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An Analytical Study of NPA and its Impact on Profitability on Indian Banks

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Abstract

India's banking sector serves as a backbone to the country's economy. A variety of issues have lately beset the banking industry in India, including asset quality management, non-performing assets and the recovery of bad debts. Non-performing assets (NPAs) and Net profits of the banks has been examined in this study. This study tries to evaluate the effect of some important financial variables on bank non-performing assets (NPAs) and give suggestions for improved NPA management. This study analysed five Indian Public and five Private Banks for the year 2016-2017 to 2020-21. The relationship between net profits and non-performing assets (NPAs) was examined using correlation analysis and P-Value.
Key Words: *Profitability, Indian Banks, Indian economy, Non-Performing Assets (NPAs).*

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1. INTRODUCTION

The banking industry plays a significant role in meeting all the necessities of life and in the economic development of the nation. The banking industry contributes to the stability of the country's financial system by providing services such as liquidity and risk management. Based on the country's banking system, its economy may be strong. The country is undergoing socio-economic transformations and technological advancement. Its prime role is to protect depositors' assets while also lending money to people and businesses. The bank then lends the deposited money to people and businesses and in return receives interest payments from them. Banks make profit from the difference between interest on the money lent and the interest on the money deposited. Banks in India are particularly concerned about non-performing assets (NPAs). A bank's NPA ratio is the greatest way to indicate the health of the industry. NPAs are an indicator of a bank's health. An asset is considered non-performing if it has not received interest on principal or principal payments for more than 90 days. Sometimes the money or assets that are granted by banks to corporations in the form of loans are not repaid by the borrowers. The loans that are paid late or not at all are what are known as Non-Performing Assets (NPAs). In some circles, they are referred to as "bad assets." In other words, NPAs is an asset of bank which is not earning any income. In the case of agricultural loans, NPAs are recorded if the interest and/or instalments or principle remain unpaid for two crop seasons. However, this time should not be more than two years. Any unpaid loan/instalments would be categorized as NPA after two years. The continuing increase of non-performing assets (NPA) is seen as the primary source of the banking industry's problems.

Due to which the non-performing assets will be reduced to a great extent. NPAs have a detrimental effect on the bank's cash reserve and liquidity ratios, which decreases shareholder confidence. Non-performing assets (NPAs) are a drag on lending availability and the soundness of banks' balance sheets. An additional ninety days should be added to loan and interest payment due dates.

1.1 Types of NPA

On the basis of time NPAs can be classified into three types.

Sub-standard: Sub-standard is an asset when NPA have aged less than or equal to 12 months.

Loss of assets: Loss of assets is assets when the bank or its auditors have identified the loss, but it has not been written off.

Doubtful: Doubtful assets is assets when NPA have aged more than 12 months.

1.2 Impact of NPA

For the Indian banking system, the problem of non-performing assets (NPAs) is one of the most important and prevalent challenges. There is a decrease in confidence in financial institutions as the number of non-performing assets (NPA) grows. Credit deployment is negatively impacted as a consequence of poor money recycling. Banks' financial health and liquidity are both harmed when loans are not repayment back.

A. *Profitability*

Non-performing assets (NPAs) have a negative effect on profitability because bank cease making money and draw more provisioning compared to their normal assets, which has a negative effect on profitability. The profitability of bank is directly impacted by the 15-25% greater provision banks typically make for growing NPAs. For sub standard assets banks makes provision 15% for secured loan. On the other hand banks makes provision for unsecured loan 25%. And doubtful assets need provision for secured 40% and for unsecured 100%. On loss of assets provision make 100% or write off.

B. ***Credit (Asset) Contraction***

An increase in nonperforming assets (NPAs) puts pressure on money recycling and reduces banks' capacity to lend more, which leads to a fall in interest revenue. It lessens the amount of money available, which can lead to a halt in economic activity.

C. ***Management of Liability***

As NPAs rise, banks seek to lower deposit interest rates while raising advance interest rates in order to preserve net interest margin (NIM). Bank activity and economic growth may be slowed as a result of this, which might have a negative impact on financial intermediation.

D. ***Adequacy of Capital***

According to Basel rules, banks must maintain enough capital on risk-weighted assets at all times. Because of this, banks are being forced to strengthen their capital buffers with each increase in non-performing assets (NPAs). Since the amount of money available is constrained. It comes with a price tag that can range from 12.5 percent to 18.5 percent.

