NON-PERFORMING ASSETS AND PROFITABILITY OF BANKS: A SELECTIVE STUDY ON NIFTY BANK INDEX

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ABSTRACT

The key term for banking corporations is nonperforming asset. Non-performing assets demonstrate the effectiveness of the efficiency of the banks. Non-performing assets are funds that the bank does not receive in return for loans disbursed. Non-performing assets have an impact on the entire financial system, not just the banking industry. Thus a study has been conducted on private sector banks listed on NIFTY Bank Index for a period from 2017 to 2021 and the relationship between their gross Non Performing Assets and net profit was measured. The result showed that all the banks under study exhibit a positive correlation between their gross Non-Performing Assets and net profits. So the study concluded that there is statistically significant relationship between changes in Non-Performing assets and Net Profit of the bank.

Keywords: on-performing assets, NPAs, Gross NPA, Net Profit

INTRODUCTION

A bank is an institution that provides banking and financial services to its customers by accepting deposits and making loans. Banks have now become an integral part of our daily lives, providing access even to the common man and their routines in order to fulfill the responsibilities and needs related to agriculture, industry, and the service sector for the growth and development of all sections of society. Banks play an important role in the economic system by maximizing production, accelerating consumption, and assisting in the circulation and exchange of money. Because it primarily deals in money, it stimulates economic growth by circulating it and provides various economic supports. The primary goal of the banking sector in India is to accelerate and support the country's financial and economic stability, with the primary goal of profiting like other commercial enterprises. The Indian banking sector has proper planning and guidelines, and it is concerned with resource allocation, sophisticated income distribution, responsibility for regional and economic growth, and the reduction and elimination of monopolies in trade and industries.

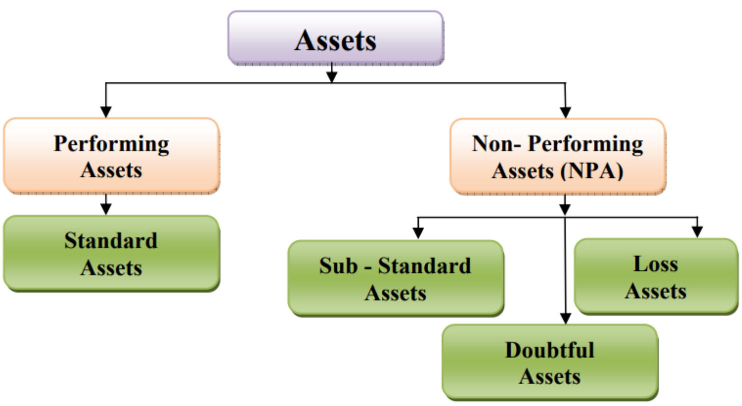
India’s financial markets have been seeing intense rivalry since its deregulation. Indian commercial banks are being exposed to a new economic environment marked by increasing competition and new regulatory requirements as a result of the liberalization of the financial industry in India. The face of scheduled commercial banks has evolved as a result of the paradigm shift in financial institutions’ attitudes regarding short-term funding. The banking situation in the economy has been flaming up due to increased competition and sluggish development in the economy, as well as a weak credit deposit ratio, a big volume of non-performing assets on the balance sheet, and a lack of automation and professionalization in operations. Banks utilize the percentage of non-performing loans to assess their risk, asset quality, and allocation of resources. Most of the financial system's assets are non-performing advances. The Financial System Committee is worried about this trend. It is unable to utilize the amount held in non-performing assets (NPAs)

Concept of Non-Performing Assets

A Non-Performing Asset (NPA) is defined as a series of advances based on monetary organizations that have received cash from the bank in exchange for the rule and premium cash that must be paid in planned interims. A nonperforming obligation is when a borrower does not make any premium installments or pay the standard cash to the bank for whatever length of time that a standard time of 90 days. When credit installments are not made for 90 days, the obligation is often referred to as nonperforming. In any case, the length of time slipped may be shorter or longer depending on the terms and conditions stated in each advance. A Non-Performing Asset, as defined below, is a credit where:

1. In the case of a term loan of 180 days or more, the installment or interest with the principal amount must be paid in a continuous manner.
2. The account remains "Out of Order" for a period of 180 days or more in terms of Cash Credit or Overdraft (OD/OS).
3. If a bill has been overdue for 180 days or more (in a discounted or purchased bill).
4. Any amount that has been overdue for 180 days or more in comparison to other accounts.

Asset Classification



Source: dbie.rbi.org.in

Standard Assets

These assets are not classified as non-performing assets. Standard assets, however, might potentially stop operating regularly owing to unanticipated circumstances, in which case they become Non-Performing Assets.

