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EFFECT OF NON PERFORMING ASSETS ON THE PROFITABILITY OF BANKS – A SELECTIVE STUDY

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ABSTRACT

Nonperforming asset is the key term for the banking corporations. Non Performing Assets show the efficiency of the performance of the banks. Non Performing Assets is the amount which is not received by the bank in return of loans disbursed. The amount of Non Performing Assets affects not only the banking industry but the total financial system and there by the economy of the country. Thus a selective study has been done on public sector banks in India to evaluate the effect of Non Performing Assets on the profitability of banks. SBI and 5 nationalized banks were selected for the study and the relation between their gross Non Performing Assets and net profit was measured. The result shows that except for SBI all the other banks exhibit a negative correlation between their gross Non Performing Assets and net profits. But for SBI the net profit is not at all affected by Gross Non Performing Assets and it is in continuous profits only.

KEYWORDS: Non Performing Assets, SBI, Net Profit, Correlation & Regression

INTRODUCTION

Indian Banking sector is considered one of the strongest among the other banking sectors. During 2008, Sub Prime Crisis India was among the least affected countries because of the strict rules and regulations of Indian banking sector. Indian banking industry is classified into Public sector banks, Private Sector banks, Regional rural banks and Cooperative banks. In India there are 27 Public sector banks of which 17 banks are nationalized. Indian banking industry announced deposits of Rs. 85331billions and loans and advances of Rs. 67352 billion for 2014 as against Rs. 74297 billions and Rs. 58798 billion in 2013. But the net profit is Rs. 912 billion in 2013 and Rs. 809 billion in 2014. The loans and advances and deposits have been increased 14.5% and 14.3% respectively but net profit has been reduced by 11.3%. This is mainly because of increase in gross nonperforming assets by 36.1%.

LITERATURE REVIEW

Definition:

- 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.

    ▪ Reserve Bank of India.

- DEFINITION of 'Non-Performing Asset - **NPA** ' A classification used by financial institutions that refer to loans that are in jeopardy of default. Once the borrower has failed to make interest or principal payments for

90 days the loan is considered to be a non-performing asset.

- Non-Performing Asset (NPA) Definition | Investopedia

  www.investopedia.com/terms/n/non-performing-assets.asp

- Defining NPAs: Non-performing Asset (NPA) means an asset for which:
  - interest or principal (or installment) is overdue for a period of 180 days or more from the date of acquisition or the due date as per contract between the borrower and the originator, whichever is later;
  - interest or principal (or installment) is overdue for a period of 180 days or more from the date fixed for receipt thereof in the plan formulated for realization of the assets
  - interest or principal (or installment) is overdue on expiry of the planning period, where no plan is formulated for realization of the assets.
  - any other receivable, if it is overdue for a period of 180 days or more in the books of the SC or ARC

-SARFAESI ACT

Classification: The Non performing assets are classified into three types.

- **Sub Standard Assets:** The assets which remain as non performing assets for not more than twelve months are called Sub standard assets. The organization is supposed to maintain 15 % of its reserves for these assets.
- **Doubtful Assets:** The assets which have not been recovered for more than twelve months.
- **Loss Assets:** The assets which are declared as loss by the auditors but which are not written off.

Causes of NPA:

- **Lending Practices of Banks:** The banks should follow strictly follow rules and regulations while lending loans. They should properly estimate the credit worthiness of the borrowers effectively. In 2008 the subprime crisis has been occurred because of bad lending practices of banks.
- **Business Risk:** The organization may sometimes face problems with its own operational environment which may result in losses for the company.
- **Environmental Risk:** Sometimes there may be environmental problems like cyclones, drought which does not give the required output to the farmers and Agri based businesses.
- **Psychology of the Borrower:** Sometimes the attitude of the individual will not allow him to repay the money even if he can.
- Incremental Credit policies of banks.

Problems caused by NPA:

- **NPA Affects the Profitability of the Bank:** The banks get their income from the loans and advances that are disbursed and if these loans are not repaid then it is not possible for them to receive profits.

- **It Will Affect the Liquidity and Goodwill of Banks:** If the Profitability of the banks reduces then automatically the bank will not be in a position to freely lend loans. Thus the organization liquidity will be affected and thereby the Good will of the company will be affected.
- **It Will Affect the Economy of the Country:** The banking sector is the backbone for all the financial resources in a country. If the banks' profitability is affected then the total economy is affected.

