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Comparative analysis of NPA and Stock Performance of selected Public & Private Sector banks in India

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Abstract:

One of the major concerns in India for the banking sector is non-performing assets (NPAS). Performance of the banks is generally reflected on the basis of NPAs. Higher the level of NPAs, higher is the probability of a large number of credit defaults, which in turn affects the profitability and net-worth of banks; also it corrodes the value of the asset. The liquidity and profitability is also affected by NPAs in addition to posturing threat on value of asset and existence of banks. The Indian banking sector has been fronting severe glitches of hovering non-performing assets NPAs the NPAs growth has a direct influence on profitability of banks. It encompasses the inevitability of provisions which shrinks the overall profits and shareholders value. The problem of NPAs is not only affecting the banks but the whole economy as well. In fact high level of NPAs in Indian banks is nothing but a reflection of the state of strength of the industry and the trade. It is essential to trim down NPAs to improve the economic conditions in the banking system of India. The banking sector in India is facing a stern delinquent of NPAs. The understanding of NPA and the effect of NPA on stock performance of public and private sector banks is taken into consideration of last three years i.e. 2016-2019 in this research paper. The research paper also tries to focus on the factors contributing to NPAS, causes for high NPAS, similarly their effect on Indian banking operations and the inclination and magnitude of NPAs in selected public and private sector Indian banks.

***Keywords**: Gross NPA, Net NPA, Public banks and Private Sector Banks.*

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Introduction:

The Indian banking system encompasses cooperative and commercial banks, out of which the former accounts to more than 90 per cent of banking systems assets. Besides a few foreign and Indian private banks, the commercial banks include nationalized banks where the majority equity holding is with the government. The majority equity holding being with the RBI in association with SBI, these banks along with regional rural banks constitute the public sector, state owned banking system in India has undergone a sea change after the first phase of economic liberalization in 1991 and also credit management. Asset quality was not prime concern in Indian banking sector till 1991 but was mainly focused on performance objectives such as opening wide networks/branches, developing rural areas precedence sector lending higher employment generation etc. The primary function of banks is to lend funds as loans to various sectors such as agriculture industry, personal loans, housing loans etc. but in recent times the banks have become very cautious with respect to extending loans.

The reason being mounting NPAS and which is also becoming the one of the major concerns faced by the banks across the nation. Bankers are the custodians and distributors of the liquid capital in the country. Therefore, the most important function of the banking system is to mobilize the savings of the people by accepting deposits from the public. The banker becomes the trustee of the surplus balances of the public. Deposit mobilization promotes the economic prosperity by controlling the money circulation along with channeling for development as well as productive purposes. In order to mobilize deposits the commercial banks undertake deposit mobilization through various deposit schemes suited to the different sections of the people. The securities along with other sources of resources namely borrowings, capital reserves form the sources of funds for the banks. The investment activities & lending’s of the bank are based on the sources of funds. Non-performing loans are also known as Non-performing assets. It is made by a bank or finance company on which interest payments or repayments are not being made on time. Loan can be defined as, an asset for a bank as the interest on payments and the repayment of the principal amount create a stream of cash flows. It is from the interest payments that a bank makes its profits. Assets which are not serviced for some time are usually declared as non-performing assets by the Banks after a certain period.

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- If payments are due for a short period a loan is classified as past due and, simultaneously if a payment is due (usually 90days) in that case the loan is categorized as non-performing. It is a sign of danger if non-performing assets are high as compared to similar lenders.
- It can be stated that, a loan is in arrears while principal or interest payments are due or unused.
- If the debtor is incapable to meet his commitments and similarly when a lender contemplates a loan is in default, then the loan agreement can be said as void.
- Clear observations on the levels of NPAS vis-a-vis the health of the bank in terms of both profitability as well as the performance of the scrips on stock exchanges.
- Banks capacity to lend has been severely affected because of mounting NPAS timely resolution of stressed assets has come under scrutiny with multiple cases being filed in courts. NPAS are a drag on the health of the bank and hence a clear impact is observed on how investors react to the increasing or decreasing levels of NPAS among the listed banks.
- In this context it is observed as the recent rise of NPAS in the country as a co-relation to the stock price performance of the banks owning these assets.