Sub-standard Assets

Assets that are not earning money for the bank and have been past due for longer than 90 days but less than 12 months are considered sub-standard assets.

Doubtful Assets

Doubtful assets are all those assets that are not generating revenue for the bank and have been NPAs for longer than 12 months.

Loss Assets

Loss Assets are those assets that the bank realizes at a loss from. The likelihood of recovering these assets is quite low. The bank, auditors, or RBI examination has identified these assets as unrecoverable, but the value has not yet been completely written off from the balance sheet.

NPAs are an inherent cost of doing business in the banking industry. The ability of banks to manage nonperforming assets (NPAs) and maintain them within acceptable limits is critical to their success. As a result, the only way to eliminate NPA is to establish and implement an effective monitoring and control policy, which should be accompanied by appropriate legal reforms. NPAs have been studied for many years in order to get understanding into the problem, its cause, and its remedy. Numerous empirical studies have been undertaken in India and elsewhere on the subject of commercial bank nonperforming assets.

LITERATURE REVIEW

Singh, (2022) conducted a study of the impact of Non-performing loans on bank's profitability in Bhutan. For the study, data was collected from secondary sources for a period ranging from 2014 to 2019.Using regression analysis impact of Non-performing loans has been analyzed on the profitability of banks. It has been found that non-performing assets negatively influence return on assets. The study showed that 68% of the return on assets is affected by Non-performing loans. Furthermore, the private sector bank had a higher gross Non-performing loan ratio than the public sector banks.

Chary and Fasi (2019) conducted a study on nonperforming assets in Public sector banks. The predominant objective of the analyse was to determine the impact of NPAs on the performance of public sector banks of India. The study was conducted for a period from 2009-2018. After analyzing the results, the study concluded that public sector banks are affected by NPAs which results in decrease in profitability and poor financial performance.

Mishra and Sahoo (2018) examined the movement of non-performing assets of SBI for a period from 2005-2017. Using various statistical techniques the study focused on assessing the causes of NPA. The results of the study concluded that there is requirement for improvement in management of Non-performing assets of SBI. By incorporating more proactive measures NPAs can be managed effectively.

Dudhe (2017) examined the impact of nonperforming assets on the profitability of the public sector banks in India for a period from 2007-2016. The study was conducted on seven public sector banks and relation between gross NPA and net profits was determined. Using Panel regression the results of the study concluded that other than SBI and PNB all other banks showed a negative relationship between gross NPA and net profits.

Balaji and Kumar (2016) analyzed and compared the financial performance of the Indian Public and Private sector banks for a period from 2011-12 to 2015-16. Using mean T-Test the study concluded that there is need for public sector banks to reformulate their strategies by taking into consideration their strengths and weaknesses.

Prasanth and Jones (2016) examined the effect of NPAs on the bank's profitability from a period ranging from 2005-2014. The study developed a relation between non-performing assets and net profits of the banks. The results of the study found that large banks are able to maintain their losses incurred through nonperforming assets whereas small banks are unable to recover the Non-performing loans. Issues of nonperforming loans are higher in case of public sector banks.

Singla and Srivastav (2016) analyzed the impact of nonperforming assets on Indian banks. This paper examines the NPAs of State Bank of India (SBI. The main objective of the study was to examine how NPAs will affect the profitability of banks. The results of the study concluded that there is significant burden of Non-priority sector advances on total NPAs of SBI bank in India.

Narula and Singla (2014) examined the impact of Non-performing assets of PNB (Punjab National Bank) on profitability of bank. The study was conducted for a period from 2007-2012. Using annual reports of PNB the results of the study concluded that there is significant positive relationship between Nonperforming assets of PNB and net profits. Decrease in NPAs is important to increase the profitability of banks.

Goel and Rekhi (2013) examined and measured the relative performance of Public sector and private sector banks of India. The results of the study concluded that profitability and efficiency are interdependent. The private sector banks perform better than the public sector banks of India.

Messai and Jouini (2013) examined the impact of non-performing loans of banks in Greece, Italy and Spain. The study was conducted from 2004-2008 and panel data analysis was used. Using various bank specific variables the results of study concluded that non performing loans have positive relationship between non-performing loans and loan loss reserves to total assets. A negative relation has been found between non-performing loans and the profitability of banks.

Salas and Saurina (2002) investigated the determinants of obstacles of loans in commercial banks of Spain from 1985-1997. Using a panel dataset and a dynamic model the study concluded that several bank specific determinants such as rapid credit expansion, market power, bank size explain fluctuations in nonperforming loans in commercial banks of Spain.

