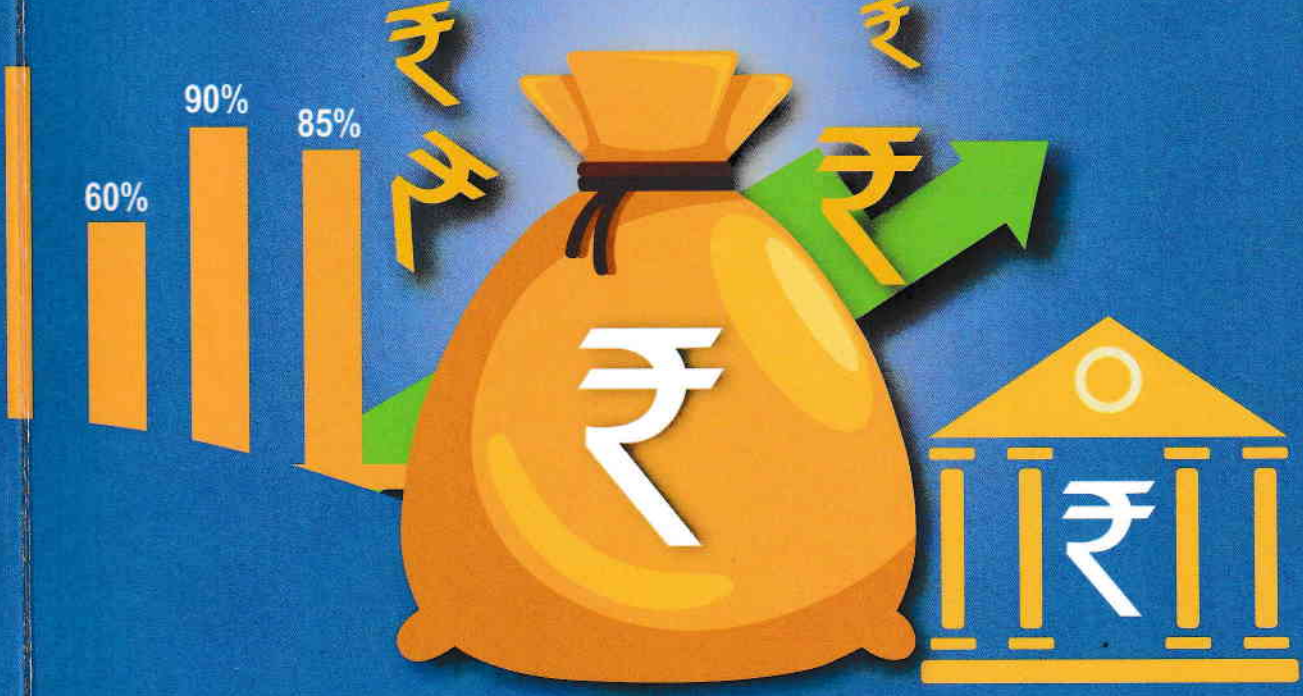
REVIEW OF OPERATIONAL ISSUES AND PROSPECTS OF COMMERCIAL BANKS IN THE CURRENT SCENARIO



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Chapter 4

Non-Performing Asset and Indian Commercial Banks

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Abstract

The state of the banking industry is a barometer of a country's economic success. The banking sector in India is also very important to the economy, and managing non-performing assets is a big concern for banks. The NPA shows the amount of loans and advances that are late or in arrears. The larger the percentage of non-performing assets (NPAs), the worse the bank's success. NPAs is a hazard to both public and private sector banks. This investigation looks at the impact of nonperforming assets in banks, with a focus on net profit. According to financial records, during the study period 2011-12 to 2020-21, two banks from both the public and commercial sectors were chosen with the highest NPA. The study found that NPAs have an influence on banks net profits, with public sector banks having a higher percentage of NPAs than private sector banks.

