A Study on Non Performance Assets Impact on Financial Sustainability of Commercial Banks in India

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Abstract: This study attempts to measures the financial sustainability towards NPA of the Commercial Banks in India. Analytical frame of the NPA emerged as an upsetting intimidation in the nation sending adverse signals on the sustainability and insurability of the debt burden banks. Among many desirable well-functioning characteristics of the financial system, management of NPA is a major one. The Government and RBI initiated multiple steps to control the upsurge in NPA, but did not result expectedly. As NPA can't be completely removed from the financial system, its furtherance should be resisted at the earliest to overcome excessive future financial erosion of capital. The study is based on secondary data collected from annual reports of department of Banking Supervision, RBI for the study period i.e. 2005 to 2017.To test the hypothesis the study has been worked on Student t-test by using SPSS. The paper has discussed on three group of banks; nationalized banks, state bank its India and its associates and public-sector banks further these banks are classified into three sectors; priority sector, non-priority sector and public-sector banks in India for scrutiny and revealed that the upward trend in NPA is persistently strong, eroding the profitability of the banks.

Key words: Operational Performance, Profitability, Non-Performing Assets, financial sustainability.

INTRODUCTION

Assets which generate income are called performing assets and but those do not generate income are called non-performing assets. Non-performing assets are further classified into the following three categories on the basis of the duration for which they have remained non-performing: Sub-standard assets – assets that have remained NPA for a period of less than or equal to 12 months. There is a distinct possibility of the bank sustaining some losses on such assets if deficiencies are not corrected. Doubtful assets – non-performing assets are in the sub-standard category for

12 months. Given the weaknesses in these assets, collection or liquidation is rendered highly improbable.

Loss assets are assets, where loss has been identified by the bank or external auditor/ RBI team but has not been fully written off. Such assets are considered uncollectible. Apart from the classification of NPAs, banks are also required to identify financial distress early by monitoring assets that have not yet turned non-performing but are showing signs of incipient stress. This is done by creation of 3 sub-categories under the 'Special Mention Accounts'

REVIEW OF LITERATURE

Kaur K. and Singh B. (2011) in their study on Non-performing assets of public and private sector banks (a comparative study) studied that NPAs are considered as an important parameter to judge the performance and financial health of banks. The level of NPAs is one of the drivers of financial stability and growth of the banking sector.

Chatterjee C., Mukherjee J. and Das (2012) in their study on Management of non-performing assets - a current scenario has concluded that banks should find out the original reasons/purposes of the loan required by the borrower. Proper identification of the guarantor should be checked by the bank including scrutiny of his/her wealth.

Rai (2012) in her study on Study on performance of NPAs of Indian commercial banks find out that corporate borrowers even after defaulting continuously never had the fear of bank taking action to recover their dues. This is because there was no legal framework to safeguard the real interest of banks

T.R. Radhakrishnan, 2016, the effective remedy of resisting the foul growth of NPA in banking sector is to eliminate the root cause of cancer NPA and removing it. The blame is to be given the banking entities rather than the corporate and industrialists tagged as willful defaulters off late. The article highlights the pertinence of early application of preventive measures before it turn out to be completely bad and in the whole process to exercise skill, care , transparency, diligence to make the banking system more robust and efficient

NEED OF THE STUDY

The study emphasizes on the fragility of the Commercial Banks in Indian, questionable sustainability and the need for the implementation of sound revival measures.

SCOPE OF THE STUDY

The present study includes only select priority sector banks, non-priority sector banks and public-sector banks that are most exposed to the NPA crisis.

OBJECTIVES OF THE STUDY

Main objectives of the study is as follows

- To understand the concept of Non-Performing Assets.
- To study the present status of Non-Performing Assets of Commercial banks in India.
- To know the NPA impact on financial sustainability of commercial Banks in India.

HYPOTHESES

For analyzing the objectives of the study, the following null hypotheses are to be tested:

- There is no financial impact of NPA on Priority Banks in India.
- There is no financial impact of NPA on Non-priority Banks in India.
- There is no financial impact of NPA on Public Sector Banks in India.

PERIOD OF STUDY

The study period covers from post 2005 to 2017. Data consisting three group of banks Nationalized Banks, State Bank its India and its associates and Public-sector Banks further classified into three sectors Non-Performing Assets of Priority Sector, Non-Priority Sector and Public-Sector Banks.

