FINANCE INDIA
© Indian Institute of Finance
Vol. XXXV No. 3, September 2021
Pages—861 - 872

The Impact of NPAs on Profitability of Public Sector Banks in India

V. RAVEENDRA SARADHI*
AREEJ A. SIDDIQUI**

Abstract

The aim of this paper is to study the NPA crisis of Indian public sector banks after the financial crisis of 2008, particularly whether an increase in the gross NPA ratio causes any decline in the profitability. This paper analyses the profitability of 26 public sector banks in India - SBI and its 5 associates and 20 nationalised banks for 13 years, from 2004-05 to 2016-17. First section introduces the problem of bad loans prevalent in the country. Second section carries out review of literature lads us to form our hypothesis. In the third section, the data procured from reputed sources is analysed using panel regression method. The results are presented in the fourth section. Last section presents interpretation of this results.The Indian banking sector is in the throes of an escalating bad loan crisis. Public sector banks were analysed specifically because a major chunk of NPAs in the banking domain are found in PSBs. The analysis found a negative impact of credit risk on the profitability of banks, with the former being calculated in terms of Gross Non-Performing Asset Ratio.

I. Introduction

THE INDIAN ECONOMY has weathered a few storms in the form of demonetisation exercise and the rollout of the Goods and Services Tax in the year 2016-2017. Domestic growth rebounded in the second - quarter of 2017-18. But, the financial institutions pose a worry because of the poor credit growth in public sector banks. According to the Economic Survey, the banking stability indicator (BSI), an important indicator of soundness and resilience of the banking industry, has shown that the risks to the banking sector remain high on ground of the deterioration of asset quality. Though scheduled commercial banks as a whole showed credit growth between March and September 2017, the performance of the public-sector banks has been consistently dismal. In the year 2018, the gross NPAs of Indian Banks

* Professor, Indian Institute of Foreign Trade, B-21, Qutab Institutional Area, Delhi 110016, INDIA
** Assistant Professor, Indian Institute of Foreign Trade, B-21, Qutab Institutional Area, Delhi 110016, INDIA

Submitted January 2019; *Accepted* March 2021

Early Warning mechanisms, banks maystrengthencredit monitoring to flag the customer accounts that havethe probability of going bad.An alternative suggestion may also be to make governance structure of banks more accountable to ensure prevention of such defaults. The government in recent years has also taken steps for preventing NPAs by enforcing Insolvency & Bankruptcy Code since 2016.

Hence,it is recommended that PSU banks need to increase internal monitoring of credit and liquidity risk measures, achieve diversification of the revenue sources and infusion of equity capital into the PSU banks.

References

Akbas, H.E., (2012), "*Determinants of Bank Profitability: An Investigation on Turkish Banking Sector*", Öneri Dergisi Vol. 10, No. 37, pp. 103–110

Angbazo, L., (1997), "Commercial Bank Interest Margins, Default Risk, Interest-rate Risk, and Off-balance Sheet Banking", *Journal of Banking and Finance*, Vol. 21, No. 1, pp. 55-87

Athanasoglou, P., D. Manthos and C. Staikouras, (2006), "*Determinants of Bank Profitability in The South Eastern European Region*", Munich Personal RePEc Archive, Paper No. 10274

Badola, B.S and R. Verma, (2006), "Determinants of Profitability of Banks in India – A Multivariate Analysis", *Delhi Business Review,* Vol. 7, No. 2, pp. 79-88

Caporale, G.M. and A. Girardi, (2013), "Fiscal spillovers in the Euro area", *Journal of International Money and Finance*, Vol. 38, No. 84

Chavan, P. and L. Gambacorta, (2016), "*Bank Lending and Loan Quality: The Case of India*", BIS Working Papers

Cucinelli, D., (2015), "The Impact of Non-Performing Loans on Bank Lending Behaviour: Evidence from the Italian Banking Sector", *Eurasian Journal of Business and Economics 2015*, Vol. 8, No. 16, pp. 59-71

De Bock R. and A. Demyanets, (2012), "*Bank Asset Quality in Emerging Markets: Determinants and Spillovers*", IMF working paper International Monetary Fund 71,

Demerguç-Kunt, A. and H. Huizinga, (2001), "*Financial Structure and Bank Profitability*", in Financial Structure and Economic Growth: A Cross Country Comparison of Banks, Markets, and Development,

