A Study on Non- Performing Assets and Its Impact on Public Sector Banks in India

M.Valliammal[#1], Dr.S.K.Manivannan[*2]

[1]Department of Management Studies, SRMIST, Vadapalani, Chennai, Tamil Nadu, India
[*2]School of Management,SRMIST,Kattankulathur, Chennai, Tamil Nadu, India

ABSTRACT

The banking industry is an important player in making of any economy and more so in India in the current trend of economic slowdown since 2008. Banks need to be financially strong for this purpose. The impact of non-performing assets on the financial performance is the focus for this study. The level of profits as an indicator of financial performance and the level of non-performing assets were studied with select banks and we find that there is a very high relationship in reduction of profits and increase in such assets. These Banks need to focus more on managing financial assets better to increase profitability.

Keywords : Non performing assets, Public sector banks, Indian banking Industry, Financial Performance, Bank profitability

I. INTRODUCTION

The Indian banking industry has played a major role in the economic growth for over 200 years. Banking intermediates transfer of financial resources from households to investors and thus enables economic growth. Further the banks also create money supply by the process of bank credit which is a channel of monetary policy transmission as well. These loans and advances given by banks to investors in expectation of future income are treated as assets for the banks.

Non-Performing Asset (NPA) is any type of asset of a bank which do not generate any income for the bank. That is a loan or advance which is not meeting its interest or principal payments which become NPA.The value of such assets will decline as they fail the requirements. The NPAs if left attended to in time become bad debts. Usually the borrowers are given a certain grace period, beyond which they are termed as NPA.

The RBI classifies loans on which interest or installment of principal that remain overdue for a period of more than 90 days from the end of a particular quarter as a Non-performing Asset.

The impact of NPAs on the profitability of the banks are as below:

1. They reduces earning capacity of the assets.

2. Uncovered NPAs carry risk weight of 100% and they block capital for maintaining Capital adequacy. As NPAs do not earn any income, they adversely affect the Capital Adequacy Ratio of the bank.

3. Carrying of NPAs increases Cost of Capital Adequacy, cost of funds, and Operating cost for monitoring and recovering NPAs.

4. The Economic Value Added (which is the Net operating profit after tax less the cost of capital) which measures business's performance towards shareholders value creation, is adversely affected by NPAs.

5. Because of NPAs, yield on loans and advances shows a lower figure than actual yield on regular Advances.

6. NPAs reduce earning capacity of the assets and thus the Return on Assets gets affected.

II. REVIEW OF LITERATURE

A Review of relevant literatures will give an over view of the studies made on NPA. Also this helps in identifying the gap in earlier studies.

Bhati and Goyal (2012) had made a study of the Indian public sector banks and the Reserve Bank of India regulatory framework. They had concluded that the non-performing assets be strictly classified so as to control the high level of NPAs observed.[1]

Khedekar (2013) had studied the India banking industry after the global financial crisis of 2008 and underlined strengthening of banks to play a key role in economic revival for the country.[2]

Murthy and Bhanu Gupta (2012) had used Structure-Content-Performance model to study the Indian banking industry and had identified relationship between competition and NPAs of the banks.[3]

I.   PROBLEM AND OBJECTIVES OF STUDY

The importance of banks in Indian economy cannot be understated. For that purpose, the concerned stakeholders and public policy must take cognizance of the financial stability and performance of the banks, both in public and private sector. The foregoing studies also had pointed to the level of NPAs as one key factor for financial performance, though the exact level of relationship had not been deeply studied. Hence the problem focus of the current study would be identify the relationship between banks NPAs and profitability.

Further as in the past, there is a greater expectation from the public sector banks to play a major role in revival of economic affairs of the country now. Accordingly, the objective of the study is to study the profitability and NPAs as well as the relationship between them especially for select public sector banks in India.

