EFFECT OF CREDIT RISK ON PROFITABILITY OF PUNJAB NATIONAL BANK

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ABSTRACT--*Punjab National Bank is one of the top leading public sector banks in India. Credit risk is one of the oldest and greatest risks of a bank. These days Punjab National Bank is facing a big problem of credit risk. The NPAs of Punjab National Bank is increasing year on year due to which it had to suffer loss during previous few years. The study attempts to identify and implementation of credit risk management and also to analyze the effect of credit risk on profitability of Punjab national bank. With the help of secondary data collected from the Punjab National Bank's annual report for last two years the effect of NPAs on profitability was analyzed. Correlation coefficient was used to analyze the effect of credit risk on the profitability of PNB. The study has an immense use to meet consumer needs and to face competition with other banks. The major reason of increased NPAs is the focus of bank on quantitative aspect of target attainment and less attention is being paid to the qualitative aspect of loan disbursement and mismanagement of funds. The synonym is also coming in that bank is no longer able to recover their NPAs because of which it has to face loss instead of profits. Now is the time when bank needs to focus more on its NPAs management.*

Keywords--*Credit risk, profitability and Bank.*

I. INTRODUCTION

Punjab National Bank is one of the big public sector banks. These days Punjab National Bank is facing a big problem of credit risk. The NPAs of Punjab National Bank is increasing year on year due to which it had to suffer loss during previous few years. Credit can be defined as "nothing but expecting of a sum of money to be received within some limited time" and credit risk is the probability that the expectation will not be met. Credit Risk is the probability of losses associated with the relapse in the credit quality of the borrower or counterparty. It arises when borrower or counterparty may not meet their obligation in terms of loan agreement's terms and conditions. The Credit Risk arises when there is a default due to the inability and unwillingness of the customer to meet their commitments in relation to lending, trading settlement and other financial transaction.

The management of credit risk is becoming increasingly important element in Indian Banking Sectors as its regulatory framework is mandated by BASEL norms for banks to implement credit risk management. Credit risk is the oldest form of risk faced by the bankers worldwide. It's a risk of default on loans. Credit risk is the biggest risk before the banks based on the nature of business, inheritance. An asset becomes non-performing when it ceases to generate revenue for the bank. A Non-Performing Asset was defined as a credit facility in respect of which the

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principal amount, interest and / or instalment of principal amount remained due for a specific period of time. The specified period was reduced in different phased manner which is discussed as under:

w.e.f. 31 March 1993 : Four Quarters

w.e.f. 31 March 1994 : Three Quarters

w.e.f. 31 March 1995 : Two Quarters

w.e.f. 31 March 2001 : 180 days

w.e.f. 31 March 2004 : 90 Days

II. CLASSIFICATION OF NON-PERFORMING ASSETS

- ***Standard Assets:***

Bank receives the principal and interest repayment, systematically from the borrower. Another important aspect is that the arrears of the principal as well as the interest does not surpass more than 90 days on the closing of the FY (Financial Year).An assets, generating regular income to the bank called standard assets.

- ***Sub-Standard Assets:***

Sub-Standard Assets are those assets which are overdue for a period of more than 90 days but less than 12 months.

- ***Doubtful Assets:***

When an Asset remained as a NPA for a period exceeding 12 months is a doubtful asset. A loan classified as doubtful includes all the weaknesses that are contained in assets that were classified as sub-standard, as well as stated weaknesses based on currently known facts, conditions, and values. Collection or liquidation is highly suspicious and impossible.

Loss Assets:

Loss assets are those assets which are doubtful and considered as non-recoverable by banks, internal or external auditor or central bank inspector.

