International Journal of Enhanced Research in Management & Computer Applications
ISSN: 2319-7471, Volume 7 Issue 1, January-2018, Impact Factor: 3.578

Assets Quality Assessment of Select Public and Private Sector Banks in India

Dr. Sangita Rani

Assistant Professor, Department Of Commerce, Maharshi Dayanand University, Rohtak

ABSTRACT

The quality of assets is one of the most critical parameter in determining the overall financial strength of a bank. The upmost managers and supervisors are always concerned with the quality of their loans as it provides earnings for the bank. The major objective behind gauging the assets quality is always to ascertain the component of non-performing assets (NPAs) as a percentage of the total assets. In the same line, the present paper is an endeavour to study the assets quality of select public and private sector banks in India over the period 2006-07 to 20016-17. The state Bank of India and HDFC were selected on the basis of their market capital and total assets and the data was analyzed with the help of asset quality indicator of CAMELS rating system. To attain the objective of the study, total investment to total assets, net NPA to net advances, and net NPA to total assets indicators were analyzed. On the basis of the final group ranks assigned to the banks, the study concluded that the asset quality of HDFC (combined rank-1.33) was healthy against the loss of value in the assets as compared to SBI (combined rank-1.67) like asset weakening, risks the solvency of the financial institutions. The component of non-performing assets as a percentage of the total assets was found more in case of SBI which is a matter of concern as theignorance of the loan quality is the major cause of bank's ascending (Yin, 1999) and banks should pay more attention to managing asset quality in order to warrant the sound development of the banking industry (Tsai, 1999).

Keywords: Assets Quality, Total Investment to Total Assets, Net NPA to Net Advances, Net NPA to Total Assets, Financial Performance

INTRODUCTION

Financial stability in an economy is largely dependent on the stability and the resilience of the banking system. To accomplish banking stability the banks are required to maintain quality bank assets that aid in achieving profitability. The failure to ensure banking stability can cause financial fragility and may lead to crisis scenarios in the event of market illiquidity and or bank contagion. The significance of banking stability can be better understood in the backdrop of the global financial crisis of 2008 that resulted into the collapse of financial markets and institutions. Moreover, output per capita is projected to slide down in countries representing three-quarters of the global economy. The consequent deterioration in the economic environment has led to a rise in the overall level of stress in the banking sectors. Commercial bank loan charge-offs in the US and Europe may exceed the levels reached during the 1991–1992 recession, even though they should remain below the levels experienced in the US during the Great Depression.

The issue of Non-Performing Assets (NPAs) has gained growing attention in the last few decades in view of the established fact that the immediate consequence of bubbling up of NPAs in the banking system is bank failure. Many researches like; Demirguc-Kunt (1989) and Barr and Siems (1994) have established that asset quality is a statistically significant predictor of insolvency for the cause of bank failures and the failing banking institutions always have high level of non-performing loans prior to failure. Further, the problem of NPAs has become synonymous to functional efficiency of financial intermediaries and believed to be the major causes of the economic stagnation problems. As per the Global Financial Stability Report of International Monetary Fund, (IMF, 2009), identifying and dealing with distressed assets, and recapitalizing weak but viable institutions and resolving failed institutions are stated as the two of the three important priorities which directly relate to NPAs.

It is obvious to note that better asset quality aids improvement in profitability. In order to improve profitability, it is imperative on the banks to manage their asset quality as well as determinants of profitability. The growing incidence of poor bank asset quality calls for a renewed look at the factors that impact on the performance of the banks in terms of both profitability and asset management. The critical role of financial and banking development in economic growth in any economy has been established by many researchers (Levine, 2004 and Singh, 2005). In the process of providing credit assistance to the investment activities and projects in the economy, the financial institutions face inherent risks in the form of default risk that results in the form of Non-Performing Assets that have a negative effect on the profitability of the financial institutions.

So, it is important to examine as to whether the performance of banks has improved and that information can be very use full to each and every stakeholder in understanding the asset quality of banking sector in India for further planning. In this framework, the present study analyse the major asset quality indicators by using CAMELS rating for the period 2006-07 to 2016-17.