Literature Review:

Many published articles are available in the area of non-performing assets and a large number of researchers have studied the issue of NPA in banking industry. A review of the relevant literature has been described. Kumar 2013 in his study on a comparative study of NPA of old private sector banks and foreign banks has said that non-performing assets NPAs have become a nuisance and headache for the banking sector in the country for the past several years. One of the major issues affecting the performance of commercial banks in the late 90s was adversely affecting the accumulation of huge non-performing assets. As per Selvarajan vadivalagan, in a study on management of non-performing assets in priority annual research journal of scms pune vol. 4 march 2016 sector reference to Indian bank and public sector banks (psbs) stated, the growth of Indian banks' lending to priority sector is more than that of the public sector banks as a whole. Indian bank has slippages in controlling of NPAS in the early years of the decade. Banks are expected to have satisfactory

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precautionary trials in fixing pre- sanctioning assessment accountability and an active post-disbursement management. Banks are expected to perform and monitor loans uninterruptedly as to identify the accounts that have probable to develop into non- performing.

According to Gupta 2012, a comparative study of non-performing assets of SBI associates other public sector banks had concluded that each bank should have its own independence credit rating agency which should evaluate the financial capacity of the borrower before credit facility and credit rating agencies should regularly evaluate the financial condition of the clients. Rai 2012 stated in her study, the performance of NPAS of Indian commercial banks found out that corporate borrowers even after defaulting continuously have never had the fear of bank taking action against them to recuperate their dues. This is because there was no legal framework to safeguard the real interest of banks.

As per Chatterjee C. & Mukherjee J. and Das 2012 , in their study on management of non-performing assets a current scenario has concluded that banks should find out the original reasons/purposes of the loan required by the borrower. Proper identification of the guarantor should be checked by the bank including scrutiny of his/her wealth.

Kaur k. and Singh b. 2011 in their study on non-performing assets of public and private sector banks a comparative study studied that NPAS are considered as an important parameter to judge the performance and financial health of banks. It can be said that the level of NPAS is an essential drivers of financial stability and growth with the respect to the banking sector. Prasad G.V.B. and Veena 2011 in their study on NPAS lessening strategies for commercial banks in India stated that the NPAS do not generate interest income for banks but at the same time banks are required to provide provisions for NPAs from their current profits thus NPAs have destructive impact on the return on assets in the following ways.

Chaudhary k. and Sharma m. 2011 in their research stated that an efficient management information system should be developed. The bank staff involved in sanctioning the advances should be trained about the proper documentation and charge of securities and motivated to take measures in preventing advances turning into NPA. As per Karunakar 2008 in his study, states that, the non-performing assets are gloomy or greedy from Indian perspective has highlighted problem of losses and lower profitability of non- performing assets NPA and liability mismatch in banks and financial sector depend on how various risks are managed in their business. The lasting solution to the problem of NPAs can be achieved only with proper credit assessment and risk management mechanism. Bhatia 2007 in his research paper explores that NPAs are considered as an important parameter to judge the performance and financial

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health of banks. The level of NPAS is one of the drivers of financial stability and growth of the banking sector.

Kaur 2006 in her thesis titled credit management and problem of NPAs in public sector banks suggested that for effective handling of NPAs there is an urgent need for creating proper awareness about the adverse impact of NPAS on profitability amongst bank staff particularly the field functionaries. Bankers should have frequent interactions and meeting with the borrowers for creating better understanding and mutual trust.

Balasubramaniam C.S. 2001 highlighted the level of NPAS is high with all banks currently and the banks would be expected to bring down their NPA. This can be achieved by good credit appraisal procedures effective internal control systems along with their efforts to improve asset quality in their balance sheets. Research and time gap in literature.

Impact of NPA Level Changes:-

NPA impact the performance and profitability of banks. The most notable impact of NPA is change in banker's sentiments which may hinder credit expansion to productive purpose. Banks may incline towards more risk-free investments to avoid and reduce riskiness which is not conducive for the growth of economy. If the level of NPAs is not controlled timely they will: reduce the earning capacity of assets and badly affect the ROI. The cost of capital will rise up. The assets and liability mismatch will widen. Higher provisioning prerequisite on mounting NPAs adversely affect capital adequacy ratio and banks profitability. The economic value additions eva by banks get distraught because eva is equal to the net operating profit minus cost of capital.

