

“A study on NPA and impact of NPA on banking performance and profitability of public sector and private sector bank” (With special reference to SBI Bank and ICICI Bank)

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ABSTRACT

Banks play a very important role in any economy. Banks function to mobilize the funds of the people and to disburse funds according to the priorities of the society and the economy. Thus, it is very important that a bank should manage its credit in an efficient manner and should recover the disbursed loan assets effectively so that it doesn't lead to NPAs. This dissertation deals with the problem of non-performing assets. A non-performing asset is defined as an asset that ceases to generate incomes to the banks for more than 90 days. This paper also discusses the financial performance of the public and private sector banks with respect to NPAs and tries to find the suggestive measures to keep a control on the increasing NPA in the banking sector in India.

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I. INTRODUCTION:

Today NPAs are the matter of utmost concern in the banking sector or other financial institutions in India. Whenever a loan amount which doesn't meet the laid payment criteria of interest amount of EMI (Equated Monthly) payments are known as non-performing assets. NPAs can be further seen as commercial and consumer loans. Commercial loans become NPA when they are overdue for more than 90 days, whereas consumer loans become NPA when they are due for more than 180 days. Recently, there have been various cases by big corporate houses which are pending with the Indian Banks. Bhushan Steel is one such example who defaulted on an amount of Rs. 56,022 crore, out of which only 63.5% (=Rs. 35,571 crore) has been realised so far. The concept of non-performing asset in banking system is only limited to loans. When a loan asset ceases to generate income (EMI, interest, or any other dues) for bank for more than 90 days, then that loan asset is declared to be an NPA. As per a report of Reserve Bank of India, the gross nonperforming assets in Indian banks is estimated at around Rs. 440,000 crore, out of which 90 percent of the NPA is accounted by the public sector banks. Narasimham Committee was the first ever committee that made it compulsory to identify and reduce the NPA and to treat this issue as a concern of national priority. Due to NPA, banks face credit risk and also become inefficient in allocating resources.

If we look at the numbers of NPA over the period of 25 years, we would find that in the year 1995, the NPAs in public sector banks were around Rs. 38,385 crore and which increased to around Rs. 71047 crore in the year 2011, and currently it is around Rs. 400,000 crore. And in private sector banks, the NPAs in the year 2001 was about Rs. 6410 crores, which increased to Rs. 17,972 crore in the year 2011 and as of now, it is around 44,000 crore rupees. Profitability and the revenues of the banks are badly impacted by the default in the payment of the loan assets which leads to the creation of NPAs.

MEANING OF NON-PERFORMING ASSETS

Meaning of Non-Performing Assets (NPAs) has been well defined by RBI. RBI (Reserve Bank of India) is the central bank of India. Now, as per RBI, a non-performing asset is:

- An asset, that also includes leased asset when it stops accumulating income for the banks or financial institutions.
- A NPA is a loan or advance where:
 - o Any interest or instalment of the principal amount remains overdue for a period longer than 90 days in case of a term loan.
 - o The bill, in case of bills purchased and discounted, remains overdue for a period of more than 90 days.
 - o The instalment of principal or interest thereon remains overdue for two crop seasons for

short duration crops, the instalment of principal or interest thereon remains overdue for one crop season for long duration crops.

- The instalment of principal or interest thereon remains overdue for one crop season for long duration crops.

- The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.

- In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

KINDS OF NPA

There are 2 kinds of NPA:

1. Gross NPA

Gross NPA is the overall quantitative amount of all those loans that have gone bad debts. It is an advance which is written off, for which bank has made provisions, and is still in bank's book of accounts.

Gross NPAs Ratio = Gross NPAs / Gross Advances

2. Net NPA

Those NPAs in which, the banks have deducted the provisions regarding NPAs from the Gross NPAs are known as Net NPAs.

Net NPA = Gross NPA - Provisions

ASSETS CLASSIFICATION

Assets can be classified into 3 types:

Standard Assets

Those assets which are not facing any problem and are not of more risk towards the customer are known as standard assets. These standard assets are considered as performing assets. A general provision of 0.25% is must to be provided on basis of global loan portfolio.

