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THE ECONOMIC CHALLENGER

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Asset Quality Analysis of State Bank of India and Punjab National Bank

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INTRODUCTION

Lending is the most profitable activity for banking sector. The interest rate realized in credit disbursement generates more cash-flow then those realized on investments. Credit deployment also fulfills the social responsibility of banks towards different sections of society. Although Non Performing Assets (NPA) adversely affect lending of banks as non-recovery of loan installments as also interest on the loan portfolio negates the effectiveness of credit-dispensation process. Besides, banks with high level of NPAs have to carry more owned funds by way of capital and create reserves and provisions and to provide cushion for the loan losses. Thus, the most critical condition for bringing about an improvement in the profitability of banks is reduction in the level of NPAs. The present study is an attempt to analyse the performance of State Bank of India (SBI) and Punjab National Bank (PNB) in terms of three parameters such as Gross NPA Ratio, Net NPA Ratio and Capital Adequacy ratio. The parameters indicate the level of mounting NPAs and the capital reserves utilised to cope up with the criticality of defaults.

REVIEW OF LITERATURE

Edward (2011) has described the credit management practices used by banks. **Krishna Murthy** (2011) has highlighted the recent trends and challenges of banking system in terms of Non Performing Assets. **Ahmad** (2011) has done critical analysis of Asset Quality and Non Performing Assets of Public sector banks. **Reddy** (2010) has described the management of Non Performing Assets in Indian Financial Institutions. **Gupta** (2010) has thrown light on perspectives and future directions for management of Non Performing Assets. **Rao** (2010) has shown the influence of Non Performing assets on business of banking sector.

OBJECTIVE OF STUDY

The Study has following objectives:

1. To analyse the Non Performing Assets of selected banks.
2. To compare the quality of assets of selected banks.
3. To draw meaningful conclusion and offer necessary suggestions to improve the performance of selected banks in terms of asset quality of both the public sector banks.

RESEARCH METHODOLOGY

The study is focused on the evaluation of asset quality of State Bank of India and Punjab National Bank. The financial data of the two banks has been taken for a period of five years from 2007 to 2011. The performance of the selected banks has been analysed on three parameters such as Gross NPA ratio, Net NPA Ratio and Capital Adequacy Ratio. The purpose of the study is to determine the effectiveness of various practices being adopted by both banks to curb their non performing assets. The study will also highlight the performance of selected banks in current competitive scenario.

Gross Non Performing Assets Ratio

Gross Non Performing Assets Ratio indicates the level of Gross NPA on the total advances of the banks. It can be calculated by dividing Gross NPA by Total Advances given by the bank. Higher the ratio, more the level of Gross NPA the bank contains.

$$\text{Gross NPA Ratio} = \frac{\text{Gross NPA}}{\text{Gross Advances}} * 100$$

Net Non Performing Assets Ratio

Net Non Performing Assets shows the level of Net NPA on Net Advances given by the bank. It can be calculated by dividing Net NPA by Net Advances. Higher the ratio, more the alarming situation for the bank.

$$\text{Net NPA Ratio} = \frac{\text{Net NPA}}{\text{Net Advances}} * 100$$

Where Net NPA= Gross NPA excluding the provisions
Net Advances= Gross Advances excluding bad debts.

Capital Adequacy ratio

Capital adequacy ratio determines the capacity of bank in terms of meeting the time liabilities and other risks such as credit risk, operation risk, and so on. It is the measure of how much capital is used to support the bank's risk asset. Higher the Ratio, better position the bank contains to diversify its risk.

$$\text{Capital Adequacy Ratio} = \frac{\text{Tier 1 Capital+Tier 2 Capital}}{\text{Risk Weighted Assets}} * 100$$