NPAs causes to decrease the value of share sometimes even below their book value in the capital market. NPAS affect the risk facing ability of banks. Reducing the earning capacity of assets and badly affect the ROI. It will raise the cost of capital. The assets and liability mismatch will widen. Capital adequacy ratio and banks profitability is affected by higher provisioning requirement on mounting NPAs. Since, eva is equal to the net operating profit minus cost of capital, Economic value additions eva by banks get upset. The value of share sometimes even decreases below their book value in the capital market due to NPAs. NPAs affect the risk facing ability of banks.

1.1 Types of NPA :

1.1.1 **Gross NPA**

Gross NPA is an advance which is considered written off, for bank has made provisions, and which is still held in banks' books of account. Gross NPA (non-performing asset) refers to overall quantity of

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loans that have gone bad debts. It consists of all the nonstandard assets like as sub-standard, doubtful, and loss asset.

"Gross NPAs Ratio = Gross NPAs / Gross Advances"

1.1.2 **Net NPA**

Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs.

"Net NPAs = Gross NPAs – Provisions / Gross Advances – Provisions"

1.2 Assets Classification:

1.2.1 Standard Assets - Standard Asset means which assets are not facing the problem and not more risk towards customer. Such assets are assumed to be performing asset. A general provision of 0.25% has to be provided on global loan portfolio basis.

1.2.2 Sub-standard Assets - An asset would be classified as sub-standard if it remained NPA for a period less than or equal to 12 months. Accordingly a general provision of 10% on outstanding has to be provided on substandard assets.

1.2.3 Doubtful Assets - These are the assets which have remained NPAs for a period exceeding 12 months and which are not considered as a loss advance. As per RBI instruction banks have to facilitate 100% of unsecured amount of the outstanding loan.

1.3 Causes of NPA:

1.3.1 Lending Practices of Banks: In 2008 the financial crisis has been happened because of bad lending practices of banks. The banks should strictly follow rules and regulations while lending loans. They should properly follow the credit policy of banks.

1.3.2 Business Risk: The organization may sometimes face problems with its own operational environment which may result in losses for the company.

1.3.3 Environmental Risk: Sometimes there may be environmental problems like cyclones, drought which does not give the required output to the farmers and Agri based businesses.

1.4 Impact of NPA:

1.4.1 Liquidity :The Banks are facing the problem of NPAs. They are not recovering which lending money to borrower. Those times money will be blocked. Banks don't have enough cash in hand for short period of time.

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1.4.2 Credit loss : Banks lose their goodwill and brand equity in market when there is problem with their NPA that further affect the value of the banks in terms of market credit.

1.4.3 Profitability : NPA not only affect on current profits but also profit of entire financial year

Non-Performing Asset (NPA) refers to an asset when it does not generate any income for the bank. Bank's assets are the loans given to the customers. If customers don't pay either interest or principal the loan turns into Bad Loan or Non-Performing Assets. As per the current norm, if a loan remains overdue for a period more than 90days, it is categorized as Non-Performing Assets. Overdue is a situation where the loan is not paid by the due date fixed by the bank. Assets of the Banks are classified into four categories.

They are Standard Assets, Sub-standard Assets, Doubtful Assets and Loss Assets.

- Standard asset refers to those assets which do not carry more than normal risk attached to the banking business. These assets are considered to be Performing assets.
- Sub-standard asset refers to those assets which remain as an NPA for a period less than or equal to 12 months.
- Doubtful asset refers to those assets which remain as an NPA for a period exceeding 18 months. These assets are so weak that their liquidation is highly improbable.
- An asset that is an NPA for a period more than 36 months is called Loss Assets.

Based on RBI guidelines, banks determine the recovery of a bad debt based on the assets pledged by the borrower and provide the non-recoverable portion as provision accounting for loss in Profit and Loss Statement. If the assets quality is worse, then the provision coverage ratio will be higher.

Objectives of study:

- To examine impact of NPA level on share prices of public and private sector banks
- To compare the relative impact of NPA levels on stock prices of public with private sector banks.

Hypothesis:

1) H0: NPA levels do not have impact on stock prices of banks.

H1: NPA have an impact on the stock prices of banks.

2) H0: NPAs of private sector banks have greater impact on their stock prices as compared to stock prices of public sector banks.

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H1: NPAs of public sector banks have greater impact on their stock prices as compared to stock prices of private sector banks.

Data Collection:

- Secondary data is used for this study. Data is collected from financial statements of banks and BSE website is used for stock prices. This is study is carried out for the years 2016-17, 2017-18, 2018-19.

