

Impact of Non-Performing Assets on the Profitability of Banks

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ABSTRACT

Non-performing Asset is a "termite" for the banking sector. Non-performing Asset is a vital factor to examine the financial performance of a bank. It affects liquidity and profitability of the bank largely; in addition, it also poses a threat to the quality of asset and survival of banks. Non Performing Assets show the competence of the performance of the banks. Non Performing Assets means which amount is not received by the bank in return of loans disbursed. Thus, a study has been done on all banks ownership wise in India to evaluate the effect of Non Performing Assets on the profitability of banks. Banks today are not judged only based on number of branches and volume of deposits but also based on standard of assets. NPAs negatively affect on the profitability, liquidity and solvency of the banks. This paper analyses the circumstances of NPAs in banks namely State Bank of India (SBI), Nationalized Bank, Private Bank and Foreign Bank. Four Banks selected on basis of ownership for the study the relation between Gross NPA and Net Profit of banks. In this paper is applying correlation. The result shows that all the other banks exhibit a negative correlation between their gross Non Performing Assets and net profits. This study based upon secondary data recovered from Report of Progress of banking in India, Websites, Journals and Articles. The scope of the study is limited to analysis of nonperforming assets of public sector banks covering the period of 2014-2017.

1. Introduction

With the introduction of financial sector reforms 1991, the faces of Indian Banking sector have extremely changed. The problems arising in the banking sector will affect the Indian economy. When the economy collapsed also affected the banking sector. Function, as an intermediary bank is not running normally. The banking sector also has a very important role in the recovery process of the country's economy as a whole. The banking industry has moved gradually from a synchronized environment to a decontrolled market based economy. In 1991-1992 India was adopted the open economy. The beginning of liberalization and globalization in market development there has been tremendous changed in the transitional role of banks in India. The problem of swelling non-performing asset is catching attention and addition of huge NPA has assumed great importance in terms of risk management. The incidence of non-performing assets (NPAs) is affecting the performance of the credit institutions financially. NPA is a disorder resulting in non-performance of a portion of loan portfolio leading to no recovery or less recovery income to the lender. NPAs represent the quantify "Credit Risk". Bankers have realized to have effective NPA management on their priority list.

NPA broadly defined as non-repayment of interest and installment of principal amount (Das & Ghosh, 2006). According to the "Narasimham Committee Report (1991), those assets (overdraft/ cash credit) for which the interest remains due for a period of four quarters (180 days) should be considered as NPAs". After, this period had reduced and from March 1995, onwards assets for which interest and principle remains unpaid for a period of 90 days were considered as NPAs. Thus, NPA constitutes an important factor in the banking system as it seriously affects the profitability of the banks. The NPA can broadly be classified into Gross NPA and Net NPA. Gross NPA

reflects the quality of the loans made by banks whereas Net NPA shows the actual burden of banks.

2. Types of NPA

• Gross NPA

Gross NPAs are the sum total of all loan assets that are classified as NPAs as per the RBI guidelines as on Balance Sheet date. It reflects the quality of the loans made by banks. It consists of all the non-standard assets such as sub-standard, doubtful, and loss assets. It can be calculated with the help of following ratio:

$$\text{Gross NPA ratio} = \text{Gross NPAs} / \text{Gross Advances}$$

• Net NPA

Net NPAs are those type of NPAs in which the bank deducts the provision regarding NPAs. Net NPA shows the actual burden of banks. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high. It can be calculated by following.

$$\text{Net NPAs} = \text{Gross NPAs} - \text{Provisions} / \text{Gross Advances} - \text{Provisions}$$

3. Assets Classification

• Standard Assets

Standard Asset means which assets are not facing the problem and not more risk towards customer. Such assets are assumed to be performing asset. A general provision of 0.25% has to be provided on global loan portfolio basis.

• **Sub-standard Assets**

An asset would be classified as sub-standard if it remained NPA for a period less than or equal to 12 months. Accordingly a general provision of 10% on outstanding has to be provided on substandard assets.

• **Doubtful Assets**

These are the assets which have remained NPAs for a period exceeding 12 months and which are not considered as a loss advance. As per RBI, instruction banks have to facilitate 100% of unsecured amount of the outstanding loan.

• **Loss Assets**

A loss asset is one where the bank’s internal auditors and RBI’s external auditors have identified loss, but the amount has not been written off fully. These kinds of assets are also considered as uncollectible, and of little value that its continuance or maintenance as a bankable asset is not warranted or acceptable though there may be some salvage or recovery value.

4. Literature review

According to Reserve Bank of India (RBI) explains the definition of NPAs, “an asset makes non-performing when it stops to generate income for the bank. Recently an asset was measured as non-performing asset (NPA) stand on the concept of ‘Past Due’. A non performing asset was examined as credit in respect of which interest of principal has remained ‘past due’ for a particular time”. In this section, an attempt is made to review the earlier studies made so far on the non-performing assets in Indian banks and highlight the need of the present study.

