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A STUDY ON ANALYSIS OF THE EFFECT OF THE NON-PERFORMING ASSETS ON THE PROFITABILITY OF THE PUBLIC SECTOR BANKS IN INDIA

Srinivasu Madagoni[1], Dr.K. Sivaji[2]

1. Research Scholar in the department of Commerce and Business Administration, Acharya Nagarjuna University, Nagarjuna Nagar, NH16, Guntur (District), Andhra Pradesh (State), India. 522 510.

2. Assistant Professor, Department of Commerce and Business Administration, Acharya Nagarjuna University Ongole Campus, Ongole, Andhra Pradesh (State), India. 523001

ABSTRACT-

Banking in modern times is the kingpin of all economic activities. It is instrumental in shaping the economic destiny of a country. Banks are considered as the nerve-centres of economics and finance of any nation and the barometer of its economic prospective. Since the banks have stupendous investment potential, they can make a significant contribution in eliminating poverty and problem of unemployment. It can bring about a progressive reduction in inter-regional/ state, inter-sectoral and inter-personal disparities in India.

The banking sector is facing the problem of rising NPAs at present. The purpose of the study is to measure the impact of NPAs on the profitability of Indian scheduled commercial banks for the period of ten years. The study discusses the impact of NPA on the profitability in India scheduled commercial banks for the past ten years. The ratio analysis, regression analysis, tests of equality of means, cross correlogram with the help of EViews 10 software were used to identify the variables pertaining to NPAs on the profitability of the banking sector. There is an increasing trend of NPAs of Scheduled commercial banks in India.

The non-performing assets increased up to Rs. 95825 crores as per the CRISIL report. The gross NPA increased from 3.3% in 31.03.2013 to 4% in 31.03.2014. Banks and other financial institutions are facing the problem of recovery of dues and banks‟ approach in managing fraudulent activities in the banking sector. It is important for a developing economy and the failure of NPA may have adverse effect on the banking sector and financial Institutions. The different aspects of literature review related to non-performing assets over the period have been collected and used for this study purpose. But there is an enormous gap existing for the complete research of non-performing assets on quality aspects. Most of the research and studies are being done on causes, and management aspects of NPAs. This study will fill the gap on the impact of NPAs on the profitability in Indian Scheduled Commercial Banks.

The objectives of the study are to analyze the impact of NPA on the

- Profitability of Indian scheduled commercial banks, to find out the Gross NPA and Net NPA of Scheduled Commercial Banks in India,
- To offer suitable solution for the management of NPA in banks.

After the first phase of economic liberalization, the Indian banking industry underwent a significant change, and the role of credit management became widely recognized. The banks have become more cautious and careful when lending money to borrowers because of the rising number of non-performing assets.

This study makes an effort to comprehend the reasons for an asset to become a non-performing asset (NPA) and various corrective steps that can be taken to reduce the amount of NPA in banks. The purpose of this study is to analyses the effect of nonperforming assets (NPAs) on the profitability of public sector banks (PSUs). Non-performing assets (NPAs) are the most pressing issue that the banks face today, and they are not only a liability for the banks but a challenge for the entire financial system. Rising non-performing assets (NPAs) have an impact on operating performance, which eventually has an impact on the bank's profitability, liquidity and solvency.

The rising number of non-performing assets (NPAs) puts a strain on fund recycling and limits banks' ability to lend further, resulting in lower interest income. NPAs must be reduced and regulated in order for banks to improve their performance and profitability. This study attempts to determine the relationship between NPAs and bank's profitability, taking into account major public sector banks that are dealing with the mounting NPAs. With the aid of the RBI, banks are now taking proactive steps to manage non-performing assets. To boost bank profitability, the level of NPA must fall, and banks must take various steps to achieve this.

Keywords: non-performing assets (NPAs), public sector banks (PSUs), economic liberalization, Gross NPA, Net NPA, gross advances, net advances, total assets and profitability.

I. INTRODUCTION

Commercial banks play an important role in the development of a country. A sound, liberal and dynamic banking system is an essential requirement for economic development of any nation. As an important sector of an economy, commercial banks act as the backbone of economic growth and wealth by acting as a substance in the process of development of nation. They instruct the habit of saving and mobilize funds from several small households and business firms feast over an extensive geographical area. The funds so mobilized are used for productive purposes in agriculture, industry, trade and

commerce. In this present scenario, non-performing assets become very serious problem for the banks while extending loans.

