

Impact of NPA Towards Profitability of Banks: A Study of Public and Private Banks

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ABSTRACT

NPA is a financial market bug. It certainly affects the bank's working capital and profit margins; it also poses a danger to financial performance and banks' self-preservation. It represents banks' results. NPA has a significant effect on the bank's efficiency, stability, and economic stability. Increased NPA means bank mismanagement, and reduced NPA reflects improved fund productivity and governance. NPA needs to be reduced and regulated to improve the performance and competitiveness of banks. Indian lenders are grappling with NPA-related problems, which have become a major issue for the Indian economy, and different steps still have to be taken to manage NPAs. The objective of this study is to perform an analysis to see the impact of NPA on the profitability of public and private sector banks. various ratio's has been taken into consideration to achieve the desired objectives.

Key Words: Non-performing assets, financial performance, ratio analysis, banking sector

BANKING SECTOR

Indian banking sector is the backbone of the nation and its people. It is a significant part of the tertiary sector and is considered a lifeline for economic progress. The banking system must not be agitated; it should also adhere to capitalize on opportunities presented by various variables, whether external or internal, and through technology. The banking system of rules turned assorted facilities to its clients, such as providing loans and credit, accepting deposits, safeguarding money and valuables, and offering payment services. Banks also offer insurance and investment products. Moreover, traditional functions had been discarded by banks, and now they are initiating innovations, changing and improving services and facilities to provide for and fulfill the emerging needs of customers. Moreover, banks are also given the freedom to frame their own policies. Electronic banking has also made many contributions to the growth of this system by availing data security benefits and avoiding risks. Although foreign banks are likely to succeed in the Indian banking system, public and private banks are also making tremendous progress.

NPA - Non-Performing Assets

Out of several indicators for financial stability, non- performing assets are considered to be a crucial element as asset quality, credit hazard, and the effectiveness in the allocation of resources to cultivable spheres are reflected. The most common problem for the banking sector is non- performing assets, as envisaged by PESTLE, i.e., political, economic, social, technological, legal, and environmental factors across the world, done by these researchers (Bhide, Prasad, & Ghosh, 2002). The performance of banks is indicated by NPA. High rate of credit defaults is suggested by a high level of NPA (Khanna, 2012).

'Out Of Order' Statutes

As per the RBI, a transaction must be viewed as ' out of order' if the amount owed appears to surpass the limit/ drawing capacity that has been approved. Where the outstanding balance in the key operating account is less than the agreed limit/ drawing strength, but there is no continuous credit for 90 days as of the balance sheet date, or allowances are not sufficient to cover the interest.

Overdue

The certain sum owed to the financial institution in any amount line is 'overdue' unless it is cashed by the bank's overdue date. NPA is also referred to as non-performing debts. It is reflected by a management company in the part where the borrower does not pay the installment or interest on time.

CAUSES OF NPA

- ✓ **Funds diversion:** Most bank funds are allocated to redundant enlargement and recreation.
- ✓ **Default:** The borrowers' voluntary default and the misappropriation of funds.
- ✓ **Fraudulent Practices:** Sometimes, banks allow credit to lenders who are not eligible to pay for those loans, give advances without any security or references, etc., which gives rise to fraudulent practices.
- ✓ **Internal Reasons:** There are some internal reasons which give rise to the NPA includes inappropriate technology & management information systems, improper SWOT analysis of the borrower, and inefficient management resulting in the miserable operation of the banks.
- ✓ **Extrinsic Reason:** It would include natural calamities, changes in government policies, and lack of demand; etc., as possible reasons for the rise of NPA.

REVIEW OF LITERATURE

Bloem (2001) suggested that the more or less predictable level of NPL varies from year to year and is caused by a number of poor economic decisions made by individuals and bad luck (bad weather, unexpected changes in the prices of products, etc.) This gives rise to NPAs as the holders of loans become unable to pay for that credit.

Namboodiri (2001) highlighted the difficulty of NPAs in Indian banks. He pointed out very basic but very crucial points which need to be kept in mind while offering any credit facility to the borrowers by the bankers. He suggested that any credit scheme must refer to 5Cs (Fictional character, Capability, Conditions, Capital & Confirmative), 6Ms (Money, Man, Machine, Market, Men & Material) and 7Ps (Product, Purpose, Program, Place, People, Profit & Policies). These eighteen points not only help in evaluating credit risk management but are also used to study the SWOT analysis of the project.

Chandra et al. (2010) Examined as a financial intermediary market; the financial industry poses a range of threats in the form of NPA deposits and unmanageable risks, such as foreign currency exchange threats and credit risk, etc. Public sector lenders utilized risk reduction practices such as period and difference assessment, where borrowing costs are managed to control their equity- liability disparity. While these practices are ideally suited for short periods, banks have to accept another risk mitigation practice for long-term plans.

