

NPA: A Threatening Force for the Indian Banking Industry

**Mr. Sangram Padhy*
***Dr. Rashmita Sahoo*

ABSTRACT

In the last couple of years, it has been viewed that the banks in India have been constantly adding a large amount of money in terms of Non-Performing Assets (NPAs) to their balance sheet. Such hike in NPAs in the banks has reduced the overall profitability of the banks as well as growth perspectives of the banks in the near future. In recent times, Non-Performing Assets (NPAs) have been viewed as one of the biggest financial threats to the Indian economy. The threat like NPA has enabled the banking institutions to maintain provisions for bad loans at a higher rate. It also gives rise to evasion of credit which affects the liquidity position of the banks. Such type of issue is prevalent in the Public Sector Banks and have quite higher number of Gross NPAs as compared to Private Sector Banks. It reduces the adequate flow of capital in the economy leading to unfavourable conditions in the growth of economy. Thus, Non-Performing Assets (NPAs) of numerous banks are proving to be a strong barrier for Indian Banking Industry in becoming a powerful and steady economy. Due to Covid-19 wave across various sectors, repayment capacity of borrowers has shown a downward slope resulting in big spike and also sharp surges in stressed assets. The present study examines the appropriate reasons behind the surge of Non-Performing Assets in Public Sector Banks in India and also to assesses the current monitoring systems and credit appraisals taken into consideration for controlling it. In addition to that, the impact of Covid-19 on NPA also needs to be examined. For such review, the data and information have been collected from various secondary sources such as journals, articles, annual publication report from Reserve Bank of India etc. The research considers the period from 2019 to 2021. The secondary sources of data have been analysed by the help of regression analysis, capital adequacy ratio and ratio analysis.

Keywords: Non-Performing Assets, Covid-19, Credit Appraisals, Profitability.

**Mr. Sangram Padhy, Ph.D. (Research Scholar), Department of Business Administration, Utkal University, Bhubaneswar*
Email: sangrampadhy48@gmail.com

***Dr. Rashmita Sahoo, Assistant Professor, Department of Business Administration, Utkal University, Bhubaneswar*
Email: rashmitasahoo0703@gmail.com

Introduction

There seems to be no end to the bad loan problem for Indian banking industry. For several years now, mainly Non-Banking Financial Companies (NBFCs) are under the scanner for non-payment of loans for over 90 days since the due date because some large business tycoons are either defaulting or defrauding the banking system. But now, the issue is widespread as it is very difficult from borrowers' side to repay loans due to the covid-19 lockdown, unemployment and job losses. So, many banks have to set aside provisions for decreasing the burden. Growing NPAs have become an unending nightmare for the Indian banking sector due to the pandemic. While some banks have implemented measures to mitigate this, but others may be at the beginning of the new NPA cycle. Public sector banks reported 60% of their aggregate operating profits in the end of June as provisions mainly for debt losses and also for asset restructure. It would help to identify the loss on a particular loan in near future and at the same time capital can be used effectively to mitigate the issue. (*Mimansa Verma, 2021*).

Public sector banks are the ones in which the government has a major holding. They are divided into two groups, i.e., nationalized banks and State Bank of India. The future of PSB's would be based on their capability to continuously construct good quality assets in an increasingly competitive environment and maintaining capital adequacy and stringent prudential norms. (*Namita et al., 2011*). The Non-Performing Assets (NPAs) are those resources that failed to produce proceeds for the banks. These have been categorized into sub-standard assets, doubtful assets, and loss assets reliant on the time duration on which they remain unpaid. It affects the fiscal health of the banks resulting in low profitability of banks. It also disturbs the fluidness and solvency position of banks. The studies have shown that public sector banks are more vulnerable to the rise in the figure of NPAs in contrast to private sector banks (*Miyan, 2017; Arasu et al., 2019; Bansal et al., 2021*). Nowadays, most of the banks are facing with issues like bad loans and increasing frauds in large scale which results into critical imbroglio in public sector banks.

