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Empirical Study on Non Performing Assets of Bank

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Abstract: Non-performing Asset is an important parameter in the analysis of financial performance of a bank as it results in decreasing margin and higher provisioning requirements for doubtful debts. NPA is a virus affecting banking sector. It affects liquidity and profitability, in addition posing threat on quality of asset and survival of banks. The motive of present study is to assess the non – performing assets of Punjab National Bank and its impact on profitability & to see the relation between total advances, Net Profits, GROSS & NET NPA. The study uses the annual reports of Punjab National Bank for the period of six years from 2006-07 to 2011-12. The data has been analyzed by using tables and coefficient of correlation. The important point to be noted is that the decline of NPA is essential to improve profitability of banks. Advances provided by banks need to be done pre-sanctioning evaluation and post-disbursement control to constrain rising non-performing assets in the Indian Banking sector. When PNB Gross & NET NPA compared with total advances we get the result that there is mismanagement on the side of PNB. While analysing the impact of NPA level on PNB we derived the conclusion that there is a positive relation between Net Profits and NPA of PNB. It simply means that as profits increase NPA also increase. It is because of the mismanagement on the side of bank.

Keywords: Nonperforming assets, Gross nonperforming assets, net nonperforming assets, Profitability, Mismanagement, Total advances.

I. INTRODUCTION

The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management came into picture. The primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal and housing etc. and to receive deposits. Receiving deposit involves no risk, since it is the banker who owes a duty to repay the deposit, whenever it is demanded. On the other hand lending always involves much risk because there is no certainty of repayment. In recent times the banks have become very cautious in extending loans, the reason being mounting non-performing assets. Non-performing assets had been the single largest cause of irritation of the banking sector of India. Earlier the Narasimha committee-I had broadly concluded that the main reason for the reduced profitability of the commercial banks in India was given importance to priority sector lending. The committee had highlighted that priority sector lending was leading to the building up of non-performing assets of the banks and thus it recommended it to be phased out. Subsequently, the Narasimha committee-II also highlighted the need the zero non-performing assets for all Indian banks with international presence. A major portion of the money lent comes from the deposits received from the public. These deposits are mostly repayable on demand. Therefore while sanctioning credit the banker should appraise the project reasonably or else it leads to the non-repayment of loans and advances. Most of the banks today in India are facing the default risk wherein some part of the profit is reserved for covering the non-performing assets.

II. REVIEW OF LITERATURE

TOOR N.S. (1994) stated that recovery of non-performing assets through the process of compromise by direct talks rather than by the lengthy and costly procedure of litigation. He suggested that by constant monitoring, it is possible to detect, the sticky accounts, the incipient sickness of the early stages itself and an attempt could be made to review the unit and put it back on the road to recovery.

DEBARSH AND SUKANYA GOYAL (2012) emphasized on management of non-performing assets in the perspective of the public sector banks in India under strict asset classification norms, use of latest technological platform based on Core Banking Solution, recovery procedures and other bank specific indicators in the context of stringent regulatory framework of the RBI. Non-performing Asset is an important parameter in the analysis of financial performance of a bank as it results in decreasing margin and higher provisioning requirements for doubtful debts. The reduction of non-performing asset is necessary to improve profitability of banks.

KAVITHA. N (2012), emphasized on the assessment of nonperforming assets on profitability its magnitude and impact. Credit of total advances was in the form of doubtful assets in the past and has an adverse impact on profitability of all Public Sector Banks affected at very large extent when non-performing assets work with other banking and also affect productivity and efficiency of the banking groups. The study observed that there is increase in advances over the period of the study. However, the decline in ratio of Non-performing Assets indicates improvement in the assets quality of SBI groups, Nationalized Banks and Private Sector Banks.

SIRAJ. K. K & PROF. (DR). P. SUDARSANAN PILLAI says that NPA is a virus affecting banking sector. It affects liquidity and profitability, in addition posing threat on quality of asset and survival of banks. The study concluded that NPA still remains a major threat and the incremental component explained through additions to NPA poses a great question mark on efficiency of credit risk management of banks in India.

