A Review of Impact of High Debt on the Profitability of the Banks

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Abstract
This study has an aim to analyze how the high debt effect the profitability of banks. If the bank is not capable of receiving back the amount of debt which it is given to the person then how bad debts amount will affect the profitability of bank. In this review paper seventeen papers related to impact of high debt on profitability of banks are review carefully. Different papers show the different results but if we explain the summary of results; when the credit management will be inefficient then the amount of bad debts portfolio will be higher which causes dilution in profitability.
Keywords: High debt, Profitability, Return of Assets, Return on Equity and Credit Management

1. Introduction
This review paper analyzes the impact of high debt on the profitability of banks. Lot of authors from the all the world write the articles about the banks which have to give debt to the others and have to discuss what will be its impact on their profitability.

The profit is the very important aim for every business. Profit is the amount which comes from after paying all the cost and expenses. The banks give the debt to the other institutions and charge the interest for increasing their profit. Debt is basically the amount which person borrows from the other person but in future the person who receives the amount of debt will be return to the giving party with interest amount paid. Basically the giving party may also called the creditors and the receiving party may also called the debtors so in other words the creditors always receive the amount of interest from the debtors. The interest rate can be increased with the increase time of payment according to the agreement. For example: If the amount of debt will be pay after 6 months then the interest rate will be 2% but if the amount of debt will be pay after 1 year then 4 % of interest rate amount will be charged.

Repayment of debt may be of different types. Firstly if the debtors repay the amount of debt before maturity then banks give them discount. Secondly, if debtor repays the amount of debt on maturity then banks charge less interest rate. Thirdly, if debtors repay the amount of debt after maturity then banks charge more interest rate. The person or company must finance from that country's banks whose currency is appreciated today but in future whose currency will be depreciated. It adversely affects the profitability ratio of the banks. But if person take finance from that country's bank which currency is depreciated today but in future its currency will be appreciated. In this situation, the company or person will be suffered loss but the profitability ratio of the bank will be increased.

The basic aim of this study is to analyze how the high debt effects the profitability of banks. If the bank is not capable of receiving back the amount of debt which it is given to the person then how bad debts amount will be effect the profitability of bank. This study analyzes the profitability ratios of banks like:

- ✓ Net profit
- ✓ Gross profit
- ✓ Operating profit
- ✓ Return on assets
- ✓ Return on equity

This study also analyzes the leverage ratios of banks such as:

- ✓ Debt to equity
- ✓ Debt to capital
- ✓ Interest coverage

If the amount of profitability ratios will be high so it is good indication for the banks. It means that bank's financial position is good. The reason of this study is to investigate about how high debt effect the profitability of banks with the help of data of 6 years over the period of 2009 to 2015

Different Scholars have different results according to their analysis regarding the profitability of banks. Mostly of the scholars results show the banks who gives less debt are better than those banks who gives high debt. Results are discussed later in this review paper in different sections of other scholars

Background of the study

Byusa and Nkusi (2012) focus on the effects of credit policy on bank performance in Rwanda. The dependents and independents variables are credit policy and bank performance. Taani (2013) focuses on the impact of capital structure on the performance of banks. Independent variables which is used in this study are total debt to total funds and total debt to total equity but the dependent variables are return on capital employed, return on equity, net interest margin and net profit

Gull and Arshad (2013) focus on influence of working capital management liquidity on financial soundness of firms listed at KSE. The study is taken ROCE as dependent variable while current ratio, quick ratio, inventory turnover ratio and account receive able turnover as an independent variable. Bolek (2013) examine the impact of liquidity and risk functions on profitability by basing on new connect market in POLAND. Free cash flow is taken as dependent variable while depreciation and amortization, changes in working capital and capital expenditure was taken as an independent variable.

Kaur and Singh (2013) study the managing efficiency and profitability through working capital. The study is also analyzed the scores of CCE, DOC, DWC, overall efficiency score. Agu, Chigozie and Okoli (2013) focus on the research work on Credit Management and Bad Debt in Nigeria Commercial Banks. The main purpose of this study is to analyze the effect of bad and doubtful debts in banks profitability. The study is also discussed about the interest rate and bank profitability as a variable.

Niresh (2013) focuses on the tradeoff between liquidity and profitability. The study is also discussed about Return on capital employed which is taken as dependent variable while current ratio, quick ratio and liquid ratio are taken as an independent variable. Khan and Sattar (2014) focuses on how the interest rate changes effect on the profitability of four major commercial banks in Pakistan.

