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CHAPTER I

INTRODUCTION

1.1 INTRODUCTION

Banking System is the backbone of every country’s economy. It is generally agreed that a strong and healthy banking system is a prerequisite for sustainable economic growth. Banks play a substantial role in capital accumulation, firm’s growth and economic prosperity. A sound and profitable banking system always supports to face the negative shocks and contribute to the stability of the financial system. Banks are in a business to receive deposits or liabilities and to issue debt securities on the one hand and create or invest in assets on the other hand. A bank collects the savings and disburses in various productive sectors. In this process, the performance of banking sector in efficient allocation of capital to the productive sectors of the economy is conditioned on its own financial performance.

The Indian Banking sector has played a commendable role in fuelling and sustaining growth in the economy. In the recent past a large part of the banking sector’s growth has been on the back of financing consumption, as reflected in the growth of retail banking. Profitability, viability and development of financial institutions are directly affected by the quality and performance of advances. Indian banks are weighted down by enormous amounts of bad loans that threaten the very health of the banking system. In fact, banks extended large number of loans to all sectors at the request of ruling government and policy makers, but their experience with these borrowers has not been satisfactory. Thus, the central bank of India, the RBI (Reserve Bank of India) has been specifically commenting on Non-Performing Assets of banking sector as it negatively influence economic growth of nation.

The new economic reforms have given a new thrust to the Indian banking sector as a whole and Private sector in particular. The banking system in the country has undergone a sea - change with the introduction of prudential norms on income recognition, asset classification and their provisioning. In spite of the commanding role of the Indian banking sector in last five decades under the competitive global environmental
conditions, the banking sector currently suffers from a number of weakness such as low recovery rate of credit, high costs, poor management practices, trade union pressures, political interferences, unprofitable branches and mounting Non-Performing Assets.

In a developing country, banking is seen as an important instrument of development, while with the demanding Non-Performing Assets, banks have become a burden on the economy. Looking to the changing scenario at the world level, the problem of mounting Non-Performing Assets becomes more crucial, because Indian banking cannot afford to remain unproductive and less competitive. Indian bankers are aware of the impact of Non-Performing Assets on their financial performances and they are trying their level best to reduce the Non-Performing Assets ever since the regulatory authorities, i.e., Reserve Bank of India and Government of India, have seriously focused on this issue. The Reserve Bank of India has classified the loans and advances on occupation basis as Agriculture, Industry, Transport operators, Professional and other services, Personal loans, Trade and Finance in order to monitor the movement of credits and its outstanding status, i.e., Non-Performing Assets. Drawing references to the above discussed issues this empirical study aims to analyse the occupation-wise distribution of Non-Performing Assets of Public and Private sector Commercial Banks in India and its impact of profitability of the banks.

1.2 CONCEPT OF NON-PERFORMING ASSETS

The banks, in their books, have different kinds of assets, such as cash in hand, balances with other banks, investment, loans and advances, fixed assets and other assets. The Non-Performing Asset concept is restricted to loans, advances and investments. As long as an asset generates the income expected from it and does not disclose any unusual risk other than normal commercial risk, it is treated as performing asset, and when it fails to generate the expected income it becomes a “Non-Performing Asset”. In other words, a loan asset becomes a Non-Performing Asset when it ceases to generate income, i.e. interest, fees, commission or any other dues for the bank for more than 90 days.

A Non-Performing Asset is an advance where payment of interest or repayment of installment on principal or both remains unpaid for a period of two quarters or more and if they have become ‘past due’. An amount under any of the credit facilities is to be
treated as past due when it remains unpaid for 30 days beyond due date. Assets are called as Non-Performing Loans, if it is made by a bank or finance company on which repayments or interest payments are not being made on time. A loan is an asset for a bank as the interest payments and the repayment of the principal create a stream of cash flows. It is from the interest payments that a bank makes its profits. Banks usually treat assets as Non-Performing if they are not serviced for some time. If payments are late for a short time, a loan is classified as past due and once a payment becomes really late (usually 90 days), the loan is classified as Non-Performing. A high level of Non-Performing Assets may be a sign of problems especially in banking business.

1.3 RATIONALIZATION OF THE STUDY

Non-Performing Assets is a major issue and challenge for Banking Industry. Non-performing Assets are threatening the stability and demolishing bank’s profitability through a loss of interest income, write-off of the principal loan amount itself. RBI issued guidelines in 1993 based on recommendations of the Narasimham Committee that mandated identification and reduction of Non-Performing Assets be treated as a ‘national priority’ because the level of Non-Performing Assets acts as an indicator showing the bankers credit risks and efficiency of allocation of resource.

