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Impact of NPA on the Operations of Indian Commercial Banks

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Abstract – In India Non-performing assets are one of the major concerns for banks.NPA is the best indicator for the health of the banking industry. In this paper we present about NPAs reflect the performances of banks. .NPAs is the primary indicators of credit risk. NPAs are an inevitable burden on the banking industry. Hence the success of a bank depends upon methods of managing NPAs. The Public Sector Banks have shown very good performance over the private sector banks as far as the financial operations are concerned.

Keywords: NPA, Private Sector Banks, Public Sector Banks, Liberalization

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INTRODUCTION

The banking diligence has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management came into picture. The primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal and housing etc. and to receive deposits. Receiving deposit involves no risk, since it is the banker who owes a duty to repay the deposit, whenever it is demanded. On the other hand lending always involves much risk because there is no certainty of repayment. In recent times the banks have become very cautious in extending loans, the reason being mounting nonperforming assets. Non-performing assets had been the single largest cause of irritation of the banking sector of India [Sonia Narula, Monika Singla, 2014].

A loan is an asset for a bank as the interest payments and the repayment of the principal create a stream of cash flows. It is from the interest payments that a bank makes its profits. Banks usually treat assets as nonperforming if they are not serviced for some time. If payments are late for a short time, a loan is classified as past due and once a payment becomes really late (usually 90 days), the loan is classified as non-performing (B.Selvarajan & G. Vadivalagan, 2013). NPA usually refers to non-performing assets and the lenders consider it as those assets that are not fetching benefits to them. The word is not new to the bankers. It is regular but disguised loan asset.. An asset becomes nonperforming when it ceases to generate income for the bank. Prior to 31st March, 2004 a nonperforming asset was defined as a credit facility in respect of which the interest or installment of principal has remained past due for a specified period of time which was four quarters. Due to the improvements in payment and settlement system, recovery climate, up gradation of technology in the banking system, etc., it has been decided to dispense with past due concept, with effect from March 31st 2004(Chandan Kumar Tiwari & Ravindra Sontakke, 2013).

REVIEW OF LITERATURE:

DEBARSH AND SUKANYA GOYAL (2012) emphasized on management of non-performing assets in the perspective of the public sector banks in India under strict asset classification norms, use of latest technological platform based on Core Banking Solution, recovery procedures and other bank specific indicators in the context of stringent regulatory framework of the RBI. Non-performing Asset is an important parameter in the analysis of financial performance of a bank as it results in decreasing margin and higher provisioning requirements for doubtful debts. The reduction of non-performing asset is necessary to improve profitability of banks. KAVITHA. N (2012), emphasized on the assessment of nonperforming assets on profitability its magnitude and impact. Credit of total advances was in the form of doubtful assets in the past and has an adverse impact on profitability of all Public Sector Banks affected at very large extent when non-performing assets work with other banking and also affect productivity and efficiency of the banking groups. The study observed that there is increase in advances over the period of the study. However, the decline in ratio of Non-performing Assets indicates improvement in the assets quality of SBI groups, Nationalized Banks and Private Sector Banks.

Years	Gross NPAs					Net NPAs		
	Gross Advances	Amount	% to Net Advances	% to Total Assets	Net Advances	Amount	% to Net Advances	% to Total Assets
2000-01	5,58,766	63,883	11.4	4.9	5,26,329	32,632	6.2	2.72
2001-02	6,80,958	70,861	10.4	4.6	6,45,859	35,554	5.5	2.3
2002-03	7,78,043	68,717	8.8	4	7,40,473	29,692	4.4	1.8
2003-04	9,02,026	64,785	7.2	3.3	8,62,643	24,396	2.9	1.2
2004-05	11,52,682	59,373	5.2	2.5	11,15,663	21,754	2	0.9
2005-06	15,51,378	51,816	3.3	1.9	15,15,669	18,529	1.2	0.7
2006-07	20,12,510	50,486	2.5	1.5	19,81,237	20,101	1	0.6
2007-08	25,07,885	56,309	2.3	1.3	24,77,039	24,734	1	0.6
2008-09	30,38,254	68,328	2.25	1.3	30,00,906	31,564	1.05	0.6
2009-10	35,45,900	84,747	2.39	1.3	34,93,393	39,126	1.12	0.6

Source: Report on Trend and Progress on Banking Sector 2010-11.

Impact of NPA on the operations of banks [C.S. Balasubramaniam**]**

- **Profitability**

NPA means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the prodigality of bank decreases not only by the amount of NPA but NPA lead to opportunity cost also as that much of profit invested in some return earning project/asset. To start with, performance in terms of profitability is a benchmark for any business enterprise including the banking industry. However, increasing NPAs have a direct impact on profitability of banks as legally banks are not allowed to book income on such accounts and at the same time banks are forced to make provision on such assets as per the Reserve Bank of India (RBI) guidelines on Performing Asset means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI. So NPA does not affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity. Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.

- **Credit Loss**

If a bank is facing problem of NPA, then it adversely affects the value of bank in terms of market for credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting in their money in the banks.

- **Involvement of Management**

Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now days, banks have special employees to deal and handle NPAs, which is additional cost to the bank.

- **Liquidity**

Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for shortest period of time which lead to additional cost to the company. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.

CONCLUSION:

NPAs reproduce in general performance of the banks. The NPAs have constantly been a big anxious for the banks in India. The Indian banking sector faced a solemn problem of NPAs. . A high level of NPAs suggests high probability of a large number of credit defaulting that affect the profitability and liquidity of banks.

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