

## NON - PERFORMING ASSETS AND ITS IMPACT ON FINANCIAL PERFORMANCE: A CASE STUDY OF STATE BANK OF INDIA

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Dr. Bhriagu Nath Ojha\*  
Dr. Md. Moazzam Nazri\*\*

### ABSTRACT

*Management of Non-Performing Assets (MNPs) is one of the biggest challenges facing the Banking sector today. Increasing NPAs adversely impacts the bottom line of banks. Banks cannot book income on such assets and they have to make provisions as per IRAC norms of RBI. The sound financial position of a bank depends upon the recovery of loans or its level of Non-performing assets (NPAs). To improve the efficiency and profitability of banks the NPA need to be reduced and controlled. Reduced NPAs generally gives the impression that banks have strengthened their credit appraisal processes over the years and growth in NPAs involves the necessity of provisions, which bring down the overall profitability of banks. This paper basically deals with the trends of NPAs and its impact on profitability in SBI and also provides some suggestions how to overcome this burden of NPAs on SBI.*

**KEYWORDS:** *Non-performing Assets (NPAs), SBI, Net Profit, Net Worth, ROA, Profitability.*

### Introduction

Indian economy and has had a pivotal role to play in the development process. With the ever increasing need of involvement of banks in the economics of involvement of banks in the economic growth process, in the recent times the issue of Non-performing Assets (NPAs) has assumed mammoth proportions. The recent developments in the form of more stringent Reserve Bank of India(RBI) guide lines and a greater push to declare stressed assets as NPAs has resulted in a drop in profits for all the banks across the spectrum as they have to create provision for bad loans. Rising NPAs levels and fresh slippages across sectors reduced market confidence due to the slowdown in the global economy; the negative spill overs from global financial State Bank of India always has a special place in the banking sector of India being a government bank. The Bank's advances portfolio witnessed a robust growth over the years. To improve the efficiency and profitability of banks the NPAs need to be reduced and controlled. In this paper, an effort has been made to evaluate the Non-performing Assets of the SBI. In the present paper a study is conducted to check the NPAs of State Bank of India during the year 2010-11 to 2017-18.

### Objectives of the Study

- To study the trends of NPAs of SBI from 2010-11 to 2017-18
- To investigate the impact of NPAs on profitability of the SBI
- To offer suggestions based on findings of the study in SBI

### Research Methodology

Research design used to carry out this study is descriptive research because it deals with statistical data and the main aim of the report is to describe the factors affecting the problem mentioned. The present study is an analytical study. For the purpose of this project non probability convenience method of sampling is used. The SBI for the purpose of study is chosen as per convenience only. The study is done on the basis of data for the period of 8 years 2010-11 to 2017-18 and secondary data is collected mainly from the sources available at internet like the RBI website, websites of the banks, Annual Reports of SBI, Report on Trend and Progress of Banking in India etc.

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\* Dean, Faculty of Commerce, Kolhan University Chaibasa, West Singhbhum, Jharkhand, India.

\*\* Assistant Professor, Faculty of Commerce, Karim City College, Jamshedpur, Jharkhand, India.

### Limitations of the Study

- A deep analysis is made non-performing assets only. The performing assets do not pose any problems to credit management.
- This study is only restricted to State Bank of India.
- The result of the study may not be applicable to any other banks.
- Since the part of the study is based on their perceptions, the findings may change over the years in keeping with changes in environmental factor.
- The present study does not ascertain the views from the borrowers who are not directly concerned with management of non-performing assets.

### Trends of Non -Performing Assets

#### Performance of SBI in Gross NPAs and Net NPAs

The performance of SBI in Gross NPAs and Net NPAs has been depicted in the Table 1.

