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Npa & Profitability: Issues and Perspectives of Commercial Banks In India

Dr.N.S. Rathi Assistant Professor, Department of Commerce, Dr.B.A.M.University, Aurangabad.- 431001 (Maharashtra)

Mr.Ram Kalani Assistant Professor, Department of Management Science, Dr.B.A.M. University, Aurangabad.- 431001 (Maharashtra)

ABSTRACT

Implementation ofBasel-III norms for banking sector with respect to Income, Assets,& Provisionary regulations in the near future managing NPAs ,has emerged as the prime challenge for most of the Indian Banks. Now -a -days banks are judged separately on the Quality of Assets .NPAs intrinsically form a major part of loan portfolio which have an adverse impact on profitability, solvency & liquidity of Banks.

KEYWORDS : NPA, NIM, banks, assets, profitability.

Introduction:

Banks play critical roles in every economy. They operate the payments system, are the major source of credit for the larger population of the economy, and generally act as a safe custodian for depositor's funds1. The banking system aids in allocating resources from those who have it in surplus to those who are in need of these funds. Apart from its role as a transformation agent,banks also perform the role of being an ***Intermediary*** which helps in matching the deposits with loans thereby providing the much needed liquidity to the economy. The efficiency of the economy can be gauged from the manner in which the banks meet the credit requirements of the public at large & the depositors in particular, at invariably low costs & apt returns respectively. Thus, banking sector acts as a catalyst for the country's economy.

Bank's also carry out the additional responsibility of achieving the government's social agenda of inclusive growth enunciated in successive 5 year development plans. Over the years banking sector has been instrumental accordingly in deposit mobilization, mass branch networking, priority sector lending, employment generation etc. Subsequently, banks came under the ambit of extensive regulatory structure. Strong & sustainable credit growth is almost synonymous with a healthy operating environment and strong economic growth. This trend leads to robust asset creation within the economy.2 .However, bank induced growth can lead to an increase in ***Stressed Assets***. An evaluation of the Indian Banking industry over the years has revealed certain facts:

Reduced Productivity,
Deteriorated Asset Quality,
Increased Cost Structure.

Amongst the above mentioned, policy makers have identified the erosion of asset quality as the detrimental factor in progress of Indian Banking Industry. Asset Classification methods used so far have concealed the gravity of the problems which incidentally impacts various performance indicators like profitability, intermediation costs, liquidity, credit worthiness ,income generating capacity & overall functioning of banks. The soundness of banking system largely depends upon the performance of loan portfolio, i.e. the fulfillment of obligations of borrower's promptly.The reduction in the asset quality results in accumulation of Non-PerformingAssets (NPAs).NPA growth needs to be supported with a higher level of provisioning, which in turn has a direct impact on bottom line.3. Accordingly, banks are forced to raise Tier-I capital to sustain the same level of disbursements thereby affecting the profitability.

Objectives Of the Study:

1) To make a comparative study of NPAs of Public sector banks & Private sector banks.
2) To deliberate the reasons on the occurrence of NPAs in banks.
3) To study the methods available for the mitigation of NPAs.
4) To observe the effects on the performance of banks.

Non-Performing Assets (NPAs):A Conceptual Frame work

A Non–Performing Asset (NPA) can be defined as a credit facility in respect of which the interest and/or installment of principal has remained "past due" for a specific period of time. In India, the definition of NPAs has changed overtime. According to Narsimham Committee–(1991), those assets for which the interest and /or installment of principal remains due for a period of 180 days should be considered as NPAs. Accordingly, the efforts taken to reduce non-performing assets showed encouraging results with the ratio of net non-performing assets (i.e. net of provisions) to total advances declining from 16.3% at the end of 1991-92 to 8.2% at the end of 1997-98.

With an aim of moving towards the compliance with International best practices & ensuring greater transparency, a standard criterion of "90 days" past due/overdue norm was fixed for identification of NPAs from 2004 onwards in the Indian Financial System. Further, NPAs were classified as:

Sub-standard Assets-*Those assets which have been classified as NPAs for a period of less than or equal to 12 months.*

Doubtful Assets-*Those Sub-standard assets which have remained in the category for 12 months*

Loss Assets-*Those assets which have no salvage value i.e. remain uncollectible as observed by the bank.*

Reasons for NPAs: In the prevailing scenario, according to the Economic survey (2012-13) ,some factors have been identified for higher incidences of NPAs.

- Switchover to a Health-Code system- based identification of NPAs by PSBs as per RBI norms
- prevailing macro-economic situation in the country
- Increased interest rates in the recent past
- Lower economic growth and
- Aggressive lending by banks in the past, especially during good times

Thus, it can be observed that prevalence of NPAs in Bank balance sheet is a prudent indicator of financial health & soundness. Subsequently, they generate a vicious cycle of effects on sustainability & growth of banking system ultimately leading to bank failures.

