the impact of revenue and cost growth due to unrelated factors simultaneously.
- HCROI of all banks gives mixed results. However, when the average HCROI of earlier and later part f the decade are compared, they do not show a significant difference. This clearly indicates that inspite of per employee business and profit showing favourable results, the Public sector banks have not improved in profitability of deployment of their HR cost.

6. Endnote

Public Sector banks have not shown marked improvement in the deployment of HR cost. There has been remarkable shortage in terms of employee growth too. Some needs of business growth and efficiency can be catered by technology based assets and systems. But nothing can replace the HR asset in banking sector. It is absolutely vital for these banks to pay serious attention to fulfilling the gaps in HR availability. The need of skilled HR is going to escalate in future with employee intensive activities like increasing the extent of financial inclusion and recovery and control of stressed assets. With additional HR availability, the HR cost by way of remuneration and other provisions is bound to increase. But the resultant increase in productivity is most likely to compensate for the same, and may ultimately lead to an improved HCROI and therefore better and more profitable deployment of HR cost.

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