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A STUDY ON IMPACT OF NON-PERFORMING ASSETS ON PROFITABILITY

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Abstract

This study explores the significant influence of non-performing assets (NPAs) on the profitability of financial institutions. Non-performing assets are loans where borrowers have failed to meet interest and/or principal payments for a specified period, typically 90 days. The escalation of NPAs can adversely affect the profitability of banks and financial entities. As NPAs increase, institutions must allocate more resources as provisions to mitigate potential losses from these delinquent loans, thereby reducing overall profits. Effective management of NPAs is crucial for maintaining a strong financial bottom line**.**

***keywords*:-** Non-performing assets (NPAs),Profitability ,Financial institutions ,Loans , Management.

1. Introduction

Banks, crucial to the economy, act as intermediaries between depositors and borrowers, with government and RBI oversight to protect depositors and maintain confidence. Modern banking in India began in the early 20th century, with significant growth post-independence, including the establishment of SBI and nationalization of major banks, expanding their reach across the country. Interest can only be recorded when received, making NPAs a key concern as they reduce bank profitability and require extra management efforts; thus, converting NPAs into performing assets is crucial.

2. Functions of Banks in the Economy

Following the introduction, you can delve into the specific functions banks perform that make them crucial to the economy. Here are some key points to consider:

Facilitating Deposits and Savings: Banks provide safe and secure avenues for individuals and businesses to deposit their money. This allows people to earn interest on their savings while keeping their funds readily accessible.

Channeling Credit: Banks act as intermediaries by accepting deposits and then lending them out as loans to individuals and businesses. This process fuels economic activity by providing access to capital for investment, expansion, and major purchases like homes and cars.

Payment Systems: Banks facilitate various payment methods like checks, debit cards, credit cards, and online transfers. This efficient system streamlines business transactions and consumer purchases, promoting a smooth flow of money within the economy.

3. Impact of Banks on Economic Growth

Expand on how banks contribute to economic growth:

Supporting Business Investment: By providing loans, banks enable businesses to acquire equipment, expand operations, and innovate. This fosters job creation and increases overall economic output.

Facilitating International Trade: Banks play a vital role in international trade by financing exports and imports, processing foreign currency transactions, and offering letters of credit to ensure secure transactions.

Mobilization of Savings: Banks encourage saving habits by offering interest on deposits. This pool of savings can then be used for lending, which fuels further investment and growth.

4. Importance of Managing Non-Performing Assets (NPAs)

As mentioned in the introduction, you can elaborate on NPAs and their significance:

Reduced Profitability: NPAs, or loans that are not being repaid, can significantly impact a bank's profitability. Banks have to make provisions for these bad loans, which reduces their net income.

Slower Economic Growth: High levels of NPAs can make banks more cautious in lending, restricting the flow of credit to businesses and hindering economic activity.

Maintaining Financial Stability: Efficient management of NPAs is essential for maintaining the overall financial stability of the banking system and the economy as a whole.

This expanded structure provides a more comprehensive understanding of the importance of banks in the economy. You can further customize it by adding specific examples of Indian banks and their role in the country's development.

Need of the study

The 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. This research explores an empirical approach to the analysis of Non-Performing Assets (NPAs) with special reference to different banks. NPAs adversely affect lending activity of banks as non-recovery of loan installments as also interest on loan portfolio. Non -recovery of loans also hurts the profit ability of banks. The outcome of the study would help the concerned more particularly the managers of banks to device appropriate management strategies to have NPA within the manageable limit to keep the performance of the banks in a healthier condition. To analyse and minimize the risk involved in different sectors of NPA.

scope of the study

Banks usually categorize loan's as non-performing after 90 days of non-payment of interest or principal amount, which can occur during the term of the loan or for failure to pay principal at the maturity date. The study could suggest measures for the banks to avoid future NPAs & to reduce existing NPAs. The study may help the banks in creating & implementing new strategies to control NPAs. The study will help to select appropriate techniques suited to manage the NPAs and develop a time bound action plan to check the growth of NPAs.

Objective of the study

- To analyse trend in sector wise Non-Performing Assets (NPA) of HDFC BANK.
- To compare year wise and sector wise contributions towards NPA.
- To examine the sector wise credit risk facing by HDFC BANK.
- The study is to examine and to take appropriate measures to be taken in reducing the carrying cost through recovery and negotiated settlement or to write off.
- To study nature and cause of credit risks facing by HDFC BANK.