Chaudhary et al. (2012) suggested a committee known as the Narasimham Committee for banking sector reforms, set up by the RBI, it studied the problems of the Indian banking sector and found NPA to be a major threat to this sector & also recommended various measures, such income recognition, asset classification & provisioning requirements, in order to solve the NPA problem.

Reddy (2004) identified the bank's lending policy as a crucial element for non-performing assets. Banks have suffered financial losses through liberalized lending regulations, procedures, and unsafe lending. He also emphasized various critical issues related to the credit delivery mechanism of the Indian banking sector, based on the credit policy, systems, and culture. He also examined the various issues giving rise to the terms of credit of Indian banks.

Saravanakumar (2009) focused on the problem of increasing NPA and the issue of managing them as well. NPAs have a direct impact on the banks' liquidity, profitability, and equity. Banks must limit their borrowing activities exclusively to appropriate leveraged securities for protected advances. In analyzing banks' financial performance, NPAs are an essential variable. Reducing NPAs is needed to enhance the bank's financial clout and meet capital adequacy standards.

Sharma (2005) found various monetary factors and other business features that influence the risk of default, which can assist in managing fresh NPAs if defined in advance. This study applied the DEA model to assess the efficiency of the Public Banks & concluded that the NPA level has a negative relationship with the efficiency estimates. The results also showed that careful monitoring, working out & selling off loans to clients must be increased or improved to control the problem of NPAs. It ultimately affects the profitability of banks & leads to a loss of liquidity.

Vadivalagan et al. (2013) conducted a study on NPAs and found that this is the emerging trend prevailing in the Indian banking industry. It is an essential element that helps to judge the performance and financial health of the banks. Some bankers feel that their responsibility ends when loans are distributed, but the problem arises here only. It has highlighted the importance of the NPAs and their impact on the liquidity of Indian banks. It has also pointed out some measures to solve the problem of NPAs like Lok Adalat, Compromise Settlement, the Securitization Act 2002 and Debt Recovery Tribunals (DRTs).

Waweru (2009) conducted a study to identify the probable causes of nonperforming loans in Kenya and found that the national economic downturn, the failure of customers to reveal critical information during the loan application process, and the lack of an aggressive debt collection policy were the major contributors to the NPA.

RESEARCH METHODOLOGY

Need Of The Study

After going through the literature review, it was found that a lot of research has been done on the NPA, but still, there is no proof that can state that the performance of the banks is not controlled properly due to the NPA. As per the CRISIL rating agency, the gross NPA levels in the Indian banking system have come to 3 percent in March 2012 as compared to previous years. The banks are facing this problem significantly. As of now, no hardcore solution has been found with regard to the NPA, and the banks' liquidity and profitability are dwindling year by year. The main concern in studying this project is to understand the impact of NPA on the profitability of Indian banks.

Objectives Of The Study

1. To understand the consequences of the NPA on the profitability of Indian banks.
2. To compare the performance of public and private sector banks with regard to the NPA. **DATA SAMPLE**

The research is based on secondary data. Information is collected from secondary sources. As the study is financial in nature, it requires dependency on previous data to carry out the project.

Sources Of Secondary Data

Annual reports of RBI, annual reports of public & private banks, Research Journals & Articles, websites. To study this project, ten banks from the private sector and ten from the public sector have been selected. The public banks include State Bank of India (SBI), Punjab National Bank (PNB), Indian Overseas Bank (IOB), Oriental Bank of Commerce (OBC), Canara Bank, Bank of Baroda, Syndicate Bank, Punjab & Sind Bank, Union Bank of India (UBI) & Andhra Bank.

The private banks include Axis Bank, Yes Bank, ING Vysya Bank, Housing Development Financing Corporation (HDFC) & Industrial Credit and Investment Corporation of India (ICICI), Federal Bank, Dhanlaxmi Bank, Indusind Bank, KMB & Karur Vysya Bank. The data have been gathered from the RBI site, Money Control, and the annual reports of the public & private banks, which are the most authentic sources for providing financial information. The sample period has been taken for the study for the time period of four years, i.e. (2021-2025).

Sampling Technique

A convenience sampling technique has been used to select the banks for the sample study.

Statistical Tools Used

The tools applied to study the profitability of these banks include Ratio Analysis – to study the trend of the Gross & Net NPA of the 20 banks selected. Ratio Analysis – to know the financial condition of these banks related to NPA and its effect on their profitability. The ratios include: Operating Profit Ratio, Net Profit Ratio and Return on Capital Employed.