III. OBJECTIVES OF THE STUDY

- I. To compare the Total Advances, Net Profit, Gross NPA & Net NPA of PNB.
- II. To study the impact of NPA on banks.
- III. To access the performance of Bank.
- IV. To study the relationship between Net profit and Net NPA of PNB.

IV. RESEARCH METHODOLOGY

Methodology is the systematic, theoretical analysis of the methods applied to a field of study, or the theoretical analysis of the body of methods and principles associated with a branch of knowledge My research methodology requires gathering relevant data from the annual reports of PNB and compiling data in order to critically analyze the Total Advances, Net Profit, Gross NPA, Net NPA of PNB and arrive at a more complete understanding about performance of PNB The study uses the annual reports of Punjab National Bank for the period of six years from 2006-07 to 2011-12. The data has been analyzed by using tables and coefficient of correlation. Table is used to compare total advances, gross NPA, net NPA & profits of PNB. By using the coefficient of correlation we want to determine whether there is any relation between Net Profits and Net NPA of PNB or not.

V. MANAGEMENT OF NON-PERFORMING ASSETS IN BANK

A mounting level of NPA's in the banking sector can severely affect the economy in many ways. If NPA's are not properly managed, it can cause financial and economic degradation which in turn signals and adverse investment climate. Nonperforming Asset is an important constraint in the study of financial performance of a bank as it results in declining margin

and higher provisioning requirement for doubtful debts. Various banks from different categories together provide advances to different sectors like SSI, agricultural, priority sector, public sector & others. These advances need to be done pre-sanctioning evaluation and post-disbursement control to contain rising non-performing assets in the Indian Banking sector. The decline of NPA is essential to improve profitability of banks and fulfil with the capital adequacy norms as per the Basel Accord.

PNB TOTAL ADVANCES COMPARED WITH NET PROFIT, GROSS NPA & NET NPA.

YEAR	TOTAL ADVANCES	NET PROFIT	GROSS NPA	NET NPA
2006-07	9659652	1815	339072	72562
2007-08	11950156	2049	331929	75378
2008-09	15470298	3091	250690	26385
2009-10	18660121	3804	321441	98169
2010-11	24210700	4434	437939	203863
2011-12	29759795	4884	871962	445423

Table 1: PNB total advances compared with net profit, gross NPA & net NPA.

Source: Annual Report of PNB

Interpretation of Result: The table is comparing Total advances with NET Profit, Gross NPA & Net NPA of PNB. With the help of this table we can get knowledge about shaking performance of PNB. We can see that on one side total advances given by PNB and Net Profits are increasing continuously since 2006. Which shows that bank is performing very well. But Gross NPA & Net NPA is also increasing which shows performance is declining due to mismanagement of banks.

VI. IMPACT OF NPA

A. Liquidity

Money is getting blocked lead to lack of enough cash in hand which lead to borrowing money for short period of time from outside which lead to additional cost to the bank. Difficulty in operating the functions of bank is another cause of NPA. Due to lack of money Routine payments and dues are not paid on time.

B. Credit loss

In case of bank is facing problem of NPA then it adversely affect the value of bank in terms of market credit. It will lose its goodwill and brand image because as we have discussed earlier that bank is not able to pay its dues on time and its negative impact is that people start withdrawing their money from bank which then cause liquidity problem and also decrease in credibility.

C. Involvement of management

Time and efforts of management is another indirect cost which bank has to bear due to NPA otherwise time and efforts of management in handling and managing NPA would have been diverted to some fruitful activities, which would give good returns. Now a day's banks have special employees to deal and handle NPAs, which is additional cost to the bank.

D. Profitability

NPA means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the profitability of bank decreases not only by the amount of NPA but NPA lead to opportunity cost also as that much of profit can be invested in some return earning project/asset. So NPA not only affect current profits but also future stream of profits, which may lead to loss of some long-term beneficial opportunity. Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.