E. ***Shareholders' Belief in the Company***

Shareholders often want to increase the value of their assets by increasing dividends and market capitalization, which is only achievable when the bank makes considerable profits through enhanced operations. Increasing levels of non-performing assets will have a detrimental effect on bank business and profitability, which will result in shareholders not obtaining a market return on their capital and, in some situations, will erode the value of the assets the shareholders own.

2. LITERATURE REVIEW

Kapoor, B., & Kumar, R. (2019) This article deals with such NPA difficulties and identifying the reasons of them. It also discusses the scale and causes of the NPA problem during the previous three years, as well as its impact on the economy. NPAs have long been a major issue for Indian banks. NPAs should be scheduled in order to enhance the economy's situation. In comparison to worldwide standards, the banking system's NPA level remains high. In order to register their competitiveness, public banks must focus on competing with private sector banks in every field.

Jayaraman, A. R., & Bhuyan, P. (2020) This research using the Nerlovian and directional distance function approaches. This work gives a method for measuring the profit efficiency of Indian commercial banks by factoring desired and unwanted outputs. With the banking sector in India experiencing a significant increase in gross NPA and bad debt write-offs in recent years.This article analyzed the profit inadequacy of banks by considering the above two unfavourable outputs and their combined impact, which is likely a unique endeavor. The findings demonstrate quite clearly that the profitability of banks has become less efficient over the past few years. The level of profit inefficiency may be seen more clearly by incorporating these two undesirable outputs into the model.

Agarwala, V., & Agarwala, N. (2019) When compared to nationalised banks, as well as the SBI and its associates, the growth rate of non-performing assets (NPAs) in private sector banks is found to be significantly lower after being evaluated. As a result of the inability of nationalised banks and affiliated banks of the State Bank of India (SBI) to adequately manage the problem of substandard loans, the number of such loans has skyrocketed to extraordinary levels.

Mohanty, Sagarika. (2021) It is difficult to completely reduce the NPA from banks but we should try to eliminate some major portion of NPA from banks. There is need to focus on NPA of every public sector bank in India. To eliminate NPA the bank should improve their credit structure and also repayment structure. It also focuses on the default risk minimization mechanism. Bank should follow all the credit policy of the government and take timely action against NPA. The bank also improved its management system regarding NPA.

Singh, A. (2013) NPAs must be decreased and regulated in order for banks to increase their efficiency and profitability. The size of non-preforming assets in public sector banks is larger than in private sector banks. The performance of public sector banks has likewise been relatively satisfactory. However, the primary issue confronting public sector banks these days is the rising quantity of nonperforming assets. The volume of non-performing assets held by banks in the public sector has been consistently increasing from one year to the next. On the other hand, with the exception of a few years, the amount of nonperforming assets held by banks in the private sector has been consistently declining from one year to the next. The need for banks to make provisions, which lowers their overall profitability, is demonstrated by an increase in non-performing assets (NPAs), whereas a decrease in NPAs indicates that banks have improved the procedures they use to evaluate credit over the course of the years. Therefore, the strategies that are used to manage non-performing loans are crucial to the success of a bank.

3. RESEARCH METHODOLOGY

- **Problem Statement**
  NPAsand its impact on profitability on Indian banks.

- **Objective of the Study**
  To find out the relationship among NPAs and Profitability of the banks.
  To evaluate the correlation between NPAs and Profitability of the banks and analysis of P-value of the banks, which is significant to banks.

- **Sampling Frame**
  The population for the analysis is five Indian Public and five Private Banks for the year 2016-2017 to 2020-21. Five public banks were selected asState Bank of India (SBI), Punjab National Bank (PNB), Bank of India (BOI), Union Bank of India (UBI) andBank of Baroda (BOB). Researchincludedfive private banks as Axis Bank Ltd., HDFC Bank Ltd., ICICI bank Ltd., IDBI and Yes Bank Ltd.

- **Research Design**
  Descriptive research is used in this study. Secondary data from bank annual reports and the RBI website will be used in this study. In this study will analyze correlation and P-value between NPA and net profitability of public and private banks.

- **Data Collection**
  This research-based is on secondary data sources. Bank's annual reports, journals, articles, newspapers, and other website sources were used as secondary data sources.

- **Limitation of Study**
  Ten banks are included in this research, out of which five are private and five public banks. We have analysed five last financial years (2015-16 to 2020-21) for research.