Impact Of Npa On The Profitability Of Public & Private Banks In India

Various ratios are there which can be used to analyze the liquidity, profitability and solvency position of the corporate sector. The study is focussing on validating the effect of NPAs on profitability of banks. The data for selected years with defined ratios are mentioned below and analysis is done by keeping financial aspects in view.

ANALYSIS

Table 1: Operating Ratio of Public Banks (%)

Public Banks	2021	2022	2023	2024	2025
State Bank of India	13.23	19.64	27.68	28.86	31.00
Indian Overseas Bank	7.25	15.24	16.97	17.14	20.18
Canara Bank	6.49	13.24	21.12	26.20	28.60
Punjab National Bank	4.67	8.42	5.37	15.42	28.14
Oriental Bank of Commerce	-8.13	-8.02	-20.95	-49.73	-14.63
Union Bank of India	8.06	12.97	17.79	25.92	31.54
Bank of Baroda	2.01	16.48	27.46	30.04	31.42
Syndicate Bank	-2.71	-17.89	-13.46	-27.68	-22.14
Punjab and Sindh Bank	-86.35	28.77	33.55	14.65	18.98
Andhra Bank	-5.26	-5.81	-11.83	-32.18	-25.51

The above table helps us understand that the SBI, Indian Overseas Bank, Canara Bank, Union Bank of India, Bank of Baroda are showing regular growth in their operating ratio, which clearly shows that these banks consistently work on their operations to stay out of the crowd. The other public banks, as PNB, OBC, Syndicate Bank, Andhra Bank, Punjab and Sind Bank, are not showing good results in their operations. The banks need to work on their operations to grow and get better customer counts.

Table 2: Net Profit Ratio of Public Banks (%)

Public Banks	2021	2022	2023	2024	2025
State Bank of India	7.69	11.49	15.12	14.71	15.33
Indian Overseas Bank	4.90	10.21	10.81	11.04	11.85
Canara Bank	3.69	8.18	12.56	13.39	14.21
Punjab National Bank	2.50	4.61	2.94	7.71	13.65
Oriental Bank of Commerce	2.49	0.77	-5.93	-33.74	0.30
Union Bank of India	4.22	7.70	10.44	13.67	16.69
Bank of Baroda	1.17	10.40	15.74	15.79	16.12
Syndicate Bank	7.04	-7.08	1.56	-14.79	-11.91
Punjab and Sindh Bank	-39.18	14.64	16.42	6.14	8.84
Andhra Bank	3.90	3.06	0.96	-18.98	-14.71

The mentioned data shows gradual growth in net profit for SBI, Indian Overseas Bank, Canara Bank, PNB, Union Bank of India, Bank of Baroda,, which clearly shows that banks are able to generate profits at the end of each financial year. The other banks, as OBC, Syndicate Bank, Andhra Bank, are not able to generate positive profits. These banks need to improve their operations to generate positive cash profits.

Table 3: ROCE of Public Banks (%)

Public Banks	2021	2022	2023	2024	2025
State Bank of India	1.64	1.42	1.59	1.47	1.73
Indian Overseas Bank	2.25	1.99	1.93	1.96	2.24
Canara Bank	1.78	1.92	2.11	2.01	1.90
Punjab National Bank	1.85	1.61	1.57	1.63	1.50
Oriental Bank of Commerce	1.88	1.58	1.68	1.61	1.41
Union Bank of India	1.85	1.89	2.05	2.09	2.14
Bank of Baroda	1.85	1.81	1.91	2.01	1.87

Syndicate Bank	1.35	1.10	1.44	1.21	0.93
Punjab and Sindh Bank	0.71	1.12	1.08	0.78	1.31
Andhra Bank	1.82	2.03	2.03	2.26	2.06

The data shows that all public banks had positive return on capital employed and these are not getting affected by NPAs. So the non performing assets do not have any direct impact on ROCE.

Table 4: Operating Ratio of Private Banks (%)

Private Banks	2021	2022	2023	2024	2025
HDFC Bank	34.54	36.40	37.36	38.54	40.01
Axis Bank	14.94	26.93	16.11	34.36	33.13
ICICI Bank	27.93	35.37	38.91	42.03	43.06
Yes Bank	-32.14	10.92	6.05	9.47	16.25
Federal Bank	21.26	23.47	31.48	32.71	30.53
Dhanlaxmi Bank	7.89	6.75	8.97	9.46	10.21
IndusInd Bank	14.12	20.58	28.68	29.82	29.89
Kotak Mahindra Bank	33.48	36.99	38.20	38.00	37.98
Karur Vysya Bank	10.52	19.32	24.53	29.34	31.88

The operating profit for all the private banks is gradually increasing in all number of years. It shows that NPAs do not have any direct relation with operating profit so on.