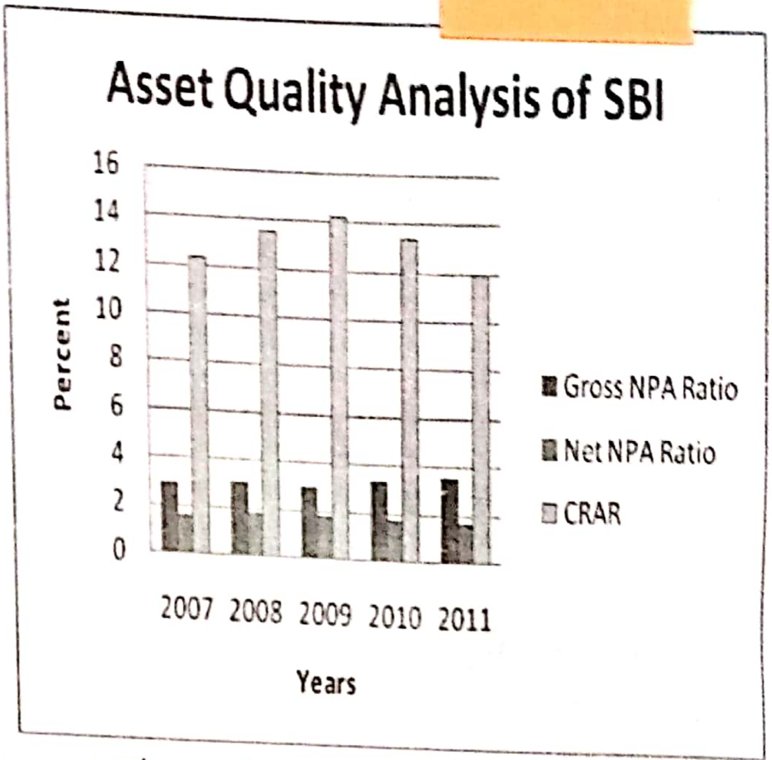
Where:

Tier I Capital is core capital which provides the most permanent and readily available support to a bank against unexpected losses. **Tier II capital** contains elements that are less permanent in nature or are less readily available. Elements of Tier I capital and Tier II capital differ with respect to Indian banks and foreign banks operating in India.

Risk Weighted Assets means Balance Sheet assets and conversion factors to off-Balance Sheet items, expressed as a weighted percentage of individual credit risk. The value of each asset/item shall be multiplied by the relevant weights to produce risk adjusted values of assets and of off-Balance Sheet items. The aggregate will be taken into account for reckoning the minimum capital ratio.

Table.1 Asset Quality Analysis of SBI

Year	Gross NPA Ratio	Net NPA Ratio	CAR
2007	2.9	1.56	12.34
2008	3	1.78	13.54
2009	2.98	1.76	14.25
2010	3.28	1.72	13.39
2011	3.5	1.63	11.98
Mean	3.132	1.69	13.1
St. Dev	0.251	0.093	0.93
C.V.	8.009	5.487	7.071