From the review of literature it has been found that most of the studies have been made on Non-performing assets but not many studies conducted on Banking Index. So the present study aims to study the performance of Banks listed on NIFTY Bank Index.

OBJECTIVES OF THE STUDY

1. To study the relationship between the non performing assets and the profitability of banks.
2. To compare the performance of the private sector banks in NIFTY Bank Index in terms of managing Non-Performing Assets.
3. To establish the correlation between Non-Performing assets and Net Profits of Banks.

HYPOTHESIS OF THE STUDY

H1: There is statistically significant relationship between changes in Non-Performing assets and Net Profit of the bank.

H0: There is no statistically significant relationship between changes in Non-Performing assets and Net Profit of the bank.

RESEARCH METHODOLOGY

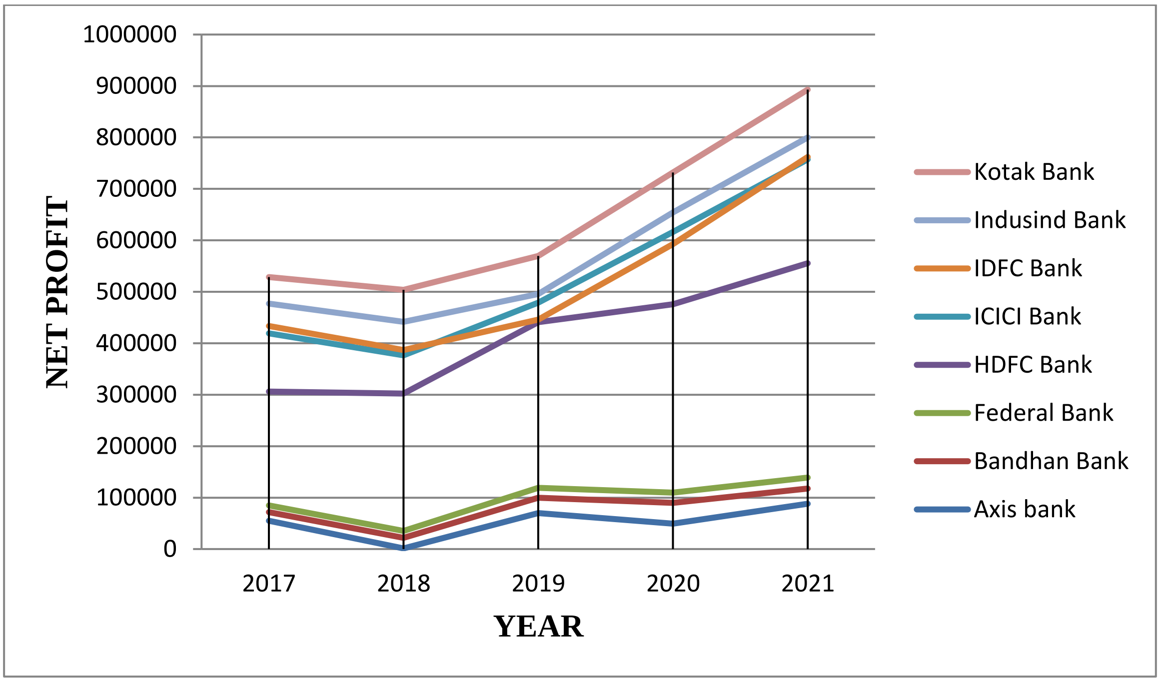
The present study is based on secondary data. The present study has been conducted for a period of 5 years from 2017-2021.The study is conducted on banks listed on NIFTY Bank Index. For the purpose of study only Private sector banks listed on the NIFTY Bank Index is selected. The sample size is 8 banks out of 12 banks listed on NIFTY Bank Index. The data relating to banks has been collected from CMIE Prowess Database and Correlation and Regression analysis is done using MS Excel.

RESULTS AND DISCUSSION

Table1: Net Profit

Year	Axis Bank Ltd.	Bandhan Bank Ltd.	Federal Bank Ltd.	HDFC Bank Ltd.	ICICI Bank Ltd.	IDFC First Bank Ltd.	IndusInd Bank Ltd.	Kotak Mahindra Bank Ltd.
2017	54675.6	17044.7	13065	221390.8	112786.1	14709.6	43596.9	51480.7
2018	1215.7	20559	13438.6	266973	74345.6	10273	54806.7	62182.2
2019	69740.9	30130.5	19072.5	321996.6	37767.6	-32951.9	49805.7	73857.9
2020	49042.3	40534.2	20325.3	366071.5	140480.4	-23785.2	61206.1	78046.7
2021	88058.5	29486.5	21372.7	416589.8	201827.2	4757.8	37841.5	93029.8