Sub-Standard Assets

Any asset which is remained NPA for a period less than or equal to 12 months is classified as sub-standard asset. A general provision of 10% on outstanding has to be provided on sub-standard assets.

Doubtful Assets

Those assets which have remained NPAs for a period exceeding 12 months and which are not loss advance. As per RBI, it is must for banks to facilitate 100% of unsecured amount of pending loan.

REASONS BEHIND NPAS

There are several reasons for a loan asset account becoming a non-performing asset. It is very important for a banking sector to flourish; otherwise it directly impacts the economy and the financial power of the country. The increasing non-

performance assets are nothing but failure of the banking sector which also indirectly affects the other sectors. Earlier, the Indian banking sector was being operated in a closed economy but since when it has been open to the economy, it has faced various challenges.

The increasing NPAs is the net result of this situation and which costs the banks so much and finally it leads to the higher cost of the banking services. One of the main reasons behind the increasing NPAs is the prescribed percentage of credit of the banking sector to the priority sectors. And this percentage is too high, i.e., 40 percent. Indian banking sector doesn't face lack of stringent norms but rather they face various legal impediments and time consuming asset disposal process.

This NPA problem is not new, and has been continuing for more than decades. It was year 1989-1990, when the Prime Minister VP Singh at that time, had given a huge waiver of Rs. 15,000 crore for the rural loan accounts, this didn't help much, but this left a very negative impact in the payer and the borrower, as after that the payer didn't use to feel obliged to pay their debts, and this negatively affected the Indian Banking Sector.

There are two factors for a loan account becoming a non-performing assets, internal factor and external factor. Internal factors are related to the funds and the borrower like when the funds borrowed for any particular purpose is not used for that purpose or when that purpose or project is not completed within the stipulated time. This creates the situation of non-payment of loan assets. Apart from this, business failures and diversions of funds for doing other things also cause the situation of NPAs. Well, all these situations occur because of the borrower and their projects. Also, wilful defaults, siphoning of the borrowed funds, frauds, loan disputes and misappropriation are the additional reasons. On the other hand, internal factors also include the deficiency on the side of the banks, when the banks fail to monitor the loan assets, and delay in follow-ups with the borrower for settlement of the loan accounts.

External factors are other factors that are due to policies, environmental, legal and social factors. Sluggish legal system is one of the major external factors as there are never ending disputes and lack in sincere efforts by the legal system to settle the disputes. And the government policies like excise and import duties affect the banking sector. Also, the industrial recession and shortage of raw materials, power and other resources are the major reasons for the increasing NPAs.

IMPACT OF NPA ON BANKING PERFORMANCE AND PROFITABILITY

The increasing non-performing assets in the Indian banking sector, not only minimises the profitability of the banks but also impacts the credibility of the banks. This massive amount of increasing non-performing assets in the commercial banks is eroding the maximum of the capital base of the public sector banks. If the banks start making losses, it starts destabilising the confidence of the customers (depositors) of the banks. And if the depositors lose confidence in their banks, they will start withdrawing their money from the banks, which would lead to the collapse of the banking system. This is why it is very important that non-performing assets must always remain within the minimum limit so that the sustainability and stability of the banks doesn't get disturbed.

This is not the only impact NPAs causes. Also when NPAs increase, it forces banks to decrease the interest rates on the saving deposit accounts to increase the margin of profitability of the banks. NPAs cause long term threats to the banking sectors with respect to its stability. Recently after demonetisation, it was noted that the profitability of the manufacturing sector reduced, which prompted the banks to stop the credit growth of the industrial sector. The shortage of funds due to NPAs affected the growth of the industrial sector. This continuous reduction of availability of credit is not only harmful for the industrial sector, but also for overall economy.