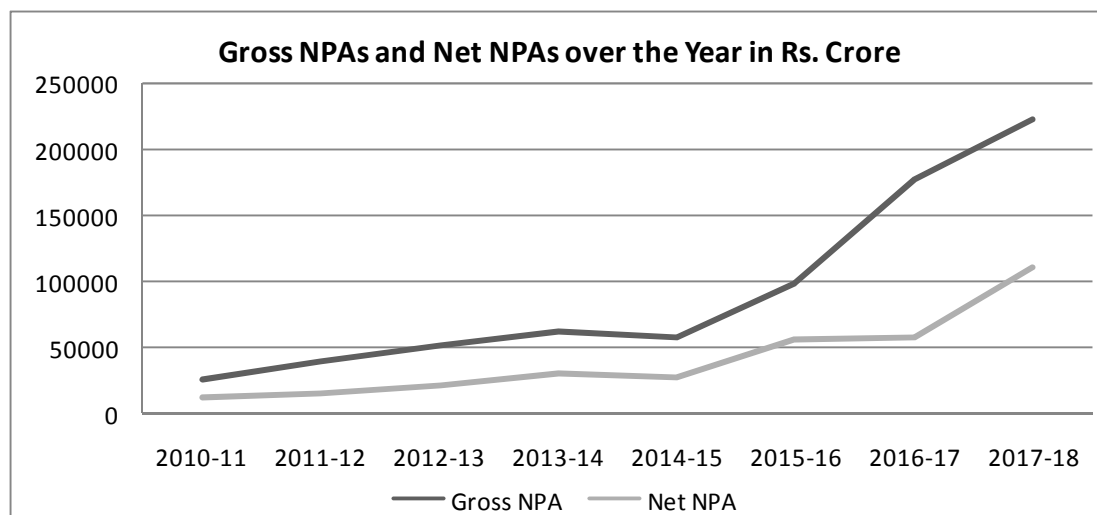
**Table 1: Gross NPAs and Net NPAs**

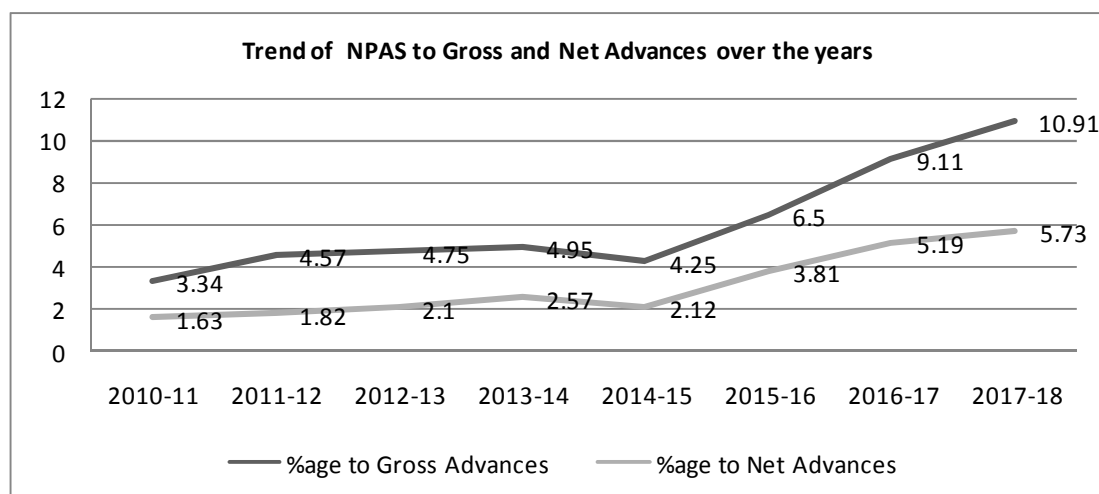
₹ in Crore

Year	Gross NPA		Net NPA	
		Percentage to Gross Advances		Percentage to Net Advances
2010-11	25326	3.34	12347	1.63
2011-12	39676	4.57	15819	1.82
2012-13	51,189	4.75	21,956	2.10
2013-14	61,605	4.95	31,096	2.57
2014-15	56,725	4.25	27,591	2.12
2015-16	98,173	6.50	55807	3.81
2016-17	1,77,866	9.11	58277	5.19
2017-18	2,23,427	10.91	110855	5.73

Source: Compiled from SBI Annual Reports (2010-11 to 2017-18)

A close scrutiny of the Table 1 shows the fact that SBI has been spectacularly managing the gross NPAs segments. An international standard of gross NPAs shows that it would be 2 to 3 percent. The gross NPAs which stood at 3.34 percent in the year 2010-11 gradually increase to 4.95 percent in the year 2013-14 and afterwards decrease to 4.25 percent in 2014-15. Again Gross NPAs is gradually increasing from 2015-16 and highest recorded in 2017-18. The Net NPA also gradually increase after the provision from 2010-11 to 2013-14 and slipped down to 2.12 per cent in 2014-15 and again increase in 2015-16 and highest increase to 5.73 percent in 2017-18.





- **NPA in relation to Total Assets and Total Advances**

NPAs as percentage to total assets and total advances have been investigated in Table 2.

**Table 2: NPAs as Percentage to Total Assets and Total Advances**

Year	NPAs as Percentage of Total Assets	NPAs as Percentage of Total Advances
2010-11	2.07	3.34
2011-12	2.97	4.57
2012-13	3.27	4.75
2013-14	3.43	4.95
2014-15	2.77	4.75
2015-16	4.34	4.44
2016-17	6.57	3.70
2017-18	6.47	5.73

Source: Compiled from annual report of the SBI (2010-11 to 2017-18)

It is noted that NPAs as a percentage to total assets has been continuously increased from 2.07 percent during 2010-11 to 3.43 percent in the last year of the study viz.2013-14. The upward trend implies that it has freeze frozen funds in NPAs and has made unavailable liquid resources into loans and investment portfolio of SBI. However, in 2014-15 it was decreased to 2.77 percent and again it is increased from 2.77 percent to 6.47 percent in 2017-18. The highest rate of NPAs is 6.57% in 2016-17 during the study period of eight years. As for NPAs in relation to total advances, there has been also continuously increased from 3.34 percent in 2010-11 to the peak 5.73% in 2017-18 which is sine of alarming.

