

## **NPAs in Indian Commercial Banks - A Comprehensive Study**

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### **Abstract**

The introduced economic reforms have led to strengthening of banking sector in India in the last one and half decades. As a consequence of great opening to the world private sector and foreign banks emerged and are creating a competitive atmosphere in the Indian banking sector. With these developments banking sector in India has to face two challenges i.e., higher Non Performing Assets (NPAs) and the challenge of younger generation banks which are highly competitive in providing required or tailor made services to the modern customers. The NPAs are high public sector Banks (PCBs) and whereas private and foreign banks are low and more profitable when compare to PSBs. Thus the major agenda of many Indian banks is to cut NPAs which will finally improve the overall capability of banks.

A strong banking sector is highly essential and failure of banks can adversely affect all the sectors. In India NPAs are a major concern but are the best indicators of health of banking industry. NPAs are predictable burden in the banking industry. Many researchers have studied that there is strong empirical evidence available today that the robust financial markets support economic growth. At present the NPAs situation is worse than expected by RBI. In the recent Financial Stability Report (FSR) June 2017, RBI has warned that gross NPA ratio could rise to as high as 10.2% of the total loans by March 2018 from 9.6% in March 2017. No progress in the reducing of NPAs is seen despite RBI directed to device relevant strategies.

### **Key words:**

NPAs, Profitability, Lending Risk, Asset Quality, Nationalized Banks

### **Introduction**

An asset becomes none performing when it no longer generate income for the bank. NPAs reflect the performance of banks and high level of NPAs indicates the presence of large size of credit defaults which affects profitability of the bank. The level of NPLs is identified as a critical indicator for assessing banks credit risk, asset quality and efficiency in allocation of resources to productive sectors. NPAs are a serious threat to the survivability of banks sending distress signals on the sustainability of the affected banks. After nationalization of banks much focus was paid towards lending policy but not attention was given to the recoveries.

The banking reforms initiated in India as per the recommendation of Narasimhan Committee (1991). This initiation was a step forward towards a more market oriented that would operate in an transparent accounting, strict capital adequacy and prudential regulation. NPAs reflect the health of the banking system. In order to presence the strength of banking industry proper provisions are required (Financial systems, committee 1991). A high level presence of NPAs reflect the performance of the banks.

### **Objectives**

1. To Study comparative composition of GNPA of SCBs.
2. To Study classification of NPAs of SCBs.
3. To Analyze the provisions of SCBs.

4. To Study the impact on profitability of PSBs.

### Research Methodology

The research is purely based on secondary data. Data have been compiled from RBI website and Handbook of Statistics on Indian Economics. The principal purposes to analyse the trend, impact and intensity of NPAs in Indian Banking sector with refers PSBs with respect to NPAs. Tools used to analyse are (1) Trend Analysis, (2) Correlation.

### Review of Literature

- Nachi Ket et al. (2002) highlighted that a few micro level issues that are at the root of unsustainable performance levels are being observed. Further, the researcher revealed that unless the micro-level issues are dealt with each after systematic are resolved, the problem of NPAs may emerge again.
- Meeker and Laura (1987) expressed that the accumulation of NPAs in banks has assumed great importance as it tends to reflect the asset quality as a whole.
- Reddy et al. (2004) discussed about the financial sector reforms in India which have progressed rapidly on aspects like interest rate deregulation, reduction in agree requirements, barriers to entry, prudential norms and risk based supervision but the progress on the structural aspects has been much slower and is a cause for concern.
- Gupta (2012) in her study observed that bank should evaluate the financial capacity of the borrower before providing any credit facility. Further, the researcher suggested that proper committees must be formed for management of NPAs as NPA is crucial rating for any bank.
- Singh (2013) emphasized that the reason for the raising NPAs is poor management of credit risk by the banks. Banks should fix pre-sanctioning appraisal and an effective post-disbursement supervision.
- Kumar (2013) observed that during 1990's a huge accumulation of NPAs were seen which affected on the profitability, liquidity, solvency, capital adequacy etc. of the banks.

### Reasons behind maintaining of NPAs

- (1) **Defective lending:** Lending without observing the three cardinal principles of bank lending. These principles are (i) principle of safety, (ii) principle of liquidity, (iii) principle of profitability.
- (2) **Inappropriate technology:** Market decisions on real time cannot be taken due to the presence of inappropriate technology and management information system and hence NPAs are increasing.
- (3) **Poor credit appraisal system:** This is another contributing to NPAs. Any advances made without a proper appraisal of the borrower leads to NPAs. Banks should use good credit appraisal system.
- (4) **Managerial deficiency:** Banks should select a proper borrower and loans must be granted against tangible assets as security. Securities must have a value of marketability, acceptability, safety and transferrable risk.
- (5) **Manager spot visit:** The risk manager should give spot visits in order to avoid willful default.