Increasing NPAs lead to the shrinking of availability of credit to the public, and hence the funds are not available to the public at large and mainly for priority sectors, which in turn halts the growth of the economy and industrial sector. Only when credit is available to the public in excess through banks, then only new entrepreneurs could establish new companies, which in turn would generate employment and will lead to a better and robust economy. Hence, it is very important that banking sectors be stabilised and NPAs should be controlled through its effective management

II. OBJECTIVES OF THE STUDY

1. To comprehend the financial performance of the public and private sector banks of India During the last 10 years.

2. To study the impact of NPAs on banking system.
3. To compare the proportion of Non-Performing assets in the public and private sector banks.
4. To study the reasons behind the occurrence and growing trend of NPAs in the both public and private sector banks.
5. To examine the recovery methods and policies being used by these banks to reduce the load of increasing NPAs in the banking sector.
6. To address the suggestive measures for the banks to efficiently and effectively handle and reduce the hindrances caused by the NPAs to the banking system in India.

III. RESEARCH METHODOLOGY:

Sources of data:

The data collected for the preparation of this dissertation is both primary and secondary in nature. The sources of data used for this dissertation include the annual reports and literatures published by Indian Banks and Reserve Bank of India, various articles, magazines and journals. The data used in this analysis is restricted to 2014-2018.

Methodology of study:

For this dissertation, quantitative method of research was used. We have reviewed the non-performing assets in commercial banks that include public and private sector banks listed in the Second Schedule of the Reserve Bank of India Act, 1934. The data has been collected from the Annual Reports of various public and private sector banks, RBI press release, RBI notifications and RBI occasional papers. The secondary data has been collected from various articles, magazines and dissertations on NPAs. Data of public sector (State Bank of India) and private sector banks (ICICI Bank) have been compared to examine the situation of credit management in both sectors.

IV. TECHNIQUES OF DATA COLLECTION AND ANALYSIS:

Simple technique of data collection has been used for this dissertation. Data for this dissertation has been extracted from various documents and records. The data obtained for this dissertation has been analysed using appropriate statistical techniques like averages, financial ratios and percentages.

NET PROFIT (In Crores)

| Year | SBI | ICICI |
|------|----------|----------|
| 2014 | 10891.17 | 9810.48 |
| 2015 | 13101.57 | 11175.35 |
| 2016 | 9950.65 | 9726.29 |
| 2017 | 10484.1 | 9801.08 |
| 2018 | -6547.45 | 6777.42 |

Table-1

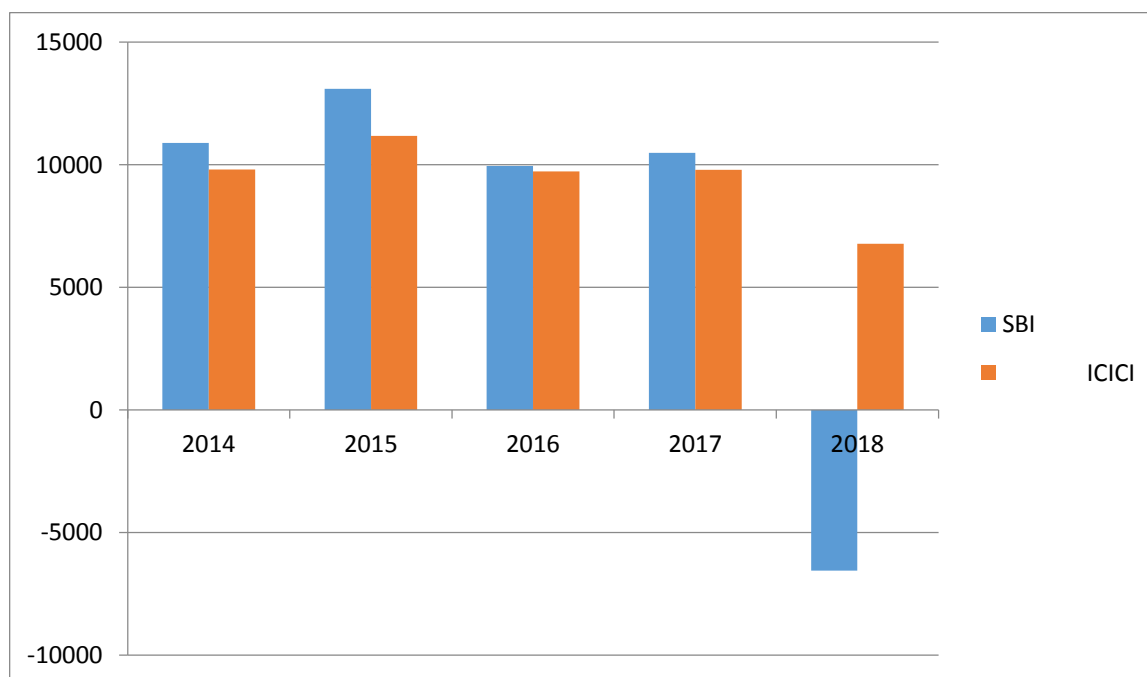


Chart-1

GROSS NPA (In Crores)