The increase in the profitability of a bank is always preceded by the composition of assets and liability. Nonperforming assets are defined as an advance where, on the date of the balance sheet, an amount to be paid to the bank is due for a period of 180 days. The loans which are unpaid beyond the due dates are categorized as non-performing assets or non-performing loans. Nonperforming assets can be Gross NPAs and Net NPAs. Non-performing loans raise to such an extent that revenues fall off and loan loss expenses, as well as operating costs engage all the incomes that continue. The causes of NPAs include disaster, sickness of the industries, in effective recovery process, business cycle, lending policy, absence of monitoring and follow up loan and managerial problems. The proportion of nonperforming Assets on selected variables are identified with the help of the following ratios:

- Ratio of Gross NPA to Gross Advances;
- Ratio of Net NPA to Net Advances;
- Ratio of Gross NPA to Total Assets;
- Ratio of Net NPA to Total Assets.

Non-performing assets are almost always an inevitable liability in the banking industry. The methods used to handle non-performing assets (NPAs) and hold them within the necessary amount are vital to the banks' success. As a result, the only way to regulate the amount of NPAs in banks is to prepare and implement an efficient monitoring and control policy that is backed up by proper legal reforms. According to the Reserve Bank of India, "An asset becomes non-performing when it ceases to generate income for the bank. Earlier an asset was considered as non-performing asset (NPA) based on the concept of 'Past Due'. A 'non-performing asset' (NPA) was defined as credit in respect of which interest and/or installment of principal has remained 'past due' for a specific period of time."

II. LITERATURE REVIEW

Many researchers have done research related to NPA and they find out different implications. Chijoriga (2000) and Batra (2003), in their study, stated that in banks, irrespective of profitability, liquidity and competitive functioning, NPA has a serious effect on the psychology of bankers related to disposition of funds towards credit delivery and credit expansion. Michael et al. (2006) insisted that, NPA affects profitability, liquidity and solvency position of banks by affecting its operational efficiency. It is essential to have a serious look on NPA, since it may affect the growth and survival of banks. Borbora (2007) pointed out that, banking sector must maintain efficient NPA management system to avoid negative financial performance. Panta (2007) emphasized that, after the initiation of banking sector reforms in 1992, most of the banks are taking initiatives to maintain NPA level and try to improve their

profitability position. Banks also consider the guidelines of RBI related to income recognition, asset classification and its norms related to various provisions.

Panta (2007) pointed out that, relationship exists between NPA and bank failure all over the world. Rajput et al (2011), in their study increasing level of non-performing assets (NPAs) in the banking sector can sternly affect the economy of the country. The reason for financial and economic reduction which in turn bad signals when NPAs are not correctly managed. Kumar and Gupta (2012) try to find out the effect of NPA on public sector banks of India by analysing their financial performance. Rajput et al. (2011) try to find out the effect of NPA on public sector banks of India by analysing their financial performance. Chaudhary and Sharma (2011), using projection of trend analysis, try to find out the efficiency of public and private sector banks in NPA management. Kumar and Singh (2012) conducted a study on NPA by selecting top performers of public sector banks and few foreign banks in India and analysed the important factors which cause NPA problems and also try to find the effective measures which are essential for effective NPA management. Patidar and Kataria (2012) conducted a research on the comparative study between SBI and Associates, Old Private Banks and New Private Banks and Nationalized Banks of the benchmark category and try to find out the significant difference of NPA and its impact on priority sector lending on the total NPA.

For the study, they used regression analysis and ratio analysis. Chatterjee et al. (2012) conducted a study and the result of their findings are NPAs have a negative effect on the achievement of capital adequacy level, funds mobilization, banking system credibility and productivity on the overall economy. Their study also reveals that private sector banks can protect themselves by adapting to the changing environment whereas public sector banks are facing enormous problems.