DATA COLLECTION

The data collected for the study is fully from secondary sources, compiling extracts from annual reports, magazines, articles, journals.

LIMITATION OF THE STUDY

The study has taken into consideration solely the commercial banks in India and for the above-mentioned period Data analysis and interpretation: Data consisting three group of banks Nationalized Banks, State Bank its India and its associates and Public-sector Banks further classified into three sectors Non-Performing Assets of Priority Sector, Non-Priority Sector and Public-Sector Banks, which are hard hit in NPAs are taken for the study and the important variable NPA is considered from the period 2005 to 2017 to study their directional movement and the same is presented below:

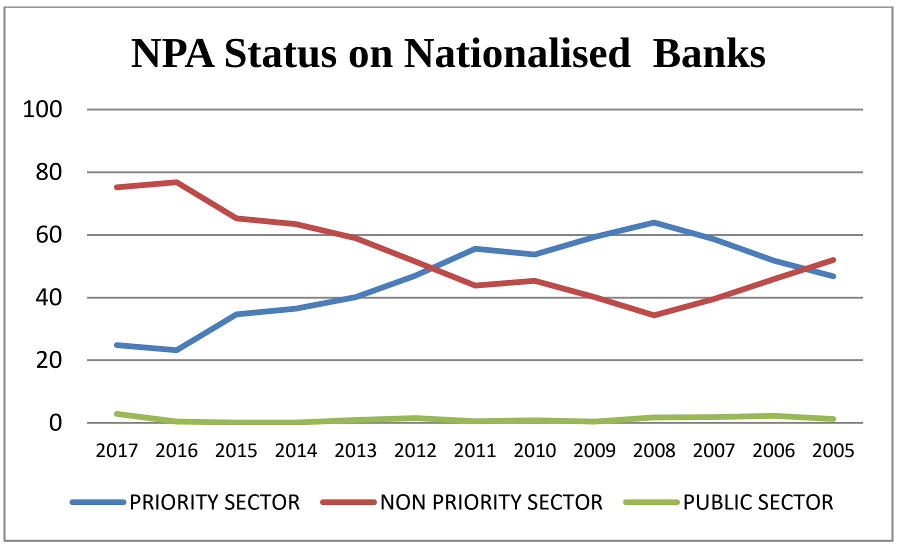
ANALYSIS OF THE STUDY

Table-1: NPA status on Nationalized Banks (Amount in ` Billion)

Year	PRIORITY SECTOR		NON PRIORITY SECTOR		PUBLIC SECTOR		TOTAL
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount
2017	1257.29	24.80	3811.93	75.20	147.20	2.90	5069.22
2016	969.03	23.18	3210.85	76.82	17.63	0.42	4179.88
2015	709.34	34.61	1337.67	65.26	2.59	0.13	2049.59
2014	537.50	36.45	935.67	63.46	1.30	0.09	1474.48
2013	408.34	40.16	599.01	58.91	9.48	0.93	1016.83
2012	324.24	46.96	355.55	51.49	10.68	1.55	690.48
2011	246.20	55.61	194.10	43.84	2.42	0.55	442.72
2010	195.67	53.76	165.23	45.40	3.05	0.84	363.95

2009	157.54	59.35	106.68	40.19	1.21	0.46	265.43
2008	159.72	63.96	85.63	34.29	4.38	1.76	249.74
2007	153.44	58.63	103.40	39.51	4.87	1.86	261.72
2006	149.22	51.78	132.27	45.90	6.68	2.32	288.17
2005	153.36	46.75	170.62	52.01	4.06	1.24	328.04
Mean	417	45.84	862.2	53.25	16.58	1.15	1283
SD	-	13.14 (2)	-	13.68 (1)	-	0.87 (3)	-
Beta			-	9.3 (1)	-	0.47 (3)	-

Source: Department of Banking Supervision, RBI. ***Brackets indicated that rank of risk*

