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Does leverage influence banks' non-performing loans? Evidence from India

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Abstract

The study examines the association between corporate leverage and banks’ non-performing loans. Using data on Indian manufacturing sector in India for 1993–2004, the findings indicate lagged leverage to be an important determinant of bad loans of banks. In terms of magnitudes, a 10 percentage point rise in the corporate leverage is, on average, associated with 1.3 percentage point rise in sticky loans relative to loans, after a one period lag. In terms of policy implications, the analysis suggests that the leverage ratio can serve as a useful signpost of asset quality and second, the analysis points to the need to improve the collection of data from the corporate sector.

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Notes

[1] The industry groups considered in the study includes: Chemicals, Construction, Diversified, Electricity, Food and beverages, Heavy industries, Machinery, Metal and metal products, Miscellaneous manufacturing, Non-metallic mineral products, Textiles and Transport equipment.

[2] This database is increasingly employed in the literature for firm-level analysis on Indian industry. See, for instance, Ghosh and Sensarma (2004) for a recent application of the database on the interlinkage between monetary policy and corporate governance.

[3] Industrial sector comprises Manufacturing, Mining and quarrying and Electricity.

[4] The banking sector in India presently comprises of 27 state-owned, 20 incumbent and ten de novo private domestic sector banks and 33 foreign banks. The totality of these banks is referred to as the commercial banking sector. The financial year for commercial entities (banks and corporates) extends from the first day of April of a particular year to the last day of March of the subsequent year.

[5] We also experimented with the square of DER, to capture possible non-linearities in the relationship between non-performing loan and leverage. The results (not reported) suggest limited impact of this coefficient on NPLs.

Size, Non-Performing Loan, Capital and Productivity Change: Evidence From Indian State-Owned Banks

Source: Journal of Quantitative Economics

Corporate Financial Structure and Financial Stability

Source: IMF Working Papers

International and Domestic Collateral Constraints in a Model of Emerging Market Crises

Source: SSRN Electronic Journal

The Determinants of Banking Crises in Developing and Developed Countries

Source: International Monetary Fund Staff Papers

Corporate Balance Sheet Restructuring and Investment in the Euro Area

Source: IMF Working Papers

Inside the Black Box: The Credit Channel of Monetary Policy Transmission

Source: The Journal of Economic Perspectives