III. LITERATURE REVIEW

The understanding of a subject is based on the good knowledge of related literature. A review of literature provides a comprehensive analysis of previous studies that touch on key variables that suggest a relationship between credit risk governance and its management in public and private sector banks. Credit risk management and risk based supervision in public and private sector banks have been the subject study of many agencies, researchers and academicians. There are various research studies conducted on the national and international level which includes the study of identifying the factors that contribute to credit risk analysis, management supervision and regulation of financial sectors. The main sources of literature are website of RBI, website of Basel committee on banking supervision, publications of academician engaged in credit risk management

Swaranjeet Arora (2013) under the study “Credit Risk Analysis in Indian Commercial Bank-An Empirical Investigation” he tried to recognize those factors which contribute to credit risk analysis in Indian Banks and to compare its practices followed by public and private sector banks of India.

M. Rajeswari (2014) reviewed in the study “A Study on Credit Risk Management in Scheduled Banks” that the effective credit risk management is a critical component of a comprehensive approach to the risk management and credit risk management is an essential to the long term success for the banking organization.

Raad Mozib Lalon,(2015) in his study “Credit Risk Management (CRM) Practices in Commercial Banks of Bangladesh: A Study on Basic Bank Ltd.” pointed out that the default clients have been a major problem for banking and financial institutions for a long and the financial institutions are trying to minimize such kind of loss by the credit risk management.

Sufi Faizan Ahmed & Qaisar Ali Malik (2015) in their study ‘‘Credit Risk Management and Loan Performance: Empirical Investigation of Micro Finance Banks of Pakistan.” The main aim to the study was to evaluate the influence of credit risk management practices on Debt Performance while taking credit terms and policies, client appraisal, collection policy and credit risk control as dimensions of credit risk management. The results of the analysis showed that the credit terms and customer evaluation have a positive and significant effect on the Debt Performance, while the Collection Policy and Credit Risk Control have positive but insignificant impact on Debt Performance.

Konovalova N., Kristovska I., Kudinska M. (2016) in their research work “Credit Risk Management in Commercial Banks” told that the most common factors that affect the value of credit risk of a bank are the average income of the borrower, amount of loan and the tenure of loan.

Wiryono et.al (2015) in the study entitled “Bank Specific Determinants of Credit Risk: Empirical Evidence from Indonesian Banking Industry.” They focused on studying the credit risk in the banking industry. According to them, banks should take credit risk seriously to avoid the growth of credit risk and its impact on the health of the bank and financial position of the country. To maintaining profitability, credit risk must be managed properly. The authors therefore focused on the bank specific determinants which have an impact on credit risk to some extent.

Aliu Muhamet, and Sahiti Arbana, (2016) carried out a study on topic “The Effect of Credit Risk Management on Banks’ Profitability in Kosovo” to determine how risk management affects the bank’s profitability and pointed out that a higher risk asset ratio would result in a marginal decline in the profitability while higher non-performing assets had a positive and more substantial effect.

IV. RESEARCH METHODOLOGY

Statement of problem

Punjab National Bank is one the large public sector bank in India. At present Punjab National bank is facing too much credit risk due to improper credit practices which creates obstacles in profitability of bank. According to the data from RBI an unprecedented 6,801frauds, totaling Rs. 71500 crores, were detected during the FY-2019. It was 15% increase in volume and 80% in the value in comparison to previous year. This increase eclipses FY-18 banking fraud at Punjab National Bank, one of the most maligned in India’s history, when it was revealed that over the period of 7 to 8 years, fugitive diamond merchant Nirav Modi and Mehul Choksi reportedly committed a scam of about Rs.13,000 crores from Borrowing.

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Objective of the Study

The study was conducted to determine the relationship between the credit risk management and profitability of Punjab National Bank.

Period of Study

To study the effect of credit risk practices on profitability of Punjab National Bank the data was taken for last two years (i.e., 2017-18 and 2018-19)

Tool for Analysis

To study the effect of credit risk practices in Punjab National Bank on profitability coefficient of correlation was used. Coefficient of Correlation is a measure of the association between two variables which ranges between +1 and -1. The signs indicate that variables are positively or negatively related.

