"An Empirical study on Financial Performance of Commercial Banks with reference to NPA in Bangalore Region"

V.GIRIDHAR, DR.SENTHILKUMAR

ASST PROFESSOR, PROFESSOR

BET COLLEGE OF MANAGEMENT,BANASWADI BANGALORE, PRESIDENCY UNIVERSITY

Abstract:

The origin of modern commercial bank in India can be traced to the 18th century. It all began with the establishment of Bank of Hindustan in 1770 in Calcutta under European management. It was liquidated in 1830-32. The Indian banking industry is comprised of commercial banks, regional rural banks, co-operative banks, small finance banks and payment banks. India's commercial banks were nationalized in two phases – 14 in 1969 and six in 1980. Upon completion of nationalization, close to 90 percent of the banking sector in terms of credit had been cornered by government owned banks. This study mainly determines the advances and total assets of commercial banks. Also it analyse and examines the movement of non-performing assets of public and private sector scheduled commercial banks. It is found that gross NPAs and net NPAs have grown almost at the same pace till 2008. Thereafter the growth of net NPAs has outpaced the growth of gross NPAs and the public sector commercial banks, have the difference between the two CAGRs which was much higher in their growth perspective.

Keywords: Commercial Bank, Nationalization, Non-Performing Assets

1.0 Introduction:

1.1. Theoretical background of the Study:

The origin of modern commercial banking in India can be traced to the 18th century. It all began with the establishment of Bank of Hindustan in 1770 in Calcutta under European management. It was liquidated in 1830-32. The growth of the Indian banking industry since the establishment of Bank of Hindustan in 1770 can be reviewed over three phases:

In the first phase, the Indian banking industry's growth until the first exercise of nationalization of banks in 1969 is examined. In the second phase, the banking industry' growth from the nationalization phase until the liberalization of the Indian economy and the initiation of banking reforms in 1991 is examined. In the third phase, the post-1991 phase of banking growth is examined.

In 1839, an attempt was made by some Indian merchants to establish a bank called Union Bank. It collapsed within a decade. Then came Allahabad Bank in 1865 and it is operating till date. It is one of the nationalized banks of the country. It is the oldest public sector bank in the country with branches all over the country. It has been in business for the last 145 years. It is also one of India's oldest joint stock banks. However, the credit for being the oldest joint stock bank of India should have gone to Bank of Upper India which was established in 1863. But the bank collapsed in 1913.

1.2 The Indian banking scenario

The Indian banking industry is comprised of commercial banks, regional rural banks, co-operative banks, small finance banks and payment banks.

1.3 Commercial banks

Commercial banks could be scheduled banks or non-scheduled banks. All the commercial banks are regulated by the Banking Regulation Act, 1949. Commercial banks are "for profit" entities.

Scheduled commercial banks (SCBs) figure in the second schedule of the Reserve Bank of India Act, 1934. To qualify as a scheduled bank, the paid up capital and collected funds of the bank must not be less than INR five lakhs. Scheduled banks are eligible for loans from the Reserve Bank of India at bank rate and admitted to the membership of clearing houses. It may be noted that co-operative banks too figure in the said schedule. Scheduled co-operative banks embrace Scheduled State Co-operative Banks and Scheduled Urban Cooperative Banks.

However, from the perspective of the RBI, the scheduled commercial banks in India are categorised into six different groups according to their ownership and / or nature of operation.
In the bank group-wise classification, IDBI Bank Ltd. is also viewed as a nationalised bank.

Non-scheduled commercial banks do not figure in the second schedule of the RBI Act, 1934. Banks with a reserve capital below INR five lakhs qualify as non-scheduled banks. They cannot borrow from the RBI for normal banking purposes, except, in an emergency or in "abnormal circumstances." Jammu & Kashmir Bank is an example of a non-scheduled commercial bank.

1.**4 Co-operative banks**

Co-operative banks operate in urban and non-urban areas. All banks registered under the Cooperative Societies Act, 1912 are called co-operative banks. These are banks run by an elected managing committee. They confer certain rights on their members. They are subject to a slew of "communally developed and approved bylaws and amendments."