| YEAR | SBI | ICICI |
|------|-----------|----------|
| 2014 | 61605.35 | 10505.84 |
| 2015 | 56725.34 | 15094.69 |
| 2016 | 98172.8 | 26720.93 |
| 2017 | 112342.99 | 42551.54 |
| 2018 | 223427.46 | 54062.51 |

Table-2

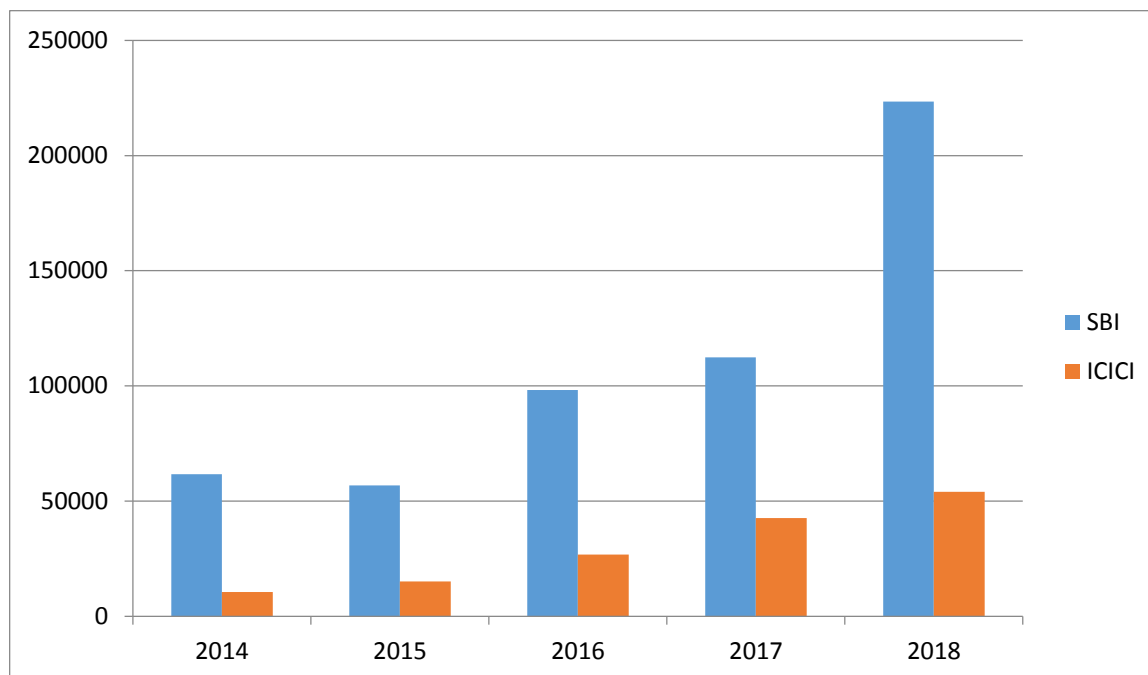


Chart-2: LOANS ADVANCED (In Crores)

| YEAR | SBI | ICICI |
|------|------------|-----------|
| 2014 | 1209828.72 | 338702.65 |
| 2015 | 1300026.39 | 387522.07 |
| 2016 | 1463700.42 | 435263.94 |
| 2017 | 1571078.38 | 464232.08 |
| 2018 | 1934880.19 | 512395.29 |

