

## **Income-Generating Efficiency of Public Sector Banks in India: An Application of Data Envelopment Analysis**

**Sunil Kumar, Rachita Gulati**

*This paper accomplishes the task of examining the inter-bank differentials in income-generating efficiency across 28 Public Sector Banks (PSBs) operating in India during the financial year 2006-2007. The technique of Data Envelopment Analysis (DEA) has been used to compute the efficiency scores for individual PSBs. The empirical findings reveal that PSBs are generating net-interest and non-interest incomes with high level of efficiency which is reflected by the mean efficiency score of 0.918. The study suggests that for improving their performance, the inefficient PSBs should concentrate more on generating non-interest income from the off-balance sheet activities (i.e., non-traditional activities) rather than interest income from the traditional activities like advancing loans and investments in other earning assets.*

### **I Introduction**

Studies on the efficiency of the financial institutions and, in particular, of the banks have gained tremendous popularity in recent years. In an economy, banks normally serve as a main channel for financial intermediation and play a major role in the payment system of the country that allows financial and real resources to flow freely to their highest-returns uses (Chen and Yeh 1999). The solvency of banks and the strength and soundness of the banking system is germane to the performance of the entire economy. In fact, there is a strong causal relationship between the development of banking activities and the rate of growth of economy. Without a sound and efficiently functioning banking system, the economy cannot function efficiently. When banking system fails, the whole of a nation's payments system is in jeopardy. Therefore, banking regulators and supervisors place a lot of emphasis on the banking efficiency. An assessment of the efficiency of banks and monitoring of their financial positions is of critical importance to policy makers, bank managers, and investors as the efficiency scores are informative signals of management quality (Barr *et al.*, 1994, Wheelock and Wilson 1995).

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Sunil Kumar, Reader in Economics, Punjab School of Economics, Guru Nanak Dev University, Amritsar 143005, Punjab, India, email: sunil12eco@yahoo.com

Rachita Gulati, Junior Research Fellow (JRF), Punjab School of Economics, Guru Nanak Dev University, Amritsar 143005, Punjab, India, email: rachita1302@yahoo.co.in

We would like to thank anonymous reviewers and the editor of this journal for providing useful comments and suggestions which have resulted in significant improvements in the quality of the paper. Errors remain unerringly our own.