Some of the impacts of the Non-Performing Assets on the banking operations are:

The efficiency of a bank is not always reflected only by the size of its balance sheet but also the level of return on its assets. The Non-Performing Assets do not generate interest income for banks but at the same time banks are required to provide provisions for Non-Performing Assets from their current profits. The Non-Performing Assets have destructive impact on the return on assets in the following ways:

- The interest income of the banks reduced, it is to be accounted only on receipt basis.
- The current profits of the banks are eroded because of providing the doubtful debts and writing it off as bad debts and it limits the recycling of funds.
- The capital adequacy ratio is disturbed and cost of capital will go up and the Economic Value Addition (EVA) by banks gets upset because EVA is equal to the net operating profit minus cost of capital.
1.4 IMPACT OF NON-PERFORMING ASSETS ON THE OPERATIONS OF BANKS

The impacts of Non-Performing Assets on the operations of banks are:

i. Profitability

Non-Performing Asset means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the prodigality of bank decreases not only by the amount of Non-Performing Assets but lead to opportunity cost also, as that much of profit invested in some return earning project/asset. So Non-Performing Assets does not affect current profit but also future stream of profit, 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 affects current earning of bank.

ii. Liquidity

Money is getting blocked, decreased profit leads to lack of enough cash at hand which leads to borrowing money for shortest period of time which leads to additional cost to the company. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.

iii. Involvement of Management

Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good return. Nowadays, banks have special employees to deal and handle NPAs, which is additional cost to the bank.

iv. Credit Loss

If a bank is facing problems of Non-Performing Assets, then it adversely affects the value of the bank in terms of market for credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting in their money in the banks.
1.5 STATEMENT OF THE PROBLEM

Commercial banking in India is being conducted in a high risk and managed with mitigated ambience. In the recent past both the Public and domestic Private sector banks in India have been reporting higher NPAs in their books because of continued slowdown of Indian economic activities that resulted in rising interest rate regime. As per RBI data, the gross NPA for all the banks together in the country stood at Rs.1.42 lakh crore at March 31, 2012. The Reserve Bank recently instructed the banks to strengthen their due diligence and credit appraisal system along with overall monitoring mechanism to contain the rising bad assets arising in the banking system.

In the present situation, evaluating the occupational-wise Non-Performing Assets of banks in India has become vital because majority of bank loans are distributed to the priority sectors as advances. Hence, an effort has been made to review and evaluate the occupation-wise Non-Performing Assets of banks. In this background, the researcher aims to answer the following questions:

- How the total deposits accumulations are distributed as advances to various priority sectors by the Public and Private sector banks in India?
- What are the factors that determine the Non–Performing Assets of Public and Private sector banks in India? and
- How the Non–Performing Assets of Public and Private sector banks impact its profitability?

1.6 SCOPE OF THE STUDY

The contribution of banking industry in Indian economic activities has been increasing. The role of banking sector in the national income is a significant one. The present study highlights the Non-Performing Assets of Public and Private sector banks in India. Even though many studies related to this topic have been carried out, the present study has greater significance, because it would help to understand the occupation-wise Non-Performing Assets of banks. As such, the study is expected to help the investors and the government at large to take valuable decision at their own. The study has academic relevance in new theoretical and practical knowledge undoubtedly. The present study will act as a masterpiece on the subject for further research and development.
1.7 OBJECTIVES OF THE STUDY

The objectives of the study are:

1. To analyse the deposits accumulation and advances distribution pattern of Public and Private sector banks in India.
2. To analyse the occupational-wise distribution of Non-Performing Assets.
3. To examine the factors determining the Non-Performing Assets of these banks.
4. To investigate the impact of Non-Performing Assets on profitability of Public and Private sector banks in India.
5. To offer findings, suggestions and conclusion for effective asset management in banking sector.

1.8 HYPOTHESES OF THE STUDY

1. There is no significant impact of increase in occupation-wise Non-Performing Assets on the profitability of the banks.
2. There is no significant difference between the total advances and gross non-Performing / net non-Performing Assets of the banks.
3. There is no significant relationship between the increase in gross Non-Performing Assets and the profitability of banks.

1.9 RESEARCH METHODOLOGY

The present study is explorative and descriptive in nature. The study is primarily based on the secondary data. In the first stage of the study, desk research was carried to collect, review and draw a clear empirical understanding of previous research works and their discussion on Commercial banks’ performances and their status on NPAs. In the second stage, secondary data for descriptive analysis were collected from RBI published database for ten years from 2002-2003 to 2011-2012. The study is confined to examine the state of occupation-wise Non-Performing Assets of Commercial Banks operating in India (i.e.,) Public and Private Sector Banks. Detailed discussion on the research methodology of the study is made in chapter III.
1.10 LIMITATIONS OF THE STUDY

Some of the practical limitations faced by the researcher are:

- This study does not cover Non-Performing Assets status of other bank categories like Foreign Banks, Regional Rural Banks and Co-operative Banks.

- The study is primarily based on the secondary data, it has its own limitations and it may influence the findings of the study.

- Since the study is conducted for a period of ten years from 2002-2003 to 2011-2012), the global and Indian economic and financial market happenings may have influenced the findings of the study. So, the findings of the study cannot be generalized with other years that are not considered for analyzing in this study.

1.11 CHAPTER SCHEME

The first chapter deals with introduction. This includes introduction, concepts of Non-Performing Assets, rationalization of the Study, Impact of Non-Performing Assets on the operations of banks, statement of the problem, scope of the study, objectives of the study, hypotheses of the study, research methodology, limitations of the study and chapter scheme.

The second chapter covers a brief description of the available review of literature.

The third chapter highlights the research design of the study.

The fourth chapter deals with the Growth and Trends of Commercial Banks in India and presents historical perspective of Indian banking sector and the factors determining the Non-Performing Assets and bank profitability.

The fifth chapter analyses the deposits and advances of commercial banks in India.

The sixth chapter analyses the occupation-wise Non-Performing Assets.

The seventh chapter deals with the impact of Non-Performing Assets on profitability of Public and Private sector banks in India.

The eighth chapter presents the summary of findings, suggestions to improve the profitability of commercial banks and the conclusion.
References

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