Table-3

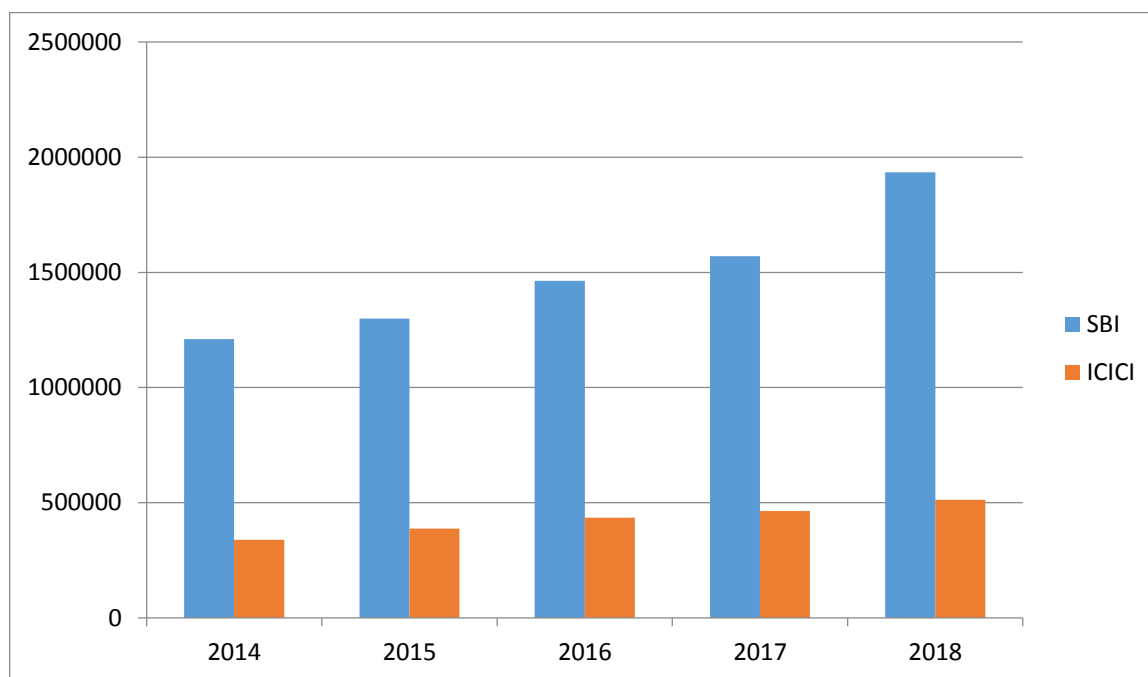


Chart-3

V. RESULTS AND DISCUSSIONS:

The study of four banks has been conducted. Two of them are public banks; where as other two are private banks. Three data sets have been taken to conduct the research. First is net profits made by these banks. Second one is gross NPA of these banks. And last one, the third one is loans advanced by these banks.

As seen in Chart 1, it is clearly evident that SBI is the bank with largest net profit of Rs. 10891.17 crore in the year 2014, and increased till the year 2015 up to 13101.57 crore rupees. The same scenario was with ICICI BANK. Subsequently the net profit of ICICI banks also started increase and decreasing in the year 2014 to 2018, State Bank of India, the largest public bank in India suffered a loss of Rs. -6547.45 crore rupees. But private sector banks managed to make profits. But none of the banks managed to increase the net profit, as seen in Chart 1

The net profitability of a bank depends on the gross NPAs of the banks, and the recovery of the loans advanced by the banks. If we refer to the Chart 3, we can see that SBI disbursed the maximum loans since ever. In 2018, SBI disbursed a total of Rs. 191,34,880.19 crores, out of which a net total of 2,23,427.46 crores resulted as NPA, and which has doubled from the year 2017, due to which State Bank of India suffered a net loss of Rs. -6547.45 crores.

If we look at the data of Bank, as of 2018, it has loans advanced of Rs. 512395.29 crores out of which around Rs. 54065.51 crore was gross NPA, which comes at almost 19.97% of the total loans advanced by the bank and the same year made a net profit of around Rs. 6777.42 crore. And hasn't decreases in any of the following year, and amounted to increase in 200% increase each year, leading to gross NPA of Rs. 86,620.05 crore in the year 2018.

bank has also failed to manage their NPA accounts as their NPA percentage to the loans advanced was net 10.5% in the year 2018, and SBI's was 11.54%. This increasing percentage of NPA to the Loans advanced is very dangerous as it is affecting the profitability of the banks and further the decrease in the interest rates on the deposit accounts. This needs to be controlled or bank's lending power may also get affected by this increasing trend of NPA.

