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USING PIOTROSKI F-SCORE FOR ASSESSING FINANCIAL HEALTH: EVIDENCE FROM LEADING INDIAN PRIVATE BANKS

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ABSTRACT:

This research investigates the efficacy of Piotroski F-score to screen firms with good financial health and to identify early signs of financial distress in Indian banking stocks. This study complements existing empirical evidence which indicate that the venerable model can provide valuable insight for investment decision making and risk management.

The evidence is drawn from valuation signals across leading private banks in India for a period ranging from 2014-2020. Piotroski F-score evaluates companies with a discrete number between zero and nine, the score facilitates determination of financial strength of the company. Higher score indicates better financial health and vice versa. The F-score is calculated as a sum of criteria which evaluates profitability signals, leverage and liquidity, sources of funds and operating efficiencies. In this study, each of these ratios have been analyzed to gain valuable insight on the banks (company-level). Analysis of Variance of various ratios, ascertains intensity of relationship across banks (industry-level). This can help manage exposure in the portfolio as per the economic environment. The Piotroski F-score evaluates the generic financial health of the firm and indicates the direction in which the firm is headed. By studying individual factors, relative strength can be assessed. Piotroski F-score ranged between 0-7 for all the banks under study, indicating that none of them were a 'compelling buy' (score 8 or 9) over the seven-year horizon. Some banks have consistently shown depleting F-score over at least 3 years, this can be interpreted as a signal of financial distress. It is evident that consistent monitoring of F-score empowers pro-active risk management.

This work attempts to introduce Piotroski F-score as an integral valuation metric in evaluating Indian banking stocks. F-score can be used for initial screening; it's consistent monitoring can facilitate optimized returns at risk-adjusted levels.

Keywords: Piotroski, Indian Private Banks, F-score, Valuation, Risk Management