Research design:

Research design is defined as a framework of methods and techniques chosen by a researcher to combine various components of research in a reasonably logical manner so that the research problem is efficiently handled. Descriptive research design with convenient sampling is used for this study. In a descriptive research design, a researcher is solely interested in describing the situation or case under his/her research study. It is a theory-based research design which is created by gather, analyze and presents collected data. By implementing an in-depth research design such as this, a researcher can provide insights into the why and how of research.

Convenient sampling is used for this study. Data is collected for 5 private sector and 5 public sector banks are taken . (16^{th} may to 31^{st} May) is taken for each bank & NPA level is taken on 31^{st} March each year.

NPA performance of Private Sector Banks

Private Banks	2016-17		2017-18		2018-19	
	Net NPA (in Rs. Crores)	Average Share price	Net NPA (in Rs. Crores)	Average Share price	Net NPA (in Rs. Crores)	Average Share price
HDFC Bank	1,843.99	1587.869	2,601.02	2023.811	3,214.52	2385.931
ICICI Bank	25451	311.3462	27886	293.4461	13577	411.3346
Kotak Mahindra Bank	1,814	953.7423	1,769	1286.038	1,696	1490.769
Axis Bank	8,627	503.8115	16,592	537.8307	18,351	780.7769
Yes Bank	1,072.27	1441.6	1,312.75	340.8230	4,484.85	144.0654

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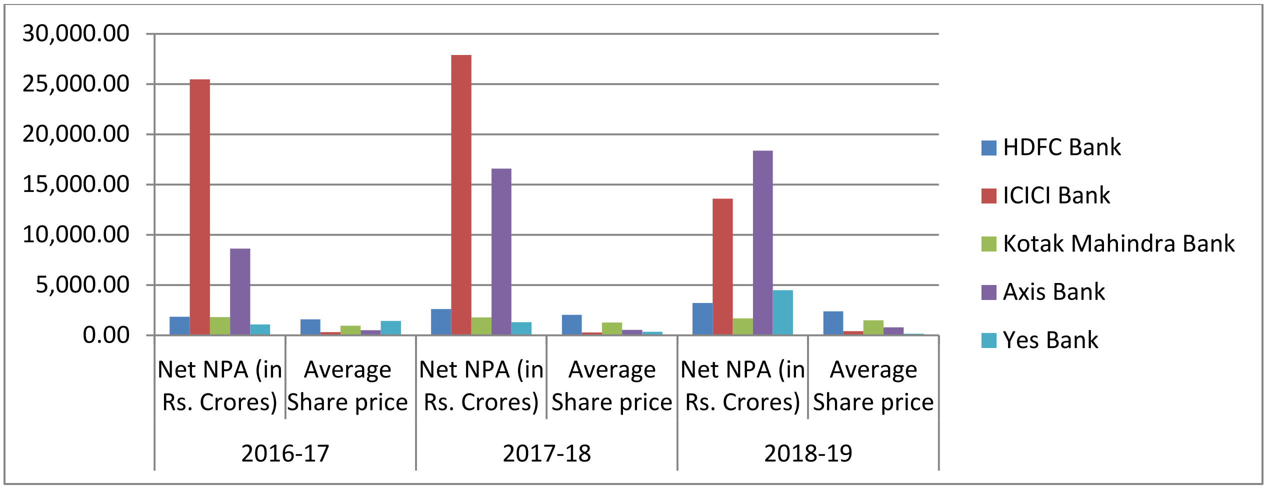
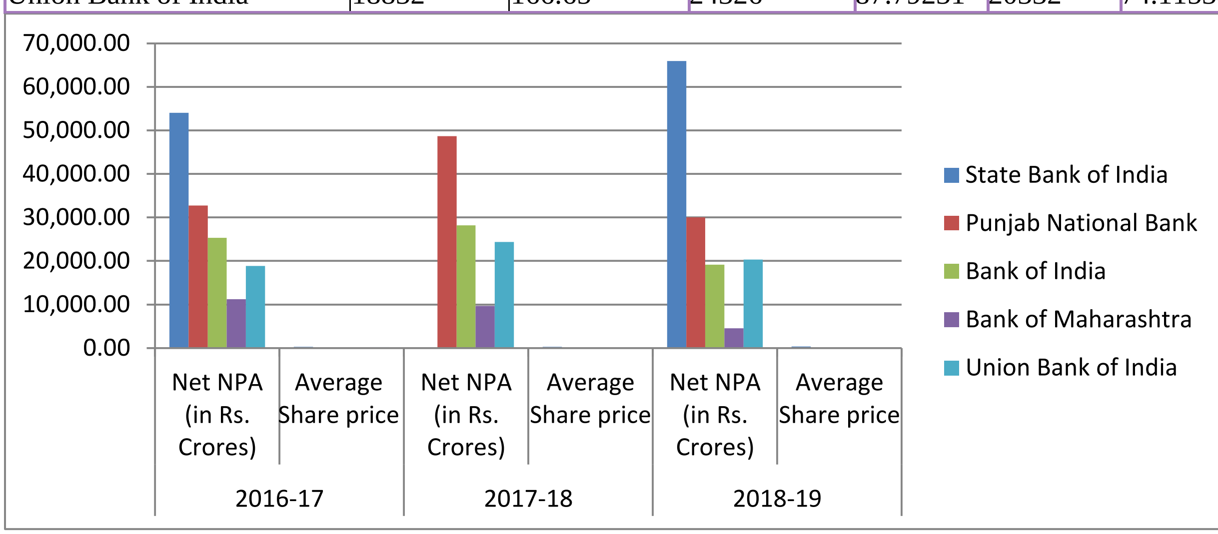