Trend in Non-Performing Assets (NPA) of Commercial Banks and Regional Rural Banks

R. K. Mishra (2015)A loan asset becomes an NPA when it ceases to generate income, such as interest, fees, or commissions, for the bank for more than 90 days. NPAs are advances where payment of interest or principal remains unpaid for a period of two quarters or more and have become past due. An amount under any credit facility is considered past due when it remains unpaid for 30 days.

Kevin Greenridge et al. (2012)The study highlights the importance of evaluating non-performing loans due to their association with bank failures and financial crises, especially in developing countries. The authors developed a multivariate model incorporating macroeconomic and bank-specific variables to forecast NPAs in the banking sector of Barbados. The model outperformed a simple random walk model in all forecast horizons and provided more accurate forecasts for individual banks over longer prediction periods.

Trend in NPA of Co-operative Credit Institutions

Nelson M. Waweru et al. (2009)This study examined the causes of NPAs in Kenyan financial institutions and the actions taken by bank managers to mitigate the problem. Using a sample of 30 managers from the ten largest banks, the study found that national economic downturns were the most significant external factor, while customer failure to disclose vital information during the loan application process was the main customer-specific factor. A lack of aggressive debt collection policies was the primary bank-specific factor contributing to NPAs.

Selvi (2008)The study examined the financial performance of the Kanya Kumari District Central Cooperatives Bank (KDCCB) in Tamil Nadu from 1999 to 2006. During this period, the bank's profitability fluctuated significantly, with losses in 2000-01 and 2005-06. The overall growth rate of loan disbursements for short-term credit was positive at 25%. The debt recovery position was unsatisfactory, with NPAs increasing by 105%. On average, NPAs were 38% in agriculture, 25% in services, 20% in industry, and 19% in the priority sector.

NPA Management by Financial Institutions with Special Reference to Agriculture

M. Karunakar et al. (2008)This study focused on the importance of norms and guidelines to make the banking sector vibrant and competitive. It discussed the issues of losses, lower profitability of NPAs, and liability mismatch in banks. The study emphasized the need for proper credit assessment and risk management mechanisms to avoid NPAs during the credit consolidation stage.

Miscellaneous Studies on NPAs

Roma Mitra et al. (2008)This paper modeled and evaluated the efficiency of 50 Indian banks, emphasizing the importance of a stable and efficient banking sector for economic growth. The study found that inefficiency in the

banking sector could be analyzed and quantified, providing insights for financial policy planners to improve bank performance.

B. Satish Kumar (2008)This article evaluated the financial performance of Indian private sector banks post-liberalization. It highlighted the significant changes in the banking industry due to economic reforms, noting that new generation banks have gained a reasonable position due to technological advancements and professional management.

Korada Jayaditya Sarma (2008) A non-performing asset (NPA) refers to loans in default or arrears on scheduled payments of principal or interest. Debt is classified as non-performing when loan payments are overdue for 90 days.

Lakshmanan and Dharmendran (2007)This study examined the trend and growth of District Central Co-operative Banks (DCCBs) in Tamil Nadu from 1998-99 to 2004-05. Positive annual growth rates were observed in deposits, loans, and advances. However, the total overdues showed negative annual growth rates in four banks, although statistically insignificant. The study suggested initiatives to mobilize more deposits and address overdues through proper recovery proceedings.

Jadhav et al. (2007) This study assessed the performance of DCCBs in the Vidarbha region of Maharashtra from 1985-86 to 2000-01. During the pre-reform period (1985-86 to 1993-94), DCCBs showed satisfactory performance in branches, membership, borrowings, recovery, and over dues. In the reform period (1994-95 to 2000-01), there was satisfactory performance in loans and advances, share capital, reserve funds, own funds, deposits, investment, working capital, profit, and cost of management.

Shah (2007)This study evaluated the rural credit scenario in Maharashtra, focusing on the credit delivery system through PACS and other apex institutions. The study found slower growth in institutional finance and faster growth in outstanding loans during the reform period (1991-2000), indicating problems with over dues.

Brijesh K. Saho et al. (2007)This paper examined the performance trends of Indian commercial banks from 1997-98 to 2004-05. The study found increasing trends in technical efficiency across all ownership groups, indicating the positive impact of reforms on the banking sector. Private banks showed higher cost efficiency compared to nationalized banks**.**

Koli and Landage (2007)The study evaluated the performance of the Rathnagiri District Central Cooperative Bank (RDCCB) from its establishment in 1983 to 2004-05. The annual growth rate of total deposits ranged from 1.26% to 47.01%. The bank was heavily dependent on borrowing, and the provision for NPAs showed an increasing trend, indicating financial concerns.

