Chapter 24
Do Nonperforming Assets Alone Determine Bank Performance?

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ABSTRACT

The post-crisis period in India witnessed economic slowdown consequent upon economy wide loan default in the infrastructure, real estate, and construction sectors. The asset quality problem of the Indian commercial banks became so acute that many of the weak banks were to be merged with strong banks in the interest of the depositors in order to arrest any contagion effect. The old generation private sector banks in India do not have government patronage or continuing support of the founder communities. This chapter analyzes the key financial ratios of these banks and tries to find out whether nonperforming assets are the sole determinants of the performances of these banks.

INTRODUCTION

On March 5, 2014 Asian News International reported that the Finance Minister of India warned the public sector banks about their growing problem of non performing assets. The problem of non performing assets is found to have been aggravating for public sector banks during the last quarter of 2013-14 relative to the private sector banks. A study reported by PTI in the beginning of 2014 on non performing assets conducted by the Associated Chambers of Commerce and Industry of India. The study mentioned (i) political interference at local levels and waiver of loans by government, (ii) lack of professionalism in the workforce, (iii) mis-utilisation of loans by borrower, (iv) faulty credit management, (v) unscientific repayment schedule, (vi) lack of timely legal settlement of cases, and above all (vii) slippage of restructured accounts to non-performing assets to be the factors contributing to aforesaid growth of non performing assets. Against this background this chapter plans to investigate into the determinants of profitability of the following old generation private sector banks in India.

1. Catholic Syrian Bank,
2. City Union Bank,
3. Dhanlaxmi Bank,
4. Federal Bank,
5. ING Vysya Bank,
6. Jammu and Kashmir Bank,

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7. Karnataka Bank,
8. Karur Vysya Bank,
9. Lakshmi Vilas Bank,
10. Nainital Bank,
11. Ratnakar Bank,
12. South Indian Bank,
13. Tamilnad Mercantile Bank.

BACKGROUND

Choudhury (2012) succinctly described the background of the old generation private sector banks in India. These were in his opinion those banks existing at the time of nationalization, but not considered to be important in matter of nationalization in 1969. The banks were developed out of patronage from some specific community. He described them as those entities which on the one hand do not have state patronage unlike the nationalized banks and on the other hand do not have the loyalty any more of the founder community, from which they used to get major business. He is also of the view that these by and large localized banks have presence across the country, which are ornamental and not contributing to the development of these banks. He described that some of these banks like Centurion Bank of Punjab and Bank of Rajasthan were acquired by new generation private sector banks like HDFC Bank (Housing Development Finance Bank) and ICICI Bank (Industrial Credit and Investment Corporation of India Bank) respectively. He reported the struggle for surviving competition by some like DCBL (Development Credit Bank Limited) and ING Vysya Bank. Devrajappa (2012) subscribed to the academically accepted view that merger of two weaker banks or merger of one strong Bank with one weak bank can be treated as a faster and less costly way to improve profitability and spurring internal growth. As per Rangan (2013) the merger between HDFC Bank and Centurion Bank of Punjab (CBOP) was billed as one of the biggest mergers in the banking history of India in 2008 and the merger aimed, *inter alia*, at leveraging the strengths of HDFC bank and CBOP in terms of branches, serving different segments of the market and the general synergy brought about by mergers. Kuriakose, Raju and Kumar (2012) analyzed the merger between ICICI Bank and Bank of Rajasthan based on strategic similarities and relatedness. They reported that the management of the acquiring entity the ICICI Bank had to focus on the intrinsic issue of differences in key parameters between the banks in the post-merger period to boost the performance of the merged entity.

LITERATURE

Ameur and Mhir (2013) using GMM Method (Generalized Method of Moments) assessed Tunisian banks' performances. They considered (i) return on assets, (ii) return on equity and (iii) net interest margin as proxy measures of bank performance. The factors responsible were found to belong to three broad categories – (a) bank specific factors (b) industry specific factors and (c) macroeconomic factors. (i) Bank specific factors are asset size, capital adequacy ratio, non-performing asset ratio, operational efficiency in terms of cost to income ratio, bank deposit growth and proportion of private ownership of the bank. (ii) Industry specific factors are concentration of banking assets with three largest banks and the ratio of total banking industry asset to GDP (gross domestic product). (iii) The macroeconomic factors are growth rate of GNP (gross national product) and annual inflation rate of the country. All these factors are ratios upon which, along with one-period lagged value of the regressor, the bank performance is regressed.

Pastori and Mutaju (2013) found that the increase in capital ratios of the Tanzanian commercial banks sometimes reduced the asset quality productivity and in most cases the levels of non-performing loans and non-performing asset