NPA performance of Public Sector Banks

Public Banks	2016-17		2017-18		2018-19	
	Net NPA (in Rs. Crores)	Average Share price	Net NPA (in Rs. Crores)	Average Share price	Net NPA (in Rs. Crores)	Average Share price
State Bank of India	54,065.61	294.8538	1,10,854.70	257.3423	65,894.74	341.7115
Punjab National Bank	32702.1	154.7846	48684.29	81.73846	30037.66	84.35
Bank of India	25305.03	160.45	28,207.27	99.13077	19,118.96	91
Bank of Maharashtra	11229.56	31.91154	9641.09	13.36077	4,559.33	15.73077
Union Bank of India	18832	166.65	24326	87.79231	20332	74.11538



Correlation of NPA & stock performance of both the banking sectors

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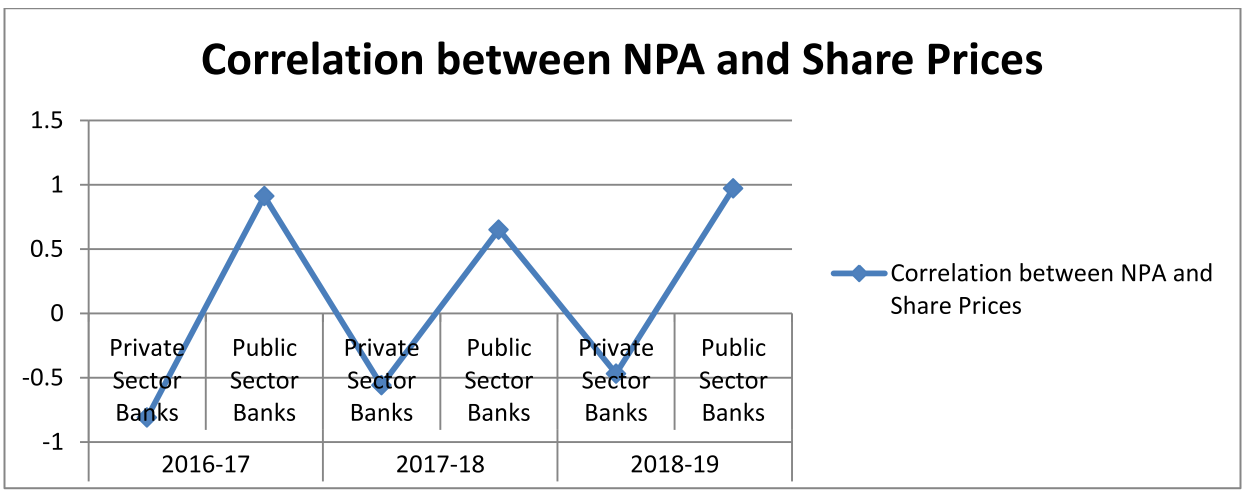
Type of Banks	Name of Bank	Correlation
Private Sector Banks	HDFC Bank	0.99
	ICICI Bank	-0.99
	Kotak Mahindra Bank	-0.96
	Axis Bank	0.72
	Yes Bank	-0.66
Public Sector Banks	State Bank of India	1
	Punjab National Bank	-0.41