After second Covid-19 wave across sectors, repayment capacity of borrowers was arising big spike and reporting sharp surges in stressed assets (*Abilash, 2021*). The proportion of net non-performing resources for net advances (NPAs) is a decent marker for deciding the credit nature of the banks. Generally, a negative connection between the dimension of efficiency and NPAs is normal since lower of this proportion encourages higher efficiency level for the banks in India and

despite what might be expected, increment in NPAs dependably makes issue for the successful tasks of the banks over the period and there is no speedy obsession for this. There have been a few and compelling measures created and attempted by the RBI convenient and ceaselessly to control the issues identified with NPAs. (*Nitesh et al., 2021*)

Literature Review

In the last few years, banks' NPAs were analysed by many researchers in India and a quite good number of papers were also published by them. For the study, more than 100 papers have been reviewed related to the topic under study. The details of reviewed literature are mentioned below:

Saha *et al.*, (2021) in their study titled, "Management of NPAs in banks with special reference to UBI" found that with the decrease in NPA level, profitability of banks increased.

Shah *et al.*, (2021) stated that the Indian economy is facing a financial crunch due to a surge in the number of credit defaulters.

Jethwani *et al.*, (2020) in their research, "Indian agriculture GDP and NPA: A regression model" came with findings that the repayment of farm loan adversely affects as factors like rural population, low export value of crop and low crop production for the year. It should be understood that the farm loan waivers cannot solve the problem.

Selvam *et al.*, (2020) in their study titled, "Impact of Corona virus on NPA and GDP of Indian Economy" resulted that the NPAs has increased during the period and suggested that government should resolve pending cases quickly and stop mandatory landings which is the real problem segment.

Adey *et al.*, (2020) in their study focused on how NPAs are weakening the bank's financial position. They found that the banks and the financial institutions must be more helpful in pursuing a systematic way of managing the NPA. The main purpose of this study was to strengthen the financial position of the banks. They also found that the public sector banks must be cautious in checking the NPA accounts and their performance and take preventive measures.

Mona *et al.*, (2020) examined the information of public sector banks and private sector banks of the past 5 years for the study of NPA. The study dealt with the evaluation of different ratios of

NPA's based on secondary data and also made comparison of different ratios of NPA's of public sector and private sector banks. After comparison of the ratios of both the banks, the result stated that the value of gross NPA's is more than the net NPA's and also the private sector banks NPA's are less than Public Sector Banks. NPA's and the profitability is related negatively.

Hussain *et al.*, (2020) analysed that the NPA's of the public sector banks and private sector banks are different and sector wise NPA's does not create any effect together on the overall NPA's of the banks. The study was meant to identify the difference in both the public and private sector banks and also to identify the relationship between the NPA and key parameters of particular banks. A major gap in this study was that the comparative analysis is done between the selected banks. And as a result of this, they found that private sector banks are better than the public sector banks, the public sector banks have higher NPA's.

Bhawna (2019) researched about the impact of rising NPA in the Indian Banking sector and also the value increased in the last decade. The study states that a major portion of the bank assets are not generating income for the bank. The main purpose of the study was to identify the profitability status of banks after the effect of NPA. In her study, she identified that comparing with the preceding year's NPA, this year it has increased gradually. And one of the limitations of this study was that it compared the data of the previous year's profitability position of the banks with that of current year position.

Research Objectives

- To examine the causes of the hike in Non-Performing Assets in the Indian Public Sector Banks.
- To assess the current monitoring systems and credit appraisals taken up by PSBs.
- To study the impact of Covid-19 on NPA on Public Sector Banks.

Research Methodology

For such review, the information and data were to be collected from various secondary sources such as journals, articles, annual publication report from Reserve bank of India etc. The research considers the period from 2019 to 2021. The secondary sources of data were analysed with the help of regression analysis, capital adequacy ratio and ratio analysis. The current review mainly

focuses on NPAs of Public sector Banks. This study considers only some selected prominent PSBs for the analysis.

Research Hypothesis

H₀: There is no significant impact of Net NPA on Net Profit.

