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NON-PERFORMING ASSETS AND THEIR IMPACT ON BANKS PROFITABILITY

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Abstract:-Hon-performing Asset plays the role of an important parameter in the analysis of the financial performance of a bank,it is a condition When there is decreasing in margin and the need of higher provision for doubtful debts. NPA affects the banking sector negatively. The Indian banking system has gone downward a important transformation following the financial sector reforms as suggested by Shri M.Narasimham Committee in 1991. The NPAs is considered as an important parameter in judging the performance and financial health of the bank. The presence of NPAs has an adverse impact on the productivity and efficiency of banks and it results in the erosion of profits. So in order to face challenges of today's scenario and to maintain the profitability and liquidity at appropriate level, it is important to make use of efficient recovery of NPA to maintain at low level. The aim of the present study is to assess the non-performing assets of Punjab National Bank and its impact on the profitability and liquidity of the bank. The study uses the annual reports of the bank from 2009-10 to 2013-14. The paper also studies the reasons for advances becoming NPAs and provides suggestions to overcome the problem of NPAs.

Keywords: Total Advances, Asset Classification, Non-Performing Assets, Gross NPA, Net NPA.

INTRODUCTION

Earlier profit earning in banks has not been a big issue, as banks were operating in a regulated region where profit margin was almost ensured. The financial sector reforms are the major steps between them. NPA refer an advance where payment of interest or repayment of principal (in case of term loans) or both remains unpaid for a period. According to the guidelines of RBI "An asset becomes non-performing when it ceases to generate income for the bank. A non performing asset (NPA) is a loan or an advance for a few reasons namely: Installment of principal or interest remains outstanding for a period of approximately more than 3 months (90 days) in respect of a term loan; the account remains inoperable in respect of an Overdraft/Cash Credit; the bill remains outstanding for a period of approximately more than 3 months (90 days) in the case of bills purchased and discounted; the installment of principal or interest on that remains outstanding for two short duration crop seasons; the installment of principal or interest on that remains outstanding for one long duration crop season."

CAUSES OF NPA

1. External causes: Natural calamities (i.e. floods, accidents and climatic conditions), Industry Recession, Political changes of the country, Government policies(i.e. changes in excise duties and custom duties) , changes in economic conditions, changes in labor laws, problems related to industries, liberalization's Impact on industries, Technical problems etc.

2 Internal causes: Mismanagement, Faulty projects, projects not completed in time, weak recovery systems, frauds, diversion of funds for non-economic projects, management disputes, improper linkages, Building up pressure for sanctions, Non-observance of system, banker's lack of professionalism and appraisal standards, procedures and non- insistence of collaterals, bank's deficiencies in monitoring and follow-ups, lack of pre sanctioning evaluation, Lack of post sanction monitoring, etc.

TYPES OF NPA

Gross NPA: Gross NPAs is the sum total of all loan assets that are classified as NPAs as per RBI guidelines of Balance Sheet. Gross NPA represented by the quality of the loans made by banks. It incorporates all the nonstandard assets like as sub-standard, doubtful, and loss assets. It can be computing with the help of following ratio:

Gross NPAs Ratio = Gross NPAs / Gross Advances
Net NPA: Net NPAs are those types of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA depicts the original burden of banks.According to the guidelines of central bank that The health of a bank is reflected by return on its assets ,the bank's balance sheets include a large amount of NPAs and the process of recovery and write off of loans is very time consuming the banks have to make provision against the NPAs are meaningful".

Assets can be categorized as:
a. Standard Assets
b. Sub standard Assets
c. Doubtful Assets
d. Loss Assets

a. Standard Assets: Standard assets are the ones in which the bank is receiving interest + principal amount of the loan regularly from the customer. It becomes important if the arrears of interest and the principal amount of loan have not exceed 90 days a Financial Year. A provision of 40% is required to be made on standard assets.

b. Sub Standard Assets: It would be one, which has lasted NPA for a period is less than or equal to period of 12 months (With effect from at the end of march,2005). Sub-standard assets required a 20% provision.

c. Doubtful Assets: A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the included feature that the weaknesses make collection or liquidation highly questionable on the basis of present conditions. An asset becomes doubtful if it listed in the sub-standard category for 12 months (With effect from 31 march 2005).
A provision of:
100% (if the loan is unsecured),
100% (if secured, but doubtful for more than three years).
20% (if secured, but is doubtful for one year),and
30% (if secured, but is doubtful for two years).

d. Loss Assets: A loss asset is one which is considered uncollectible and has a little value that its continuance as a bankable asset is not warranted (there may be some salvage or recovery value.100%provision is required On loss assets .

REVIEW OF LITERATURE

Mishra, T.P. (2003) exposed the high rise in Gross NPA and Net NPA of the banking sector in the recent past years as the exponential rate, suggest that the ongoing recession was taking a heavy toll on corporate audit discipline.It was supported with the Recovery conditions,access of the lenders towards lending, legal system, and so on.According to(TOOR N.S.,1994) recovery of non-performing assets should be through the process of compromise by direct talks rather than by lengthy and costly procedure of litigation. He claimed that by having supervising, it is possible to measure the thesaurus sickness of advances in the early stages, by reviewing and put it back on the path to recovery. In 2012, Kavitha, N conducted a study and emphasized on the assessment of the impact of non -performing assets on profitability. In the earlier time Credit of total advances was in the form of doubtful assets and has negative impact on profitability of all Public Sector Banks. The study analyzed that there is an increase in advances over the period of the study. However, the decline in the ratio of NPAs shows the increase in the asset quality of Private Sector Banks, SBI groups, and Nationalized Banks.