RELATIONSHIP BETWEEN NET NPA & NET PROFITS OF PNB

Correlation: Correlation is a numerical measure used to determine the degree of relationship between Variables.

Reason of Using the Technique: By using the correlation we want to determine whether there is any relation between Net Profits and Net NPA of PNB or not.

$$\text{Formula: } r = \frac{N\sum dx dy - \sum dx \sum dy}{\sqrt{(\sum dx^2 - (\sum dx)^2)} * \sqrt{(\sum dy^2 - (\sum dy)^2)}}$$

CALCULATION OF CORRELATION BETWEEN NET PROFIT & NET NPA OF PNB:

YEAR	NET PROFIT (X)	dx=X-A A=1815	dx ²	NET NPA (Y)	dy=Y-A A= 1267	dy ²	dx dy
2012	4884	3069	9418761	4454	3187	10156969	9780903
2011	4434	2619	6859161	2038	771	594441	2019249
2010	3804	1989	3956121	982	-285	81225	-566865
2009	3091	1276	1628176	264	-1003	1006009	-1279828
2008	2049	234	54756	754	-513	263169	-120042
2007	1815	0	0	726	-541	292681	0
	$\sum X = 20077$	$\sum dx = 9187$	$\sum dx^2 = 21916975$	$\sum Y = 9218$	$\sum dy = 1616$	$\sum dy^2 = 12394494$	$\sum dx \sum dy = -9833417$

TABLE 2: Calculation of Correlation between Net Profit & Net NPA of PNB:

By putting the above calculated values in our formulae we get:

$$r = \frac{6 * 9833417 - 9187 * 1616}{\sqrt{(6 * 21916975 - (20077)^2)} * \sqrt{(6 * 12394494 - (1616)^2)}}$$

So $r = 0.31$

Interpretation of Result: As we can see that r that is correlation coefficient is equal to 0.31. It means that there is a positive relation between Net Profits and NPA of PNB. It simply means that as profits increase NPA also increase. It is because of the mismanagement on the side of bank. NPA is directly related to Total Advances given by bank and banks main source of income is interest earned by bank. Since we have seen earlier that total advances are increasing so interest income is increasing and profits are also increasing. But as we know there are two types of Customers (good and bad). Good customers' leads to increase in profits by paying interest and installments on total advances timely and Bad customers leads to increase in NPA by not paying interest and installment on total advances timely. This is because of mismanagement and wrong choice of client. That is the only reason of positive relation between NPA and Profits. But think if there is good management by bank then amount of NPA decrease and Profits will increase more by the amount not become NPA. Then there will be negative relation between profits and NPA.

VII. FINDING AND CONCLUSION

- I. Gross NPA & Net NPA of PNB are increasing every year.
- II. Total advances given by PNB and Net Profits are increasing continuously since 2007.
- III. Because of mismanagement in bank there is a positive relation between Total Advances, Net Profits and NPA of bank which is not good.
- IV. Positive relation between NPA & profits are due to wrong choice of clients by Banks.
- V. There is an adverse effect on the Liquidity of Bank.
- VI. Bank is unable to give loans to the new customers due to lack of funds which arises due to NPA.

VII. Bank performance is shaking due to varieties of customers.

VIII. SUGGESTIONS

- I. Advances provided by banks need to be done pre-sanctioning evaluation and post-disbursement control so that NPA can decrease.
- II. Good management needed on the side of banks to decrease the level of NPA.
- III. Proper selection of borrowers & follow ups required to get timely payment.

IX. LIMITATIONS OF STUDY AND FURTHER PROSPECTIVE FOR RESEARCH

This research is based on secondary data .We just made the conclusion on the bases of analysing the data collected through Annual reports of past 6 years. We suggest the research scholars that they can further do the research on the topic related to comparison of NPA of various banks.

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