Private Sector Banks	**16-17**	**17-18**	**18-19**
Correlation between NPA and Share Prices	-0.81	-0.56	-0.47
Public Sector Banks	**16-17**	**17-18**	**18-19**
Correlation between NPA and Share Prices	0.91	0.65	0.97



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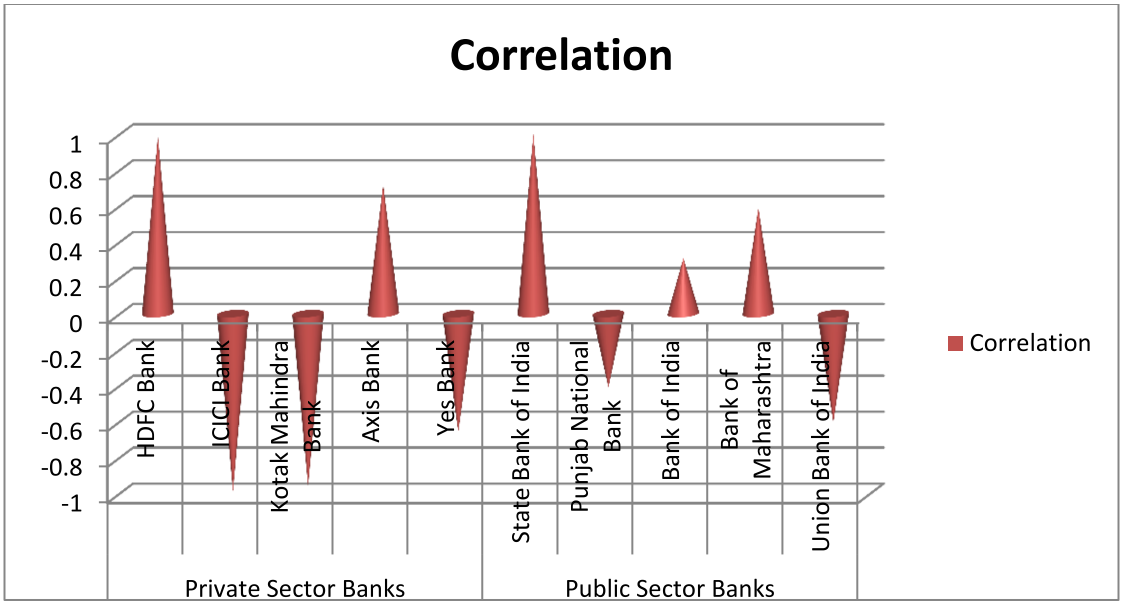
Bank of India	0.31
Bank of Maharashtra	0.59
Union Bank of India	-0.61



Findings:

- ICICI Bank, Kotak Mahindra Bank, Yes Bank, Punjab National Bank and Union Bank of India show negative correlation.
- Public Sector banks have no effect on share price at the time of declaration of NPA data.
- Most public sector banks show positive correlation.
- HDFC Bank and State Bank of India show nearly exact positive correlation in spite of a clear increase in NPA.

Inferences :

- Market reacts adversely to the declaration of NPA data for the above banks.
- ICICI Bank and Kotak Mahindra Bank are worst affected.
- Other Banks are moderately affected.
- Good Fundamentals of public sector banks may have shown positive impact of share prices.
- Market confidence in public sector banks is clearly seen.
- The percentage of NPA to Net Advances is very low so increase in NPA does not affect market performance.

- HDFC Bank has earned decent profits.
- SBI is in losses for last two years, but market has lot of confidence in the biggest bank in India.

Conclusion:

- The NPAs have always been a big worry for the banks in India. It is just not a problem for banks but a curse for the economy too.
- The money locked up in NPAs is not available for productive use and adversely affect on banks' profitability.
- The extent of NPA is comparatively higher in public sectors banks. To improve the efficiency and profitability, the NPAs have to be scheduled.
- The NPAs level of our banks is still high as compared to the international standards. Indian banks can try in competing with foreign banks to maintain international standard.
- One cannot ignore the fact that a part of the reduction in NPAs is due to the writing off bad loans by the banks.
- The Indian banks should take care to ensure that they give loans to creditworthy customers as prevention is always better than cure.
- Due diligence and utmost care must be taken by the branch managers before sanctioning the loans to the clients and specially in case of lending to priority sector.
- In conclusion to above, with the rise in the NPA in the Indian economy, various other elements are getting affected and there is a major role of NPA in affecting the stock market.

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