Parekh (2002) in his attempt found that the gross NPAs of public, private and foreign banks are rising at a fast rate over the period. Therefore, he suggested that the Indian banking industry to embrace the sophisticated risk management practices.

Jain Vibha (2007) examined the status of NPAs in scheduled commercial banks in India. The study found that there is more acute problem of gross and net NPAs in Indian public sector banks including foreign banks during the period 1997-2003. The study concluded that the new private sector and foreign banks also failed to prevent this problem.

Gurumurthy (2012) analyzed that in the liberalized economy, banking and financial sector get higher priority. The banks in India are facing the problems of the NPAs and with that the earning capacity and profitability of banks is highly affected because of the NPAs

Narula and Singla (2014) evaluate the non-performing assets of Punjab National Bank and its impact on profitability and to establish the relationship between total advances, net profits, gross and net NPAs. This study concluded that there is a positive relationship between net profits and NPAs of the PNB. The problem of NPAs is because of the mis-management on the side of bank

Siraj and Sudarsanan Pillai says, “NPA is a virus affecting banking sector. The study concluded that NPA still remains a major threat and the incremental component explained through

additions to NPA poses a great question mark on efficiency of credit risk management of banks in India”.

Ranjan, R., Dhal, S.C. (2013) explores an empirical approach to the analysis of the Indian commercial banks’ nonperforming loans by regression analysis. The empirical analysis evaluates as to how the NPAs are influenced by three major sets of economic and financial factors, i.e., terms of credit, bank size induced risk preferences and macroeconomic shocks.

5. Research Methodology

This present research paper is to analyze the trends in NPAs in terms of values, gross NPAs and net profit. Several research studies on NPA in Indian banking sector are available, the studies on a closer look validated NPA problem using secondary data. The primary emphasis of this research is focused on analyzing nonperforming assets of public sector banks in India during the period 2013 to 2017. The present study is a descriptive study which tries to establish the relationship between the non performing assets and net profits. The data for the study has been sourced from Reserve Bank of India (RBI) bulletins, statistical tables relating to banks in India, report on existing and progress of banking in India, issued by the RBI. The final analysis is done by Correlation using MS Excel. The paper consists of secondary data, which has been collected from different publications such as the Reserve Bank of India publications, the reports published by commercial banks, various issues of the IBA journal etc. The empirical findings using observation method and statistical tools like correlation and data representation techniques identifies that there is a negative relationship between profitability measure and NPAs.

Table and Figures –I (Net Profits) (Amt in Millions)

Year	State Bank of India & Associates	Other nationalized Banks	Private Banks	Foreign Banks
2013	177833	327994	289954	115865
2014	136686	233503	337541	101397
2015	163020	212380	387347	128032
2016	115894	-295824	413137	108275
2017	-13827	-100060	422041	129650

Figure

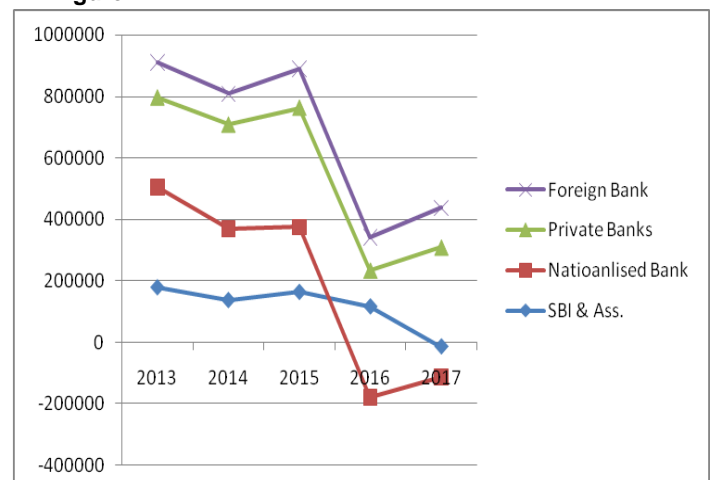


Figure 1: Net profit of Four Banks of last 5 year

Source: <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications>

This is the trend of Net Profit for the different banks for the years 2013 –2017. Almost all the banks have experienced a negative growth in the year 2016.

A remarkable difference observed in the financial status of the banks in the year 2016 & 2017. All the banks profits growth decrease in 2016 and in 2017 all banks increase profits except SBI & associates. The Profit/loss percents of the banks- SBI & Ass., other Nationalized Banks, Private banks and Foreign banks in the year 2017 as compared to 2016 , -111.93, -66.18, 2.15, and 19.74 respectively (Table-1.). Among the banks, only Foreign and Private Banks could achieve profit consistently in all the years.