In the urban centres, they mainly finance entrepreneurs, small businesses, industries, self-employment ventures and cater to home buying and educational needs. Likewise, co-operative banks in the rural areas primarily cater to agricultural-based activities, which include farming activities, dairy activities and hatchery ventures. They also extend loans to small scale units, cottage industries, and self-employment activities like artisanship.

Unlike commercial banks, which are profit-driven, co-operative banks operate on a "no profit, no loss" basis. These are regulated by the Reserve Bank of India under the Banking Regulation Act, 1949 and Banking Laws (Application to Co-operative Societies) Act, 1965.

1.5 Regional rural banks

Regional Rural Banks or RRBs, simply put serve the rural areas and agricultural sectors with basic banking and adequate financial services. They were set up in 1975, based on the recommendations of a committee. Based in Moradabad, Prathama Bank, established on 2 October 1975, is the first RRB to open in India. It was sponsored by Syndicate Bank. The RRBs are owned by the central government (50 percent), the state government (15 percent) and the sponsor bank (35 percent). Several commercial banks have sponsored RRBs. Prominent examples include the Maharashtra Gramin Bank (sponsored by the Bank of Maharashtra) and the Himachal Gramin Bank (sponsored by Punjab National Bank). RRBs were set up to eliminate informal financiers like money lenders and to supplement the efforts of co-operative banks.

2.0 Nationalisation of commercial banks

India's commercial banks were nationalized in two phases – 14 in 1969 and six in 1980. Upon completion of nationalization, close to 90 percent of the banking sector in terms of credit had been cornered by government owned banks. A few foreign banks and some small private banks accounted for the rest of the credit. During the period 1980–92, the PSU banks had been completely government owned. The first bank to go public was the State Bank of India – it went public in 1992-93.

Post liberalization in 1991, the government appointed various committees to review the functioning of the Indian banking sector and recommend policy changes to make the banks healthier, competitive and efficient. Two expert committees were set up under the chairmanship of Mr. M. Narasimham in 1991 and 1998. The recommendations made by these committees (popularly known as Narasimham Committee I and II) furnished a roadmap for banking sector reforms. The committees recommended several micro prudential measures. They included adoption of risk based capital standards, and uniform accounting practices for income recognition and provisioning against bad and doubtful debts. The objective was to benchmark against international best practices as contemplated in the Basle I norms defined by the Basle Committee on Banking Supervision (BCBS). Following the recommendations of the Narasimham committee I, Indian banks were subjected to a capital to risk-weighted assets mechanism. Accordingly, the banks had to achieve a CRAR or capital to risk-weighted assets ratio of eight percent by 1996. The CRAR measures the ratio of a bank's paid-up capital to its advances and other assets. The Narasimham Committee II also made several recommendations on asset classification. It raised banks' CRAR to 10 percent by 2002 and recommended constitution of Asset Reconstruction Companies (ARCs) that would take over the stressed assets of banks. The RBI has since progressively introduced prudential norms for income recognition, asset classification, and provisioning for the advances portfolio of banks. The Narasimham Committee I also recommended issuance of new licenses to private sector entities to set up banks. Consequently, RBI issued licenses for setting up new owned banks in the private sector. While most of these new private sector banks started functioning in the mid-1990s, their share of the banking business remained modest until 2000. Other banking sector reforms based on the committee's recommendations included interest rate deregulation, allowing PSU banks to raise capital up to 49 percent of their equity from the capital market and gradual reduction of the Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR). The move was meant to improve the banks' profitability. The banking sector has grown remarkably since then. During the period 1969 to 2015, the number of commercial banks went up from 89 to 152. Dependence on bank finance has also increased over the years. The following Table reveals where the operational status of the Indian banking sector as of FY 2016-17.

Table-1.1

Operational status of Indian banking sector as of FY 2016-17 (in INR billion)

