INTERNATIONAL RESEARCH JOURNAL OF HUMANITIES AND INTERDISCIPLINARY STUDIES
(Peer-reviewed, Refereed, Indexed & Open Access Journal)
DOI : 03.2021-11278686 ISSN : 2582-8568 IMPACT FACTOR : 5.828 (SJIF 2022)

The Impact of Non-Performing Assets on Bank Performance With Reference to State Bank of India, Kalaburagi District

Dr. Rekha N. Patil
Assistant Professor,
VTU Centre for PG Studies,
Kalaburagi (Karnataka, India)
E-mail: rekhapatil_mba@yahoo.co.in

Ravikumar D. Awanti
Assistant Professor,
M.Com Programme,
Sharnbasva University,
Kalaburagi (Karnataka, India)
E-mail: ravi.awanti@gmail.com

DOI No. 03.2021-11278686 **DOI Link ::** https://doi-ds.org/doilink/03.2022-72119163/IRJHISIC2203032

Abstract:

In emerging economies, banks play a more prominent role in financial intermediation, along with carrying additional responsibility for attaining the government's social objectives as well. This inevitable relationship between banking and economic development, the growth of the overall economy, is naturally related to the health of the banking sector. The recent global financial crisis highlighted the importance of a healthy banking system. It emphasized the focus on proper monitoring and non performance evaluations of banks, as this can impact their overall efficiency, productivity, performance, and profit.

Keywords: *NPAs, Bank performance, Bank profitability, Indian banks.*

1. Introduction:

In emerging economies, banks play a more prominent role in financial intermediation, along with carrying additional responsibility for attaining the government's social objectives as well. This inevitable relationship between banking and economic development, the growth of the overall economy, is naturally related to the health of the banking sector. The recent global financial crisis highlighted the importance of a healthy banking system. It emphasized the focus on proper monitoring and non performance evaluations of banks, as this can impact their overall efficiency, productivity, performance, and profit.

Growing incidence of non performing advances or loans can have potential adverse impact on the performance of the banks by squeezing their earnings, thereby reducing their profitability.

Typically, a loan or advance becomes non-performing assets (NPAs) when a borrower defaults on the repayment of either the principal amount or unable to serve its debt. An NPA not only makes an asset unproductive, banks also fail to recover the principal capital. On the one hand, the interest earning of the bank declines; on the other side, there is a risk of recovery of principal amount. Falling interest income while directly impacts the profitability of a bank, under recovery of principal capital can result in erosion of bank's capital base. Beyond a threshold level, the combination of both can potentially affect the stability a bank.

The Reserve Bank of India (RBI) has defined the NPAs as those assets for which principal or interest payment remains overdue for a period of ninety days. The RBI has classified three types of assets within the category of NPAs—substandard assets, doubtful assets, and loss assets. A substandard asset is one if it remains as an NPA for a period less than or equal to 12 months. Similarly, a doubtful asset is defined as an asset which has remained as an NPA for a period of more than 12 months. In case of loss asset, the loss has already been identified and the amount is not written off. The combination of the above three types of assets forms total NPAs in a bank. The NPAs reduce the profitability of banks due to increase in operating costs and decline in their interest margins. Studies have shown that a bank with high level of NPAs generally incurs 'carrying costs' on non-performing assets that reduces their profitability. Also, a rise in NPA is likely to cause adverse impact on the profitability of the banks due to huge amount of provisioning requirements out of operating profits, which acts as a drain on profitability of banks. Thus, provisioning and carrying costs of NPAs act as drain on the profitability of the banks. Berger and Young examined the relationship between bad loans and bank efficiency. They found that increasing incidence of loan failures forces banks to incur extra operating costs in the form of increased spending on monitoring of such assets and selling off of these loans. The banks are preoccupied with recovery procedures instead of concentrating on expanding their business. Higher the bank operating costs lower will be the cost efficiency of banks and thus lower will be the profits. Operating costs include wages and salaries of employees and costs of running branch offices. These costs have an adverse impact on profitability of banks.

There are several factors, including non-performance of loans that can potentially affect the profitability of the banks. It can broadly be categorised into the bank specific and macroeconomic factors. The bank-specific factors include non-performing advances, deposits non-interest income (Harbi 2019), interest income, operational efficiency, and capital adequacy. The macroeconomic factor includes GDP growth, rate of inflation, and interest rate.