Table and Figures -2 (Gross NPA's) (Amt in Millions)

The Gross NPA has been continuously increasing for all the banks for the specified period. As the business, operations of the bank increasing the amount of NPAs have also increased.

Year	State Bank of India & Associates	Other nationalized Banks	Private Banks	Foreign Banks
2013	281000	59949	619362	26626
2014	418151	88615	885787	31657
2015	372777	141283	1226734	17617
2016	688944	2515681	266774	27619
2017	969322	2861597	477802	21406

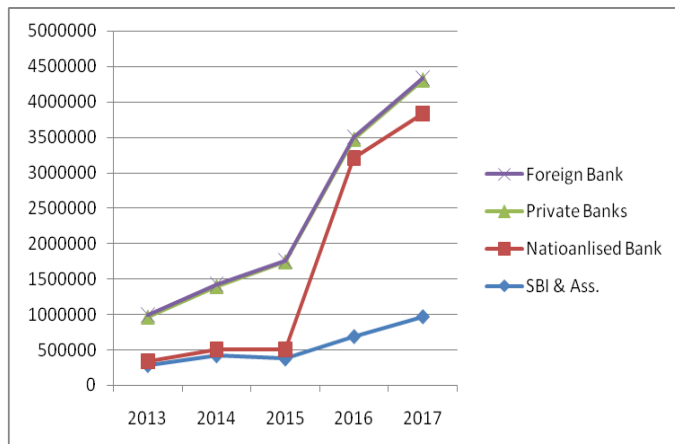


Figure 2: Non-performing assets of four banks of last 5 years
Source: <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#14>

NPA of all the banks went on increasing in all the years except Foreign Banks but a drastic raise observed in the year 2016 & 2017. The percentage raise of NPA of the banks in the year 2017 as compared to 2016 were SBI & Ass.– 40.69, Nationalized - 13.75, Private- 79.10, Foreign - (22.49).

Table and Figures-3 (Net NPA's) (Amt in Millions)

Year	State Bank of India & Associates	Other nationalized Banks	Private Banks	Foreign Banks
2013	627785	210705	1022272	79649
2014	798115	245424	1474474	115556
2015	735085	341062	2049595	107610
2016	1219686	4179879	561874	158052
2017	1778106	5069213	932092	136291

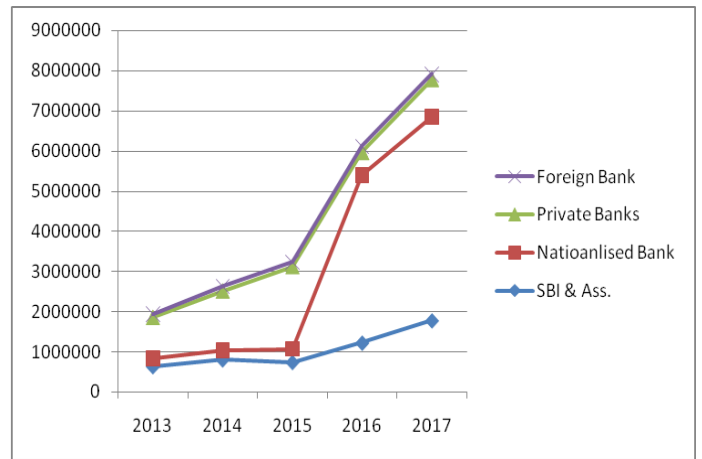


Figure -3 : Non-performing assets of four banks of last 5 years
Source: <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#14>

Table: 4 Correlation between NPA and Net Profit of the selected banks

Bank	Correlation
State Bank of India	-0.97211
Nationalized Banks	-0.91032
Private Banks	-0.16865
Foreign Banks	-0.1021

Source: Prepared by author

In Table 4 is showing the negative correlation for all the banks. NPA is directly related to Total Advances given by bank and banks main source of income is interest earned by bank. NPAs are increasing in every year but net profit decrease. The banks have expressed correlation between Gross NPA and the Net profit.

6. Conclusions

NPAs affect the financial performance of Indian banks as well financial growth of economy. Indian banking system is facing the NPAs problem. Every country's economic growth depends upon their financial system. The financial system mainly comprises banking sector. Especially public sector banks should focus on their NPA Management to grow their profitability. Non-performing assets (NPAs) is affecting the performance of financial institutions both financially and psychologically. Absorbing the credit management skills has become all the more important for improving the bottom-line of the banking sector. The current NPAs status continues to disturb Indian banking Sector. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and liquidity of banks.

Credit Information Bureau India LTD (CIBIL) the institutionalization of information sharing arrangement is now possible through the newly formed Credit information Bureau of India Limited (CIBIL) it was set up in the year 2001, by SBI, HDFC, and two foreign technology partners. This will prevent those who take advantage of lack of system of information sharing amongst leading institutions to borrow large amount against same assets and property, which has in no measures contributed to the incremental of NPAs of banks.

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