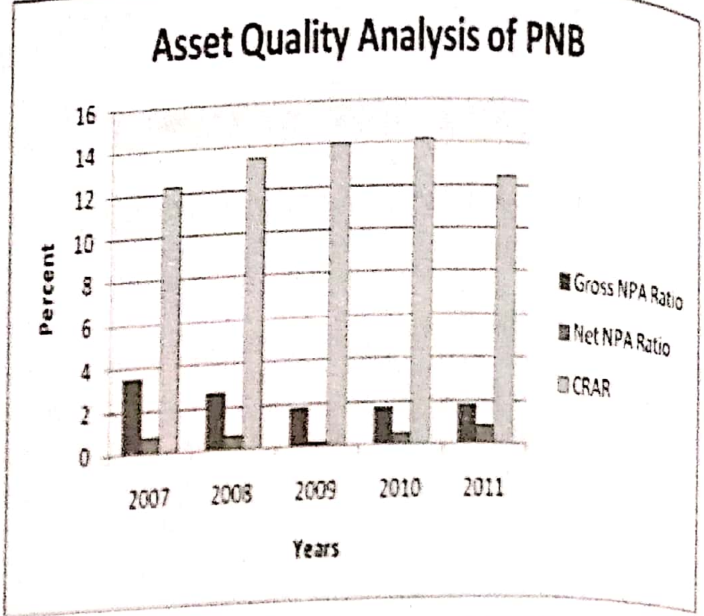


It can be analysed from the Table1 that all the ratios under considerations are showing a fluctuating trend during study period 2007 to 2011. The Gross NPA Ratio is showing a rise of 20.6 per cent from 2007 to 2011owing to increase in default cases especially in small scale industries. The ratio has shown maximum increase in 2011 where the NPA reached up to 3.5 per cent while in 2007 the NPA was on its minimum level with Gross NPA at 2.90 per cent. Net NPA Ratio is also showing an increase of 4.4 per cent for 2007 to 2011 due to increase in interest rates of the credit. The Net NPA Ratio is maximum in 2008 with 1.78 per cent Net NPA which lies on its minimum in 2007 with1.56 per cent Net NPA. The increase of NPA has affected the capital base of the bank reserved for hedging the credit risk. The **Capital Adequacy Ratio** is showing a decrease of 2.9 per cent from 2007 to 2011.The bank has maintained maximum Capital Adequacy Ratio of 14.25 per cent in 2009 due to increase in capital base of the bank while showing a minimum Capital Adequacy Ratio of 11.98 per cent in 2011 due to increase in provisions for bad debts.

It can be analysed from Table.2 that Punjab

Table2. Asset Quality Analysis of PNB

Years	Gross NPA Ratio	Net NPA Ratio	CAR
2007	3.5	0.76	12.29
2008	2.7	0.64	13.46
2009	1.77	0.17	14.03
2010	1.71	0.53	14.16
2011	1.79	0.85	12.42
Mean	2.294	0.59	13.278
St,Dev	0.789	0.264	0.88
C.V.	34.386	44.763	6.63



National Bank is showing a decrease of 48.8 per cent in Gross NPA Ratio during study period from 2007 to 2011. The Gross NPA falls from 3.5 per cent in 2007 to 1.79 per cent in 2011. The decrease can be credited to better utilisation of practices to curb NPA then SBI. The Ratio is maximum in 2007 with 3.5 per cent Gross NPA which reached its minimum level in 2010 with 1.71 per cent Gross NPA. **Net NPA Ratio** is however showing an increase of11.8 per cent from 2007 to 2011due to increase in NPA as economy has shown a slowdown during the period of study. The Net NPA Ratio is maximum in 2011 with 0.85 per cent Net NPA while showing minimum Net NPA of 0.17 per cent in 2009. Although Net NPA Ratio of PNB is significantly lower than Net NPA Ratio of SBI as the bank has lesser cases of NPA. Capital Adequacy Ratio has shown an increase of 1.05 per cent during study period of 2007 to 2011.The ratio is maximum with 12.42 per cent in 2011 while lies on its minimum level of 12.29 per cent in 2007. The improvement is due to earning of bank from secondary market operations. The performance of PNB in terms of Capital Adequacy Ratio is better than SBI as the bank has more capital base being used as a cushion hedge the credit risk than that of SBI .

CONCLUSION AND SUGGESTIONS

From the above analysis it can be concluded that the performance of PNB is better than SBI in terms of Gross NPA Ratio, Net NPA Ratio and Capital Adequacy Ratio during study period from 2007 to 2011. SBI has to take necessary steps to curb its mounting NPAs. Better credit appraisal with credit disbursement only to prime customers can decrease the chances of turning accounts into NPA. Serious attention needs to be paid to monitor the loans sanctioned by the bank. Comprehensive preventive monitoring mechanism to maintain sound and healthy loan portfolio needs to be developed by the bank. Besides bank needs to adopt its own risk rating system to access the risk of lending.

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