Camels Rating Framework

The CAMEL model is recognized as an effective supervisory tool used to investigate the financial performance of the banking institutions on basis of six acute dimensions grounded on bank's operations and financial performance. The model was pronounced for the very first time by the U.S. supervisory specialists who used this system of on-site examinations to measure the financial strength of the banks. Then, this uniform financial institution rating system was adopted by the Federal Financial Institution Examination Council in November 13, 1979 and by the National Credit Union Administration in October 1987 (The United States, Uniform Financial Institutions Rating System, 1997).The financial soundness of banking institutions is tracked on various indicators based on Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality and Liquidity. After that, a sixth indicator was added to this rating model to make the scale core market risk-focused and then all six parameters are used to study the financial, operating and regulatory compliance of the banks all over the world. For the rating purpose, each parameter is rated on a scale of 1 (best) to 5 (worst) and afterwards a composite rating is given which is considered as the primary indicator of a bank's current financial condition. Hence, CAMELS is, basically, a ratio based rating system based on six components that completely reflects the safety and soundness of banking institutions. A rating system, CAMELS, based on financial ratios is a common phenomenon all over the world that is used to evaluate the financial health and management efficiency of the bank on the basis of few financial parameters. So, CAMELS rating system is a very significant tool in the hands of regulators to judge both financial and operational performance of the banks.

Asset Quality: An Important Parameter Of Camels Rating

The quality of assets is an important indicator that replicates the extent of credit risk prevailing in the financial institution that is a result of its quality and composition of investments, loans and advances in balance sheet. The assets quality determines the financial soundness possessed by a bank. This indicator measured the quality of assets with respect to scale and sturdiness of NPAs as a share of total assets, adequacy of provisions and scattering of assets, etc. The declining trend of asset quality has a negative effect on capital, as losses are written off against capital, and eventually affects the earnings of the bank.
The following ratios are analysed to examine the Assets quality ofBanks:

A. Net Non-Performing Assets (Npa) To Net Advances Ratio (Nnpa's/ Adv Ratio):

This ratio indicates the overall quality of banks advances and reflects the actual status of the financial burden on the banking institution. The higher ratio indicates the rising bad quality of loans in the balance sheet. It is the most standard measure of assets quality.
Symbolically,

NNPA's/ ADV Ratio = Net Non-Performing Assets / Net Advances

B. Net Npa To Total Assets

This ratio also indicates the share of non-performing assets in the total assets that shows the overall quality of bank's loan book and the efficiency of the bank in assessing credit risk and, to an extent, recovering the debts. Lower ratio indicates better quality of advances (better utilization of assets) and performance of the Bank.
Symbolically,

Net NPA to Total Assets Ratio = Net NPA / Total Assets Ratio

C. Total Investment To Total Assets Ratio (Tot Inv / Tot Ass Ratio):

The extent of total assets that are sealed as investments is measured by total investment to total assets ratio. A comparatively low investment to asset ratio replicates the aggressiveness of bank and a high ratio unfavourably affects the profitability of the bank because the interest income earned through the investments is much less than income earned by the way of granting advances.
Symbolically,

Tot INV / Tot ASS Ratio = Total Investment / Total Assets.

REVIEW OF LITERATURE

The assessment of asset quality has become an emerging issue in banking literatures because most of the researchers agreed that bank can be declared bankrupt if a sizeable amount of non-performing loans exists in bank because asset quality is an indicator for the liquidation of banks. The literature is as followed:

Kwan and Eisenbeis (1997)assessed that the asset quality is commonly used as a risk indicator for financial institutions, which also determines the reliability of capital ratios. The study indicated that capitalization affects the operation of financial capitalization affects the operation of financial institution. More the capital, higher is the efficiency.

Streeter (2000) reported that asset quality management is considered one of banks major management problems based on the self-administered questionnaires served to the members of American Bankers Association Board which composed of one-third of bank officials from all U.S. banks, the result of the above survey sufficiently proves that asset quality management is a common issue for bankers in practice.

Bhattacharaya (2001) studied the banking strategy, credit appraisal and lending decision of Indian banks. The study opined the fact that in an increasing rate regime, quality borrowers may tend to other avenues like capital markets, internal accruals to meet their credit requirements. In such context the banks may dilute the quality of borrowers there by increasing the probability of generation of NPAs.

Reddy (2002) made a comparative study of Non-Performing Assets in India in Global context by examining the similarities and dissimilarities and suggest the remedial measures. The study established that financial sector reform in India has progressed rapidly on aspects like interest rate deregulation, reduction in reserve requirements, barriers to entry, prudential norms and risk-based supervision. The study also revealed that the sheltering of weak institutions while liberalizing operational rules of the game is making implementation of operational changes difficult and ineffective. Changes required to tackle the NPA problem would have to span the entire gamut of judiciary, polity and the bureaucracy to be truly effective.

Gene Miller (CEO of America Corp.) considered asset quality as the second most important management issue and formed a task force to specifically handle rising bad assets.The bank asset quality and operating performance are positive related from because management accounting perspective if a bank’s asset quality is insufficient such will have to increase its bad debt losses as well as expend more resources on the collection of non-performing loans (Abata, 2010).

