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A STUDY ON IMPACT OF OPERATING EXPENSES ON PROFITABILITY OF COMMERCIAL BANKS

D. Premaselvaraji* & Dr. A. L. Kamalavalli**

* Assistant Professor of Commerce, Sree Saraswathi Thyagaraja College, Pollachi, Coimbatore, Tamilnadu

** Associate Professor in Commerce, N.G.M College, Pollachi, Coimbatore, Tamilnadu

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Abstract:

The banking industry is one of the significant sectors of the financial system in most countries. Banks play a crucial role in promoting the growth of the economy by mobilising savings and using the mobilised savings in financing the most productive sectors of the economy. Profitability refers to money that a bank can produce with the resources it has. The goal of the most organisation is profit maximisation. Factors that influence commercial bank's profitability are divided into internal and external. Internal factors are those factors which bank's managers can control whereas external factors are those outside or beyond bank's management control. The main objective of the study is to study the impact of operating expenses towards profitability of banks and to analyse their relationship through dependent and independent variables. For this purpose a sample of 3 banks was used for the study, five years data were collected from the balance sheet of the banks and were analyzed using correlation and multiple regressions. It is concluded that operating expenses of the selected banks have a minimal impact on the Return on Investment.

Key Words: Profitability, Return on Investment, Operation Expenses & Investment

Introduction:

An operating expense is an expense a Bank incurs through its normal business operations. Often abbreviated as OPEX, and it includes rent and Taxes, Printing and Stationery, Advertisement, Director Fees, Auditors fees, Law Charges, Postage and Telegram, Repairs and maintenances, Insurance, Provision for Employees toward research and development. One of the typical responsibilities that management must contend with it is to determine how operating expenses can be reduced to lower level without significantly affecting a firm's ability to compete with its competitors.

Review of Literature:

Bryan et al. (2015) in their study "Impact of Internal Factors in Measuring Profitability of Local and Foreign Banks: Evidence From 16 Malaysia Commercial Banks". Reveals that the cost efficiency is the most influencing factor towards the bank profitability in Malaysia commercial Banks.

Badola and Richa (2006) made a study entitled "Determinants of profitability of banks in India." based on secondary data and the period of study was from 1991-2004. For Analysis, a Stepwise multivariate regression model is used. The study has brought out that the variables on non-interest income, operating expense, provision and contingencies and spread had a significant relationship with net profit.

Sarah and Richard (2013) in their study entitled "Islamic banks and profitability: an empirical analysis of Indonesian banking", covers a period from 2006-2012. Sampling size is on 54 banks. The study revealed that there are no significant differences in the profitability of Islamic and commercial Banks.

Gupta and Sikarwar (2013) in their study on "A comparative study of profitability management of Punjab national bank of India and HDFC bank ltd." employed standard deviation and coefficient of variation. For the analysis primary parameter of the study is interest income, and interest paid, other income and operating expenses of the banks. HDFC Bank has performed much better than Punjab National Bank.

Research Methodology:

Operating Expenses are taken as Independent variables. They are Rent and taxes, Printing, Advertisement, Directors fees, auditor's fees, Law charges, Postage & telegram, repairs & maintenance, insurance and payment provision for the employee. Return on Investment is considered as a measure of profitability. It is taken as dependent varaiable. To assess the relationship betweenoperating expenses and Return on investement correlation analysis is employed. To findout the impact of operating expenses on ROI multiple regression analysis is used. The main objective of this study is to assess the impact of operating expenses on profitability of banks.

Correlation Analysis:

To find out the relationship between dependent and independent variable Karl Pearson's correlation is employed.

Table 1.1: Allahabad Bank

Relationship between Operating Expenses and Return on Investment

Independent Variable	Correlation coefficient (r)
Rent and Taxes	.965**

Advertisement	-0.44
Directors Fees	-0.778
Postage and telegram	-.892*
Repairs and maintenance	.952*
Insurance	.910*
Payment provision for employee	-0.874
**. significant at 0.01 level	
*. significant at 0.05 level	

Table 1.1 reveals Rent and taxes, Repairs and maintenance and Insurance expenses exhibits a high positive correlation with Return on investment indicating increase, in these three variables increases the ROI, whereas Advertisement, Directors fees, Postage and telegram, Payment provision for employees shows a negative correlation implying an increase in these variables decrease the ROI.