### External Factors

- (1) **Ineffective recovery:** The negligence of recovery tribunals makes the bank to suffer the consequence of non-recovery which results in reduced profitability and liquidity.
- (2) **National calamities:** The Acts of god are the major factor driving the growth of NPAs. In India Acts of god are common and borrowers may feel inability to pay the loan installment in time.

(3) **Willful defaulters:** Some borrowers are capable of paying the installment in time but are guided by other factors to act. These groups should be identified and proper action should be taken to see that the installment is got back.

**Lack of demand:** Production of goods without anticipating product demand is yet another external factor driving huge accumulation of NPAs. The recovery after selling the assets being small and minimum and insufficient to meet the obligation. The bank has to record the non-recovered amount and should make provision against such trends.

**Industrial sickness:** Ineffective management, lack of knowledge to operate project, lack of adequate reindustrial sickness. Therefore the trend may end in bank low recovering thus reducing banks profitability.

### **Prevention of NPAs: Strategies**

(1) Recognise the problem at an early stage to avoid rehabilitation of the project and recovery problems.

(2) Study the history of borrower and his intention to borrow and genuineness.

(3) Time is crucial factor and hence timely response is essential which helps in rehabilitation and restructuring activity. Adequate responsiveness must be extended by the bank and response should be based on technique economic study and borrowers commitment.

(4) Effective management in processing adverse business conditions is most important and facing these trends affects the borrowers fortune. Consultancy if needed should be taken by the borrower in case of need and necessity.

(5) Cash flow must be properly focused. Fund flow helps in analyzing fresh credit requirement. Therefore appraisal should be based on that only on fund flow but also on the cash flow.

### **Study Findings**

Table - 1 reveals information regarding composition of gross non-performing assets Ratio (GNPA) of scheduled commercial banks (SCBs). Three year moving average shows that the concentration of NPAs of nationalised banks declined during 2006-10 and from 2011 they show increasing trend. Further the table reveals that NPAs of private sector banks is more or less stable from 2006-2014 and from 2014 onwards NPAs are rising. In case of foreign banks there is a fluctuation trend and the ratio of foreign banks is higher than private banks. The status of GNPA of nationalised banks shows least NPA ratio from 2007-11 and afterwards NPA ratio growth is severe and stood at 10.69 being the highest of all private and foreign banks. Table shows overall GNPA of SCBs increasing trend.

Table-2 shows data about NPA classification of SCBs. Table reveals that standard advances to total advances is gradually decreasing since 2009. But before 2009 standard advances with little more or less were similar. The increasing trend in standard advances indicates more making of provisions is necessary for those which are turning into substandard assets. Further, it is evident from the table that the concentration of substandard, doubtful and loss assets is increasing and this trend may pose threat to the survivality of banking system as a whole.

Table - 3 shows information about provisions of SCBs. The extent of provision creation is exclusively depends on asset classification. The data expressed in Table-2 that the percentage of standard asset out of total advances is continuously decreasing since 2009. As a consequence of this trend more provisions has to be created and this can be cross checked and we can see more increase in the provisions since 2009. Finally, such a huge provision creation will reduce banks profitability and also destabilise the capital structure.

Table-4 highlights the data an impact of NPA on profitability of PSBs. The correlation between NNPA to ROE is -0.946 which shows very high negative correlation i.e., there is inverse

relationship between ROE and NNPA. Further the relation between NNPA to ROA is -0.86 showing a negative relationship between the variables.

It is concluded here there exist significant relationship between NNPA & RO and NNPA & ROE.

**Conclusion:**

The present research concludes that there is a growing trend in GNPA of all SCBs. The standard assets are declining and the provisions are increasing. NPAs are capable reducing operational and financial and managerial efficiency of the bank. The money locked up in NPAs has a direct impact on profitability of the banks. The problem of recovery is common with large amount borrowers. The government should also make fast settlement of pending cases since priority sector lending becomes difficult. Further, larger amount of loan sanction should be made with proper study of the background of borrower and lending should be in line with intention of the project and guard against large scale overseas fund transfer. The apex bank should take cognisance of safety security and liquidity and any fraud intentions of borrower must be clearly understood by the bank. In the light of the previous innovative frauds committed, the banks should take care and diligence at the time of sanction of loan.