Malyadri (2011) conducted a comparative Study of Non-Performing Assets in Indian Banking Industry for the period 2004-2010. The study observed that the asset quality management of Indian public sector and private sector banks have improved in NPA management by the implementation of prudential regulations of accounting, income recognition, provisioning and exposure, introduction of CAMELS supervisory rating system and reduction of NPA’s and up gradation of technology. But in order to bring on par international level the government should formulate bank specific policies and should implement these policies through Reserve Bank of India enhancement of Public Sector Banks. The researcher noticed that NPA percentage has decline during their period of study i.e. from 2004 to 2010 as percentage of advances to weaker sections from 18.9 per cent to 3 per cent in case of public sector banks and from 12.15% to 0.5 per cent in case of private sector banks.

Srivastava (2012) studied the asset quality of private banks in India. The study defined that the share of public sector banks is almost 2/3rd shares of total advances in the economy in Indian banking industry. The sub-standard assets showed increase from 1.1 per cent in 2006-07 to 2.0 per cent in 2008-09 but further decrease from 1.5 per cent in 2009-10 to 0.6 per cent in 2011-12. Further, the study found that doubtful assets showed a reduction from 1.0 per cent in 2006-07 to 0.9 per cent in 2007-08 but further increase 1.5 per cent in 2010-11 and also further decrease to 1.2 per cent in 2011-12. The loss assets showed increase from 0.2 per cent in 2006-07 to 0.4 per cent in 2010-11 and decrease to 0.3 in 2011-12, indicating up and down trends of financial soundness of private sector banks.

Balasubramaniam (2012) conducted a conceptual study to assess the impact of NPA on Profitability of commercial Banks in India. The study exposed that Indian bank are facing a challenges in their business operations with introduction of NBFC’s and competition from foreign banks. The introduction of Basel III norms would make banks able to bring financial stability in their performance.

Mohnani (2013) studied the impact of non-performing assets on public and private sector banks by taking the sample of a SBI, PNB, ICICI and HDFC and analysed the position of NPAs for the period 2003 to 2012. The study found that there has been marginal decrease in NPAs level over the period in all selected banks i.e. SBI from 11.95 per cent to 3.28 per cent, PNB from 11.38 per cent to 1.79 per cent, HDFC from 3.18 per centto 1.06 per cent and ICICI position is about 5.08 per cent. The study also suggest that banks should appoint a committee to review the credit appraisal of banks through well documented loan policy and review should be done weekly basis in order to curtail the increase of new accounts of NPA’s.

Mahajan (2014)examined the trends of NPAs in Indian Banking Sector and compare the status of Indian banking NPAs with BRICS nations. The study explained that the APEC countries consider a loan as non performing only after it has been in arrears for at least six months whereas in India it is considered as NPA if it is due for 90 days, but the recovery process in India is quite time taking as compared to developing countries. Finally, the study concluded that magnitude of India banking NPAs are high compared to developing countries.

Sharma (2014)assessed the quality of assets for public and private sector banks in India. The study analyzed the trends in NPAs of public sector banks for the period 2001 to 2013 and showed a constant rise in values of Gross NPA and Net NPA from 2000-2004 and decline trend from 2004-2008 and after that it is increasing at constant rate. Whereas, in case of the private sector banks it was observed that Gross NPA and Net NPA is in increased trend from 2000 to 2003 and decline trend up-to 2006 and thereafter it showed increased trend.

RESEARCH METHODOLOGY

The research design of the study is descriptive cum analytical as the trends of assets quality were described and analyzed on the basis of CAMELS rating system. The study assessed the asset quality of the select public and private sector banks in India over the period 2006-07 to 2016-17. The State Bank of India (SBI) and Housing Development and Finance Corporation (HDFC) were selected to assess the asset quality. The required data were gathered from the published annual reports of respective banks and analyzed with the help of asset quality indicator of CAMELS rating in terms Net NPA to Net Advances, Net NPA to Total Assets, and Total Investment to Total Assets ratios.

Analysis and Interpretation

The asset quality of a bank determines the healthiness against the loss in the value of assets. The following tables portray the asset quality parameter of CAMELS rating for SBI and HDFC in terms Net NPA to Net Advances, Net NPA to Total Assets, and Total Investment to Total Assets ratios. The table 1 exhibits the financial parameter of Net NPA to Net Advances, displaying for SBI that the portion of net NPAs in net advances is lower in the initial period of the study and hence the quality of assets is good and vice-versa for the later years. The table is exhibiting the highest level of NPAs (3.81 per cent) in the year 2015-16 that further reflects the adverse asset quality of the bank.