Data Analysis and Interpretation:

Table 1: Net NPA of Selected PSBs (in Crores)

Financial Year	SBI	PNB	IDBI	BOI	BOB
2019-20	51,871	26,598	5,439	14,320	21,577
2020-21	36,810	33,879	2,519	12,262	21,800

(Source: Self Compiled)

Table 2: Net Profit of Selected PSBs (in Crores)

Financial Year	SBI	PNB	IDBI	BOI	BOB
2019-20	3,581	336	-12,887	-2,957	546
2020-21	6,451	2,022	1,359	2,160	829

(Source: Self Compiled)

Table 3: Regression Analysis of Net NPA on Net Profit of Selected PSBs (2019-20)

SUMMARY OUTPUT	
<i>Regression Statistics</i>	
Multiple R	0.821979579
R Square	0.675650428
Adjusted R Square	0.567533904
Standard Error	4186.986034
Observations	5

(Source: Self Compiled)

Here,

Dependent Variable – Net Profit of all Selected PSBs (2019-20)

Independent Variable – Net NPA of all Selected PSBs (2019-20)

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	-9434.167077	3421.250323	-2.757520259	0.070298034
Net NPA	0.298734071	0.119500512	2.499855991	0.087717783

From the above summary output, it can be stated that Multiple R is in positive sign which shows the significant relationship between Net NPA and Net Profit. So, it can be expressed that if NNPA will increase, then Net Profit will also increase at the rate of 82%. Likewise, R Square is 0.67 which means that only 67% of the dependent variable is estimated by the independent variable. The value of adjusted R square is 0.56 which means the additional input has quite less impact on total income. Here the standard error is high which shows huge dispersion between the Net Profit of the last 2 years and also points out that NNPA is highly volatile. It has been found that there is no substantial influence of Net NPA on Net Profit with the following equation:

$$Y = -9434.17 + 0.298X_1 + E$$

Table 4: Regression Analysis of Net NPA on Net Profit of Selected PSBs (2020-21)

SUMMARY OUTPUT	
<i>Regression Statistics</i>	
Multiple R	0.610608023
R Square	0.372842158
Adjusted R Square	0.163789544
Standard Error	2046.192929
Observations	5

	Coefficients	Standard Error	t Stat	P-value
Intercept	533.3400866	1774.803613	0.300506536	0.783412344
Net NPA	0.094661131	0.070882167	1.33547175	0.274005964

(Source: Self Compiled)

Here,

Dependent Variable – Net Profit of all Selected PSBs (2020-21)

Independent Variable – Net NPA of all Selected PSBs (2020-21)

From the regression statistics, it can be depicted that Multiple R is in positive sign which shows the significant relationship between Net NPA and Net Profit. So, it can be expressed that if Net Profit will increase, then NNPA will also increase at the rate of 61%. Similarly, R Square is 0.37 which means that only 37% of the dependent variables is estimated by the independent variable. Then, the value of adjusted R square is 0.16 which means the additional input has very less impact on total income. The standard error is high which shows that there is a huge dispersion between the Net Profit of the last 2 years and also figure out that NNPA is highly volatile. It has been found that there is no substantial influence of Net NPA on Net Profit with the following equation:

$$Y = 533.34 + 0.095X_1 + E$$

Table 5: Capital Adequacy Ratio of Selected PSBs

Public Sector Banks	2019-20	2020-21	Minimum CAR (As per RBI Norms)
SBI	13.06	13.74	12
PNB	14.14	14.32	12
IDBI	13.31	13.64	12
BOI	13.30	14.90	12
BOB	13.26	15.55	12

(Source: Self Compiled)

Capital Adequacy Ratio (CAR) is the share of a bank's capital to its share of risk. It is also termed as the Capital to Risk -weighted Assets Ratio (CRAR). Furthermore, it is the ratio of a bank's capital to its risk-weighted assets and current liabilities. The CAR of all the above banks namely - SBI, PNB, IDBI, BOI and BOB have been quite higher in comparison to the minimum mandated norms of the RBI. This means that all the banks are quite efficient and secure to meet their financial obligations. Higher the Capital Adequacy Ratio in comparison to RBI norms, better it is for the banks as the risk of becoming insolvent is reduced to a considerable level. All the banks

selected for the study would be able to meet their financial obligations as their CAR will be utilized to enhance the efficacy and constancy of fiscal operations of banks.