#### **Impact of NPAs**

The resources locked up in NPAs are borrowed at a cost and earn no return to service this cost. NPAs on the one hand do not earn any income but on the other hand drain the profits earned by performing assets through the chain of provisioning requirements; bring down the yield on advances and the net profit, hitting the bottom line of the banks.

- **Impact of NPAs on Net-Worth of SBI**

In an attempt to appraise the impact of NPAs on net-worth of SBI, we have estimated net-worth of SBI after accounting for Net NPAs of SBI. For this purpose, the level of Net NPAs are taken into account, because net NPAs are derived after excluding all sorts of provisioning part payment received. Table 3 shows the impact of NPAs on net worth of the bank .The table shows that estimated share of net NPAs to existing net worth was as high as 38.69% in 2015-16, while it was lowest in 2016-17 2.85%. If net NPAs are knocked out from the total net-worth of State Bank of India, the net-worth would stand reduced to 81% of the existing aggregate net-worth in 2010-11 and about 95.91% in 2017-18. This incipient portion of total assets is actually giving misleading information to the stakeholders of the Bank

**Total Net worth vis-a-vis Net worth after Account for Net NPA****Table 3**

Year	Capital	Reserve	Total Net Worth	Net NPAs	Net NPAs to Net Worth in%	Actual Net Worth	Reduced Net Worth In %
2010-11	635	64,351	64,986	12,347	19.00	52639	81.00
2011-12	671	83,280	83,951	15,819	18.84	68132	81.15
2012-13	684	98,200	98,884	21,956	22.20	76928	77.79
2013-14	747	1,17,536	1,18,283	31,096	26.28	87187	73.71
2014-15	747	1,27,692	1,28,439	27,591	21.48	100848	78.51
2015-16	747	1,43,498	1,44,245	55807	38.69	88438	61.31
2016-17	797	20,44,751	20,45,548	58277	2.85	1,987,271	97.15
2017-18	892	27,06,344	27,07,236	110855	4.09	2,696,151	95.91

Source: Annual Reports of SBI (2010-11 to 2017-18)

- **Impact of NPAs on Return of Assets (ROA) of SBI**

NPAs have a direct impact on Return on Assets (ROA). It has been affected because while the total assets include the net NPAs which is the denominator, but net profit does not recognize the income on NPAs which is the numerator in the ratio. If income on NPAs is allowed to added back to the profit of the bank, probably SBI would have one of the top rated banks in terms of ROA. In table 2.2 an attempt has been to appraise the effect of NPAs on ROA of SBI.

**Impact of NPAs on ROA****Table 4**

Year	Total Assets (₹ in Crores)	Net Profit (₹ in Crores)	Existing ROA	Net NPAs (₹ in Crores)	Bank Rate	Opportunity Cost of net NPAs (₹ in Crores)	New Net Profit (₹ in Crores)	Actual ROA
1	2	3	4 (3/2)	5	6	7 (5*6)	8 (3+7)	8 (8/2)
2010-11	12,23,736	8,265	0.71	12,346.90	6	740.81	9005.81	0.73
2011-12	13,35,519	11,707	0.88	15,818.85	9.5	1502.79	1320.79	0.97
2012-13	15,66,211	14,105	0.97	21,956.48	8.5	1866.30	15971.30	1.00
2013-14	17,92,748	10,891	0.65	31,096.07	9	2798.64	13689.64	0.74
2014-15	20,48,080	13,102	0.68	27,590.50	8.5	2345.19	15447.19	0.74
2015-16	2,357,617	99,51	0.46	55,807.02	8.5	4743.59	14694.59	0.65
2016-17	2,705,966	10484	0.41	58277	7.0	4079.39	14563.39	0.005
2017-18	3,454,752	-6547	-0.19	110855	6.25	6,928.44	381.44	0.000

Source: Report on Trend and Progress of Banking in India, RBI, (2010-11 to 2017-18)

The table shows that in 2010-11 ROA of the bank is 0.71 while the estimated actual ROA of the bank is 0.73 has been gradually waning to the year 2012-13. After 2012-13 existing ROA and actual ROA have been continuously falling and in 2017-18 distress from loss. Existing ROA is- 0.19 and actual ROA is nil. The situation proves that NPAs are a biggest challenge of State Bank of India. The situation indicates that the return on assets is decreasing every year due to the NPA, the effects of NPAs could not be nullified