Khedekar Pooja S. (2012), asserted that a strong Banking Sector is essential for a flourishing successful economy. The NPAs acts as a needle showing the credit risks & efficiency of allocation of resource. NPA need to maintain the provisions if rise in which decreases the overall profitability of the banks. This have a negative impact on the Bank profitability as well as NPA affects the economy as a whole.

Kohli, (1997) analyzed the impact of directed credit under priority sector on the profitability of commercial banks in India. She focus the matters related to the directed credit, which was not solely responsible for the decreasing in the profitability and the poor quality of the portfolio of the financial institutions.

THE IMPACT OF NPAS

- The day to day working of the bank becomes difficult.
- NPAs reduce the earning capacity of the assets and badly affect the return on assets.
- Capital gets blocked in advances which are unrecoverable.
- Higher provisioning required for the rising amount of NPAs, adversely affects the bank profitability.
- Time and efforts of management is wasted on NPAs.
- Liquidity position of banks also deteriorates.
- NPAs results in decline in the value of shares.

OBJECTIVES OF THE STUDY

- Study and analyze Non-performing assets (NPA) and their impact on profitability and liquidity of the banks.
- Study the reasons for assets becoming Non-performing assets.

DATA COLLECTION AND RESEARCH METHODOLOGY:

Data is collected from the secondary sources through annual reports of PNB, RBI bulletins, and compile data in order to analyze the amount of Net Profit, Gross NPA and Net NPA so as to analyze the performance of PNB. The study uses the data for the period 2009-10 to 2013-14.

TOOLS OF DATA ANALYSIS

NPAs has been analyzed by preparing tables and using coefficient of correlation. The tables have been used to compare the total advances, net profit, gross NPA and net NPA so as to see the trend of these for the period under study and correlation is used so as to see whether there is any relationship between total advances & net profit and Gross NPA & Net NPA.

Comparison of Net Profit and NPAs

(Amount in crores)

YEAR	NET PROFIT	GROSS NPA	NET NPA
2009-10	3804	3214.41	981.72
2010-11	4434	4379.39	2038.63
2011-12	4884	8719.62	4454.23
2012-13	4784	13465.79	7236.50
2013-14	3343	18880.06	9916.99

Interpretation of results: The table is comparing Net Profit with Gross NPA and Net NPA. The table depicts the shaking performance of the Bank. From the table, we can see that from 2009-10 to 2011-12 the net profits are increasing, but after than these starts reducing due to the large amount of NPAs. The amount of Gross NPAs and Net NPAs is increasing continuously and there is a sharp rise in the amount of NPAs after 2011-12, which has resulted in a huge reduction in net profits.

Relationship between Net Profit and Net NPAs

Correlation is used to see whether there exists any relationship between the net profits and Net NPAs.

Formula: $$R = \frac{N\,\Sigma dx.dy - \Sigma dx.\,\Sigma dy}{\sqrt{\{\Sigma dx2 - (\Sigma dx)\,2\}} * \sqrt{\{\Sigma dy2 - (\Sigma dy)\,2\}}}$$

YEAR	NET PROFIT(X)	dx=X-A (A=3804)	dx^2	NET NPA(Y)	dy=Y-A (A=4454)	dy^2	dx.dy
2010	3804	0	0	982	- 3472	12054784	0
2011	4434	630	396900	2039	- 2415	5832225	- 1521450
2012	4884	1080	1166400	4454	0	0	0
2013	4784	980	960400	7236	2782	7739524	2726360
2014	3343	- 461	212521	9917	5463	29844369	- 2518443
	? X=21249	? dx=2229	? dx^2= 2736221	? Y=24628	? dy=2358	? dy^2= 55470902	? dx.dy= - 1313533

Now by putting the calculated values in the formula, we get:

$$R = \frac{5*(-1313533) - 2229*2358}{\sqrt{\{5*2736221-(2229)\,2\}} * \sqrt{\{5*55470902-(2358)\,2\}}}$$

SO, R = 0.005%

Interpretation of result:

As the value of r is very low, we can say that there is no relation between the net profits and Net NPAs. Although from 2009-10 to 2011-12 the net profits and Net NPAs both are increasing, but after that profits start declining and the amount of NPAs rise rapidly. This may be due to the management failure in the collection of debts timely.

FINDINGS AND CONCLUSION:

- Gross NPA and Net NPA of PNB are increasing year by year.
- There is an adverse effect of NPA on the profitability and liquidity of the bank.
- The Net Profits rise till 2011-12, after that these start decline.
- High and rising amount of NPA has restrained the bank from giving loans to the new customers.
- The performance of the bank is shaking and not stable.

SUGGESTIONS

- Bank should strengthen their credit management system from the very beginning of selection of borrowers to the recovery of loans.
- Bank should do the pre-sanctioning surveys before sanctioning the loan and there should be a post sanctioning review and control also so as to ensure better performance.
- There should be some special groups or team members of the recovery and follow-up of advances so as to minimize NPAs.
- There should be a proper selection of the borrower.

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