The financial system in India, similar to other emerging countries, is bank dependent, and banks hold a significant share of total financial assets in the system. It is also having a reasonably large share of public sector banking and a higher level of NPAs compared to the other emerging countries. Recently, the Indian banking system is witnessing a sharp increase in the gross NPA level, and the government-owned public sector banks are mostly responsible for the NPA problem. The Reserve Bank of India (RBI) Financial Stability Report of 2017 states that the public sector banks have 14.6% gross NPA to total gross loans, and for all the other banks, it was at 11.2% in 2017. This number is almost fourfold higher than the world gross NPA of 3.45% in 2017, as reported by the IMF Financial Stability Report of 2017. As highlighted by Bawa et al. NPAs in Indian banks are much higher than the other emerging countries like China, Mexico, and Brazil that have a gross NPA of 1.7%, 2.1%, and 3.6%, respectively, in 2017.

The Indian banking sector is maintained by RBI act of 1934. The BANKING REGULATION ACT 1949 by issuing direction to the maximum amount of deposits, the period and the rate of interest they could offer on the deposits accepted. India reserve bank, provides different rules and guidelines, polices and notifications on time to time to control the banking industries.

2. Statement of Problem:

Non-Performing Asset is the key term for the banking corporations. Non-Performing Assets show the competence of the performance of the banks. From, the last few months ago we heard about NPA, that is the Bank had increased NPAs Drastically.

Banks are providing large amount of loans to the corporate without configuring the overall process, they grant loans. NPA not only affect banks profitability but also to the economy. As the NPA of the banks will rise, it will bring a scarcity of funds in the Indian security markets Against this background, the present study focused on the level of NPA and how it influences the profitability of banks.

3. Review of Literature:

Sandeepa and Gupta, in their analysis of the banking efficiency in the post-crisis period from 2009 to 2013, demonstrated that SBI and its associate banks obtained the highest efficiency scores compared to other banks. The Indian banking system, dominated by public sector banks, has undergone a substantial change in terms of restructuring, mergers, and recapitalization due to the persistent growth of non-performing assets (NPA). It often mentioned as being the harbinger of an impending crisis within the Indian financial system. Jayaraman and Srinivasan provided a holistic analysis of the Indian banking efficiency using the Nerlovian methodology and concluded that the profit inefficiency of Indian banks is mainly because of allocative inefficiency. Further, the study stated that the role of profit inefficiency was more compared to the technical inefficiency.

4. Objectives:

- To study the importance of bank based external components that contribute to NPA
- To know the reasons of Non-Performing Assets

5. Hypotheses:

Null Hypothesis (H_0): There is a no significant difference between the importances of bank based internal components that contribute to NPA.

Alternative Hypothesis (H_1): There is a significant difference between the importances of bank based external components that contribute to NPA

6. Methodology:

In order to accomplish the purpose of the study a suitable methodology has been adopted. Research done is in descriptive in nature.

Statistical Tools Used Friedman Test: The Friedman Test is a non-parametric test. It is used to test for differences between groups when the dependent variable being measured is ordinal.

7. Data Analysis and Interpretations:

Table 7.1 Mean and SD of Bank based internal components that Contribute to NPA

Sr. No	Importance to the Bank based internal components that contribute to NPA	Mean	Standard Deviation
1	Improper Selection of Borrowers	2.18	0.872
2	Deficiency of Processing	2.00	0.886
3	Improper appraisal of assets	2.10	0.834
4	Lack of monitoring pre and post sanction of loan	2.57	0.680
5	Terms and conditions of credit	1.59	0.494
6	Unsecured loans	2.42	0.665

From the above table, Lack of monitoring pre and post sanction of loan has the highest mean followed by Unsecured loans, Improper selection of borrowers, Improper appraisal of assets, Deficiency in processing and Terms and conditions of credit. Highest standard deviation of Deficiency in processing shows low focus on the particular internal components that contribute to NPA.

Table7.2: Mean and SD of bank based external components that contribute to NPA

Sr. No	Importance to the bank based external components that contribute to NPA	Mean	Standard Deviation
1	Selection of unsuitable and Unviable scheme	2.12	0.832
2	Mis-utilization of fund	2.59	0.678

3	Insolvency or death of borrower	1.32	0.645
4	Low income from project	2.01	0.649
5	Lack of infrastructure, Modern Technology and marketing facilities	1.33	0.493
6	Political interference and labor unrest	2.40	0.662
7	Willful default due to liberal government policy	2.42	0.799
8	Sluggish legal system	1.62	0.673
9	Price escalation of inputs	1.81	0.755
10	Power failures	1.99	0.891

From the above table, mis-utilization of fund has the highest mean followed by Wilful default due to liberal government policy, Political interference and labor unrest, Selection of unsuitable and Unviable scheme, Low income from project, Power failures, Price escalation of inputs, Sluggish legal system, Lack of infrastructure, Modern Technology and marketing facilities, Insolvency or death of borrower . Highest standard deviation of Power failures shows low focus on the particular external components that contribute to NPA.

Hypothesis I

Null Hypothesis (H_0): There is no significant difference between mean ranks towards Importance to the Bank based internal components that contribute to NPA.