Demirguc-Kunt, A. and H. Huizinga, (1998), "Determinants of commercial bank interest margins and profitability: some international evidence", *World Bank Economic Review*, Vol. 13, pp. 379-408

Demirgüç-Kunt, A. and H. Huizinga, (2001), "Financial Structure and Bank Profitability, in "*Financial Structure and Economic Growth: A CrossCountry Comparison of Banks, Markets, and Development*", In: Demirguc-Kunt, A., Levine, R. (Eds.), MIT Press, Cambridge

Dudhe, Chetan, (2017), "*Impact of Non-Performing Assets on The Profitability of Banks – A Selective Stud*", The Annals of The University Oradea Economic Sciences, Oradea, Romania, TOM XXVI 2017, Vol. 1

Festi , M., A. Kavkler and S. Repina, (2011), "The macroeconomic sources of systemic risk in the banking sectors of five new EU member states", *Journal of Banking & Finance*, Vol. 35, No. 2, pp. 310-322

Guru, B., J. Staunton and Balashanmugam, (2002), "*Determinants of commercial bank profitability in Malaysia*", University Multimedia working papers

Jimenez, G, J. Saurina, (2006), "Credit cycles, credit risk and prudential regulations", *International Journal of Central Banking*, Vol. 2, No. 3, pp. 65–98

Kaveri, D.V., (2017), "Ordinance on New NPA Resolution Policy - an Overview", *Journal of Commerce & Management Thought*, pp. 2-14

Khemraj, T. and S. Pasha, (2009), "*The determinants of non-performing loans: An econometric case study of Guyana*", The Caribbean Centre for Banking and Finance Bi-annual Conference on Banking and Finance, St. Augustine, Trinidad

Kosmidou, K., (2008), "The Determinants of Banks' Profits in Greece during the Period of EU Financial Integration", *Managerial Finance*, Vol. 34, pp. 146- 159

Kyriaki, Kosmidou, (2008), "The determinants of banks' profits in Greece during the period of EU financial integration", *Managerial Finance,* Vol. 34 No. 3, pp.146-159

Messai, A. S., and F. Jouini, (2013), "Micro and macro determinants of non-performing loans", *International Journal of Economics and Financial Issues*, Vol 3, No. 4, pp 852

Molyneux, P. and P. Thornton, (1992), "Determinants of European Bank Profitability: A Note", *Journal of Banking and Finance*, Vol. 16, No. 6, pp. 1173-1178

Ozili, P. K., (2015), "Loan Loss Provisioning, Income Smoothing, Signaling, Capital Management and Procyclicality: Does IFRS Matter? Empirical Evidence from Nigeria", *Mediterranean Journal of Social Sciences*, Vol. 6, No. 2, pp. 224

Ozili, Peterson Kitakogelu, (2015), "Determinants of Bank Profitability and Basel Capital Regulation: Empirical Evidence from Nigeria, *Research Journal of Finance and Accounting*, Vol. 6, No. 2, pp. 124-131

Perry, P., (1992), "Do banks gain or lose from inflation?", *Journal of Retail Banking*, Vol. 14, No. 2 pp. 25-31

RBI, (2017), "*Financial Stability Report*", Vol. 16, Reserve Bank of Mumbai,

Salas, V and J. Saurina, (2002), "Credit risk in two institutional regimes: Spanish commercial and savings banks", *Journal of Financial Services Research*, Vol. 22, No. 3, pp. 203–224

Sharifi, Omid and Javaid Akhter, (2016), "Effect of Non Performing Assets on the Profitability of Public Sector Banks of India", *International Journal of Engineering and Management Research*, Vol. 6, No 5 , September-October 2016 pp. 383-388