Keywords: Banking industry, Non-Performing Assets, Net profit

Introduction

India is a fast-growing economic powerhouse. Banks serve as a foundation for economic growth. The predominance of nonperforming assets (NPAs) is a huge danger to the banking sector. The NPA shows the amount of loans and advances that are late or in arrears. Loans and advances, as well as interest on those loans, are how banks make money. The NPA will cause a disruption in the banking industry's credit flow. Indian economy was in a boom phase during the early 2000's and 2008, and public sector banks lent extensively to corporate during this period. As a result of the worldwide economic slump, the prohibition on mining projects has resulted in a reduction in revenue. This has resulted in an inability to repay and has exacerbated the pace of nonperforming assets (NPAs). Although NPA is a major problem that necessitates a large amount of work to resolve, it must be tackled swiftly or the Indian economy would suffer. The current study examines the impact of nonperforming assets (NPAs) on Indian commercial bank's profitability and provides a comparison between public sector and private sector banks.

Non-Performing Assets

One of the important functions of commercial banks is the lending of money to borrowers. And this loan given by the bank is considered as its asset. Sometimes, this loan given to the borrowers remains unpaid. This late or non-payment amount is defined as Non-Performing Assets. Any asset which stops giving returns as the principle or the interest or both the components of a loan is not being serviced by the bank, and then it would be considered as a NPA. According to FSR, the gross NPA would go up from 11.3% in March 2020 to 15.2% in March 2021, and to 16.3% under a very severe stress scenario.

Types of NPA

Gross NPA

The overall quantity of loans that have gone bad debts is known as gross non-performing assets. Gross NPA is a non-standard asset, on which bank has made provisions. Gross NPA= Gross NPA/Gross Advance

Net NPA

Those advances which are obtained after deducting the provisions from gross NPA is referred to as Net NPA. It will show the actual burden of the banks.

Net NPA= Gross NPA- Provisions/ Gross advances-provisions

Classification of NPA

- **Standard Assets:** Arrears of interest and the principal amount of the loan do not exceed 90 days at the end of a financial year.
- **Sub-standard Assets:** Assets which have remained NPA for a period less than or equal to 12 months.
- **Doubtful Asset:** An asset which has remained in the sub-standard category for a period of 12 months and is not considered as a loss advance.
- **Loss Assets:** A loss asset is considered uncollectable and of such little value that its continuance as a bankable asset is not warranted. It is an NPA for a period of more than 36 months and this loss is identified by the bank through internal or external auditors or by the central bank inspector

Table 1 Provision requirements of NPA

Category	Provision Requirement
Substandard Asset	*15% of the sum of net investment in the lease and the unrealized portion of finance income net finance charge component * Additional 10% for unsecured lease exposure i.e. total 25%
Doubtful Asset	*100% of the finance not secured by the realizable value of the leased asset *Additional provision on the unrealized portion of finance income net of finance charge component of the secured portion under: Period for which the advance remained in doubtful category and the provision (%) Up to one year is 25% provision, one to three years 40% provision, More than three years 100%.
Loss Asset	To be written off or 100% of the sum of the net investment in the lease and the unrealized portion of finance income net of finance charge component.

Source: http://www.iibf.org.in/documents/IRAC.pdf

Reasons for NPA

Historical Factors:

The slowdown in the global economy, the ban on mining projects, and fluctuations in the price of raw materials have led to the inability to repay and accelerated the rate of NPA.

Relaxed lending norms:

One of the important reasons behind the NPA is the relaxation of lending norms. Without properly analyzing their credit ratings, the loans were granted to corporates.

Lack of contingency planning

To mitigate the project loss, contingency planning is essential. Since then, the banks have failed to do adequate contingency planning. That has also led to the NPA.

Restructuring of loan facility:

Companies with inadequate profit and over-leverage problems have extended loan facilities and become one of the reasons for NPAs in the banking sector.

Unforeseen economic shocks like Demonetization and Covid 19:

The RBI says there is an increased number of non-performing assets due to the Covid 19 pandemic and demonetization.

Impact of NPA in Banking Sector

- Profitability: there is an inverse relation between profits and NPA. As a result of NPA, banks do not receive payments and also need to create provisions ranging from 20% to 50%.
- Credit contraction: NPA will affect the lending capacity of banks. It will in turn affect the income of banks.
- Shareholder's confidence: NPA will affect the profitability of banks and it will reduce the amount of dividends paid to shareholders. As per the RBI rules, need to get approval from the RBI before declaring a dividend if the NNPA of 5% or more.
- Credibility of banks: the credibility of banks is questioned with the increase in NPA and it will give rise to liquidity issues as people may not be ready to invest or deposit money in banks.