V. DATA ANALYSIS AND INTERPRETATION

Punjab National Bank is one the top leading Public sector Banks in India during last few years it has faced so many banking fraud due to which the profitability of Punjab National Bank fell down. The % of Gross NPA and Net NPA has greater fluctuation during the two years of study % of Gross NPAs and Net NPAs of Punjab National Bank

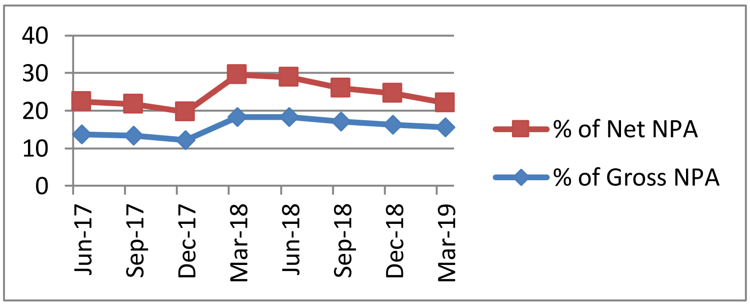

Figure 1: Net npa,Gross npa

Source: financial reports Punjab National Bank

TABLE 1: Net profit ,loss

	Net Profit/Loss (Rs. In crore)
Mar-19	-4749
Dec-18	246.51
Sep-18	-4532.35
Jun-18	-940.01
Mar-18	-13416.91
Dec-17	230.11
Sep-17	560.58
Jun-17	343.4

Source: financial reports Punjab National Bank

Gross NPA ratio represents a relationship between the amounts of Gross NPAs to Advance. It reflects the negative feature of bank's stability. Higher the Gross NPAs ratio shows the poor financial stability. As per the records the % of Gross NPAs of PNB was at its peak during quarter ending March 2018 i.e., 18.38 %.

The Net NPAs ratio is another indicator of negative performance for financial stability and soundness of bank. It shows the relationship between Net NPAs and to Advance. Higher the Net NPAs ratio shows the poor financial stability. The % of Net NPAs to Advance was highest during quarter ending March 2018 which was 11.24%.

VI. RESULTS AND CONCLUSION

Result Details & Calculation	Key
X Values $\sum = 299766.89$ Mean = 37470.861 $\sum(X - M_x)^2 = SS_x = 254192441.896$ *Y Values* $\sum = -22257.67$ Mean = -2782.209 $\sum(Y - M_y)^2 = SS_y = 162612697.331$ *X and Y Combined* $N = 8$ $\sum(X - M_x)(Y - M_y) = -128674156.411$ *R Calculation* $r = \sum((X - M_y)(Y - M_x)) / \sqrt{((SS_x)(SS_y))}$ $r = -128674156.411 / \sqrt{((254192441.896)(162612697.331))} = -0.6329$ *Meta Numerics (cross-check)* **r = -0.6329**	*X*: X Values *Y*: Y Values M_x: Mean of X Values M_y: Mean of Y Values $X - M_x$ & $Y - M_y$: Deviation scores $(X - M_x)^2$ & $(Y - M_y)^2$: Deviation Squared $(X - M_x)(Y - M_y)$: Product of Deviation Scores

The value of R is -0.6329.

This is a negative correlation, which means there is a tendency for high Net NPAs to go with low profitability. The negative correlation states the negative relationship between the NPAs and the profitability of Punjab National Bank. As the NPAs of PNB is increasing the profit earning capacity of bank is decreasing. The NPAs of PNB are increasing which affecting negatively the earning capacity of Bank. The performance of a bank depends on how it manages Non-Performing Assets effectively because if there is a higher amount of NPAs in bank it has to suffer a appalling condition.

VII. CONCLUSION

The present study investigates the effect of credit risk on profitability of Punjab National Bank. Specifically, this research is intended to determine the significant effects of credit risk which influence the profitability of banks. The result of the analysis showed that there is a negative and significant relationship between Net Non-Performing Assets and the profitability during the period of study. After the analysis of data of Punjab National Bank it was concluded that as the Non-Performing Assets Increase, the profit earning capacity of bank will decrease. The bank's Gross NPAs ratio and Net NPAs ratio also gives a negative reflection towards the banks as both are the negative indicator for banks performance.

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