Table 6: Relative Ratio Analysis of Selected PSBs

Financial Year	SBI		PNB		IDBI		BOI		BOB	
	Return on Capital Employed (ROCE)	Return on Assets (ROA)	Return on Capital Employed (ROCE)	Return on Assets (ROA)	Return on Capital Employed (ROCE)	Return on Assets (ROA)	Return on Capital Employed (ROCE)	Return on Assets (ROA)	Return on Capital Employed (ROCE)	Return on Assets (ROA)
2019-20	1.79	0.36	1.80	0.04	1.74	-4.29	1.80	-0.45	1.77	0.04
2020-21	1.64	0.45	1.83	0.16	2.50	0.45	1.53	0.29	1.85	0.07

(Source: Self Compiled)

From the above table, it is depicted that ROCE of PNB, IDBI and BOB banks are increasing in every financial year. It further shows that these banks are efficiently generating profit from their capital. It exhibits that the long-term profitability ratio of the banks and also shows how efficiently resources of the bank are being utilized for long-term financing. A higher ratio is more favourable as it shows long term profitability of the banks. The ROCE of SBI bank has reduced in the year 2021 from 1.79% to 1.64% in compared to previous year i.e., 2020 and on the other hand, the ROCE of BOI has also been declined to 1.53% in the year 2020-21 from 1.80% in the year 2019-20.

A positive ROA ratio generally results in upward movement of the profit of the banks. In the case of selected banks i.e., SBI, PNB, IDBI, BOI and BOB, the return on assets is constantly increasing which proves that these banks are efficient to convert their assets into profits in every financial year. An increased ROCE and ROA ratios always contribute to the long-term survival of the banks in the economy. So, it is the responsibility of the banks to keep eye on these ratios every year and should put effort to increase in a constant manner.

Reasons for Hike in NPAs

- First and foremost reason for the rise of NPA is the liberalised lending norms without proper analysis of their financial status and credit rating especially for big corporate houses.

- Textile, Infrastructure, Mining and Aviation Industry contribute mostly to the NPA as the lenders are the PSBs and most of loan defaulters are from these industries.
- Public Sector Banks lend 80% of the credit to these industries. As per SBI, its 20% of NPA constitute education loans.
- Business losses of corporate houses due to considerable change in environmental policies can lead to rise in NPA.
- Because of unplanned expansion, misgovernance and diversification of funds, there is a hike in quantum of NPA.
- Natural disasters like flood, earthquake, cyclone, drought, tsunami etc. are also responsible for the growth of NPA.

Strengthening Monitoring System and Improving Credit Appraisal Procedures

A sound credit appraisal necessarily involves examination of Character, Capacity and Capital (3Cs) of the prospective borrower. The most difficult from these three is to evaluate the character and intent of the borrower.

The capacity of the borrower is to successfully operate, frequent expansion and run diverse businesses but these are mostly overestimated. Many a time the ambitions and dreams of entrepreneurs are not backed up by adequate capacity to operate businesses in this VUCA (Volatile, Uncertain, Complex and Ambiguous) world. In this practical world, capacity to successfully run business and repay is a moving target.

Now, the forensic audit reports reveal that in many cases of bad loans, borrowers haven't brought adequate capital and they only circulated debt from one bank as equity in another project through a web of references. Some of these irregular borrowers have dozens of these affiliates and even hundreds of bank accounts. This makes tracking movement of funds in real time difficult, but looks not impossible. This remains still a challenge for banks and needs to be addressed both by banks and regulators or government. These 3Cs need to be evaluated not only at the entry level but also at regular intervals. Banks may take the help of external experts. This framework looks obvious but has a lot of noticeable response which requires a lot of expertise.