NPAs: Effect on Bank Performance

- Reduction of Interest Income
- High level of Provisioning impacts profitability adversely
- Gradual decline in ability to meet steady rise in cost
- Increased pressure on NIM

- Reduced competitiveness
- Difficulty in augmenting Capital resources

- Leads to vicious cycle of sustainability & growth leading to bank failures

Literature Review:
Large number of studies has been carried out on NPAs by researchers over a period of time .The researcher has made attempts to present some of the studies. ***Kaveri***(2001) studied the NPAs of various banks & suggested strategies to reduce the quantum of NPAs. ***PrashanthK. Reddy***(2002)focused on NPAs of Indian Banks in the global context wherein he emphasized the importance of macro-economic variables in general& systemic issues pertaining to banks in particular. ***Dong He*** (2002) reviewed the nature of NPAs IndianBanking & discussed key elements of Asset Reconstruction Companies for effectiveness in resolving the issues of NPAs.***Ghosh***(2003) empirically examined NPLs of Indian PSBs in terms of indicators such as asset size, creditgrowth, operating efficiency.***Meenakshi and Mahesh (2010)*** in their exploratory paper examined the trends at global level & found that NPAs were high in priority sector, self-help groups were found to be effective in recovery of NPLs.***Hosmani and Hudagi (2011)*** carried out an empirical study on NPAs in Public Sector Banks in India & found that NPA issues can be resolved by diverse asset class & timely management may prevent degradation of such assets.

Research Methodology:
Literature Review reveals that existing studies concentrated on PSBs with Private Banks & Foreign Banks. The present study has focused on the comparison on NPA ratios between PSBs &Private banks. The banks under study include prominent banks from respective sectors:

Public Sector-State Bank Of India(SBI),Bank Of Baroda (BOB)
Private Sector-ICICI Bank, Axis Bank.

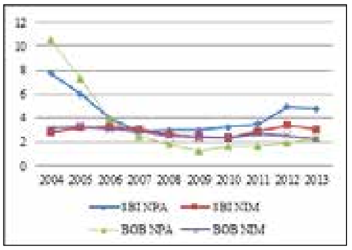
For the study, Secondary data has been collected has been collected from various publications of RBI which include:

Annual Reports of RBI, Trends &Progress of Banking in India, Statistical tables related to Banks in India, Reports on Currency & Finance, Guidelines of RBI pertaining to NPAs, Various Websites, and Articles&Research papers

In the present study Statistical tools *viz* Measures of Central Tendency, Standard Deviation, Co-efficient of Relation have been used to analyze & interpret the data accordingly. The study is for a period from 2004-2014.

Tables & Figures 1:
Public Sectors Banks

YEAR	SBI NPA	SBI NIM	BOB NPA	BOB NIM
2004	7.75	2.85	10.52	3.18
2005	6	3.21	7.3	3.31
2006	3.9	3.27	3.9	3.05
2007	2.9	3.06	2.5	2.95
2008	3	2.64	1.8	2.52
2009	2.98	2.48	1.27	2.42
2010	3.28	2.35	1.64	2.35
2011	3.5	2.86	1.62	2.76
2012	4.9	3.38	1.89	2.56
2013	4.75	3.06	2.4	2.28



Tables & Figures 2:
Private Sectors Banks

YEAR	ICICI NPA	ICICI NIM	AXIS NPA	AXIS NIM
2004	4.7	1.62	2.88	2.58
2005	3	1.94	2	2.36
2006	1.5	2.25	1.7	2.47
2007	2.1	2.23	1.1	2.55
2008	3.3	2.83	0.8	1.96
2009	4.32	2.87	1.08	2.15
2010	6.52	2.19	1.39	3.05
2011	5.8	2.34	1.28	3.1
2012	4.83	2.4	1.18	3.04
2013	3.22	2.7	1.19	3.09

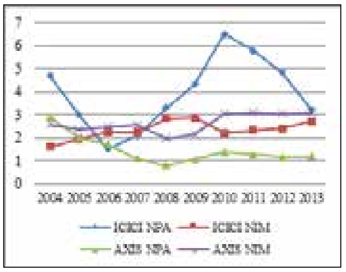


Table3
Results

Statistical Tool	SBI	BOB	ICICI	AXIS
Co-relation Coefficient	0.373	0.771	-0.061	0.020

Analysis: It can be observed from the graph & the results table that there is a moderate Co-relation between the NIM & NPAs of SBI whereas in case of BOB, NIM & NPAs are having strong positive Correlation .Incase of ICICI Bank; the resultant value of correlation reveals an interesting perspective .A negative correlation here implies that NIM is independent of NPA performances. However, the results if Axis Bank reaffirms the fact that NIM are related with NPA, though the results reflect a weak correlation.

Suggestions:
- Periodic Classification of Assets
- Asset Monitoring By ***Digital Technology***
- Enhancing Credit Appraisal process on Real Time basis
- Make the Legal System more robust
- Making the Write-off of NPAs for new banks conditional
- Less dependence on Interest income on Loans
- Improve the robustness of CEBIL
- Publication of List Of Defaulters on Bank Websites
- Provide DRTs with more powers to attach properties of defaulters.

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