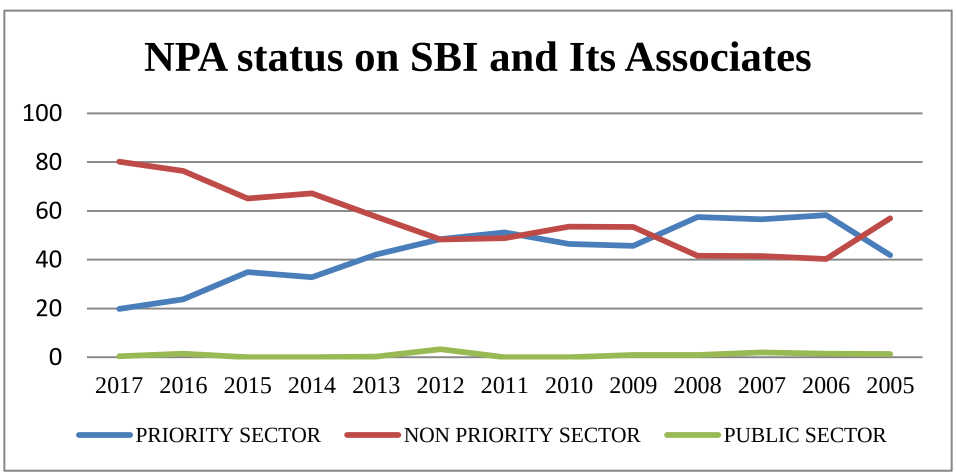


It can be seen from the above table and graph; NPA status on Nationalized banks consisting of three segments of banks; both priority and non-priority sector have high systematic risk and unsystematic risk and their standard deviation and betas are high as compared to the public sector banks. Risk point of view non priority sector banks have first rank, priority sector banks have secured second rank and public sector banks have third rank. It is indicated that public sector banks have low risk of NPA as compared to the priority and non-priority sector banks in India.

Table-2: NPA status on SBI and its Associates (Amount in ` Billion)

	PRIORITY SECTOR		NON PRIORITY SECTOR		PUBLIC SECTOR		TOTAL
Year	Amount	Percentage	Amount	Percentage	Amount	Percentage	Total
2017	352.13	19.80	1425.98	80.20	7.46	0.42	1778.11
2016	289.06	23.70	930.62	76.30	17.18	1.41	1219.68
2015	256.76	34.93	478.32	65.07	0.00	0.00	735.08
2014	261.49	32.76	536.68	67.24	0.00	0.00	798.17
2013	264.42	42.12	361.30	57.55	2.06	0.33	627.79
2012	233.56	48.44	232.71	48.27	15.88	3.29	482.15
2011	155.67	51.22	148.26	48.78	0.00	0.00	303.93
2010	109.29	46.45	125.91	53.51	0.09	0.04	235.29
2009	84.47	45.70	98.60	53.35	1.76	0.95	184.83
2008	89.02	57.50	64.44	41.62	1.36	0.88	154.82
2007	71.75	56.57	52.63	41.49	2.45	1.93	126.83
2006	73.14	58.27	50.52	40.25	1.87	1.49	125.52
2005	62.00	41.84	84.31	56.90	1.86	1.26	148.18
Mean	177.4	43.02	353	56.19	3.99	0.92	532.3
SD	-	12.34 (2)	-	12.39 (1)	-	0.96 (3)	-
Beta	-	0.92 (2)	-	1.89 (1)	-	0.20 (3)	-

Source: Department of Banking Supervision, RBI. ***Brackets indicated that rank of risk*



It can be seen from the above table and graph; NPA status on SBI and its associates consisting of three segments of banks; both priority and non-priority sector have high systematic risk and unsystematic risk and their standard deviation and betas are high as compared to the public sector banks. Risk point of view non priority sector banks have first rank, priority sector banks have secured second rank and public sector banks have third rank. It is indicated that SBI and its associate banks with public sector banks are low risk of NPA as compared to the priority and non-priority sector banks in India.

Table-3: NPA status on Public Sector Banks (Amount in ` Billion)

	PRIORITY SECTOR		NON PRIORITY SECTOR		PUBLIC SECTOR		TOTAL
Year	Amount	Percentage	Amount	Percentage	Amount	Percentage	Total
2017	1609.42	23.50	5237.91	76.50	154.66	2.26	6847.32
2016	1258.09	23.30	4141.48	76.70	34.82	0.64	5399.57
2015	966.11	34.69	1815.98	65.21	2.59	0.09	2784.68
2014	798.99	35.16	1472.35	64.79	1.30	0.06	2272.64
2013	672.76	40.91	960.31	58.39	11.55	0.70	1644.61
2012	557.80	47.57	588.26	50.17	26.56	2.27	1172.62
2011	401.86	53.82	342.35	45.85	2.43	0.32	746.64
2010	304.96	50.89	291.14	48.58	3.14	0.52	599.24
2009	242.01	53.75	205.28	45.59	2.97	0.66	450.26
2008	248.74	61.48	150.07	37.10	5.74	1.42	404.56
2007	225.19	57.96	156.03	40.16	7.32	1.88	388.54
2006	222.36	53.75	182.79	44.18	8.55	2.07	413.70
2005	215.36	45.22	254.94	53.53	5.92	1.24	476.22
Mean	594	44.7	1215	54.36	20.58	1.08	181