Tariq, Usman, Mir, Aman and Ali (2014) studied the Determinants of Commercial Banks Profitability. The variables which had been used in this study are 13 independent variables, assets composition ratio, capitals, size, deposits, credit risk, debit risk, on-interest expenses, tax, assets quality and external variables inflation and real interest rate, and profitability as dependent variables..

Yegon, Cheruiyot, Sang and Cheruiyot (2014) studied the Effects of Capital Structure of the banking sector Profitability in Kenya. Return on equity is used as a dependent variable but firm size and sales growth is used as an independent variable in this study.

Anafo, Amponteng and Yin (2015) investigated the impact of capital structure on profitability of banks listed on the Ghana Stock Exchange. The dependent variables which are used in this study is ROA, ROE and EPS but independent variables are long-term debt to total asset (LTDTA), short-term debt to total asset (STDTA), firm size (SIZE) and asset growth rate (AGR). Enow and Brijlal (2014) examined the effect of working capital management on profitability. ROA was dependent variable while growth, size, leverage, cash convention cycle and sales were independent variables in this study.

Rehman, Khan and Khokhar (2014) studied to select financial ratios as a Determinant of Profitability. Rebecca, Oluoch and Fredrick (2014) studied the effects of liquidity management on the performance of companies of security market listed at NSE. Quang and Xin (2014) conducted the research on the Impact of Ownership Structure and Capital Structure on Financial Performance of Vietnamese Firms. The financial profitability of firm i.e. ROA and ROE was dependent variable while financial leverage, managerial owner ship, state ownership, growth opportunity and firm size was independent variable.

Kolapo, Oke and Ajayi (2015) examined the effect of working capital management on corporate performance. The dependent variables were Return on assets and gross working capital while independent variables were average collection period, cash conversion cycle and inventory turnover in days. Aggarwal and Chaudhary (2015) studied the Effect of Working Capital Management on the profitability of Indian firms. The dependent variable was gross operating profit ratio while independent variable was cash conversion cycle, size, fixed financial asset ratio and debt ratio.

Research Methodology and Data Analsis

Byusa and Nkusi (2012) collect data through Questionnaire. The total number of respondents are 24 but the male and female respondents are 18 and 6. Taani (2013) uses deduction method but he employs secondary source like quantitative techniques i.e. descriptive statistic, correlation matrix and regression models etc.

Gull and Arshad (2013) are taken 19 firms that is listed in cement sector as a sample. The data is obtained from World Wide Web, books and publications. The study is used empirical and regression model. Bolek (2013) take the data of non-financial companies listed on new connect market from 2007 to 2012. Kaur and Singh (2013) is used SPSS 17.0 software in their study to analyze the working capital performance and profitability.

Agu, Chigozie and Okoli (2013) collect data through primary source such as questionnaire, direct oral interview and secondary source such as journals, magazines and newspapers respectively. They use Vector auto regressive model to measure the variables in this study. Niresh (2013) is taken 31 manufacturing companies as a sample. He collected the data from the income statement and balance sheet of the sample firms. He used Pearson correlation model in his study.

Khan and Sattar (2014) collect the data from annual reports of the different banks, articles and other publications etc. and the period involved in this study from 2008 to 2012. The researchers use the two approaches for the collection of data i.e. quantitative and qualitative approach. The researchers use the Pearson correlation techniques in this study.

Tariq, Usman, Mir, Aman and Ali (2014) use dynamic panel data technique. Linear regression model is also used in this study. Data collects from web sites and annual financial reports of the sample firms on NSE. Data of 8 years (2004-2012) is taken in this study. The sample size which is taken in this study is 11 firms of banking industry.

Anafo, Amponteng and Yin (2015) use the data of 2007 to 2013 in this study. Data is gathered from Ghana stock exchange and the annual report of 17 listed banks. Descriptive statistics and regression models are used for the analysis of data. Enow and Brijlal (2014) collect the data from secondary source such as websites of different firms. The time period of data collection is from 2008 to 2012. Data is analyzed through SPSS software.

Rehman, Khan and Khokhar (2014) involve fourteen Petrochemical companies in Saudi Arabia stock exchange as a sample size. The multiple regression model technique is used in this study. Rebecca, Oluoch and Fredrick (2014) involve 63 companies as sample. The inferential and descriptive statistics method is used in this study. Data collects from the web sites and publications.