Figure 1: Net Profit

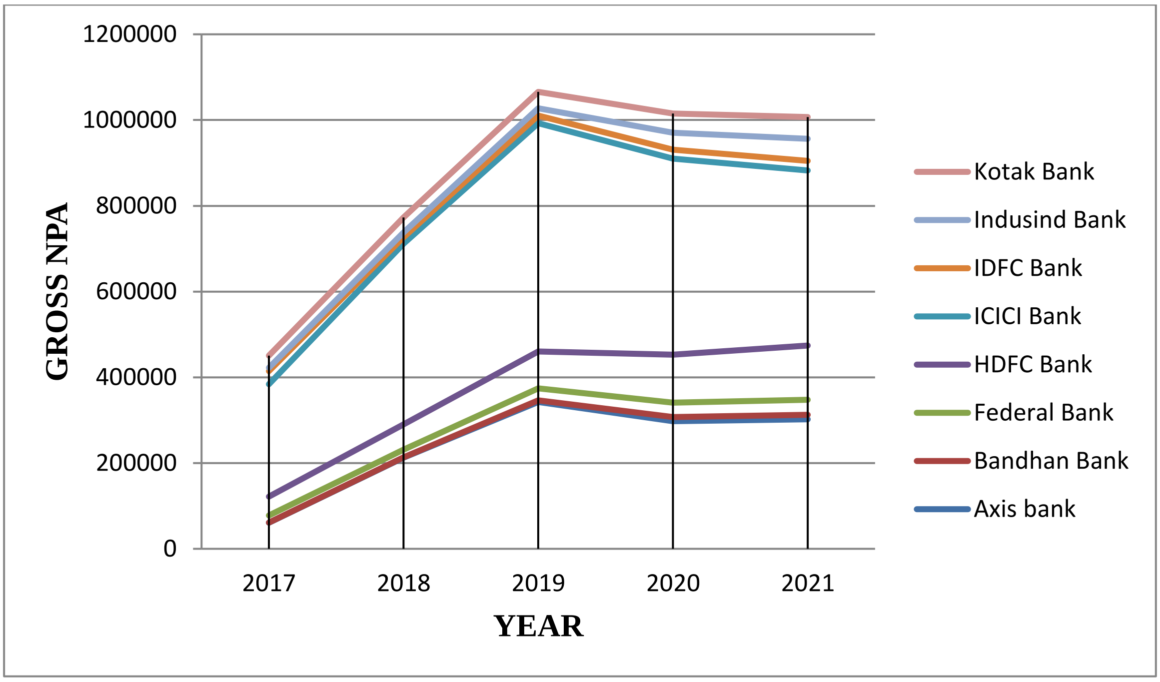


This is the trend of Net Profit for the different banks for the years 2017 – 2021. Almost all the banks have experienced a positive growth in Net profit from 2017 to 2021 but IDFC first bank suffered a loss in the year 2019 and 2020 in comparison to the other banks.

Table 2: Gross NPA

Year	Axis Bank Ltd.	Bandhan Bank Ltd.	Federal Bank Ltd.	HDFC Bank Ltd.	ICICI Bank Ltd.	IDFC First Bank Ltd.	IndusInd Bank Ltd.	Kotak Mahindra Bank Ltd.
2017	60875.1	187.7	16677.7	43928.3	262212.5	30583	7768.2	28381.1
2018	212804.8	862.6	17270.5	58856.6	421593.9	15421	10548.7	35786.1
2019	342486.4	3731.4	27956.2	86069.7	532401.8	17790.5	17049.1	38253.8
2020	297894.4	9340	33537.6	112241.6	456760.4	21360.4	39474.1	44679.4
2021	302338.2	9927.8	35308.3	126499.7	408290.9	22795.6	51467.4	50268.9

Figure 2: Gross NPA



The Gross NPAs have been tremendously increasing for all the select banks for the period under study from 2017-2021. As the business operations of banks have been increasing the amount of Non-Performing assets have also increased.