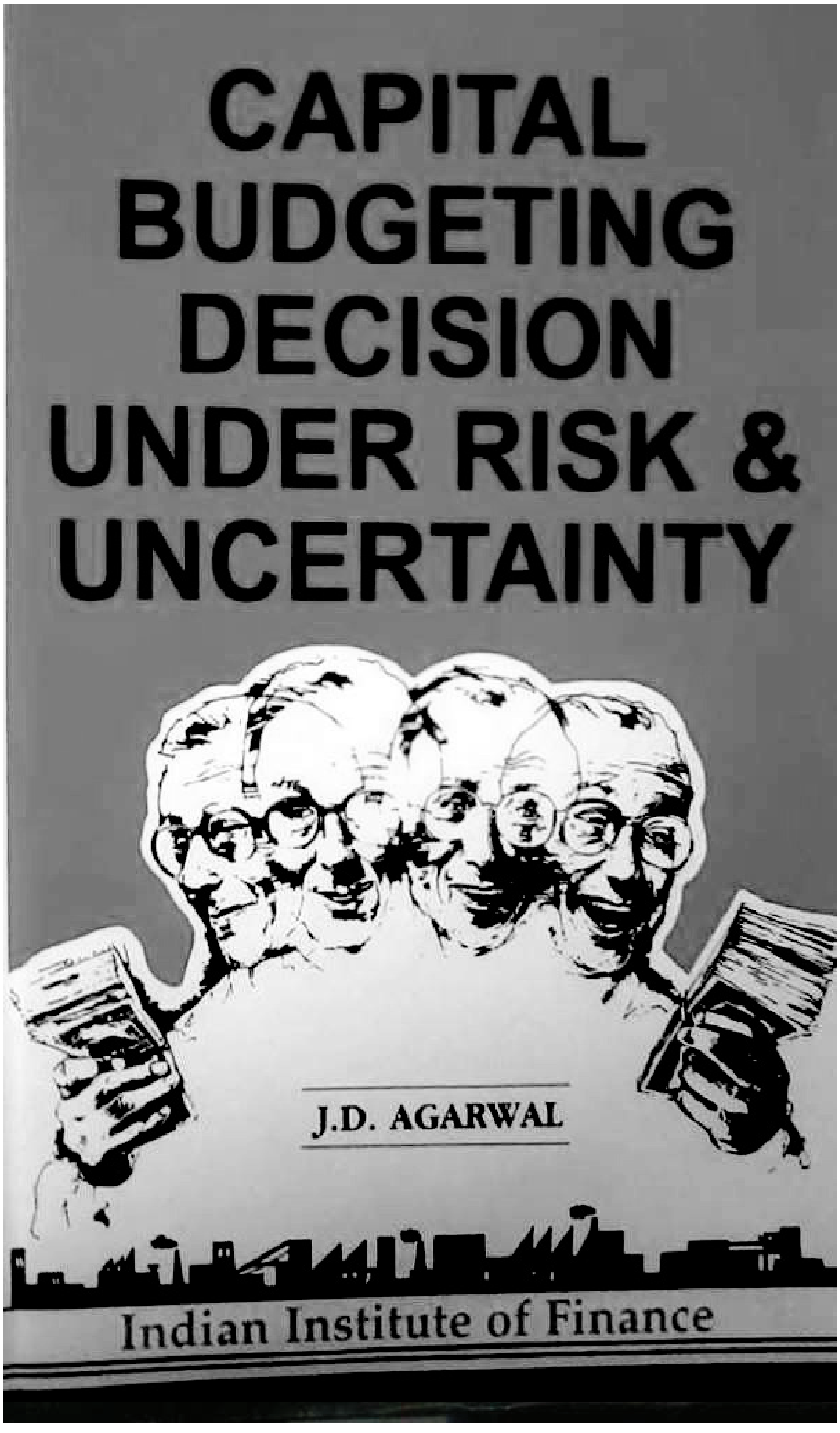
Siraj, K.K. and P. Sudarsanan Pillai, (2013), "Efficiency of NPA Management in Indian SCBs -A Bank-Group Wise Exploratory Study", *Journal of Applied Finance & Banking*, Vol. 3, No. 2, 2013, pp. 123-137

Skarica, B., (2013), "*Determinants of non-performing Loans in Central and Eastern European Countries*", EFZG working paper Series, 07, University of Zagreb Faculty of Economics and Business, pp. 1-19

Symss, Jacqueline, V., Raveendra Saradhi and Pooja Nehra, (2018), "Determinants of Non-performing assets in Indian banking sector", *The Management Accountant,* Vol. 53, No. 7, pp. 91-98

Vaidyanathan, K., (2013), "*Credit Risk Management for Indian Banks*", Sage Publications, Delhi

Petria, N., B. Capraru and I. Ihnatov, (2015), "Determinants of banks' profitability: evidence from EU 27 banking systems", Procedia Economics and Finance, Vol. 20, pp. 518-524


CAPITAL
BUDGETING
DECISION
UNDER RISK &
UNCERTAINTY
J.D. AGARWAL
Indian Institute of Finance