Quang and Xin (2014) collect data from the financial statements of listed companies on Ho Chi Minh Stock Exchange (HoSE) for the period of 2009 to 2012. 134 sample size is taken in this study. Kolapo, Oke and Ajayi (2015) involve eight companies as a sample. Data collects from the Annual audited accounts and NSE fact books in this study. Aggarwal and Chaudhary (2015) take 364 firms in this study which is listed in ISE. The data of 5 years that is 2010 to 2014 is used in this study. The Quota sampling technique is used in this study.

Discussion and Conclusion

Byusa and Nkusi (2012) concluded that when interest rate spread and interest margin is increased due to poor competition and inefficiency. The results are also indicated that credit policy also affects the profitability of banks. Taani (2013) determined the result in this study is that ROCE, Net profit and return on equity are averaged 15%, 9% and 10% respectively. The debt to equity ratio is 82.5% and debt to total funds is averaged 89%.

Ali Gull and Arshad (2013) determined that there is an inverse relationship among account receive able turnover, inventory turnover and return on capital employed. Bolek (2013) determined that risk factors are influenced the profitability. Profitability is influenced by accounting cash flows. Kaur and Singh (2013) determined that weighted overall efficiency score is 0.1153 and cash conversion efficiency is 0.425.

Agu, Chigozie and Okoli (2013) showed in this study that when the credit management will be inefficient then the amount of bad debts portfolio will be higher. Niresh (2013) in this study determine that relationship between return on capital employed and liquidity variables is negative. Khan and Sattar (2014) determine in this study is that there is an indirect relationship between interest rate and banks profitability. The results show that that there is –0.69 correlation between the interest rate and commercial banks profitability.

Tariq, Usman, Mir, Aman and Ali (2014) show in the results that when there is high loan to assets ratio then level of earning will also be higher. When equity to capital ratio will higher then it will lead to high profitability and performance enhancement. The impact of debt risk will be negative on the profitability of banks due to bankruptcy. Yegon, Cheruiyot, Sang and Cheruiyot (2014) in the results show that average value of return on equity over 8 years is 22.1% but the sales growth is 16.35%.

Anafo, Amponteng and Yin (2015) show in the results that there is minimum ROA i.e. 0.68% and maximum ROA i.e. 6.96% but minimum EPS i.e. 0.1% and the maximum EPS i.e. 397%.There is 7% minimum return on equity with 50% maximum return on equity. The study is indicated that there is 36% annual asset growth rate with 0.28507 of standard deviation. Enow and Brijlal (2014) show that results in this study 35.5% is the amount of ROA with the 18.8% standard deviation.92 days, 89 days, 46 days are the amount of collection period, payable period and cash conversion cycle period.16.3% and 2.6% are the amount of sales growth and current ratio.

Rehman, Khan and Khokhar (2014) show that there is no significant relation of debtor turnover ratio with the net profit margin. Rebecca, Oluoch and Fredrick (2014) show in their results that coefficient of such portfolio which is liquid will be highly risky as compared to ill liquid portfolio. Quang and Xin(2014) show in this study that managerial ownership is inversely related to financial performance which is determined by ROE 8.33% and 15.86% is the amount for the ROA and ROE in this study.

Kolapo, Oke and Ajayi (2015) show in the results that there is an indirect relationship between ROA and coefficient of average payment period with -0.382 and there is a direct relationship between gross working capital and coefficient of average payment period with 0.544. When there is increased in cash conversion cycle then return on asset is appreciated by 0.075 and gross working capital is depreciated by 0.2182. Aggarwal and Chaudhary (2015) show in the results that relationship among profitability, CCC and Debtors collection period is negative while the relationship between profitability and creditors payment period is positive.

Further Recommendations

In Pakistan banks play an important role for providing the debts to the business firms. The debt also effect on the profitability of banks. How it can effect on the profitability of banks you can study it by analyzing the banks financial statements. Mostly 5 years past data is used for analyzing in Pakistan but for further studies it can also be increased for better determining the impact of high debts on the profitability of banks. Researchers can classify the high debt and low debt providing banks then they can determine which types of bank effect more on the profitability. In Pakistan, the data of annual report of Askari bank, Habib Bank, Bank Alfalah, Punjab bank, MCB bank and Faysal bank can be analyzed for determining the effect of high debt on the profitability of banks.

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