Banks deploy over 20 monitoring tools starting from the stock movement statement to analysts' reports. There are over 20 parameters like basic sales reports, end use of funds to evolving market dynamics, competitive position of the borrowers etc. Lenders need to connect the dots to effectively strengthen monitoring tools and enforce remedial measures.

Impact of COVID on Loan Recovery

Loan recovery by public sector banks slowed down in the last fiscal amid the disruptions caused by the Covid-19 pandemic. According to the Reserve Bank of India sources, loan recovery as a percentage of gross non-performing assets was at 12.28% for FY21 as compared to 14.69% of previous financial year.

The scope of legal recourse for banks has also increased over time. In accordance with the RBI's master circular on willful defaulters, banks can take a series of legal measures against borrowers/guarantors for recovery of dues, including initiating criminal proceedings against willful defaulters wherever deemed necessary. Filing a suit in civil courts, in debts recovery tribunals, appealing to the National Company Law Tribunal under the Insolvency and Bankruptcy Code, and through sale of NPAs are among other measures, the parliamentary reply stated.

Other legal actions against willful defaulters according to the RBI's instructions include:

- Wilful defaulters are not sanctioned any additional facilities by banks, non-banking financial companies or financial institutions.
- Their unit is debarred from floating new ventures for five years.
- As per SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2016, even companies with wilful defaulters as promoters/directors will be debarred from accessing capital markets to raise funds.
- The IBC debars wilful defaulters from participating in the insolvency resolution process.

Conclusion

All the banks selected for the study would be able to meet their financial obligations as their CAR will be utilized to enhance the efficacy and constancy of fiscal operations of banks. The banks should maximize their profitability ratios i.e., ROCE and ROA. Banks need to take precautionary

actions or measures regarding the credit assessments and also should take measures in pre-and post-sanction of the loans to avoid slippages and standard assets of NPA. The banking industry is the lending institution that helps millions of people to get sufficient funds for carrying out their operations. The government should take measures to overcome the menace created by these increasing NPAs in the banking industry. The proper monitoring system and credit appraisal of loans will help to manage the credit risk in the banking industry.

Limitations of the Study

The study covers only two years data i.e., 2019 – 2021 and other variables like total income, Gross NPA etc. have not been taken into consideration for the study. The study only considers top five Public Sector Banks having highest NPAs in recent years and ignores Private Sector Banks, Foreign Banks, Regional Rural Banks etc. for the assessment.

References

- Agrawal, Ram &Goyal, Mredu. (2021). Non-Performing Assets of Banks: A Literature Review PJAEE, 18 (10) (2021) "Non-Performing Assets of Banks: A Literature Review". *Pal Arch's Journal of Archaeology of Egypt/ Egyptology*. 18. 330-340.
- Adey, R., Goyal, D. Y., Siddiqui, M. N., &Dhruw, L. (2020). Comparative Analysis of Non-Performing Assets amongst Various Banking Sector of India. *IOSR Journal of Economics and Finance*, 11(3), 38-43.
- Bhawna Mittal. (2019). The Snowball effects of NPA on Indian Economy – *Journal of the Gujarat Research Society* – ISSN: 0374-858, Vol- 21, Issue – 9, Nov-2019.
- Esha Jain, JonikaLamba, &NitikaSoni. (2021). A Comparative Examination of Non-Performing Asset Management of Banks in India. *International Journal on Recent Trends in Business and Tourism (IJRTBT)*, 5(3), 20-32. <https://doi.org/10.31674/ijrtbt.2021.v05i03.003>.

Links

- <https://www.bqprime.com/business/covid-impact-shows-up-in-loan-recovery-rate-of-psu-banks>
- <https://www.thehansindia.com/posts/index/Education-and-Careers/2017-10-11/Understanding-the-NPAs-and-their-impact/332611>
- <https://www.thehindubusinessline.com/opinion/preventing-the-pile-up-of-npas-i/article35686885.ece>
- <https://ejournal.lucp.net/index.php/ijrtbt/article/view/1417/1585>

-00-