Year	Items	Amount Outstanding	Percentage Variation
2016-17	**1 Balance Sheet Operations**		
	1.1 Total Liabilities/assets	141586	7.8
	1.2 Deposits	111139	10.1
	1.3 Borrowings	12807	-11.6
	1.4 Loans and advances	81162	2.8
	1.5 Investments	36522	9.7
	1.6 Off-balance sheet exposure (as percentage of on-balance sheet liabilities)	107	-
	1.7 Total consolidated international claims	7168	48.8
	2 Profitability		
	2.1 Net profit	439	28.6
	2.2 Return on Asset (RoA) (Per cent)	0.4	-
	2.3 Return on Equity (RoE) (Per cent)	4.2	-
	2.4 Net Interest Margin (NIM) (Per cent)	2.5	-
	3 Capital Adequacy		
	3.1 Capital to risk weighted assets ratio (CRAR) @	13.6	-
	3.2 Tier I capital (as percentage of total capital) @	82.1	-
	3.3 CRAR (tier I) (Per cent) @	11.2	-
	4 Asset Quality		
	4.1 Gross NPAs	7918	29.4
	4.2 Net NPAs	4331	23.8
	4.3 Gross NPA ratio (Gross NPAs as percentage of gross advances)	9.3	-
	4.4 Net NPA ratio (Net NPAs as percentage of net advances)	5.3	-
	4.5 Provision Coverage Ratio (Per cent)**	43.5	-
	4.6 Slippage ratio (Per cent)	5.7	-

	5 Sectoral Deployment of Bank Credit #		
	5.1 Gross bank credit	71347	7.3
	5.2 Agriculture	9924	12.4
	5.3 Industry	26800	-1.9
	5.4 Services	18022	16.9
	5.5 Personal loans	16200	16.4
	6 Technological Development		
	6.1 Total number of credit cards (in million)	30	21.8
	6.2 Total number of debit cards (in million)	772	16.6
	6.3 Number of ATMs	208354	4.9
	7 Financial Inclusion		
	7.1 Credit-deposit ratio (Per cent)	73	-
	7.2 Number of new bank branches opened	4830	-30.9
	7.3 Number of banking outlets in villages (Total)	598093	2.0

(Source: Database on Indian economy, RBI)

3.0 Statement of the Problem

NPAs have been threatening to emerge as the worst scourge, the country's banking industry has faced till date. Had it been nipped in the bud, the banking industry of the country would not be in such a plight. However, it was not nipped in the bud for various reasons. Additionally, vested interests exploited the industry and its participants for selfish reasons. However, it is better late than never. The government of India as well as the regulator, the Reserve Bank of India, should immediately initiate measures to arrest the further rise of NPAs. The study had focussed more on movement of non-performing assets of public and private sector scheduled commercial banks

4.0 Objectives of the study

The objectives of the study are to:

1. To determine the advances and total assets of commercial banks.

2. To analyze the movement of non-performing assets of public sector scheduled commercial banks

3. To examine the movement of non-performing assets of private sector scheduled commercial banks

5.0 Research Design

5.1 Methodology

This is a descriptive type of research where investigation bas been done based on pure secondary data of public and private sector banks

5.2 Sources of data

The data required for the present study have been collected from sources. Secondary data was collected from reputed financial journals, banking websites and RBI bulletin.

5.3 Results and Discussion:

5.3.1 Advances and total assets of all commercial banks during the period 2005-17

The advances extended by all commercial banks and the total assets carried by them on their books for the period 2005-17 should be indicative of the growth the said banks have clocked in the two areas. The following Table reveals the relevant statistics.