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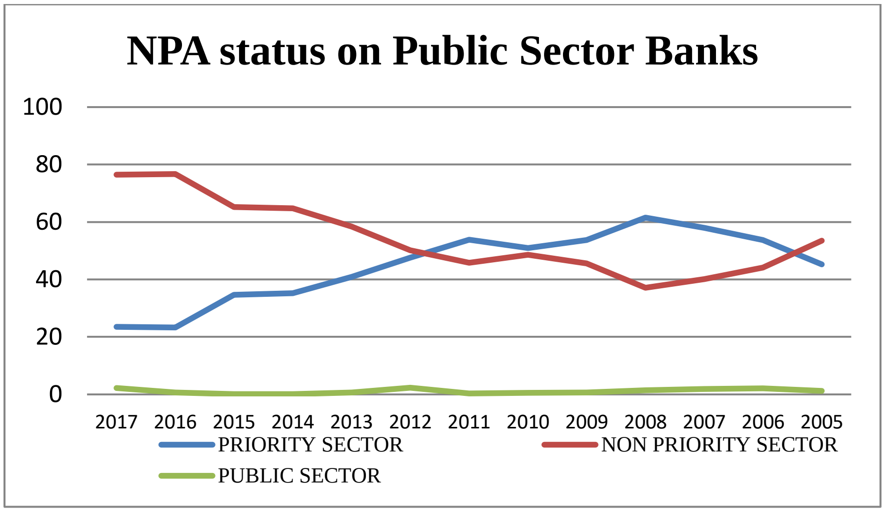
SD	-	12.46 (2)	-	13.02 (1)	-	0.81 (3)	-
Beta	-	9.09 (2)	-	10.11 (1)	-	0.59 (3)	-

Source: Department of Banking Supervision, RBI. ***Brackets indicated that rank of risk*



It can be seen from the above table and graph; NPA status on public sector banks consisting of three segment of banks; both priority and non-priority sector have high systematic risk and unsystematic risk and their standard deviation and betas are high as compared to the public sector banks. Risk point of view non priority sector banks have first, priority sector banks have secured second rank and public sector banks have third rank. It indicated that commercial banks with their public sector banks have low risk of NPA as compared to the priority and non-priority sector banks in India.

TESTING OF HYPOTHESES

In this paper the researcher has made three hypotheses are used to know the financial impact of NPA on commercial banks in India. Whereas, t-test is used for computing the appropriate, t -value to test the correlation significance. The simplest formula for computing the appropriate t- value is to test significance of a correlation coefficient. It employs the t distribution:

$$t = r\sqrt{\frac{n-2}{1-r^2}}$$

The degrees of freedom for entering the t-distribution is N – 2. Table value of (13-2) i.e. 11 degrees of freedom at 5% level of significance is 2.201 for two tailed test. The hypotheses are re-stated as follows:

Table: 4, Correlation and t-test results for total NPA impact on Priority Banks in India.

	'R' VALUE	CORRELATION RESULT	'T' VALUE	HYPOTHESIS RESULT
NATIONALIZED BANKS	-0.89	HIGH NEGATIVE AND SIGNIFICANT	//6.44//	REJECTED
SBI AND ITS ASSOCIATES	-0.92	HIGH NEGATIVE AND SIGNIFICANT	//7.4//	REJECTED
PUBLIC SECTOR BANKS	-0.91	HIGH NEGATIVE AND SIGNIFICANT	//7.32//	REJECTED

Source: Computed

Table 4: reveals that the total financial impact on NPA of priority sector banks in India. It can be seen that all priority sector banks of Nationalized, SBI and its Associates and Public sector banks have high negative correlation and statistically significant. Whereas, by t-test results, it is clear that the computed value of " t" is above the critical value of 't' at 5% level of significance. Therefore, the first null hypothesis is rejected. Hence, the relation can be strong and significant. There is a financial impact of NPA on priority sector banks in India with three segments of commercial banks.