Mir and Jegadeeshwaran (2013) conducted a study, “NPA and causes for NPA”. They collected secondary data for five years and carried out analysis by using various tools like mean, CAGR, ANOVA and Rank. In their findings, they ranked the performance of banks based on NPA management. Das and Dutta (2014) conducted a study, “The growth of NPA in the public and private sector banks in India”. They collected data from „report on trend and progress of banking in India, RBI report on currency and finance, RBI economic surveys of India‟ and analysed by focusing on sector wise nonperforming assets of the commercial banks. The result of their study shows that the performance of the banks is low because of worse NPA management. Ranjan and Dhal (2013) conducted a research on the Indian commercial banks‟ nonperforming loans by using regression analysis and they analysed the terms of credit, risk preference based on the size of the bank and macroeconomic shocks. Das and Dutta (2014) conducted a study, “The growth of NPA in the public and private sector banks in India”. They collected data from „report on trend and progress of banking in India, RBI report on currency and finance, RBI economic surveys of India‟ and analysed by focusing on sector wise non-performing assets of the commercial

banks. The result of their study shows that the performance of the banks is low because of worse NPA management.

III. METHODOLOGY

The present study is based on census method. The secondary data were collected from the annual reports of Indian Bank Bulletin, Reserve Bank of India Annual reports, RBI websites, Various issues of Economic survey, various news daily papers and magazines dealing with the current banking scenario. The period of the study is ten years from 2007-2008 to 2016-2017. The ratio analysis, regression analysis, tests of equality of means, cross correlogram with the help of E-Views 10 software were used to identify the variables pertaining to NPAs on the profitability of the banking sector.

IV. IMPLICATIONS AND FUTURE SCOPE OF STUDY

The success of banking sector is determined by its profit and quality of assets. Though banks are providing various services like, lending, networks and generating employment to the public, its growth and survival depends on the quality of assets it possesses and the profitability position it holds. The greatest challenge for banking sector is the existence of Non-Performing Assets (NPA). NPA creates threat to the assets of the banks and for its survival by affecting its liquidity and profitability. Hence, it becomes essential to strengthen the financial systems in the developing economies and emerging markets. It is evident that, sound financial systems will assist in achieving economic growth through fund mobilization and utilizing them productively to transform various risks involved. The banking sector can improve their recovery process by focusing on large borrowers and they can implement some strict norms to solve this problem.

It is the right time that, government should take some effective measures to improve the settlement of pending cases and banks can avoid mandatory lending to some priority sector. Thus, serious concern is essential on the part of NPA, otherwise it may collapse the profitability of banks and that in turn may affect the growth on Indian economy. It is the onus on the concerned bank which has given the loan to tackle the problem of NPA. Therefore, the recommendations of Narasimham Committee which suggest that, the asset management companies or asset reconstruction fund must redress the NPAs to be reviewed. The use of technology will bring important change in the way banks manage their NPAs. Bankers may resort to Compromise Settlement or One Time Settlement for the recovery measures. Lok Adalats and Debt Recovery Tribunals are other ways for the recovery of dues as a part of NPA remedial measures. RBI may take actions against defaulters by publishing their names in Newspapers, broadcasting the information in media, which may enable other banks and financial institutions. Banks may prefer one-time settlement as a corrective measure and other existing ways to recover dues are Lok Adalats and Debt

Recovery Tribunals. If banks found that dues are because of genuine reasons like, draught, floods or other natural calamities then they can restructure their plans accordingly.

V. FINDINGS AND DISCUSSIONS

- It can be observed from the above data, that there has been a steep rise in the NPAs of Public Sector Banks since 2014. However, it wasn't until 2016, that banks started running into losses as till 2015, even with the rise in NPAs banks still managed to be profitable.
- There has been increase in the NPAs since 2014, which suggests that banks lacked transparency and weren't showing the actual picture of the status of the loans that had gone bad. This could be attributed to the fact that the loans were already defaulted by the borrowers and were under the NPA category but they weren't acknowledged by the banks till after 2014.
- From the Table 2. We can perceive that the Net Profits of the Public Sector Banks have dwindled in the past 5 years due to heavy provisions for Non-Performing Assets and other contingencies.
- As, it can be seen, that there is a moderately negative relationship between the Net profit and GNPAs of all the 12 Public Sector Banks, meaning a rise in one variable leads to a decline the other.
- There is a strong negative relationship between GNPAs and the Net Profits of the banks, with the profits steadily decreasing and the GNPAs rising due to poor appraisal of pre and post disbursement of loan, aggressive lending practices, wilful defaults, loan frauds and corruptions, poor follow-up by the banks and economic slowdown.
- However, Net Profits of some public sector banks have turned around in 2019-20 after continuous losses in previous years despite COVID-19, owing to the relief provided by RBI with respect to moratorium period, asset classification and ploughing back of dividends which shored up their performance.
- It can also be observed that Indian Overseas Bank had managed to significantly decrease their NPA burden from Rs. 33,398.12 cr to Rs. 19,912.70 cr due to capital infusion of Rs. 4,360 cr by the government.