III. METHODOLOGY AND OBSERVATIONS

Bank profitability needs secondary data from published bank annual statement. We have selected a few public sector banks as representative of the

A. Research Hypothesis

The study focuses on the profitability and NPAs of the banks. When we look closer, we have different types of measuring profit like gross profit, net profit etc. However, the ultimate result of a bank's operations for its stakeholders will be its net profit. Similarly, the net NPA would be a better measure than the gross NPA. Hence the null hypothesis used in the study would be that there is no relationship between Bank net profit and net NPA.

B. Analysis and Interpretation

To begin with we analyzed the trend of net profits across different banks over a 7-year time period to identify both good performers as well as bad performers in terms of net profit.
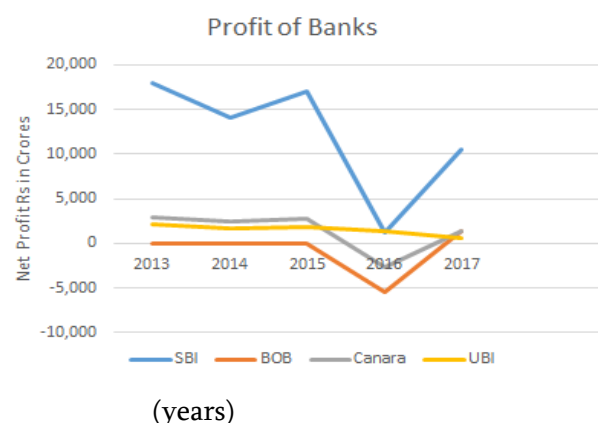

(years)

Fig. 1 Net Profit of select Banks across years

The foregoing graph makes it clear that not all public sector banks have performed equally and there are

good and average performers. Even the good performers have had lapses, especially in 2016. To understand further, we can explore one of the causes we have hypothesized, namely the net NPA data and how it had progressed over the same period.
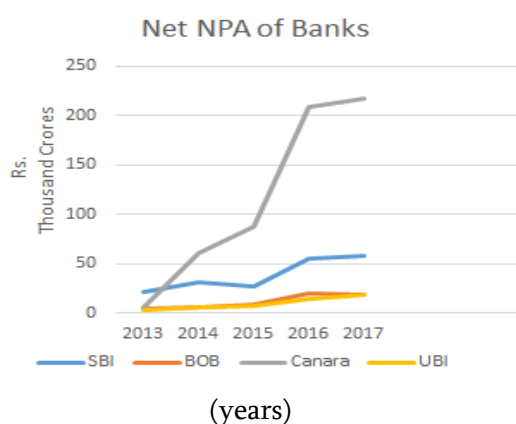

(years)

Fig. 2 Net NPA of select Banks across years

Now we could see that the decrease in net profits are accompanied by increase in Net NPAs as well. To check the extend of relationship between net NPA and profits the correlation between these two data for the different banks were calculated as below.

TABLE I

CORRELATION BETWEEN NET NPA AND NET PROFIT OF BANKS

Bank	Correlation Score
State Bank of India	-0.85
Bank of Baroda	-0.47
Canara Bank	-0.74
Union Bank of India	-0.95

The correlation analysis shows that the NPA and profits of banks are generally strongly negatively correlated. The level of inverse relationship is a weaker in case of Bank of Baroda only and in rest of the banks the impact of NPAs are strongly felt on the profitability.

IV. CONCLUSION

The banks we had studied have shown significant level of impact on profitability due to NPAs as seen from our analysis. Hence it is imperative on them to manage their NPAs with suitable measures so as to improve on their profitability. Further this research model also can be used to study the bank performance in other public sector and private sector banks as well.

V. REFERENCES

[1] Bhati, G., & Goyal, C. K. Degradation in asset quality: A Sectoral study of non-performing assets in public sector banks in India.

[2] Khedekar, P. S. (2012). Performance of Non-Performing Assets in India. Aweshkar Research Journal, 13(1).

[3] Murthy, K. B., & Gupta, L. (2013). Growth Accounting Approach: Impact of Non-Performing Assets on Performance. The Indian Economic Journal, 60(4), 55-80.