4. Data Analysis

A. Relationship among NPA and Profitability of Private Banks

Table 1: Net Profit and Net NPA of Private Sector Banks from 2016-2017 to 2020-2021

Years	Axis Bank Ltd.		HDFC Bank Ltd.		ICICI Bank Ltd.		IDBI Bank Ltd.		Yes Bank Ltd.	
	Net NPA	Net Profit	Net NPA	Net Profit	Net NPA	Net Profit	Net NPA	Net Profit	Net NPA	Net Profit
2020-2021	6,994	6,558	4,555	31,117	9,118	16,193	2,519	1,360	9,813	-3,462
2019-2020	9,360	1,627	3,542	26,257	9,923	7,931	5,440	-12,887	8,624	-16,418
2018-2019	18,351	4,677	3,215	21,078	13,450	3,363	14,837	-15,116	4,485	1,720
2017-2018	16,592	276	2,601	17,487	27,824	6,777	28,665	-8,238	1,313	4,225
2016-2017	8,627	3,679	1,844	14,550	25,217	9,801	25,206	-5,158	1,072	3,330
Correlation	-0.362209		0.981156**		-0.278534		-0.142719		-0.760614	
P-value	0.549114		0.003097		0.650000		0.818903		0.135437	

Data of bank rounded off to nearest 1 in above table in NPA and Net Profit. #(in Rs. Cr.) Correlation is significant at the 0.01 level (2-tailed) of HDFC bank.*

From Table No. 1 demonstrates the relationship between non-performing assets (NPAs) and Net profits of private banks. AXIS Bank Ltd. has negative correlation (-0.362209). On the other hand, Correlation is significant at the 0.01 level (2-tailed) of HDFC Bank Ltd. i.e., (0.981156) and P-value of HDFC Bank Ltd. is (0.003097). While high negative correlation between Yes Bank Ltd. (-0.760614) and AXIS Bank Ltd. (-0.362209). Although, correlation of IDBI Bank is least negative (-0.142719). and ICICI Bank Ltd. have moderately negative i.e., (-0.278534).

B. Relationship between NPA and Profitability of Public Banks

Table 2: Net Profit and Net NPA of the Public Sector Banks from 2016-17 to 2020-21

Years	State Bank of India(SBI)		Punjab National Bank(PNB)		Bank of India(BOI)		Bank of Baroda(BOB)		Union Bank of India(UBI)	
	Net NPA	Net Profit	Net NPA	Net Profit	Net NPA	Net Profit	Net NPA	Net Profit	Net NPA	Net Profit
2020-2021	36,810	20,411	38,576	2,022	12,262	-5,547	21,800	829	27,281	2,906

2019-2020	51,871	14,488	27,219	336	14,311	-6,044	21,577	546	17,303	-2,898
2018-2019	658,947	862	30,038	-9,976	19,119	-1,558	15,610	434	20,332	-2,947
2017-2018	110,855	-6,548	48,684	-12,283	28,207	-6,089	23,483	-2,432	24,326	-5,247
2016-2017	58,277	10,484	32,702	1,325	25,305	1,709	18,080	1,383	18,833	555
Correlation	-0.4617		-0.4670		-0.3668		-0.5655		-0.3200	
P-Value	0.4337		0.4277		0.5436		0.3204		0.5996	

**Data of bank rounded off to nearest 1 in above table in NPA And Net Profit. #(in Rs. Cr.)*

From Table No. 2 we demonstrate the relationship between non-performing assets (NPAs) and Net profits of private banks. But there is no significant relationship between all public bank. In all banks have negative correlation i.e., State Bank of India(SBI) (-0.4617), Punjab National Bank(PNB) (-0.4670), Bank of India(BOI) (-0.3668), Bank of Baroda (-0.5655), and Union Bank of India(UBI) (-0.3200).

5. Conclusion

Non-performing assets (NPAs) are currently a major problem for the Indian banking system. There should be strict NPA rules to prevent problems caused due to increase in Non-Performing Assets (NPAs). The interest rate on loan and advances would be reduced, which would have an impact on consumers. So, they can repay their loan on time. On the basis of data analysis and interpretation in the private sector banks HDFC bank Ltd. has significant correlation between NPAs and profitability. In contrast of public sector banks there are insignificant correlation between NPAs and profitability.

Banking profitability and the economy are both affected by the rise of non-performing assets (NPAs). Poor credit management practises, deliberate loan defaults, and loans granted without an investigation for agricultural purposes are all factors that contribute to the increase of NPA. The aggressive lending approach of releasing large amounts of loans is one factor for the increase in NPA. The attempts of the government and banks to recover from the bad loan situation are futile. the government and banks should take proactive measures to recovery of loan. It is necessary to place stronger limitations on big borrowers in order to solve this problem. Banks should keep an eye out for loan accounts that are at risk of going into default. Nonperforming assets (NPA) are a severe issue that must be addressed if banks are to remain profitable.

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