According to Rajesh Parmer (2014) managing NPAs is a daunting task for every bank in the financial sector. NPAs affect the position and performance of the banks in many dimensions. The NPAs are mainly because of willful defaulters, Ill Processing of loans etc. As per Chatterjee, Mukherjee & Das (2012) NPAs have a negative effect on the achievement of Capital Adequacy level, Funds mobilization, Banking system credibility and productivity on the overall economy. As per their study the public sector banks are facing maximum problems in the banking sectors because of the social responsibility they should bear. The private sector banks are upgraded with technology and are able to cope up with changes and protect themselves.

According to Balasubramaniam & Gowde the banks are coping well with the situations and trying to be profitable even in the critical conditions. The banks are managing their NPA levels and are able to reduce the NPAs with good credit appraisal systems.

Sameer & Deepa (2013) expresses their opinion based on their study that the incidence of NPAs is affecting both the banks and financial institutions psychologically and financially. The willful defaulters should be identified and treated well to recollect the funds.

According to the study conducted by **Dr. D. Ganesan and R. Santhanakrishnan** the banks' profitability can be reduced only by effective management of NPAs. The NPAs of SBI has been continuously increasing for over a decade but as the operations are more for SBI it is able to manage the profits. But still the remedial measures are to be specified to control NPAs.

Santhanu Das have undergone a research work of managing NPAs in Indian public sector banks with special reference to Jharkhand. Jharkhand is having the credit – deposit ratio half when compared to other parts of the country. The borrowers blame the market failure for their inability to pay loans in time. Almost 32% of the bankers feel that lack of entrepreneurship is the reason for NPAs 29.5% feel that willful defaulters are the reason for NPAs in Jharkhand.

Prasanth Reddy identifies the following solutions for managing NPAs in the organizations.

- Don't try to eliminate NPAs but manage them.
- Asset Reconstruction Companies should work effectively.
- Capital markets should be well developed.
- Securitization is very important
- Realignment of Performance indicators should be proper.
- Consistency and contextual decision making should be there.

Meenakshi & Mahesh explores the trend of NPAs in India. It shows the public sector banks which work with welfare motive also records reduction of NPAs when compared to private sector banks.

Objectives of the Study:

The objectives of the present study are

- To examine the relationship between the non performing assets and the profitability of banks.
- To compare the performance of the Top bank in the industry with the least five banks in terms of managing NPAs.
- To establish the correlation between NPAs and Net Profits of Banks.

Hypothesis of the Study:

H_1: There is no statistically significant relationship between changes in NPA and Net Profit of the bank.

H_0: There is no statistically significant relationship between changes in NPA and Net Profit of the bank.

Research Methodology:

The present study is a descriptive study which tries to establish the relationship between the non performing assets of a bank and its respective net profits.

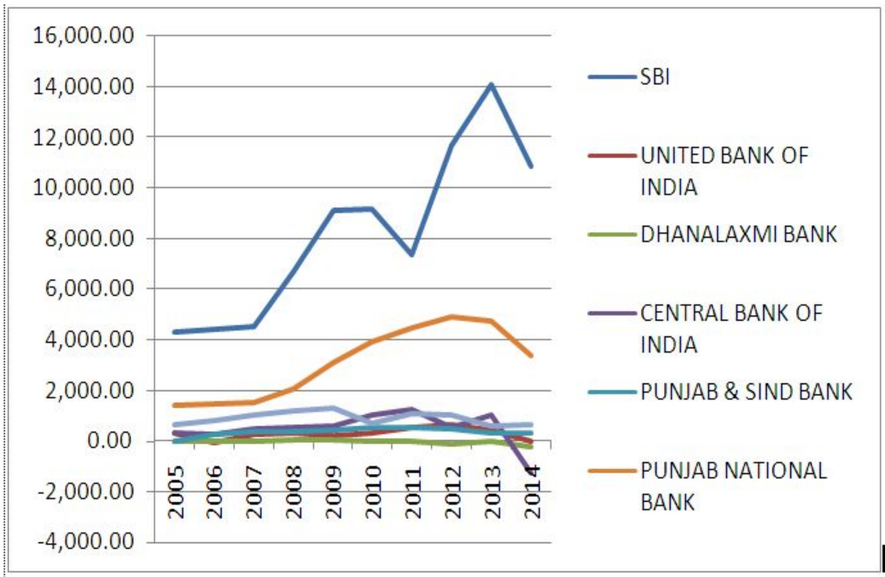
The total public sector banks in India are 27. The sample is six public sector banks have been selected which is 22.22% of the total population. The criteria is the top performer in the industry i.e., SBI and the five other banks with high nonperforming assets as per the announcement of Finance ministry in the recent past. The final analysis is done be Correlation and Regression using MS Excel.