Table 1: Asset Quality- Net NPA to Net Advances

Years	Net NPA to Net Advances (%)	
	SBI	HDFC
2006-07	1.56	0.43
2007-08	1.78	0.47
2008-09	1.79	0.63
2009-10	1.72	0.31
2010-11	1.63	0.19
2011-12	1.82	0.18
2012-13	2.10	0.20
2013-14	2.57	0.28
2014-15	2.12	0.26
2015-16	3.81	0.28
2016-17	3.71	0.33
Average	2.24	0.32
Rank	2	1

Source: Analyzed through CAMELS Rating

On the other side, the analysis registered the lowest level (1.56 per cent) of NPAs in total advances in the very first year of the entire study period and after that the ratio showed constantly increasing trend signifies the large quantity of credit defaults that further distresses the profitability and net worth of the bank as well as deteriorates the value of the assets. The same asset quality indicator shows less credit risk in case of HDFC as the fraction of non-performing assets in total advances is lower (0.18 per cent) in the year 2011-12, but showing the high risk by displaying the highest ratio (0.63 per cent) for the year 2008-09, although that is quite lesser than the lower ratio of SBI (1.56 per cent). When the average performance is taken into consideration, it is crystal clear that HDFC topped the category by securing all time lowest ratio (0.32 per cent) signifies that overall good quality of the bank's loan book on the other hand higher ratio in case of SBI indicates escalating bad quality of loans.

Similarly, when the asset quality was measured by taking the another parameter of net NPA to total asset, the analytical table 2 reflects good asset quality for SBI in the first year (2006-07) of the study period as the ratio is lower (0.93 per cent), but the asset quality kept on dwindling year on year and recorded highest (2.47 per cent) in 2015-16.Supplementary, the table exhibits that HDFC remained successful in stabilizing the good quality assets during the entire study period. The bank is found utmost efficient in gauging the credit risk and recovering the debts in theyear 2011-12 as the ratio is lowermost (0.10 per cent) followed by.

Table 2: Asset Quality- Net NPA to Total Assets

Years	Net NPA to Total Assets (%)	
	SBI	HDFC
2006-07	0.93	0.22
2007-08	1.03	0.68
2008-09	1	1.08
2009-10	1.03	0.18
2010-11	1.01	0.11
2011-12	1.18	0.1
2012-13	1.4	0.12
2013-14	1.73	0.17
2014-15	1.35	0.15
2015-16	2.47	0.18
2016-17	2.15	0.21
Average	1.39	0.29
Rank	2	1

Source: Analyzed through CAMELS Rating

0.11 and 0.12 per cent in the year 2011-12 and 2012-13 per cent respectively. On the other hand, HDFC, in the year 2008-09, was found incompetent to manage the quality of its assets as the ratio is recorded highest (1.08 per cent) of all time. Finally, on the basis of average values of this indicator, it can visibly be drawn that HDFC found highly efficacious in alleviating the good quality assets as compare to SBI.

The table 3 exhibits the Total Investment to Total Assets ratio that is also one of the key parameter to reflect the asset quality of the banking sector. In the present study, the public sector bank SBI is found more focused to its core activities i.e. advances by showing a lower ratio (22.25 per cent) in the year 2013-14 followed by 23.38 and 23.52 per cent in years 2011-12 and 2014-15 respectively. On the other side, the table is displaying higher level of investments in total assets in the year 2008-09 (28.61 per cent) followed by 28.31 per cent in the year 2016-17 that clearly indicates lack of credit off-take in the economy. Further, the table exhibits that HDFC was found utilising its assets for investment from total assets in the year 2007-08 as the ratio is quite high (37.09 per cent) whereas the private sector bank was found highly indulging in its main activities, i.e. advances in the year 2013-14 by securing the lowest ratio of 24.60 per cent.

Table 3: Asset Quality- Total Investment to Total Assets

Years	Total Investment to Total Assets (%)	
	SBI	HDFC
2006-07	26.33	33.5
2007-08	26.26	37.09
2008-09	28.61	32.09
2009-10	27.13	26.35

2010-11	24.16	25.57
2011-12	23.38	28.85
2012-13	24.4	27.88
2013-14	22.25	24.6
2014-15	23.52	28.19
2015-16	24.42	26.44
2016-17	28.31	24.83
Average	25.34	28.67
Rank	1	2

Source: Analyzed through CAMELS Rating

The overall average for the ten years clearly signposts that the public sector bank, SBI is found more engrossed in advances by securing lower average ratio (25.34 per cent) whereas the private sector bank, HDFC is found utilizing more of its assets to investment as secured higher average (28.67 per cent).