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**Table. 1: Composition of Gross Non-Performing Assets Ratio (GNPA) of SCBs**

Year	Nationalised	3 YMA**	Private	3 YMA	Foreign	3 YMA	SCBs*	3YMA
2005	5.36	-	3.83	-	3.05	-	4.92	-
2006	3.81	3.95	2.41	2.81	2.12	2.36	3.35	3.60
2007	2.69	2.85	2.19	2.36	1.92	1.99	2.52	2.71
2008	2.06	2.17	2.47	2.53	1.92	2.74	2.26	2.36
2009	1.75	1.95	2.92	2.79	4.37	3.55	2.31	2.36
2010	2.03	1.92	2.99	2.80	4.36	3.78	2.51	2.39
2011	1.97	2.22	2.48	2.52	2.61	3.24	2.35	2.60
2012	2.67	2.63	2.09	2.11	2.76	2.80	2.95	2.84
2013	3.24	3.33	1.77	1.88	3.04	3.22	3.23	3.34
2014	4.09	4.20	1.78	1.88	3.86	3.37	3.83	3.78
2015	5.26	6.68	2.10	2.24	3.20	3.75	4.27	5.20
2016	10.69	-	2.83	-	4.20	-	7.49	-

[Source: RBI- Database on Indian Economy;

\* SCBs = Scheduled Commercial Banks]

[\*\*3YMA = Three Year Moving Average]

**Table. 2: NPA classification of SCBs (in Billion)**

Year Total	Std. Advance		Sub Std. Adv.		Doubtful Adv.		Loss Adv.		Gross NPAs		
	Amt.	% Amt.	% Amt.	% Amt.	% Amt.	% Adv.	% Adv.				
2005	8379	94.6	110	1.2	308	3.5	59	0.7	476	5.4	8856
2006	10926	96.4	113	1.0	246	2.2	55	0.5	414	3.7	11340
2007	14262	97.4	143	1.0	198	1.4	48	0.3	389	2.7	14651
2008	17786	97.8	173	1.0	192	1.1	40	0.2	405	2.2	18191
2009	22378	98.0	203	0.9	206	0.9	41	0.2	450	2.0	22828
2010	26735	97.8	288	1.1	254	0.9	58	0.2	599	2.2	27335
2011	32718	97.8	350	1.1	332	1.0	65	0.2	747	2.2	33465
2012	38255	97.0	623	1.6	490	1.2	60	0.2	1173	3.0	39428
2013	43957	96.4	815	1.8	761	1.7	68	0.2	1645	3.6	45601
2014	49887	95.6	958	1.8	1216	2.3	99	0.2	2273	4.4	52159
2015	53382	95.0	1054	1.9	1630	2.9	100	0.2	2785	5.0	56167
2016	52875	90.7	2005	3.4	3232	5.5	163	0.3	5400	9.3	58275

[Source: RBI- Database on Indian Economy]

**Table. 4: Provisions of SCBs (in Millions)**

Year	Provisions
2006	37026
2007	62930
2008	80077
2009	91617
2010	171425
2011	259559
2012	345716
2013	430630
2014	554503
2015	683756
2016	1538840

[Source: RBI- Database on Indian Economy]

**Table - 4: Impact of NPA on Profitability of PSBs  
GNPA& NNPA ratios of PSBs**

Year	GNPA to Gross Advances	GNPA to Total Assets	NNPA to Gross Advances	NNPA to Total Assets	ROA	ROE
2005 (1)	5.4	2.7	2.1	1	0.95	17.24
2006 (2)	3.7	2.1	1.3	0.7	0.88	15.39
2007(3)	2.7	1.6	1.1	0.6	0.92	16.08
2008(4)	2.2	1.3	1	0.6	1.00	17.13
2009(5)	2	1.2	0.9	0.6	1.03	17.94
2010(6)	2.2	1.3	1.1	0.7	0.97	17.47
2011(7)	2.2	1.4	1.2	0.7	0.96	16.90
2012(8)	3	1.9	1.5	1	0.88	15.33
2013(9)	3.6	2.4	2	1.3	0.80	13.24
2014(10)	4.4	2.9	2.6	1.6	0.50	8.48
2015(11)	5	3.2	2.9	1.8	0.46	7.76
2016(12)	9.3	6	5.7	3.5	-0.20	-3.47

[Source: RBI- Database on Indian Economy]