RESULTS AND DISCUSSIONS

Net Profit:

Table 1

	Sbi	United Bank of India	Dhana Laxmi Bank	Central Bank of India	Punjab & Sind Bank	Punjab National Bank	Indian Overseas Bank
2005	4,304.52	300.18	-21.6	301.5	6.92	1,410.12	651.36
2006	4,406.67	-73.87	9.52	257.42	284.58	1,439.31	783.34
2007	4,541.31	267.28	16.14	498.01	390.27	1,540.08	1,008.43
2008	6,729.12	318.95	32.48	550.16	389.57	2,048.76	1,202.34
2009	9,121.23	184.71	57.45	571.24	434.41	3,090.88	1,325.79
2010	9,166.05	322.36	23.3	1,058.23	508.8	3,905.36	706.96
2011	7,370.35	523.97	26.06	1,252.41	526.17	4,433.50	1,072.54
2012	11,707.29	632.53	-115.63	533.04	451.29	4,884.20	1,050.13
2013	14,104.98	391.9	2.62	1,014.96	339.22	4,747.67	567.23
2014	10,891.17	0	-251.91	-1,262.84	300.6	3343	601.74

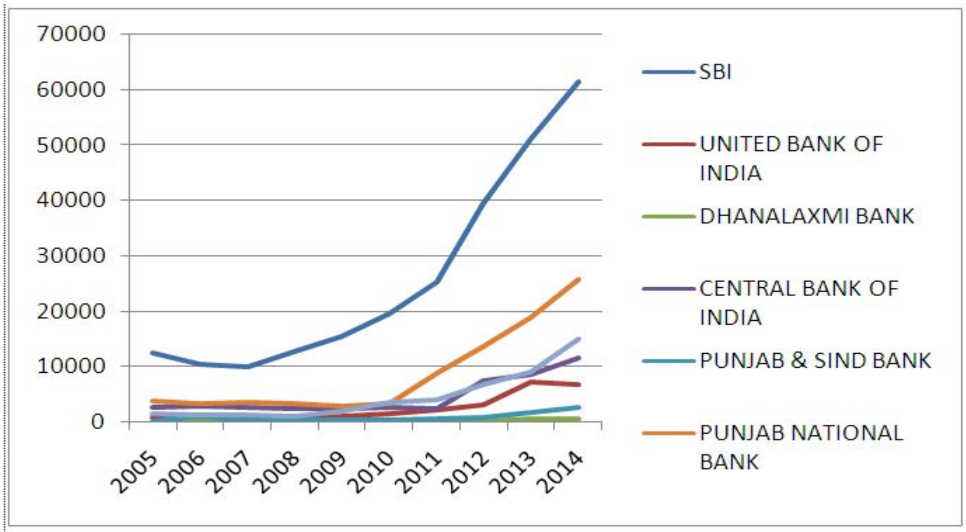


This is the trend of Net Profit for the different banks for the years 2005 – 2014. Almost all the banks have experienced a negative growth in the year 2014 when compared to the net profit of 2013.

Gross NPA:

Table 2

Year	SBI	United Bank of India	Dhanalaxmi Bank	Central Bank of India	Punjab & Sind Bank	Punjab National Bank	Indian Overseas Bank
2005	12456.3	726.4	125.6	2621.4	0	3741.3	1388.2
2006	10375.8	744.3	111.4	2684.2	941.5	3138.3	1227.6
2007	9998	817	96	2572	291	3391	1120
2008	12,837.34	761	63	2350	136	3319	997
2009	15,588.60	1019.6	64.4	2316.5	161	2767.5	1923.4
2010	19,534.89	1,355.78	77.5	2457.9	206.2	3214.4	3441.7
2011	25,326.29	2,176.42	67.09	2,394.53	424.28	8,719.62	3,920.07
2012	39,676.46	2,963.82	104.27	7,273.46	763.44	13,465.79	6,607.96
2013	51,189.39	7,118.01	380.27	8,456.18	1,536.90	18,880.06	9,020.48
2014	61,605.35	6,552.91	485.82	11,500.01	2,553.52	25,694.86	14,922.45



The Gross NPAs have been continuously increasing for all the banks for the specified period. As the business operations of banks have been increasing the amount of NPAs have also increased.