Table 4: Combined Average based on Assets Quality Parameter of CAMELS Rating

Asset Quality Indicators	Net NPA to Net Advances (%)		Net NPA to Total Assets (%)		Total Investment to Total Assets (%)	
	SBI	HDFC	SBI	HDFC	SBI	HDFC
Rank	2	1	2	1	1	2
Combined Group Rank						
SBI	1.67					
HDFC	1.33					
Final Group Rank						
SBI	2					
HDFC	1					

Source: Authors' Calculations based on CAMELS Rating

The table 4 represents the composite indicator of asset quality, which is a combination of composite raking of net NPA to net advances, net NPA to total assets and total investment to total assets ratios. The final group ranks reflecting that the asset quality of HDFC (1.33) was healthy against the loss of value in the assets as compared to SBI (1.67) like asset weakening, risks the solvency of the financial institutions. The component of non-performing assets as a percentage of the total assets was found more in case of SBI which is a matter of concern.

CONCLUSION

The quality of the assets is one of the most acute aspects in order to determine the operational and financial performance of the banking institutions. Loan or asset quality provides earnings for the bank and hence the bank's management is always concerned with the quality. In the present study the combined group rank was determined after evaluating each parameter of assets quality and final ranks was assigned to the banks. On the basis of the final group ranks assigned to the banks, the study concluded that the asset quality of HDFC (combined rank-1.33) was healthy against the loss of value in the assets as compared to SBI (combined rank-1.67) like asset weakening, risks the solvency of the financial institutions. The component of non-performing assets as a percentage of the total assets was found more in case of SBI which is a matter of concern as theignorance of the loan quality is the major cause of bank's ascending (Yin, 1999) and banks should pay more attention to managing asset quality in order to warrant the sound development of the banking industry (Tsai, 1999).

REFERENCES

[1]. Balasubramaniam CS (2012). Non-Performing Assets and Profitability of commercial Banks in India: Assessment and Emerging Issues. Journal of Research in Commerce &Management.

[2]. Bhattacharaya H (2001). Banking strategy, Credit Appraisal & Lending Decision: A Risk-Return Framework, Oxford Scholarship Online, New Delhi, India.
[3]. Economics & Business, 4:1, 88-133
[4]. Economics & Business, 4:1, 88-133
[5]. Economics & Business, 4:1, 88-133
[6]. Economics & Business, 4:1, 88-133.
[7]. Economics & Business, 4:1, 88-133.
[8]. Kwan, S and Eisen be is, RA (1997). Bank risk, Capitalization, and Operating Efficiency, Journal of Financial Service Research, 12 (2/3), 9-14.
[9]. Levine, Ross(2004). The Corporate Governance of Banks: A Concise Discussion of Concepts and Evidence. Policy Research Working Paper No. 3404, World Bank, Washington, D.C. © World Bank.
[10]. Mahajan S (2014). Trends of NPAs in Indian Banking Sector. International Journal of Innovative Research and Studies 3, 498-512.
[11]. Malyadri P, Sirisha S (2011). A Comparative Study of Non-Performing Assets in Indian Banking Industry. International Journal of Economic Practices and Theories.
[12]. Mohnani P, Deshmukh M (2013). A Study of Non-Performing Assets on Selected Public and Private Sector Banks.
[13]. Reddy PK (2002). A Comparative Study of Non-Performing Assets in India in the Global context examined the similarities and dissimilarities, remedial measures.
[14]. Sharma SJ, Arora J (2014). NPA: A Comparative Study of Public Sector and Private Sector Commercial Banks.
[15]. Singh, C. (2005), Financial sector reforms and state of Indian economy, Indian Journal of
[16]. Singh, C. (2005), Financial sector reforms and state of Indian economy, Indian Journal of
[17]. Singh, C. (2005), Financial sector reforms and state of Indian economy, Indian Journal of
[18]. Singh, C. (2005), Financial sector reforms and state of Indian economy, Indian Journal of
[19]. Singh, C. (2005), Financial sector reforms and state of Indian economy, Indian Journal of
[20]. Singh, C. (2005). Financial Sector Reforms and State of Indian Economy. Indian Journal of Economics & Business, 4:1, 88-133.
[21]. Srivastava V, Bansal D (2012). A Study of trends of Non-Performing Assets in Private Banks in India, International Journal in Multidisciplinary and Academic Research 2.
[22]. Tsai L.L. (1999). Regulations about Bank Assets quality and Earnings in Standards for Safety and Soundness ofAmerican Banking Institutions.
[23]. Yin, N. P. (1999). Look at Taiwan's Banking Problems from Asia Financial Crisis, Banking Finance.1.