Journal for Research | Volume 03 | Issue 01 | March 2017
ISSN: 2395-7549

A Study of Non-Performing Assets and its Impact on Banking Sector

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Abstract

Banks plays an important role in the economic development of a country. Banks are growth-driver and the banking business is exposed to various risk, such as credit risk, liquidity risk, interest risk, market risk, operational risk and management risk. Apart from these risks the very important risk is loan recovery. The sound financial position of a bank depends upon the recovery of loans or its level of Non-performing assets (NPAs). Reduced NPAs generally gives the impression that banks have strengthened their credit appraisal processes over the years and growth in NPAs involves the necessity of provisions, which bring down the overall profitability of banks. The Indian banking sector is facing a serious problem of NPA. The magnitude of NPA is comparatively higher in public sectors banks. To improve the efficiency and profitability of banks the NPA need to be reduced and controlled.
Keywords: NPA, Banking Sector

I. INTRODUCTION

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank and is then termed as Non-Performing Asset (NPA). RBI has defined NPA as a credit facility in respect of which the interest and / or instalment of principal has remained 'past due' for a specified period of time as stipulated by RBI. NPA is an important parameter in the analysis of financial performance of a bank as it results in higher provisioning requirements and thus decreasing margin. It affects liquidity and profitability, in addition to posing threat on quality of asset and survival of banks. It points out the credit risk of the banks. It emerged about 25 years ago in our banking sector, sending disappointing signals on the sustainability of affected banks. At present, Public Sector Undertaking Banks (PSU) are facing more problems than Private Sector Banks (PRSB). A mounting level of NPAs in the banking sector can severely affect the economy in many ways. If NPAs are not properly managed, it can cause financial and economic degradation which in turn signals an adverse investment climate.

II. OBJECTIVES OF THE STUDY

- To understand the concept of non-performing assets.
- To understand the NPAs sector wise.
- To understand the recovery through various channels.
- To know the impact of NPAs on Indian Banking Sector.

III. REVIEW OF LITERATURE

1) Prashanth K Reddy in his research paper "A comparative Study of Non-Performing Assets in India in the Global context – similarities and dissimilarities, remedial measures" stressed the importance of a sound understanding of the macroeconomic variables and systemic issues pertaining to banks and the economy for solving the problem NPAs along with the criticality of a strong legal framework and legislative framework.
2) Dr. Sonia Narula & Monika Singla (2014) in their research paper "Empirical Study on Non-Performing Assets of Bank" found that Because of mismanagement in bank there is a positive relation between Total Advances, Net Profits and NPA of bank which is not good. Bank is unable to give loans to the new customers due to lack of funds which arises due to NPA.
3) Neha Rani (2014) in her research paper "Analysis of Non-Performing assets of Public Sector banks" revealed that share of nationalized banks in priority sector NPA was greater in 2008 but after that it is decreasing. However amount of NPA of both banks is increasing but there percentage share in total NPA is decreasing after 2010 continuously.

IV. RESEARCH DESIGN

A. Data Collection

- The study is based on secondary data pertaining to the period 2011-16. The data pertaining to banks was sourced from annual reports of banks.
- The data collected is mainly secondary in nature. The sources of data for this research include the literature published by Bank of Maharashtra and the Reserve Bank of India, various magazines, Journals, Books dealing with the current banking scenario and research papers.

B. Analytical Tools of Data Analysis

1) Ratio Analysis

Ratio Analysis is a form of Financial Statement Analysis that is used to obtain a quick indication of a firm's financial performance in several key areas. The ratios are categorized as Short-term Solvency Ratios, Debt Management Ratios, Asset Management Ratios, Profitability Ratios, and Market Value Ratios.

2) Statistical tools for data analysis

Use of tables, Pie diagrams and column charts are done to compare the ratios of five financial years & interpret the analysis of the same.

V. DATA ANALYSIS & INTERPRETATION

A. Net NPA Ratio

$$\text{Net NPA Ratio} = \frac{\text{Net NPA}}{\text{Net Advances}} \text{ X } 100$$

Table – 1
Data Analysis & Interpretation

Year	Net NPA	Net Advances	Net NPA Ratios (%) (₹ In Crore)
2015-16	6832.03	107562.67	6.35
2014-15	4126.57	98599.1	4.19
2013-14	1807.32	88920.4	2.03
2012-13	392.93	75470.78	0.52
2011-12	469.57	56059.76	0.84

1) Analysis & Interpretation

It can be noticed that Net NPA ratio which was 0.84% in 2011-12 has reduced to 0.52% which is good sign that the bank is succeeded in making good provisions against NPA. But in the last three years of study i.e. from 2013-14 to 2015-16, the net NPA has increased and finally reached to 6.35% which indicates that the bank had failed to make sufficient provisions against NPA in these years which is not satisfactory. The Management of the Bank has not taken enough care in granting advances and they are not able to recover from defaulters.