Sujatha (2007)The study analyzed the financial performance of the Krishna District Cooperative Central Bank (KDCC) from 1995 to 2005. Strengths included higher levels of own funds and reasonable costs of deposits and borrowings. Weaknesses included high levels of liquid and cash assets and low credit-to-deposit ratios. The study suggested converting weaknesses into strengths and addressing threats to improve performance.

Vradi et al. (2006)This study measured the efficiency of Indian banks from 1990 to 2002-03 using data envelopment analysis. It concluded that public sector banks were more efficient than private sector banks based on profitability, productivity, asset quality, and financial management indicators.

Goyal et al. (2006)This study examined the performance of primary agricultural credit cooperatives in Haryana from 1980-81 to 2002-03. Significant growth was observed in share capital, owned capital, working capital, loan advances, and membership. However, there were concerns regarding overdues.

Kulandaiswamy and Murugesan (2004)This study evaluated the performance of Primary Agricultural Cooperative Credit Societies (PACS) in India based on eight variables. Of the 30 PACS studied, seven (23.3%) showed good performance, 14 (40%) moderate performance, and 13 (36.7%) poor performance. The study called for policy interventions to correct deficiencies and improve overall efficiency.

Shah (2003)This study evaluated rural financial institutions in Maharashtra from 1991 to 2000. The results indicated slower growth in institutional finance due to mounting NPAs, high transaction costs, and poor repayment performance. The study suggested strategies to improve the rural credit delivery system, including sustainability, operational efficiency, recovery performance, and balanced sectoral development.

Das and Ghosh (2003)This study empirically examined NPAs in India's public sector banks based on asset size, credit growth, macroeconomic conditions, and operating efficiency indicators. The study highlighted that an increase in the riskiness of loan assets was linked to unselective and inadequate assessment of sectoral prospects in banks' lending policies.

Belay et al. (2003)This study analyzed the recovery performance of Primary Land Development Banks (PLDBs) in Haryana from 1988-89 to 2007-08. The amount of loans recovered increased steadily, but chronic overdues remained a serious issue. Factors affecting overdues included loan purpose, amount borrowed, diversion into unproductive uses, and repayment capacity. The study suggested measures for better NPA management, including scientific appraisal of loan proposals, effective supervision, technical guidance, and timely disbursement of loans.

Research methodology

The basic principle in the research has been adopted in the overall methodology. The following

methodology has been used for meeting the requirements,

Data analysis and interpretation:

		Frequency	***Percentage (%)***	***ValidPercent***	***Cumulative Percent***
Valid	***0-2years***	1	7.7	7.7	7.7
	2-3years	2	20.4	20.4	23.1
	3-5years	5	38.5	38.5	61.5
	5-yearsabove	5	38.5	38.5	150.0
	Total	18	150.0	150.0	

Interpretation:

The data shows the distribution of a certain category (represented by 'Valid') across different age groups. Out of 18 observations (total frequency), 7.7% fall into the 0-2 year age group, 20.4% fall into the 2-3 year age group, and 38.5% each fall into the 3-5 year and 5-years above groups. There seems to be an issue with the 'Cumulative

Percent' column, as the value for '5-years above' (150%) exceeds 100%. It's recommended to check the calculation of this column.

Table:2sincehowlongthepresenceof NPA isobserved?

		Frequency	*Percentage (%)*	*ValidPercent*	*Cumulative Percent*
Valid	***0-1yrs***	3	23.1	23.1	23.1
	1-2yrs	7	53.8	53.8	76.9
	above-5yrs	3	23.1	23.1	150.0
	Total	18	150.0	150.0	

Interpretation:

The data shows the distribution of a certain category (represented by 'Valid') across different age groups. Out of 13 observations (total frequency), 23.1% fall into the 0–1-year age group, 53.8% fall into the 1-2 year age group, and 23.1% fall into the above-5 year age group. There seems to be an issue with the 'Cumulative Percent' value for 'above -5yrs' (100.0). It's likely a calculation error.