Table-1.2

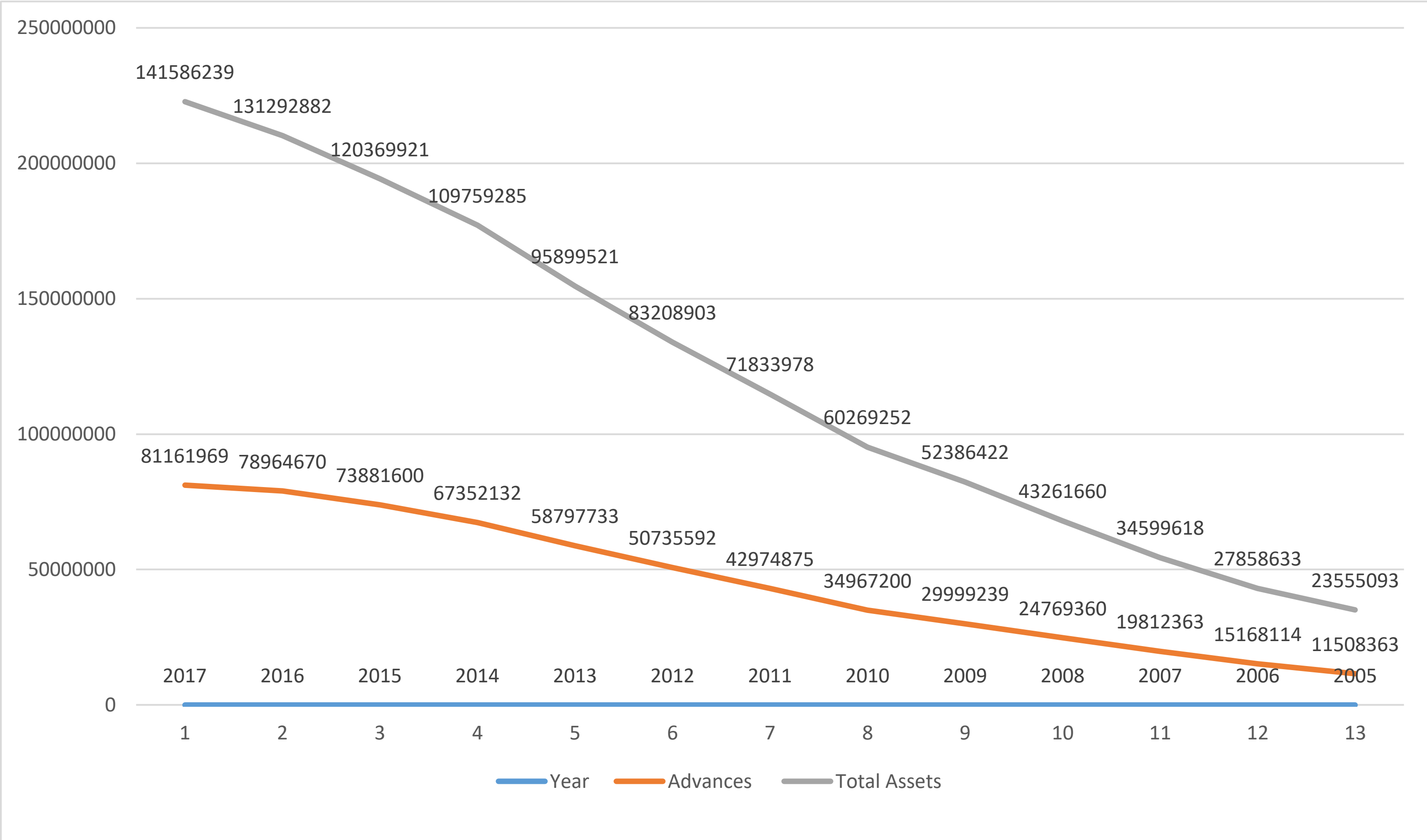
Advances and total assets of all commercial banks during the period 2005-17 (in INR Million)

Year	Advances	Total assets
2017	81161969	141586239
2016	78964670	131292882
2015	73881600	120369921
2014	67352132	109759285
2013	58797733	95899521
2012	50735592	83208903
2011	42974875	71833978
2010	34967200	60269252
2009	29999239	52386422
2008	24769360	43261660
2007	19812363	34599618
2006	15168114	27858633
2005	11508363	23555093
CAGR (%)	17.6779	16.121156

(Source: Database on Indian economy, RBI)

Figure-1.1

Advances and total assets of all commercial banks during the period 2005-17 (in INR Million)



(Source: Database on Indian economy, RBI)

It is clear from the Table and the Figure that the advances have grown at a slightly higher CAGR of 17.68 percent approximately compared to the CAGR of 16.12 percent registered by total assets. The two have almost moved in tandem and aggressively too in spite of the global financial meltdown they had to contend with during the early part of the period under review. Thus, the performance on the two fronts is noteworthy.

5.3.2 Non-performing assets (NPAs)

Banks' job does not end with lending. They have to recover the money they lent along with the interest due on the money lent. They should recycle the recovered money by relending it at a lucrative interest rate. The interest recovered by the banks on the loans they lent goes to service the depositors since it is the depositors' money the bank has lent in the first place. Interest on the depositor's money is paid from the interest the bank recovers from their borrowers on the money they lent. The principal banks recover from the borrowers goes to return the deposit they raised from the depositors. Obviously, when the banks fail to recover the loans and the interest thereon, they have to repay the principal and / or return the deposit to the depositors from their own kitty. Hence, while the banks may be happy with their ability to identify the borrowers and lend to them, they must also ensure that they are in a position to recover the money they lent along with the interest due thereon. Hence, the responsibility of the banks do not end with mere lending. In fact, it is at the lending stage that the banks are saddled with the responsibility of recovering the loan along with the interest due thereon.