B. Total Provisions Ratio

$$\text{Total Provisions Ratio} = \frac{\text{Total Provisions}}{\text{Gross NPAs}} \text{ X } 100$$

Table – 2
Data Analysis & Interpretation

Year	Provision	Gross NPA	Total Provision Ratios (%) (₹ in crore)
2015-16	3266.62	10385.85	31.45
2014-15	2136.49	6402.06	33.37
2013-14	1009.90	2859.85	35.31
2012-13	709.69	1137.55	62.39
2011-12	790.11	1297.03	60.92

1) Analysis & Interpretation

From the above table it can be interpreted that Bank has not made enough provisions for their gross NPAs. From the table we can see that of 5 consecutive years under study, in 2012-13 the provisions was the highest i.e. 62.39% but after it is being decreased to 31.45% in the year 2015-16, which is not a good sign for bank. The bank need to make sufficient provision in order to reduce the level of NPA.

C. Problem Assets Ratio

$$\text{Problem Assets Ratio} = \frac{\text{Gross NPA}}{\text{Total Assets}} \text{ X } 100$$

Table – 3
Data Analysis & Interpretation

Year	*Gross NPA*	*Total Assets*	*Problem Assets Ratios (%) (₹ In Crore)*
2015-16	*10385.85*	*160957.32*	*6.45*
2014-15	*6402.06*	*146018.79*	*4.38*
2013-14	*2859.85*	*136320.06*	*2.10*
2012-13	*1137.55*	*116952.81*	*0.97*
2011-12	*1297.03*	*91137.38*	*1.42*

1) Analysis & Interpretation

The problem assets ratio shows the proportion of Gross NPA to total assets and the table given above shows that the Bank was having decreasing trend of problem assets till the year 2012-13, which depicts decreasing trend of NPA. But in last three years i.e. 2013-14, 2014-15 & 2015-16 the trend is increasing, which is also increasing the trend of NPA. It seems that less attention has been given by the management to the proportion of Gross NPA and total assets of the bank. Hence there is a positive correlation between NPA and problematic assets. The gross NPA is on the rise due to the increase in advances.

D. Depositor's Safety Ratio

$$\text{Depositor's Safety Ratio} = \frac{\text{Total Standard Assets}}{\text{Total outside liabilities}} \text{ X } 100$$

Table – 4
Data Analysis & Interpretation

Year	*Total Standard Assets*	*Total Outside Liabilities*	*Depositor's Safety Ratio (%) (₹ In Crore)*
2015-16	*100854*	*152170*	*66.28*
2014-15	*94808*	*137951*	*68.73*
2013-14	*87509*	*128952*	*67.86*
2012-13	*75259*	*110556*	*68.07*
2011-12	*55682*	*86415*	*64.44*

1) Analysis & Interpretation

From the above table and graph it can be interpreted that the Depositor's Safety Ratio of Bank of Maharashtra is satisfactory in the last five years, especially in the year 2014-15. It is good sign for common investors that the ratio is consistent in the last five years, although it has dropped down in 2015-16 to 66.28% it can be stated that the depositor's money is safe in this bank.

E. Shareholder's Risk Ratio

$$\text{Shareholder's Risk Ratio} = \frac{\text{Net NPAs}}{\text{Total Capital \& Reserves}} \text{ X } 100$$

Table – 5
Data Analysis & Interpretation

Year	*Net NPA*	*Capital & Reserves*	*Shareholder's Risk Ratios (%)(₹ In Crore)*
2015-16	*6832.03*	*8787.14*	*77.75*
2014-15	*4126.57*	*8067.33*	*51.15*
2013-14	*1807.32*	*7368.15*	*24.53*
2012-13	*392.93*	*6396.94*	*6.14*
2011-12	*469.57*	*4722.66*	*9.94*

1) Analysis & Interpretation

From the table given above, we can see the position of Bank. A risk ratio was low in the year 2012-13. After that it is increasing year by year and reached to 77.75% which is the highest in the given period. This indicates the bank has failed in making provisions against NPAs. However, it is not the good sign that the risk ratio is increasing, the bank has to take some instant actions to lower down the risk or it can affect the goodwill, market price of the shares and the competitive market. This signifies that the shareholder's fund in this bank are not clearly safe.