Table: 5, Correlation and t-test results for total NPA impact on Non-Priority Banks in India.

	'R' VALUE	CORRELATION RESULT	'T' VALUE	HYPOTHESIS RESULT
NATIONALIZED BANKS	0.89	HIGH POSITIVE AND SIGNIFICANT	//6.44//	ACCEPTED
SBI AND ITS ASSOCIATES	0.90	HIGH POSITIVE AND SIGNIFICANT	//6.85//	ACCEPTED
PUBLIC SECTOR BANKS	0.91	HIGH POSITIVE AND SIGNIFICANT	//7.32//	ACCEPTED

Source: Computed

Table 5: reveals that the total financial impact on NPA of non-priority sector banks in India. It can be seen that all non-priority sector banks of Nationalized, SBI and its Associates and Public sector banks have high positive correlation and statistically significant. Whereas, by t-test results, it is clear that the computed value of "t" is above the critical value of 't' at 5% level of significance. Therefore, the second hypothesis is rejected. Hence, the relation can be strong and significant. There is a financial impact of NPA on non-priority sector banks in India with three segments of commercial banks.

Table: 6, Correlation and t-test results for total NPA impact on Public Sector Banks in India.

	'R' VALUE	CORRELATION RESULT	'T' VALUE	HYPOTHESIS RESULT
NATIONALIZED BANKS	-0.13	NEGATIVE AND INSIGNIFICANT	//0.43//	ACCEPTED
SBI AND ITS ASSOCIATES	-0.20	NEGATIVE AND INSIGNIFICANT	//2.19//	ACCEPTED
PUBLIC SECTOR BANKS	-0.53	NEGATIVE AND INSIGNIFICANT	//2.07//	ACCEPTED

Source: Computed

Table 6: reveals that the total financial impact on NPA of public sector banks in India. It can be seen that all public sector banks of Nationalized, SBI and its Associates and Public sector banks have negative correlation and statistically insignificant. Whereas, by t-test results, it is clear that the computed value of "t" is below the critical value of't" at 5% level of significance. Therefore, the third null hypothesis is accepted. Hence, the relation can be weak and insignificant. There is no financial impact of NPA on public sector banks in India with three classifications of commercial banks.

CONCLUSION AND SUGGESTIONS

This study presents the major findings of the financial impact of NPA on commercial banks consisting of public sector banks, SBI associates and Public sector banks in India in all segments includes priority, non-priority and public sector banks over a period of thirteen years from 2005 to 2017. The following observations were found, which are discussed here under.

- It is observed that nationalized banks have high financial impact of NPA with their non-priority and priority sector banks.
- SBI and its Associates also have high risk of NPA with priority and non-priority sector banks and also highly and adversely influence financial sustainability with NPA.
- Public sector banks have low risk of NPA as compared to the priority and non-priority sector banks in India
- It is observed that NPA is not influenced the financial performance of public sector banks.
- SBI and its associate banks with public sector banks have low risk of NPA as compared to the priority and non-priority sector banks,
- It is found that all three segment of commercial banks; non-priority sector banks have first rank and priority sector banks has second rank with NPA risk for last 13 years.

To conclude, our findings from the financial impact of NPA on financial sustainability of commercial banks the following precautions are to be required.

- As per RBI mandate 2015, Forensic audit to trace the intention of the defaulters and to draw a line to their incessant loops in the repayment process can be a step in curing the NPAs.
- Public sector banks should stop the disorganized and whimsical lending ceremony to the favoured corporate without validating the justified Return on Investment (ROI).
- Adequate disclosures of NPA status, as hiding the fact can turmoil the image of the banking sector. The banks should follow adequate provisioning measures with complete transparency as demanded by the RBI norms, subduing which can lead to de-growth and lower profitability.
- The entire financial system will be inefficient unless followed up by the structural changes in the thinking of the Government and RBI rules and policies.
- The hard hit public sector banks are surrounded by the NPAs which got heightened in the past one year.

Priority sector lending is also mostly maintained by the public sectors; therefore Government should correctly devise a roadmap for the concerned banks to merge. Over the last two decades, RBI has widened the scope of NPA management by introducing newer tools to identify stress in banking assets and working towards its early resolution. With the onset of the Insolvency and bankruptcy code, the time taken for resolution/ recovery should come down thereby aiding ease of doing business in India.

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