It can be seen that the mean NPA of the banks has only increased during this period and never decreased, it shows the lack of effective management of the NPAs by these banks.

The same results are seen while calculating the median NPA of these banks, median of public banks have been higher than the private sector

banks. During the period of 2014-2018,. And if we look at the combined NPA of all these 2 banks, it could be said that the median NPA of all the banks together has increased many times during the period of 2014-2018. This adversely affected the profitability of the banks, which can be seen. Whereas the mean net profit of the private banks was almost half of the mean net profit of the public sector banks, but in year 2014, mean net profit of private banks was more than the mean net profit banks of the public banks. And since then the mean net profit of the public banks have been decreasing and became negative in the year 2018, while the mean net profit of private banks also fell down, and struggled hard to make profits., but became negative in the year 2018 due to the increasing NPAs during the period of 2014-2018. Similarly, the median net profit of the public banks were higher than the median net profit of the private sector banks, but the private banks overtook the median net profit of public sector banks in the year 2014. And since then, public banks have failed in making profits. But if we look at the median net profit of all the banks, they combined together managed an increased median net profit till the year 2016 only.

the State Bank of India combined advanced mean loans of Rs. 2, 69,169.62 crore whereas the bank and Axis bank together advanced mean loans of Rs. 1, 42, 638.57 crore, which is relatively lower than the combined means of the public sector banks, and there has been no such instances where the private banks advanced more loan than public sector banks during the period of 2014-2018. and which never decreased during the period of 2014-2018, and increased many times in 2018 during this period. Also, the median of loans advanced of all these banks during the period of 2014-2018.

VI. CONCLUSIONS:

The non-performing assets have been a very big problem for the banking sector in India. This doesn't only affect the banking sector in India but also affects the Indian economy. The percentage of the NPAs to the loans have been increasing rapidly in both the private and public sector banks. Private Banks are also unable to decrease this ratio, but they are still better at managing their NPAs when compared to the public sector banks. As we can see the percentage of gross NPA to the loans advanced of State Bank of India, ICICI Bank in 2014. And which increased to 11.54%, 19.97%, 10.55% and 7.78% respectively in 2018. If we compare all these 2 banks, we would find that the SBI is the worst performer in managing their NPAs, followed by ICICI.

But when we compare the status of Public Sector and Private sector banks, the research

concludes that the Private sector banks, if not effectively, then still better managing the NPAs than the Public Sector Banks. Also, Private banks have managed to make profits, even after being hit by trends of increasing NPAs, unlike in public sector banks, which have results in loss of 1000s of crore of rupees. This money being stuck in the case of non-performing assets have a direct effect on the profitability of the banks as these banks' income usually depends on the interests earned on the amount of loans advanced by these banks. This present study concludes that the extent of non-performing assets is higher in public sector banks in contrast to the private sector banks. It can be considered that it is far from impossible for banks to have 0 NPA, but still this increasing NPAs must be controlled in order to revive the banking sector and to boost the economy of India. For this, banks will have to introduce the speedy recovery process to combat this situation. Reserve Bank of India, which is the Central Bank of India, should revise the ting credit appraisals and the monitoring system, and banks should improve upon the ting methods of loan recovery process, and strengthen them and should also bring new methods of loan recovery. Credit appraisal and the monitoring system are the two very important and crucial steps that all the banks should focus on, especially public sector banks. For this, banks should do regular follow-up with the defaulters and remind them, and if possible personal visits may also be made.

The government has already brought legislations to recover these NPAs through SARFAESI Act and Bankruptcy & Insolvency Code. Now, it is time for government to make stringent provisions so that all the defaulters have to repay these NPAs. Now, if we see the defaulters, we would find that the problem of NPA is not with the small borrowers, but with the borrowers with larger amount. There should be speedy recovery mechanism and speedy trials to adjudicate the NPA cases, otherwise this problem of NPA will be continuously affecting the profitability of the banks, which is not at all good for the Indian economy, which tends to grow at the fastest rate among other economies.

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