Non - Performing Loanan Encumbrance for Maximizings Hareholder Wealth?- A Study on Two Leading Private Sector Banks in India

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Abstract: - Shareholder's value plays a crucial role in a highly volatile and complicated market. Just like how a bank has got a moral obligation towards its customer, the obligation towards a shareholder or investor is also equally important. Increasing Non-performing loans have not only been a period of eclipse for the bank's financials and brand value, but also for the shareholders of the bank. This paper shows the impact of Non-Performing loans on Shareholder value and ways to reduce the same to increase the shareholder's confidence.

Key Words: Non-Performing loans (NPL), Economic Value Added (EVA), Market Value added (MVA), Shareholder's value

I. INTRODUCTION

Shareholder value is a business concept and is referred to as shareholder value maximisation and shareholder value model that shows the ultimate achievement of the company. The idea of shareholder approach tries to improve bank's value by increasing bank's earnings, by increasing the market value of corporation shares and also increase the frequency of dividend paid. The corporate Directors are under high pressure to measure, manage and report the creation of shareholder value regularly. Various measures have been developed to measure the share holder value and it needs to focus all metrics. Recently NPL has become an important factor to measure the shareholder's value as it has got a direct impact on balance sheet of the banks and also on the brand value and reputation of the bank. Value based management system is a managerial approach in which primary purpose is long run shareholder wealth maximization. The objective of the firm, its systems, strategy, processes, analytical techniques, performance measurements and culture have their guiding objective as shareholder wealth maximisation.

In India, private sector banks have always been proactive in maintaining healthy relationship with shareholders than the public sector banks. The reason could be better CRM systems, good financial performance or low NPLs. The basic objective of this paper is to find out the extent to which the NPL has an impact on the shareholder's value.

II. RESEARCH METHADOLGY& ANALYSIS

The two leading private sector banks ICICI and HDFC Bank have been selected for analysis. 10 years data on NPL, NOPAT, Market Capitalisation and Weighted average cost of capital has been collected and worked out for both the banks. The two indicators used for measuring shareholder value are Economic value added (EVA) and Market value added (MVA). All the data required for calculation were collected from secondary sources like annual reports, RBI, website of government of India, BSE and NSE websites.

EVA= Net operating profit after tax (NOPAT) – (capital invested * Weighted average Cost of Capital)

MVA = Market Capitalisation – Capital invested.
EVA and MVA were calculated individually for both the banks for a period of 10years using the above formulae and regression and correlation were done with Non-performing loans. The following hypothesis were assumed.

H1: NPL has a negative impact on EVA of ICICI BANK
H2: NPL has a negative impact on MVA of ICICI BANK
H3: NPL has a negative impact on EVA of HDFC BANK
H4: NPL has a negative impact on MVA of HDFC BANK

R	R Square	Adjusted R Square	Std. Error of the Estimate
.62	.39	.31	102.36

ANOVA(EVA) FOR ICICI BANK

	Sum of Squares	df	Mean Square	F	Sig.
Regression	53501.80	1	53501.80	5.11	.054
Residual	83822.70	8	10477.84		
Total	137324.50	9			

R	R Square	Adjusted R Square	Std. Error of the Estimate
.43	.18	.08	3.35

KARL PEARSON's COEFFICIENT OF CORRELATION FOR ICICI BANK

	Sum of Squares	df	Mean Square	F	Sig.
Regression	20.09	1	20.09	1.79	.217
Residual	89.67	8	11.21		
Total	109.76	9			

		NPL	EVA	MVA
NPL	Pearson Correlation	1.00	-0.62	0.43
	Sig. (2-tailed)		0.05	0.21
	N		10.00	10.00
EVA	Pearson Correlation	-0.62	1.00	0.35
	Sig. (2-tailed)	0.05		0.31
	N	10.00		10.00
MVA	Pearson Correlation	-0.43		1.00
	Sig. (2-tailed)	0.21		
	N	10.00		