When the loans are not recovered promptly, troubles mount for the bank. They have to make additional efforts to recover the loan and the interest due thereon. In some cases, the banks may not be able to recover the loans at all with the result that they have to write off such loans. Inevitably, the bottom lines of the banks take a hit in such cases. Hence, as explained in paragraph 1.1.2 above, banks are required to put in place certain systems and procedures to ensure that their bottom lines are minimally hit.

Substandard assets

Assets which have remained non-performing for a period of up to and inclusive of 12 months are substandard assets.

Doubtful assets

Assets turn doubtful when they remain in the substandard category for a period of 12 months.

Loss assets

Loss assets are uncollectible and are of little value – so little that their continuance as a bankable asset in the books of the bank concerned is not warranted, even if they carry some salvage or recovery value.

5.4 Movement of non-performing assets (NPAs) of public sector scheduled commercial banks

As explained in a previous paragraph, the country's banking industry has been witness to two major NPA episodes in the post liberalization era. Hence it is relevant to examine the movement of non-performing assets

(NPAs**)** of scheduled commercial banks around the period the second crisis erupted and eventually settled down. In the following Tables and Figures, the movement of non-performing assets **(**NPAs**)** of scheduled commercial banks is captured, category-wise. The categories defined for the purpose are scheduled commercial banks from the public sector, scheduled commercial banks from the private sector and the SBI group, with its associates. It may be noted here that on April 1, 2017 all the associate banks of SBI were merged with the SBI.

Table-1.3

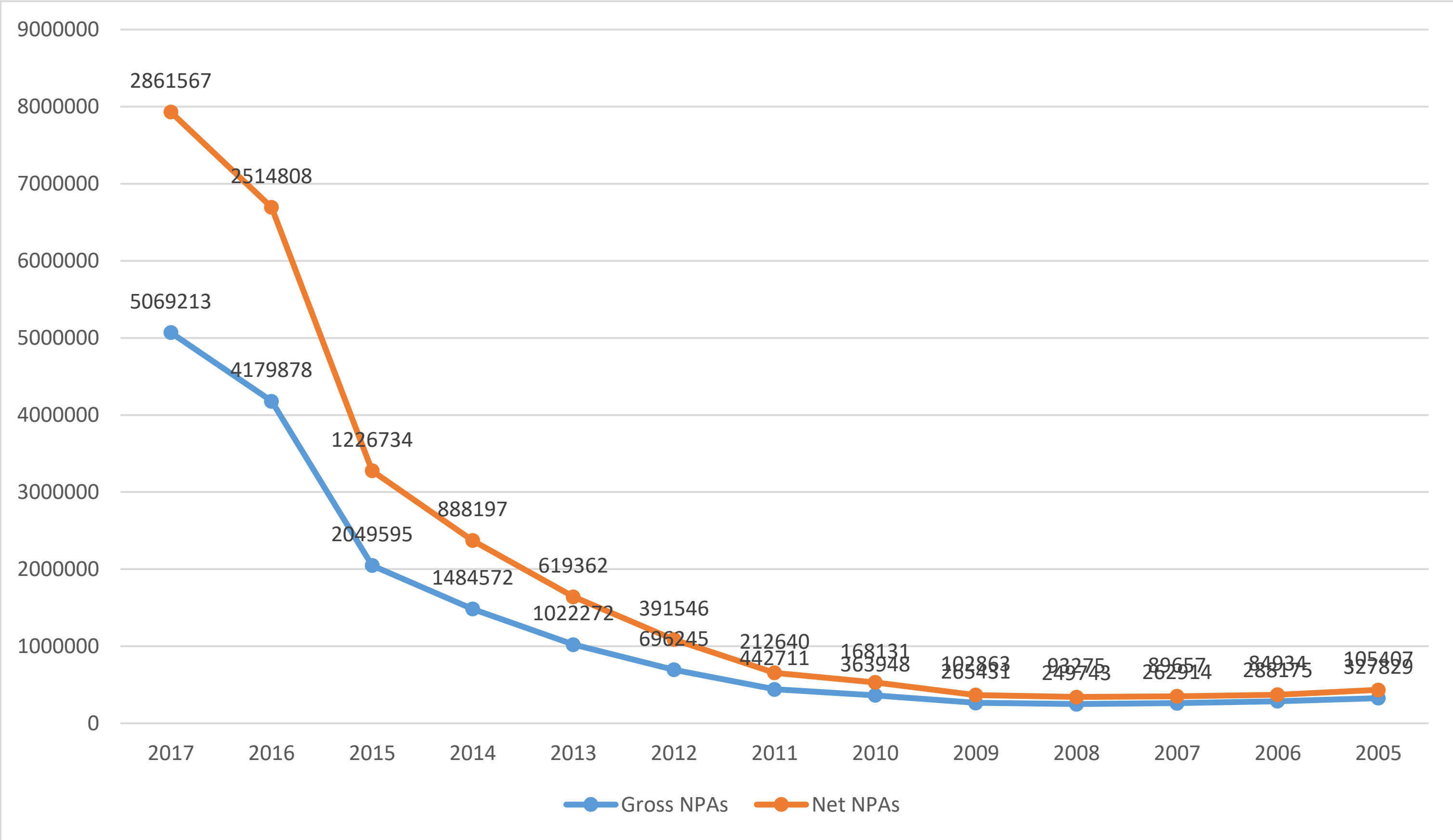
Movement of non-performing assets (NPAs) of public sector scheduled commercial banks (in INR Million)