F. Sub-Standard Assets Ratio

$$\text{Sub} - \text{Standard Assets Ratio} = \frac{\text{Total Sub} - \text{Standard Assets}}{\text{Gross NPAs}} \text{ X } 100$$

Table – 6
Data Analysis & Interpretation

Year	*Sub-Standard Assets*	*Gross NPA*	*Sub-Standard Assets Ratios (%)(₹ In Crore)*
2015-16	*5342.65*	*10385.85*	*51.44*
2014-15	*2974.68*	*6402.06*	*46.46*
2013-14	*2159.03*	*2859.85*	*75.49*
2012-13	*581.70*	*1137.55*	*51.14*
2011-12	*681.49*	*1297.03*	*52.54*

1) Analysis & Interpretation

From the above table it is found that ratio has been increasing in the first three years i.e. 2011-12, 2012-13 & 2013-14, which is not a good sign. The variations in the sub-standard assets ratio are caused by higher percentage of doubtful assets over sub-standard assets in the bank. The management should take necessary measures to reduce doubtful assets and loss assets and to increase the percentage of sub-standard assets.

G. Doubtful Assets Ratio

$$\text{Doubtful Assets Ratio} = \frac{\text{Total Doubtful Assets}}{\text{Gross NPAs}} \text{X } 100$$

Table – 7

Data Analysis & Interpretation

Year	*Total Doubtful Assets*	*Gross NPA*	*Doubtful Assets Ratios (%) (₹ In Crore)*
2015-16	*4498.9*	*10385.85*	*43.32*
2014-15	*2375.02*	*6402.06*	*37.10*
2013-14	*587.66*	*2859.85*	*20.55*
2012-13	*388.91*	*1137.55*	*34.19*
2011-12	*467.37*	*1297.03*	*36.03*

1) Analysis & Interpretation

The doubtful assets ratio of Bank are presented in the above table. Banks can recover more of the advances through compromise. From the table we understand that the ratio had been decreasing from the year 2011-12 to 2013-14 which is satisfactory except for the years i.e. 2014-15 & 2015-16. Nevertheless, the doubtful assets ratio is less than sub-standard assets ratio which is a positive sign. The management must try to recover as much doubtful advances as possible so that the gross NPAs are reduced.

H. Loss Assets Ratio

$$\text{Loss Assets Ratio} = \frac{\text{Total Loss Assets}}{\text{Gross NPAs}} \text{X } 100$$

Table – 8

Data Analysis & Interpretation

Year	*Total Loss Assets*	*Gross NPA*	*Loss Assets Ratio (%)(₹ In Crore)*
2015-16	*544.2*	*10385.85*	*5.24*
2014-15	*1052.35*	*6402.06*	*16.44*
2013-14	*113.15*	*2859.85*	*3.96*
2012-13	*166.93*	*1137.55*	*14.67*
2011-12	*148.15*	*1297.03*	*11.42*

1) Analysis & Interpretation

Loss assets ratio shows the proportion of loss that the banks are likely to suffer as compared to gross NPAs. The ratio must be minimum, as it will indicate that the assets to be lost would be lower as compared to gross NPAs. The loss assets are likely to be recovered at all and so higher ratio would suggest higher losses. From the above table it is understood that the loss assets ratio had been very low in the years of study i.e. 2013-14 but it is high for remaining years and is 16.44% for the year 2014-15. The bank should take its condition seriously and work out action plans to reduce the loss assets ratio.

VI. CONCLUSION

The bank seems to have an increasing trend of NPA in last four years. The bank needs be proactive in the selection of clients and customers while sanctioning of loans. The operation of the bank is wide enough to cater to the needs of broad spectrum of the society and economy of India at large. Bank of Maharashtra should strictly follow all the norms and derivatives given by RBI.

Bank needs to have better credit appraisal system so as to prevent NPAs from occurring. However, once NPAs do come into existence, the problem can be solved only if there is enabling legal structure, since recovery of NPAs often requires litigation and court orders to recover stock loans. With long-winded litigation in India, debt recovery takes a very long time. Even if the bank is taking necessary measures for recovering the loans, but it needs the support of the system. But it takes at least one to two years to get permission from the court for physical possession of any property, which delay’s the further procedure.

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