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A Comparative Study on Impact of Non-Performing Assets of Public and Private Banks on its Profitability

Deepak S. Jejani
Researcher

Dr. Pradeep D. Hadke
Associate Professor

DNC, Nagpur

Abstract
Non-performing assets are one of the major concerns for banks in India. NPAs reflect the performance of banks. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. NPAs affect the liquidity and profitability, in addition to posing threat on quality of asset and survival of banks. The Indian banking sector has been facing serious problems of raising Non-Performing Assets (NPAs). The NPAs growth has a direct impact on profitability of banks. It involves the necessity of provisions, which reduces the overall profits and shareholders' value. The problem of NPAs is not only affecting the banks but also the whole economy. In-fact high level of NPAs in Indian banks is nothing but a reflection of the state of health of the industry and trade. It is necessary to trim down NPAs to improve the financial health in the banking system. The Indian banking sector is facing a serious problem of NPAs. To improve the efficiency and profitability, the NPAs have to be scheduled. Various steps have been taken by governments to reduce the NPAs. It is highly impossible to have zero percentage NPAs. But at least Indian banks can try competing with foreign banks to maintain international standard. The objective behind this study is to find the factors contributing to NPAs, reasons for high NPAs and their impact on Indian banking operations, the profitability, the trend and magnitude of NPAs in selected Indian banks.

Keyword: Liquidity and Profitability, Economy, Trend and Magnitude.

Introduction
In Indian Financial System, Banks play significant role and carries main business of accepting deposits and lending loans to individuals and institutions. The business of banking is associated with financial risks in many forms. One of the major risk is nonpayment of loans by the borrowers in scheduled time due to which the accounts may get converted into Non Performing Asset. Banks had to lose interest income from the NPA accounts and nonpayment of principal amount also affects income of banks and in turn their profitability. In addition to this banks need to make provision for such non-performing assets out of theircurrent profit. Such situation affects the liquidity and profitability of the banks.

Non-performing assets is the most significant and suitable attribute to measure the health and robustness of banks and financial institutions. Broadly it can be said that, any assets generally turn into NPAs when they fail to yield income during certain period. NPAs form a substantial drag not only for individual banks as well as the banking system of a country.

At present, the Indian banking sector is facing a deep crisis. The Reserve Bank of India (RBI) has said gross non-performing assets (NPA) of urban banks (UCBs) shot up to Rs 11,922 corer for the fiscal 2003-04. To make matters worse, RBI said apart from UCBs, central co-op banks have recorded NPAs of Rs 13,862 crore, and state banks' NPAs was Rs 6,284 crore as on March 31st, 2003.

In its report on 'Trend and Progress of Banking 2003-04', RBI said while the deposits of 55 urban banks have risen to a staggering Rs 39,305 crore, their accumulated losses were Rs 2,320 crore. The deposits and advances of all UCBs were Rs 1,10,256crore and Rs 67,930 crore respectively as on March 2004. Due to the absence of clear demarcation of regulatory powers between state government, NABARD and RBI, it has resulted many times in cross-directives from the controlling agencies thereby undermining the working of co-operatives.

Due to the cut throat competition and shrinking spreads, banks are striving to keep NPA's much below the level of 10% to make net earnings necessary for their survival and growth. The banks have played an important role in the socio-economic development of rural economy in particular and entire country in general.

Review of literature

Bhaskaran and Josh (2000) concluded that the recovery performance of credit institutions continues to unsatisfactory which contributes to the growth of NPA even after the introduction of prudential regulations. They suggested legislative and policy prescriptions to make credit institutions more efficient, productive and profitable organization in tune with competitive commercial banking.

Singh and Singh (2006) In their study titled, "Funds Management in Central Banks−Analysis of Financial Margin" attempted to estimate the impact of identified variables on the financial margin of the central banks in Punjab with the help of correlation and multiple step-wise regression approach. The ratio of own funds to working funds and the ratio of recovery to demand were observed to be having positive significant influence on financial margin, whereas over dues to total loans were found to be negatively associated with the concerned parameter. A high percentage of own funds and timely 14 recovery of previous loans outstanding, as a source of funding new loans by the bank, increased the financial margin in these banks.

Research Methodology

This research is done in two major components-

The first component analyses the conceptual framework and the second component consists of primary data study.

The conceptual Research is based on abstract ideas, concepts or theory. It results in the development of new concepts or reinterpretation of existing one.

Objectives of Study

1. To study NPA trend in last 5 years of private and public sector banks.
2. To make a comparative study of NPA's of public sector and private sector banks.

Research Design

The research design that will be use is Descriptive Research

- Uses description as a tool to organize data into patterns that emerge during analysis.
- Often uses visual aids such as graphs and charts to aid the reader.

Hypothesis

H0: There is insignificant relationship between the NPA and the Loans & Advances offered by the Banks and financial institutions.

H1: There is a significant relationship between the NPA and the Loans & Advances offered by the Banks and financial institutions.

Sample Size

In the study following banks are considered for research:
Public Banks: Bank of Maharashtra, State Bank of India
Private Banks: DCB Bank Ltd., ICICI Bank, The HDFC Bank

Data analysis

To test the hypothesis i.e. "There is no significant relationship between level of NPA's and Loans and Advances" One Way ANOVA test is applied using SPSS tool provides an ANOVA table, the 6th column of Sig. provides the p. value which depends on the F value of the 5th column. We can set the following rules at 5% level of significance:

If p value > 0.05, then the model is non-significant model and support the statement of the null hypothesis

If p value ≤0.05, then the model is significant model to determine the statement of alternative hypothesis. This means that t*here is a significant relationship between level of NPA's and Loans and Advances*. Hence, they support the fact under alternative hypothesis.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.238[a]	.056	.054	9.45031

a. Predictors: (Constant), NPA to Loan Advances Ratio

From the above table the R square value is .056 and adjusted R square value is 0.238 and thisenlighten us that the model account for only 5.6% of variance in the present study.This is the clear indication that this model is a weak model and changes in credit deposit ratio is only 5.6% affected by NPAs and there are several other factors that affect the changes in Loans &Advances.Also the R value is 0.238 which states that there is **weak relationship** between change in NPA to loans and advances ratio.

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2126.932	1	2126.932	23.816	.000[b]
	Residual	35544.704	398	89.308		
	Total	37671.635	399			

a. Dependent Variable: Loans & Advances
b. Predictors: (Constant), NPA

The above table shows the F value of 23.816 and sig. value (p value) of 0.00 calculated from the difference between the mean values. Since the p value calculated above is less than the alpha value of 0.05, it is concluded that there is significant relationship between level of NPA's and Loans and Advances. Hence on the basis of means and ANOVA calculated it is concluded that the hypothesis i.e. There is no significant relationship between level of NPA's and Loans & Advances is **rejected**and alternate hypotheses i.e. there is significant relationship between level of NPA's and Loans & Advances is **accepted**.

Conclusion

In the present study an attempt is made to study the relationship between level of NPA and Capital adequacy of Banks. For this purpose, R-Square value, regression analysis and ANOVA is applied. It is found from the analysis that there is **strong relationship** between change in NPA to loans and advances ratio and capital adequacy. This proves that NPA affects the capital adequacy of banks. Also the results show that there is significant relationship between level of NPA's and capital adequacy.

Also an attempt is made to study the relationship between level of NPA and value of firm. For this purpose, R-Square value, regression analysis and ANOVA is applied. It is found from the analysis that there is **strong relationship** between change in NPA to loans and advances ratio and value of firm. This proves that NPA affects the value of firm. Also the results show that there is significant relationship between level of NPA's and value of firm.

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