Table 7.3: Friedman test for significant difference between mean ranks towards Importance to the Bank based internal components that contribute to NPA.

Sr. No	Importance to the Bank based internal components that contribute to NPA	Mean Rank	Chi-Square	P Value
1	Improper Selection of Borrowers	3.62	280.580	0.000**
2	Deficiency of Processing	3.10		
3	Improper appraisal of assets	3.36		
4	Lack of monitoring pre and post sanction of loan	4.71		
5	Terms and conditions of credit	1.89		
6	Unsecured loans	4.32		

*Source: Primary Data ** Denotes significance at 1% level*

Since P value is less than 0.01, the null hypothesis is rejected at 1 per cent level of significance. Hence it is concluded that there is significant difference between mean ranks towards importance to the Bank based internal components that contribute to NPA. From the table, based on mean rank, Lack of monitoring pre and post sanction of loan (4.71) is the best internal component that contribute to NPA, followed by Unsecured loans (4.32), Improper selection of borrowers (3.62), Improper appraisal of assets (3.36), Deficiency in processing (3.10) and Terms and conditions of credit (1.89).

HYPOTHESIS II

Alternative Hypothesis (H_1): There is significant difference between mean ranks towards importance to the Bank based External components that contribute to NPA.

Table7.4. Friedman test for significant difference between mean ranks towards Importance to the Bank based External components that contribute to NPA.

Sr. No	Importance to the bank based external components that contribute to NPA	Mean Rank	Chi-Square	P Value
1	Selection of unsuitable and Unviable scheme	6.15	547.007	0.000**
2	Mis-utilization of fund	8.04		
3	Insolvency or death of borrower	3.04		
4	Low income from project	5.75		
5	Lack of infrastructure, Modern Technology and marketing facilities	2.85		
6	Political interference and labor unrest	7.47		
7	Willful default due to liberal government policy	7.39		
8	Sluggish legal system	3.95		
9	Price escalation of inputs	4.78		
10	Power failures	5.59		

*Source: Primary Data ** Denotes significance at 1% level*

From the table, based on mean rank, Mis-utilization of fund (8.04), Political interference and labour unrest(7.47), Wilful default due to liberal government policy and expectation of debt relief(7.39),Selection of unsuitable and Unviable scheme(6.15),Power failures(5.59),Low income from project(5.75),Price escalation of inputs(4.78),Sluggish legal system(3.95),Insolvency or death of borrower(3.04),Lack of infrastructure, Modern Technology and marketing facilities(2.85).

Findings of the Study:

From Table 7.1 Bank based internal components that Contribute to NPA are ranked on the basis of the response and mean score calculated. Lack of monitoring pre and post sanction of loan has the highest mean followed by Unsecured loans, Improper selection of borrowers, Improper appraisal of assets, Deficiency in processing and Terms and conditions of credit.

From Table 7.2, Bank based external components that contribute to NPA are ranked on the basis of the response and mean score calculated. Mis-utilization of fund has the highest mean followed by Wilful default due to liberal government policy, Political interference and labor unrest, Selection of unsuitable and Unviable scheme, Low income from project, Power failures, Price escalation of inputs, Sluggish legal system, Lack of infrastructure, Modern Technology and marketing facilities, Insolvency or death of borrower .

From Table 7.3, By Friedman Test it is concluded that there is significant difference between mean ranks towards Importance to the Bank based internal components that contribute to NPA.This shows the validity of ranking based on mean.

From Table 7.4, By Friedman Test it is concluded that there is significant difference between mean ranks towards Importance to the Bank based external components that contribute to NPA. This shows the validity of ranking based on mean.

Conclusion:

The NPA and its circumstances in the banks during the decade. It even depicts the various reasons for the growth of NPA. NPAs reflect the overall performance of the banks. A high level of NPA is a poor indicator of bank performance. The NPA growth involves the necessity of provisions, which reduces the overall profits and shareholders' value. Careful steps by the bankers like selection of right borrowers, viable economic activity correct end use of funds and timely recovery of loans are absolutely necessary pre conditions for preventing or reducing the incidence of new NPAs which will enhance the credibility of the banks and attain the objective of the sound financial system.

References:

1. Hafsal, K., Suvvari, A. & Durai, S.R.S. Efficiency of Indian banks with non-performing assets: evidence from two-stage network DEA. *Futur Bus J* 6, 26 (2020). https://doi.org/10.1186/s43093-020-00030-z
2. Das, S.K., Uppal, K. NPAs and profitability in Indian banks: an empirical analysis. Futur Bus J 7, 53 (2021). https://doi.org/10.1186/s43093-021-00096-3
3. Sandeepa K, Gupta PK (2015) Productive efficiency mapping of the Indian banking system using data envelopment analysis. Procedia Econ Finance 25:227–238