Table 5: Net Profit Ratio of Private Banks (%)

Private Banks	2021	2022	2023	2024	2025
HDFC Bank	25.74	28.93	27.29	23.53	22.41
Axis Bank	10.35	19.33	11.24	22.73	21.49
ICICI Bank	20.46	27.02	29.20	28.61	28.92
Yes Bank	-17.27	5.60	3.16	4.53	7.78
Federal Bank	11.55	13.83	17.91	16.76	15.36
Dhanlaxmi Bank	3.99	3.91	4.60	4.79	5.04
IndusInd Bank	25.94	31.70	31.93	30.09	31.08
Kotak Mahindra Bank	6.56	12.04	16.97	19.56	20.06
Karur Vysya Bank	9.78	14.96	20.31	19.56	5.43

The above table shows the growth in net profit for private banks. It clearly shows that most of banks except Karur Vysya Bank have rise in net profit in all number of years for 2021,2022, 2023, 2024 and 2025. It depicts that NPAs do not have effect on the growth of banks.

Table 6: ROCE of Public Banks (%)

Private Banks	2021	2022	2023	2024	2025
HDFC Bank	3.42	3.22	2.97	2.71	2.66
Axis Bank	2.70	2.20	1.57	2.62	2.73
ICICI Bank	3.10	2.92	3.27	3.27	3.32
Yes Bank	1.91	0.96	0.94	0.87	1.05
Federal Bank	1.91	1.74	1.88	1.72	1.79
Dhanlaxmi Bank	0.82	0.99	0.83	0.44	0.54
Indusind Bank	3.34	3.30	3.26	3.17	2.01

Kotak Mahindra Bank	3.32	2.93	3.15	3.41	3.68
Karur Vysya Bank	1.96	2.10	2.85	2.78	2.78

The above data reveals that NPA do not have effect on ROCE but we can say it is gradually increasing but not rapidly. It means that ROCE should be increased with good pace and can be higher up with more control of uncertain factors.

Overall Analysis

The private banks operating profit ratio, net profit ratio and ROCE are showing better growth rate than public banks. It can be demonstrated that NPAs do have effect on public banks profitability than the private banks gets effect. The public banks should have to analyze the adequate reasons for the slow growth than the private banks. The factors should be determined by which the NPAs can be controlled and the banks profitability can be increased.

Limitations Of The Study

1. The study is limited to the Banks that have been ranked as the top 20 Banks by the Indian Banks Association (IBA) & Money control.
2. The period of the study is limited to the period.
3. The banks located only in India have been considered for the study.
4. The data on the ratios of the Public & Private Banks shows the percentage as per BASEL –II norms.

RECOMMENDATIONS

The NPA Recovery Management Team should also be held responsible for the loss of performing assets. One of the basic causes of NPA is the inefficiency of the management team in recollecting debts, which affects the banks profitability. The members of the banks should discuss such issues & how to reduce them, because it cannot be eliminated at one go but can only be reduced by taking some strict measures and procedures. The bankers must also respond in an ethical and moral way in doing the job. The banks should also update their technology whenever required so that inefficient or outdated technology does not cause the rise in NPA. The Higher Authorities like Reserve Bank of India (RBI) should initiate actions such as commercializing the defamations of the defaulters’ list in the public press, media, etc., which helps other banks & financial institutions to keep a check on such steps before providing any loan to clients. The banks can also adopt alternative measures like Compromise Settlement Scheme, Lok Adalat, Debt Recovery Tribunals (DRTs), securitization, and other ways to recover their dues. The governments should also make the recovery of loans as fast & effective because it is very slow in reality.

CONCLUSION

Nonperforming Assets not only affect current earnings but also upcoming profits, which may lead to the failure of some long-term beneficial opportunities. With the NPAs, money for the bank is getting blocked as clients are unable to repay their loans, resulting in a decrease in profit. This leads to borrowing enough cash for a short period of time, which then again increases the cost of the bank. The banks are facing the problem of losing their goodwill & brand image, which creates a negative impact on customers’ minds of the customers to put their money into that bank. Often, genuine borrowers face difficulties in banks in obtaining funds due to the rise in NPAs. Non-performing resources have a detrimental impact on profitability, adequacy rate achievement, allocation of capital, and the financial system and national economy. Bankers can avoid loan sanctioning to willful defaulters by adopting certain measures. It is very essential to evaluate the formal and informal goodwill of the borrower so that he/she becomes aware about the credit-worthiness of the client’s and the loan extension can be stopped there itself. Therefore, concerned efforts are required at the RBI, Ministry of Finance, and bank levels to control the threat of the NPA.

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