



NON-PERFORMING LOANS: EVIDENCE FROM US STATES

**NUR AMIRA FARAHIN ABDUL RAZAK
2014317569**

**Submitted in Partial Fulfillment
of the Requirement for the
Bachelor of Business Administration (Hons)
Investment Management**

**FACULTY OF BUSINESS MANAGEMENT
UNIVERSITI TEKNOLOGI MARA
SEGAMAT, JOHOR.**

JANUARY 2017

ACKNOWLEDGEMENTS

I would first like to express my deepest gratitude to Allah S.W.T for surrounding me with great people to guide and nurture me and made this research paper possible. It also gives me great pleasure in acknowledging the support and guidance of my thesis advisor, Dr. Faridah Najuna Binti Misman. Without her support, this research would not be coordinated in the right way.

I would also like to say thanks to my previous lecturers which have taught in my Investment management course. Without their teachings and knowledge being shared, it would be impossible to conduct this research.

I would also like to express my greatest appreciation to my family members and friends for expressing their opinions and support for this research. I am truly indebted to them as they are truly very supportive throughout this research paper.

TABLE OF CONTENTS

	Page
Title Page	i
Declaration of Original Work	ii
Letter of Submission	iii
Acknowledgements	iv
Table of Contents	v
List of Tables	vii
List of Figures	viii
List of Abbreviations	ix
Abstract	x
Chapter 1: Research Overview	
1.1 Overview	1
1.2 Background of study	2
1.3 Problem statement	5
1.4 Research objective	6
1.5 Research question.....	7
1.6 Significance of study	7
1.7 Scope of study.....	8
Chapter 2: Literature Review	
2.1 Introduction	9
2.2 Non-performing loans.....	9
2.3 Loans to deposit.....	12
2.4 Net interest margin.....	13
2.5 return on equity	14
2.6 Unemployment rate.....	15
Chapter 3: Research Methodology	
3.1 Introduction	17
3.2 Population and sample	18
3.3 Data collection	18
3.4 Variables.....	18
3.4.1 Non-performing loans.....	19
3.4.2 Loans to deposit.....	19

ABSTRACT

This research provides analysis for state level banking industry specific as well as macroeconomic determinants of Non-performing Loans (NPLs) for banks in the North American region of the US States. The sample consists of banks from the state of New York City and Washington D.C from year 2006 until year 2015. These states are chosen because they were some of the states that were affected by the Global Financial Crisis (GFC). The banks chosen is based on the rankings on the bank's total assets. The banks specific variables include Return on Equity (ROE), Net Interest Margin (NIM) and Loan to Deposit ratio (LTD) while the Macroeconomic variables would be the Unemployment rate. Panel Ordinary Least squares (OLS) method is used to analyze the data sample. LTD has a significant negative relationship with NPL which contradicts with results from previous studies. The inverse relationship between LTD and NPL are due to the decrease of NPLs after the subprime crisis. NIM displays a positive relationship towards NPL. The result for ROE shows a significant negative correlation towards NPL while the unemployment rate results show that there is a positive relationship between unemployment and NPL.

CHAPTER 1: INTRODUCTION

1.1 Overview

Banks play a very important role towards economic development in any country San (2015). To ensure growth as well as general welfare, savings are channeled into productive activities. Financial system of banks will ensure that lenders in this case the household and firms will supply funds to borrowers, who consist of governments, households and firms Allen and Carletti (2008). Therefore, the basic function of banks would be to grant loans and receive deposits. A statement by Kjeldsen (2003), loans have longer duration of maturities while deposits can be taken out without notice. When banks provide loans, they will face a risk of borrowers of not being able to execute their obligations. This situation is associated with a risk called credit risk. A research done by Drigă and Dura (2014) which defined credit as an immediate purchasing power traded for a promise to make payment at a later date including interest and also provide pledged collateral until the loan is paid fully. When the promise to constantly make payments is broken, these unexecuted payments will be categorized as non-performing loans (NPL's).

The flow of this chapter continues with section 1.2 which explains the background of study. Problem statement, research objective, research questions, significance of study and the scope of study are based on section 1.3, 1.4, 1.5, 1.6 and 1.7 respectively. This chapter is important to justify the issue of this research and the purpose of this research paper.