Table:3what istheappropriatevalueofNPAisyourbranch?(rsinlakhs)

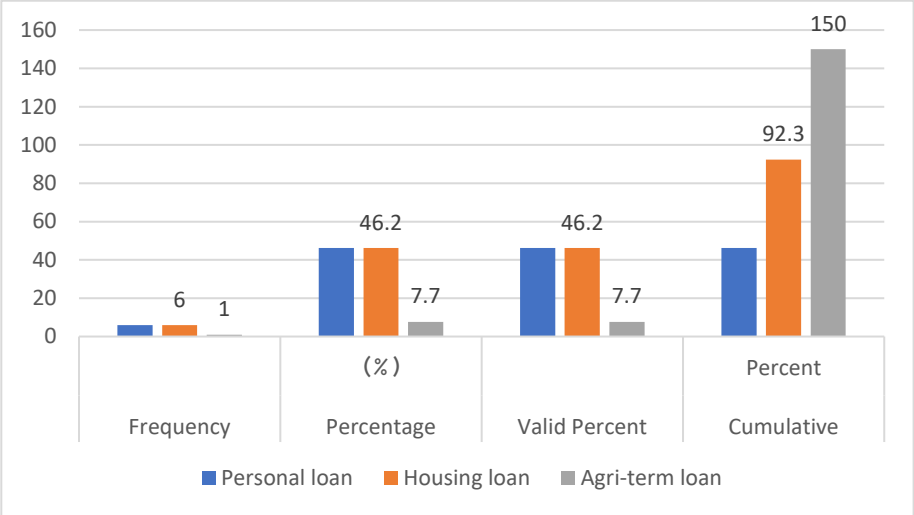
		Frequency	*Percentage (%)*	*ValidPercent*	*Cumulative Precent*
Valid	***1-15***	5	38.5	38.5	38.5
	15-20	6	46.2	46.2	84.6
	20-30	1	7.7	7.7	92.3
	above-40	1	7.7	7.7	150.0
	Total	18	150.0	150.0	

Interpretation:

The table shows the distribution of non-performing assets (NPAs) at a bank branch, likely measured in lakh rupees. Almost all the observations (84.6%) fall within the 1-20 lakh range, with the majority (38.5%) concentrated between 1-15 lakhs. There's a smaller presence (7.7% each) in the 20-30 lakh and above 40 lakh categories. However, there appears to be a data error in the "Cumulative Percent" for "above 40" as it exceeds 100%.

Table:4Forwhichcategorythe NPAisbeingobserved

		Frequency	*Percentage (%)*	*ValidPercent*	*Cumulative Percent*
Valid	***Personalloan***	6	46.2	46.2	46.2
	Housingloan	6	46.2	46.2	92.3
	Agri-termloan	1	7.7	7.7	150.0
	Total	18	150.0	150.0	



INTERPRETATION:

The table shows the distribution of non-performing assets (NPAs) at a bank branch, categorized by loan type. Nearly half (46.2% each) of the NPAs are from personal loans and housing loans. A smaller portion (7.7%) falls under agri-term loans. There seems to be an error in the "Cumulative Percent" for "Agri-term loan" (150.0%) as it shouldn't exceed 100%.

Table:5measuresforrecoveryofNPAadopted bythebank

		Frequency	*Percentage (%)*	*ValidPercent*	*Cumulative Percent*
Valid	***Legalmeasures***	6	46.2	46.2	46.2
	Bothlegalandnon-legal	7	53.8	53.8	150.0
	Total	18	150.0	150.0	

Interpretation:

The table shows the distribution of approaches taken to recover bad loans at a bank branch. Over half (46.2%) of the cases involve using solely legal measures. The remaining cases (53.8%) involve a combination of both legal

and non-legal methods. There appears to be an error in the "Cumulative Percent" for "Both legal and non-legal" (150.0%) as it shouldn't exceed 100%.

Table:6TowhatextentNPAhasbeenconvertingintogoodasset.