ANOVA(EVA) FOR HDFC BANK

R	R Square	Adjusted R Square	Std. Error of the Estimate
.51	.26	.16	329.98

ANOVA(MVA) FOR HDFC BANK

	Sum of Squares	df	Mean Square	F	Sig.
Regression	299.58	1	299.58	9.22	.016
Residual	259.90	8	32.49		
Total	559.48	9			

KARL PEARSONS CORRELATION COEFFECIENT FOR HDFC BANK

		NPL	EVA	MVA
NPL	Pearson Correlation	1.00	-0.51	0.73
	Sig. (2-tailed)		0.14	0.02
	N		10.00	10.00
EVA	Pearson Correlation	-0.51		-0.30
	Sig. (2-tailed)	0.13		0.39
	N	10.00	10.00	10.00
MVA	Pearson Correlation	0.73	-0.30	1.00
	Sig. (2-tailed)	0.01	0.39	
	N	10.00		

FINDINGS FOR ICICI BANK

1. Significance F for ICICI bank is .054 at 95% confidence intravel This indicates the regression analysis on the whole is significant and we conclude saying NPL has a significant impact on EVA of ICICI BANK
2. R square of .39 implies that 39% variation of percentage change in Nonperforming loans can be explained by percentage change in EVA
3. The negative correlation value -.62 for NPL-EVA signifies that when NPL increases EVA decreases, which is quite obvious from previous researches.
4. Significance F for ICICI bank is .217 at 95% confidence intravel. This indicates the regression analysis is significant and we conclude saying NPL has a significant impact on MVA of ICICI BANK
5. R square of .18 implies that 18% variation of percentage change in Non –performing loans can be explained by percentage change in MVA
6. The negative correlation value of -.43 for NPL-MVA signifies that NPL and MVA are negatively correlated , as NPL increases MVA decreases, which supports the previous researches on NPL's impact on share price

FINDINGS FOR HDFC BANK

1. Significance F for HDFC bank is .136 at 95% confidence intravel. This indicates the regression analysis on the whole is significant and we conclude saying NPL has a significant impact on EVA of HDFC BANK
2. R square of .26 implies that 26% variation of percentage change in non-performing loans can be explained by percentage change in EVA
3. The negative correlation value of -.51 for NPL-EVA signifies that NPL and EVA are negatively correlated which means as NPL increases Eva decreases

4. Significance F for HDFC BANK is .016 at 95% confidence intravel. This indicates the regression analysis is significant and we conclude saying NPL has a significant impact on MVA of HDFC BANK

5. R square of .54 implies that 54% variation of percentage change in Non-performing loans can be explained by percentage change in MVA

6. There is a positive correlation of .73 for NPL-MVA of HDFC Bank. This shows, unlike ICICI bank HDFC bank's share price and market capitalization is not affected by NPL. The reason could be the bank's efficiency in maintaining the price earnings ratio and earnings per share.

III. CONCLUSION

Traditionally the shareholders have based their investment decision on parameters such as EPS, Cash EPS, Price earnings ratios, Dividend payout ratio etc. Investors who are a bit more sophisticated use Current yield,Return on Net worth and financial ratios. These traditional tools rely largely on historic data, as published financial information on performance of companies. These traditional parameters are poor predictors of how the scrip reacts to economic and industry level changes, they provide poor estimates of expected returns and do not offer measures of variability. Methods like Economic Value added and Market Value added are derived based on the market data and the volatility is also justify. Hence these methods turns out to be more accurate in measuring company's performance and shareholder wealth. As far as Non-Performing loans are concerned they play a major role in measuring shareholder wealth. Non-performing loans have to be reduced to increase the shareholder's confidence in investing in the bank. Private sector banks have always been on a better side when it comes to shareholder value as their NPLs are within control. Public sector banks in India should also take necessary steps in maximizing the shareholder's wealth.

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