Objectives of the study

- To understand the concept of Non-Performing Assets
- To identify the relationship between NPA and net profit in the banking sector.
- To compare the NPA in public sector and private sector banks.

Research Methodology

The study is based on descriptive research. The analysis relies on secondary data gathered from bank annual reports and the Reserve Bank of India's official website. The study was conducted using a combination of public and private sector banks. State Bank of India, Punjab National Bank, and Bank of India were chosen as public sector samples, meanwhile ICICI, IDBI, and Axis Bank were chosen as private sector case studies. In both the public and private sectors, these banks are among the top three in terms of nonperforming assets (NPA). Data is analyzed using correlation analysis and multiple regression analysis.

Table 2 Correlation between NNPA ((in Cr.) and Net profit (in Cr.) of public sector banks

Year	SBI		PNB		BOI	
	NNPA	Net Profit	NNPA	Net Profit	NNPA	Net Profit
Correlation	-0.513943189		-0.743948558		-0.8625916	
P-value	0.004512		0.013622		0.001318	

The correlation between NNPA and the net profit of public sector banks. SBI (-0.513943189) shows a negative correlation. While PNB (-0.743948558) and the Bank of India (-0.8625916) show a high negative correlation. All these banks show an inverse relationship between net profit and net non-performing assets. The p-value was obtained by applying linear regression to the net profit and NNPA of all the selected banks. Since the p-value is less than.05 in the case of all the three public sector banks, the null hypothesis is rejected at a 5% level of significance. Hence, it is concluded that the net profits of the banks were affected by the net non-performing assets.

Table 3 Correlation between NNPA (in Cr.) andNet profit (in Cr.) of Private Banks

Year	ICICI		AXIS		IDBI	
	NNPA	Net Profit	NNPA	Net Profit	NNPA	Net Profit
Correlation	-0.13769		-0.72713444		-0.5018229	
P-value	0.704473		0.017186		0.13945	

Source: Collected from moneycontrol.com

The correlation between NNPA and the net profit of private sector banks. ICICI (-0.13769) shows a negative correlation. While Axis (-0.72713444) and IDBI (-0.5018229) show a higher negative correlation than ICICI. All these banks show an inverse relationship between net profit and net non-performing assets. The p-value was obtained by applying linear regression to the net profit and NNPA of all the selected banks. Since the p-value is less than.05 in the case of Axis Bank, the null hypothesis is rejected at a 5% level of significance. In the case of ICICI and IDBI, the p-value is not less than.05. So the null hypothesis is accepted at a 5% level of significance. Hence, it is concluded that the net profits of Axis are affected by the net non-performing assets, since in the case of ICICI and IDBI, there is no significant relation between the net profits and NNPA for the last 10 years.

A comparison of gross non-performing assets of selected public and private sector banks. The public and private sector banks showed an increasing trend in gross NPA from 2011 to 2017 and from 2017-2018 to 2020-21, GNPA is declining. Public sector banks have higher GNPA compared to private sector banks in most of the years, except 2016-17 and 2018-19. The GNPA has risen from 9.71% to 32.87% during 2011-12 to 2020-21 for the selected public sector banks, and in the case of private sector banks, the GNPA has increased from 7.05% to 31.08% during the last 10 years. In both public and private sector banks, the percent of GNPA is increasing and the rate of growth is high in the public sector compared to the private sector. The strict loan policy of the private sector is the suggested reason for the same. The GNPA was higher during 2017-18 in both public and private banks. There are many economic reasons for this NPA pile up, but the hike is from the RBI's February 12 circular.

Conclusion

The NPA is one of the most important issues that might have an impact on the financial sector. The flow of credit is critical to an economy's growth, and NPA has a significant impact on that flow. NPA is regarded as a barometer of the banking sector's soundness. The success of a bank is determined on how skillfully it manages its NPAs. A high level of NPA leads to a large number of credit defaults, which has an impact on bank profitability and share value. Now is the moment to take effective steps to minimize NPA to a bare minimum. Some of the steps that could be implemented include effective monitoring, timely inspection of loan accounts, and proper appraisal of loan applications before issuing credit. It's probably impossible to achieve an NPA of 0%. Yet, steps should be done to hasten the recuperation process.

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