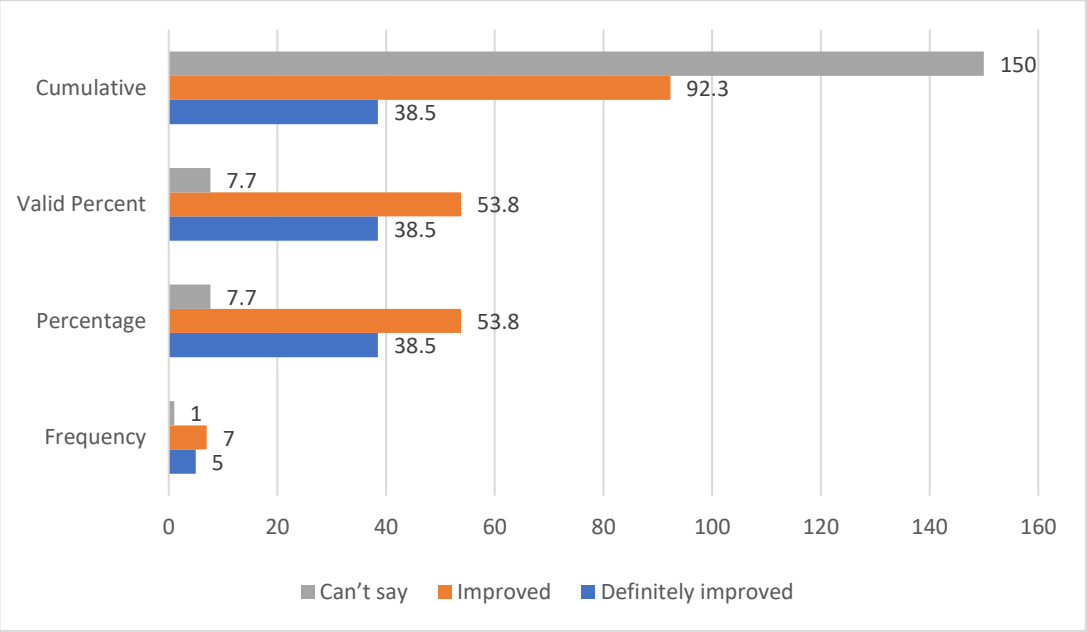
		Frequency	*Percentage (%)*	*ValidPercent*	*Cumulative Percent*
Valid	***1%***	1	7.7	7.7	7.7
	2%	1	7.7	7.7	20.4
	4%	1	7.7	7.7	23.1
	5%	1	7.7	7.7	30.8
	>5%	9	69.2	69.2	150.0
	Total	18	150.0	150.0	

Interpretation:

The table shows the distribution of delinquency rates for loans at a bank branch. The vast majority (69.2%) of loans have delinquency rates exceeding 5%. Smaller percentages fall within specific ranges: 1% (7.7%), 2% (7.7%), 4% (7.7%), and 5% (7.7%). It's worth noting that there likely is an error in the "Cumulative Percent" for ">5%" (150.0%) as it shouldn't be more than 100%.

***Table*:7Hastheprofitabilityimprovedafter adoptingreductiontechnique?**

		Frequency	*Percentage (%)*	*ValidPercent*	*Cumulative Percent*
Valid	***Definitelyimproved***	5	38.5	38.5	38.5
	Improved	7	53.8	53.8	92.3
	Can'tsay	1	7.7	7.7	150.0
	Total	18	150.0	150.0	



Interpretation:

A study revealed that over half (53.8%) of banks witnessed improved profitability, with nearly 39% experiencing a definite increase, after implementing NPA reduction techniques. These techniques should involve a shift in focus from outdated technology projects and large exposures to single borrowers. Additionally, upskilling credit staff and prioritizing project viability over collateral security are crucial. To prevent delays and cost overruns, timely loan approvals and disbursements are essential. Banks must also implement measures to curb fund diversion by borrowers. During working capital assessments, staff should scrutinize inventory and receivables levels. The credit department needs to be vigilant for warning signs like missed quarterly interest payments or bounced checks. A robust inspection system and identifying the root causes of NPA accounts are critical for asset quality improvement and initiating appropriate recovery actions. Finally, focusing on recovering loans from capable but non-repaying borrowers, with strategic use of coercive measures in some cases, can be highly beneficial.

Conclusion:

One of the most concerning challenges faced by private Indian banks is the escalating level of Non-Performing Assets (NPAs). These are essentially loans that borrowers are failing to repay. If left unaddressed, NPAs can severely hamper a bank's ability to function effectively. Ignoring NPAs poses a significant risk to the entire banking sector.

NPAs create a domino effect. They erode a bank's current profits by reducing interest income. This disrupts the smooth flow of funds needed for lending to other potential borrowers. To compensate for these losses, banks may be forced to raise interest rates for other borrowers. This, combined with potentially lower deposit rates, discourages saving and weakens financial markets. Ultimately, this hinders India's economic growth. Therefore, actively managing and regulating the rise of NPAs is critical for banks. Doing so ensures a healthy financial system and a thriving economy for the nation.

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