VI. RECOMMENDATIONS AND CONCLUSION RECOMMENDATIONS

- To minimize the Non-Performing Assets (NPAs), banks should take proper steps to determine the creditworthiness of borrowers. Borrower's "Credit Information Bureau (India) Limited (CIBIL)" score should be evaluated to assess their creditworthiness.

- Banks should also try to ascertain prematurely that there is going to be a default and report it to the "Central Repository of Information on Large Credits (CRILC)".
- Before a loan is granted or released, a due diligence reports detailing the borrower's financial background must be prepared. As a result, banks must ensure that a rigorous audit is undertaken before accepting any loan volume.
- Loans can be issued depending on the output of properties in different sectors across various industries and various settlement schemes can be used.
- To combat the rising cases of lost money, strict fines may be imposed on loan defaulters or others who supply false or incorrect details and actively circulate information of the defaulters.
- To boost the recovery of advances by Public Sector Banks, banks must enforce adequate and strict recovery procedures.
- Alternate dispute resolution mechanisms can be used for more rapid clearance of the dues such as "LokAdalats and Debt Recovery Tribunals".
- For monitoring and governing the amount of NPAs in India's public sector banks, banks should approach the Debt Recovery Tribunals (DRT), LokAdalats, CIBIL, SARFAESI Act 2002, and Credit Information Bureau.
- The government must ensure that such cases are quickly resolved, since an uptick in nonperforming assets (NPAs) limits the circulation of money in banks and impacts the overall flow of the economy.
- There have been recent developments to tackle the rising NPAs such as Insolvency and Bankruptcy Code (IBC), Credit Risk Management and amending banking laws to give RBI more power than just inspection of the borrower.
- Giving RBI more power would ensure that they are able to not only monitor the large accounts but also be able to create oversight committees.
- There is a need for a suitable and operational Management Information System (MIS) to monitor warnings.
- Banks need to develop proper framework and guidelines for senior-level appointments.

CONCLUSION:

Every country's economic growth is dependent on the proper operation of the country's financial systems, which includes the banking sector. Non-performing assets (NPAs) have always harmed the Indian banking industry. They have a negative effect on the profitability of the banks. They not only affect the bank's financial performance but also the economy's financial growth. Since our economic

development is dependent on the financial system, the banks need to concentrate on NPA management in order to boost profits. An increasing NPA implies a huge number of credit defaults, which in turn has a bearing on a bank's profitability, liquidity, and solvency. The problem of nonperforming assets (NPAs) primarily affects public sector banks. The capital becomes unavailable when deposits become non-performing assets (NPAs) due to defaulting on the payment of dues, which has a direct effect on the bank's profitability because Indian banks depend heavily on interest income on funds borrowed.

VII. LIMITATIONS OF THE STUDY

The study's first and most important drawback is that it is focused on secondary results, from which some conclusions are drawn based on interpretation of the data.

- Furthermore, this analysis is limited to Indian Public Sector Banks, which does not offer a detailed image of the banking industry's results.
- The report is limited to the past ten years, from 2011 to 2020. As a result, the findings may not be exhaustive or generally relevant, as no consumers were consulted as part of the study, which is contrary to the bank's policies.
- The scope of the analysis is restricted by the data's availability.
- Since the details on Non-Performing Assets are very critical, bank officials are unable to disclose the facts and figures they have.
- NPAs are changing over time and the research is carried out in the present time, with little consideration for future possible changes.
- The Reserve Bank of India Publications was used to classify Non-Performing Assets.

FUTURE PERSPECTIVE

The Indian economy is on the threshold of a significant transition, with many policy reforms set to take place soon. Strong market perceptions, increased customer sentiment, and better-controlled inflation are all projected to aid the country's economic progress. Improvements in infrastructure investment, quicker project execution, and the continuity of changes are projected to fuel demand even further. All of these factors suggest that India's banking sector is self-sufficient in terms of stable and robust expansion, as rapidly expanding companies would turn to banks for credit. Phone and online banking systems have risen to prominence as a result of technological advances. In order to boost the customer's experience while giving them a strategic advantage, the banking industry is putting a stronger focus on delivering better services to their customers and improving their technological infrastructure.

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