- **Opportunity Cost of NPAs**

In this section, an attempt has been made to calculate the operating cost of NPAs and also the opportunity of cost at the prevailing Bank Rates for the period 2010-11 to 2017-18. For the purpose of calculating operating cost, 11% maintenance cost has been assumed. The assumption made on the fact that normally the cost of maintaining accounts comes around 10% to 12% [Regional Office, SBI, Silchar]. Table 5 shows that estimated maintenance cost of gross NPAs of SBI come around ₹ 2785.89 crores in 2010-11 increased to ₹ 24576.97 crore at the end of 2017-18. Opportunity loss calculated at the bank rate has highest in the year 2017-18 ₹ 38541.16 crores and the lowest in the year 2010-11 ₹ 1619.58 crore. This is, however, due to the bank rates. The maintenance cost and opportunity cost of gross NPAs of SBI is continuously increasing from. ₹ 4405.47 crore in 2010-11 to as high as ₹ 38541.16 crore in 2017-18

**Opportunity Cost of NPAs of SBI****Table 5**

Year	Gross NPAs (₹ in Crores)	Maintenance Cost® 11% p.a. (₹ in Crores)	Bank Rate	Opportunity Cost at Bank Rate with quarterly rest (in ₹ Crores)	Total loss in ₹
1	2	3 (2*3)	4	5 (2*4)	6 (3+5)
2010-11	25326	2785.89	6.00	1619.58	4405.47
2011-12	39676	4364.44	9.50	3769.26	8133.70
2012-13	51,189	5630.83	8.50	4351.09	9981.92
2013-14	61,605	6776.59	0.90	5544.48	12321.07
2014-15	56,725	6239.78	8.50	4821.65	11061.43
2015-16	98,173	10,799.00	8.50	8344.68	19143.68
2016-17	1,77,866	19565.26	7.00	12450.62	32015.88
2017-18	2,23,427	24576.97	6.25	13964.19	38541.16

Source: Report on Trend and Progress of Banking in India, RBI, (2010-11 to 2017-18)

It is evident from table 2.3 that NPAs are directly and indirectly hitting the bottom-line of SBI and nullifies the bank's effort to increase its profitability. Over the years, the total loss due to NPAs has increased to its peak of ₹38541.16. Crores in 2017-18.

**Suggestion**

There are a number of factors responsible for weak performance and as a result accounting turning into NPAs. NPAs occur due to the factors ascribed to the borrowers, lenders and also due to external environment. Borrowers may switch their funds for expansion, modernization; diversification etc. SBI is required to have adequate preventive measures in fixing pre-sanctioning appraisal responsibility and effective post-disbursement supervision. SBI should continuously monitor loans to identify accounts that have potential to become non-performing. The following effective tools may be helpful in recovery of NPAs:

- Picking up early caveat signals and providing remedial measures in time can prevent the account from turning into NPA.
- Customary contact with borrowers/guarantor has its own impact in NPA recovery.
- Effective use of legal measures and SARFEAST, LokAdalats and Public Money Recovery Act of the respective States.
- Coercion of the impact of CIBIL
- Timely Rephasement /Reschedulement can help in prevention
- Greater focus should be laid on preventing an account from becoming NPAs rather than applying remedial measures at the post
- More considerate treatment should be given to the borrower customers who continue to make payments even after being classified as NPA.
- While adopting recovery measures SBI should follow code for collection of dues and repossession of security as approved by Board of Directors. Appointment of Recovery/ Enforcement Agents should be in accordance with guidelines issued by Reserve Bank of India from time to time.
- In the NPAs cases where the borrowers' unit/company may be facing long term problems with structural deficiencies and may not be able to operate on sustained profitable lines, including non-viable sick / closed units, compromise/OTS option should be considered on merits.

**Conclusion**

Thus NPAs are at the core of financial problem of the State Bank of India. Concrete efforts have to be made to improve recovery performance. Measures required to be undertaken are mainly two-fold. SBI should make efforts first to avoid fresh addition on NPAs by their effective appraisal and then through monitoring and secondly to recover the amount from accounts which have already turned bad. The main reasons of NPA of SBI are defaults, ineffective supervision of loan accounts and lack of technical and managerial expertise on the part of borrowers. NPAs put detrimental impact on the profitability, capital adequacy ratio and credibility of SBI. NPA is a doubled-edge weapon. On the one side SBI cannot recognize interest on NPAs accounts and on the other; it is a drain of the SBI's profit by way

of provisioning. Higher NPA ratio shakes the confidence of investors, depositors, lenders etc. It also causes poor recycling of funds, which in turn will have deleterious effect on further availability of credit but also financial soundness of the credit of organization. In 2017-18 actual return on assets is negligible (nil) which indicates that performance of assets is very poor. Therefore it is necessary that strong steps should be taken by the bank for immediate recovery of NPAs.

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