As of Mar 31	Gross NPAs	Net NPAs
2017	5069213	2861567
2016	4179878	2514808
2015	2049595	1226734
2014	1484572	888197
2013	1022272	619362
2012	696245	391546
2011	442711	212640
2010	363948	168131
2009	265431	102863
2008	249743	93275
2007	262914	89657
2006	288175	84934
2005	327829	105407
CAGR (%)	25.63416753	31.66729

(Source: Database on Indian economy, RBI)

Figure-1.2

Movement of non-performing assets (NPAs) of public sector scheduled commercial banks (in INR Million)



(Source: Database on Indian economy, RBI)

Until 2008 at least, gross NPAs and net NPAs have grown almost at the same pace. Thereafter the growth of net NPAs has outpaced the growth of gross NPAs. Post 2011, the gap between the two 'worms' has widened suggesting that net NPAs have grown even faster in the post 2011 phase.

5.5 Movement of non-performing assets (NPAs) of private sector scheduled commercial banks

In the following Tables and Figures, the movement of non-performing assets (NPAs) of private sector scheduled commercial banks is captured.

Table-1.4

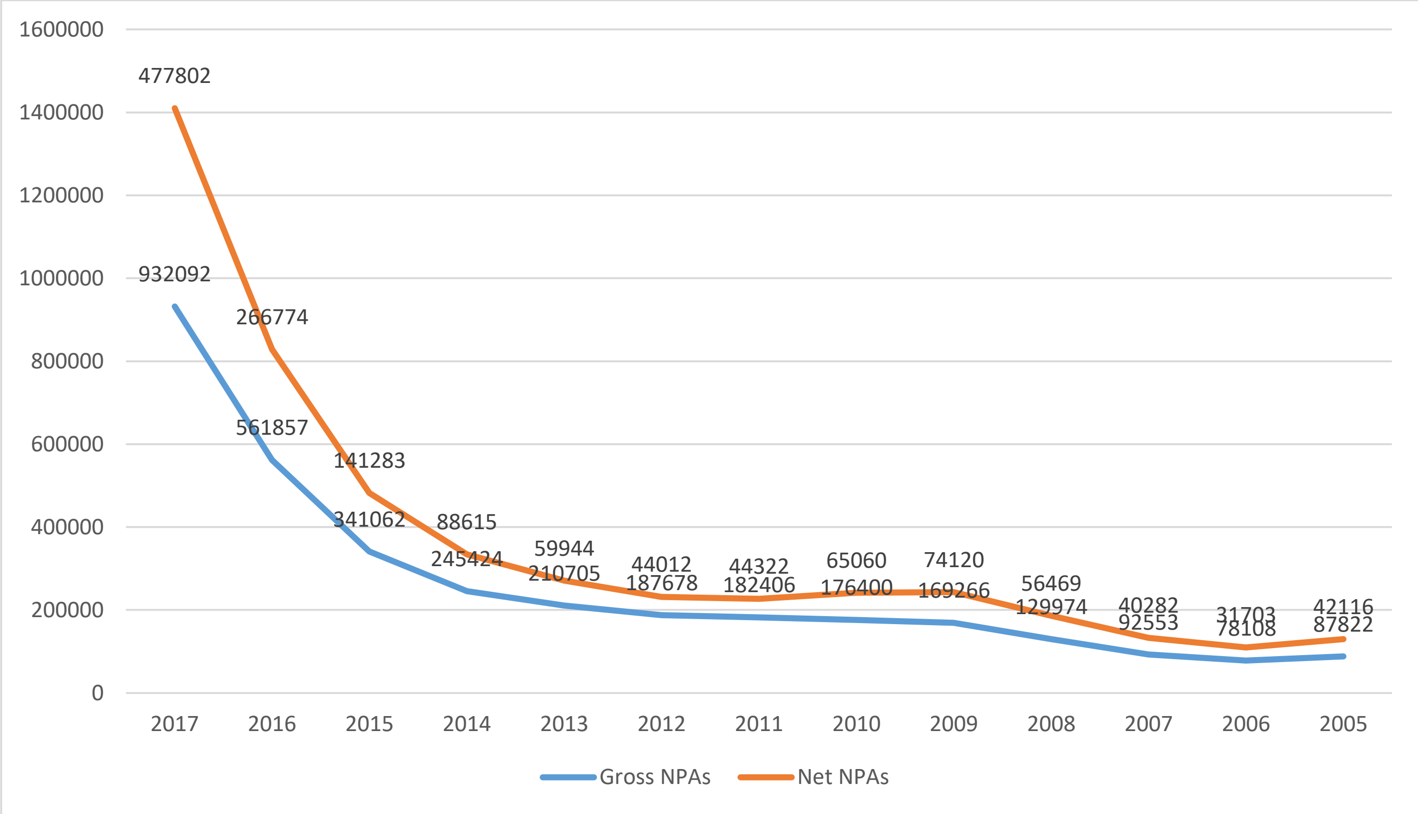
Movement of non-performing assets (NPAs) of private sector scheduled commercial banks (in INR Million)

As of Mar 31	Gross NPAs	Net NPAs
2017	932092	477802
2016	561857	266774
2015	341062	141283
2014	245424	88615
2013	210705	59944
2012	187678	44012
2011	182406	44322
2010	176400	65060
2009	169266	74120
2008	129974	56469
2007	92553	40282
2006	78108	31703
2005	87822	42116
CAGR (%)	21.75536416	22.43356

(Source: Database on Indian economy, RBI)

Figure-1.3

Movement of non-performing assets (NPAs) of private sector scheduled commercial banks (in INR Million)



(Source: Database on Indian economy, RBI)

It is clear from the Table and Figure that gross NPAs and net NPAs have grown at the same rate more or less. The CAGRs are 21.75536416 percent and 22.43356 percent respectively. In the case of public sector commercial banks, it may be recalled, the difference between the two CAGRs was much higher, at six percent! Here the difference is hardly one percent!

6.0 Conclusion:

India must prepare to tackle the issue of NPAs by monitoring asset quality review (AQR) with down-to-earth appraisal and effective implementation of possible new solutions (Sanjay, 2017). The researcher welcomes the RBI's 'bold move' to clean up the banks' balance-sheets by resorting to AQR. However, with the country's stressed assets accounting for 12.3 percent of the total outstanding loans which is the highest among major emerging markets, decisive solutions to resurrect the banking sector are needed, asserts the researcher. The surge in NPAs has taken a heavy toll on credit growth, which has already hit rock bottom. With NPAs rising steeply, banks (particularly the public sector banks) have a tough time retaining their capital base. They have pruned their lending operations for the purpose. The rise of NPAs and a continuous fall in non-food bank credit over the past few years portends trouble. Several researches established a strong correlation between growth and bank credit for the effective measures of NPAs among private and public sector commercial banks.

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