Correlation between Gross NPA and Net Profit of the select banks is explained as follows:

Table 3: Correlation

Bank	Correlation
Axis Bank Ltd.	0.328369
Bandhan Bank Ltd.	0.838936
Federal Bank Ltd	0.99272
HDFC Bank Ltd.	0.994245
ICICI Bank Ltd.	0.342878
IDFC First Bank Ltd.	0.41098
IndusInd Bank Ltd	0.165226
Kotak Mahindra Bank Ltd.	0.980052

Figure 3: Correlation

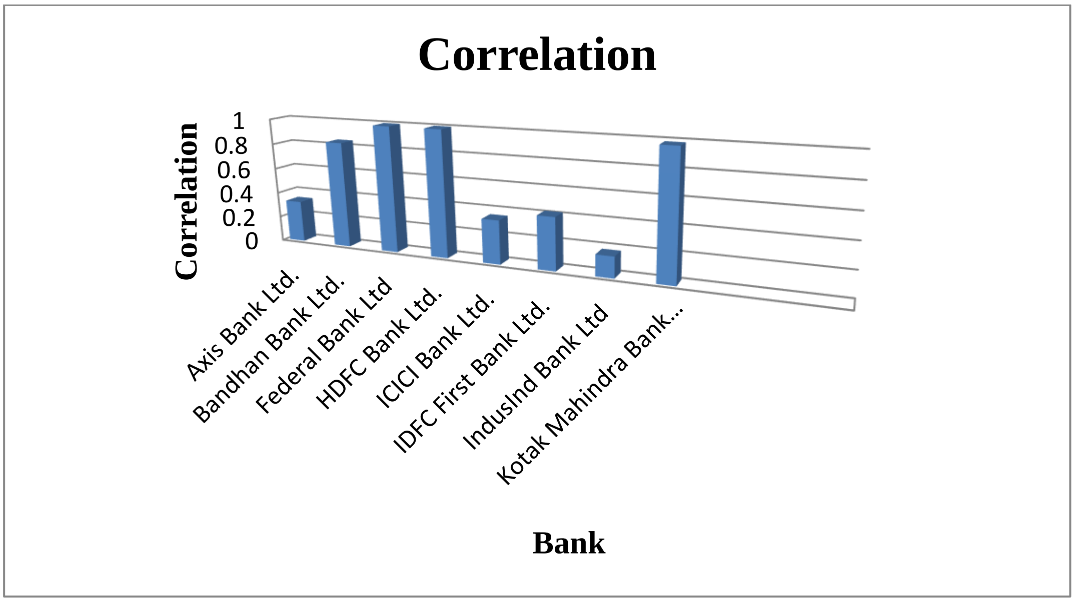


Table 4: Regression

Bank	Correlation		Regression Coefficients	Standard Error
Axis Bank Ltd.	0.328369	Intercept	29488.33	41433.38
		X Variable	0.094781	0.157406
Bandhan Bank Ltd.	0.838936	Intercept	19493.22	3973.229
		X Variable	1.675245	0.62744
Federal Bank Ltd	0.99272	Intercept	5887.445	846.2375
		X Variable	0.442346	0.030985
HDFC Bank Ltd.	0.994245	Intercept	129228.4	12535.62
		X Variable	2.214427	0.137759
ICICI Bank Ltd.	0.342878	Intercept	204336.6	146971.3
		X Variable	-0.21837	0.345403
IDFC First Bank Ltd.	0.41098	Intercept	-38264.8	43291.13
		X Variable	1.522246	1.949523
IndusInd Bank Ltd	0.165226	Intercept	51441.14	8295.358
		X Variable	-0.07877	0.27145
Kotak Mahindra Bank Ltd.	0.980052	Intercept	-1135.95	8682.681
		X Variable	1.845662	0.216087

All the banks selected under study have shown a positive correlation between Net profit and Gross NPA. Normally, the banking sector's profitability is determined by the timely repayment of loans disbursed to various sectors. It does not imply that the greater the number of NPAs, the greater the profits, but the banks of India are able to earn more profits due to their wide range of financial services and effective management of NPAs.

FINDINGS OF THE STUDY

After analyzing the data we have found that all the banks have non-performing assets in their balance sheets and are increasing with the passage of time. Almost all the banks are able to maintain the losses but not able to recover the loans. All the banks selected under study have are facing the major problem of non-Performing assets and only few banks are able to recover their NPAs. However, if NPAs continue in this manner, even large banks will stumble, as Lehman Brothers did in the United States, resulting in an international economic crisis. The study concluded that there is statistically significant relationship between changes in Non-Performing assets and Net Profit of the bank.

CONCLUSION

Every country's economic growth is dependent on the country's financial system functioning properly. The banking sector is the most important component of the financial system. Our government is currently focusing on developing our economy, which requires significant financial resources. Thus, India's GDP will only grow if the necessary funds are invested in the economy, resulting in faster economic growth. Thus, the banking sector should now primarily focus on effective management of NPAs in order to increase their profitability and thus provide as much funds to the industry as possible. The organisations should devise new strategies to improve loan recovery.