Table 1.2: Bank of Baroda

Relationship between Operating Expenses and Return on Investment

Independent Variable	**Correlation coefficient (r)**
Rent and Taxes	.926*
Printing and Stationery	.944*
Advertisement	-0.62
Directors Fees	-0.495
Law charges	.959**
Postage and telegram	.913*
Repairs and maintenance	.920*
Insurance	-0.837
Payment provision for employee	-0.842
*. significant at 0.05 level	
**. significant at 0.01 level	

From Table 1.2, it is evident that Rent and taxes, Printing and stationery, Law charges, Postage and Telegram, Repairs and Maintenance exhibit the significant high positive correlation with Return on investment indicating increase in these five variables increases the ROI, whereas Advertisement, Director Fees, Insurance and Payment provision for employees exhibit a negative correlation implying that an increase in these variables decreases the ROI.

Table 1.3: Bank of India

Relationship between Operating Expenses and Return on Investment

Independent Variable	**Correlation coefficient (r)**
Rent and Taxes	0.827
Printing and Stationery	-0.765
Advertisement	-0.643
Directors fees	.923*
Law charges	-0.626
Postage and telegram	-0.706
Repairs and maintenance	0.809
Insurance	-0.743
Payment provision for employee	-0.263
*. significant at 0.05 level	
**. significant at 0.01 level	

From Table 1.3, It is known that Rent and taxes, Directors Fees, Repairs and Maintenance shows a high positive correlation with Return on investment indicating increase in these three variables increases the ROI, whereas Advertisement, Law Charges, Postage and Telegram, Insurance, Payment Provision for Employees exhibits a negative correlation indicating increase in these variables decreases the ROI.

Regression Analysis:

To assess the impact of operating expenses on ROI multiple regression models is used which is given below

$Y=a+b_1x_1+b_2x_2+b_3x_3+b_4x_4+b_5x_5+b_6x_6+b_7x_7+b_8x_8+b_9x_9+u$

Y=ROI (Return on Investment),

b_1 to $b_{9=}$ Regression co efficient for the respective variables,

a =Constant

x_1= Rent and Taxes

x_2=Printing and Stationery
x_3= Advertisement
x_4=Directors Fees
x_5= Law Charges
x_6=Postage and Telegram
x_7=Repairs and Maintenance
x_8= Insurance
x_9= Payment Provision for Employee

Table 2.1: Allahabad Bank

Impact of Operating Expenses and Return on Investment

Variable	Regression coefficient
Advertisement	0.002
Directors fees	0.001
Law charges	0.008
Payment provision for employee	0

R^2 = 0.893

Table 2.1 shows that increase in Law charges by one unit increases the ROI by .008. A unit increase in Advertisement will increase ROI to the extent of 0.002. From R Square value, it is evident that change in ROI to the extent of 8.93% is due to selected independent variables.

Table 2.2: Bank of Baroda

Impact of Operating Expenses and Return on Investment

Variable	Regression coefficient
Advertisement	0.004
Directors Fees	-0.13
Insurance	0
Payment provision for employee	0

R^2 = 0.925

From the above Table No.2.2. It is evident that increase in Advertisement by one unit increases the ROI by .004 times. A unit increase of Directors Fees reduces ROI to the extent of 0.130. From R Square value, it is evident that a change in ROI to the extent of 9.25% is due to selected independent variables.

Table 2.3: Bank of India

Impact of Operating Expenses and Return on Investment

Regression Value of Significance	Regression coefficient
Directors Fees	-0.379
Postage and telegram	0
Repairs and maintenance	0
Payment provision for employee	1.69E-05

R^2 =0.793

From Table No.2.3, it is apparent that a unit increase in Directors Fees reduces ROI to the extent of .379 times. R square value indicates that a change in ROI to the extent of 7.93 is due to selected Independent variables.

Findings:

There is a Positives correlation between Return on investment and Rent and Taxes, Repairs and Maintenance and Insurance of the Allahabad Bank.

In Bank of Baroda, there is a Positive correlation of ROI with Rent and Taxes, Printing and Stationery, Law Charges, Postage and Telegram and Repairs and Maintenance of the bank.

There is a significant correlation between Return on investment with Rent and Taxes, Directors Fees and Repairs and Maintenance of the Bank of India.

Multiple Regression Analysis of Allahabad bank shows that profitability changes to the extent of R Square value 0.893 are due to the advertisement, Directors fees and Law charges.

In Bank of Baroda that profitability changes to the extent of R Square value 0.925 are due to Advertisements.

Multiple Regression Analysis of Bank of India that profitability changes to the extent of R Square value 0.793 are due to payment provision to the employee.

Suggestions:

Operating expenses does not affect profitability to a large extent. On an average over 8.7 per cent of changes in the profitability of Allahabad Bank, Bank of Baroda and Bank of India are due to operating expenditure. Remaining 92.3 percent of changes in the ROI due to other internal factors and external factors. Hence these three Banks many concentrate on other factors to increase their Return on Investment.

Conclusion:

It is concluded that Operating expenses of the selected banks have a minimal impact on the Return on Investment.

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