Correlation between Gross NPA and Net Profit of the selected banks:

Table 3

Bank	Correlation
SBI	0.831428753
United Bank Of India	0.022008474
Dhanalaxmi Bank	-0.714992969
Central Bank Of India	-0.591325706
Punjab & Sind Bank	-0.07562175
Punjab National Bank	0.555161197
Indian Overseas Bank	-0.506536905

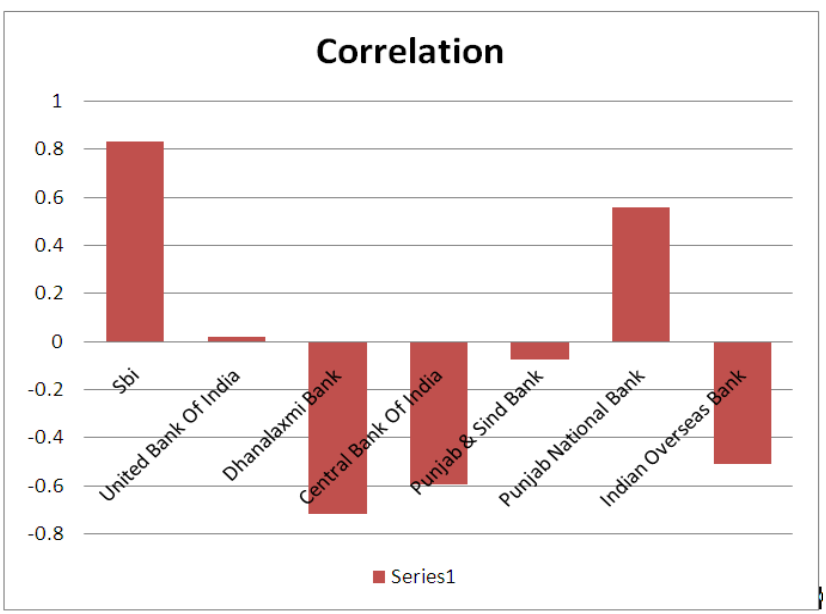


Table 4

Bank	Correlation	Regression		
			Coefficients	Standard Error
SBI	0.831428753	Intercept	4332.533816	1115.09143
		X Variable 1	0.150885921	0.03565049
Dhanalaxmi Bank	-0.714992969	Intercept	48.44397626	32.7758379
		X Variable 1	-0.448160575	0.15493368
Central Bank Of India	-0.591325706	Intercept	1025.570966	324.402859
		X Variable 1	-0.122833271	0.05922601
Punjab National Bank	0.555161197	Intercept	2260.202956	584.949038
		X Variable 1	0.095455528	0.05056221
Indian Overseas Bank	-0.506536905	Intercept	1030.466819	111.734722
		X Variable 1	-0.029949346	0.01802389

The banks have expressed a surprising correlation between Gross NPA and the Net profit. SBI and Punjab National Bank have shown positive correlation, United Bank of India does not represent any correlation while all the others expressed negative correlation.

Normally the profitability of the banking sector depends on recovery of loans on time which are disbursed to the different sectors. The performance of banking sector depends on how effectively you manage the non performing assets. Here the banks like Central Bank of India, Dhanalakshmi Bank etc are experiencing severe losses which results in the negative growth rate of the company. Except SBI and Punjab National Bank all the banks are facing problems with respect to NPAs. It does not indicate that the more NPAs the more profits for SBI but the largest bank of India is able to receive more profits only because of its wide variety of financial services and effective management of NPAs. But if NPAs continue in the same manner then even large banks will also stumble like Lehman Brothers in USA which resulted in International economic crisis.

Findings of the Study:

- All the banks are having non performing assets in their balance sheets.
- The NPAs are going on increasing for all the banks.
- The large banks are able to maintain the losses by NPAs but small banks are not able to recover.
- SBI is also having huge losses but it is also earning high profits.
- Public sector banks are facing more issues by NPAs.

CONCLUSIONS

The economic growth of every country depends on the proper functioning of financial system of the country. The financial system mainly comprises banking sector. Now a days our government is concentrating in developing our economy which needs huge financial resources. Thus the GDP of India will only grow if the required funds will be invested in the economy which gives rise to faster growth in the economy. Thus banking sector should now mainly focus on effective management of NPAs to increase their profitability and thereby provide as much funds as possible to the industry. The organisations should develop new strategies to improve the recovery of loans.

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