The Impact of NPAs on Profitability of Public Sector Banks in India

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Abstract

The aim of this paper is to study the NPA crisis of Indian public sector banks after the financial crisis of 2008, particularly whether an increase in the gross NPA ratio causes any decline in the profitability. This paper analyses the profitability of 26 public sector banks in India - SBI and its 5 associates and 20 nationalised banks for 13 years, from 2004-05 to 2016-17. First section introduces the problem of bad loans prevalent in the country. Second section carries out review of literature lads us to form our hypothesis. In the third section, the data procured from reputed sources is analysed using panel regression method. The results are presented in the fourth section. Last section presents interpretation of this results. The Indian banking sector is in the throes of an escalating bad loan crisis. Public sector banks were analysed specifically because a major chunk of NPAs in the banking domain are found in PSBs. The analysis found a negative impact of credit risk on the profitability of banks, with the former being calculated in terms of Gross Non-Performing Asset Ratio.

I. Introduction

THE INDIAN ECONOMY has weathered a few storms in the form of demonetisation exercise and the rollout of the Goods and Services Tax in the year 2016-2017. Domestic growth rebounded in the second quarter of 2017-18. But, the financial institutions pose a worry because of the poor credit growth in public sector banks. According to the Economic Survey, the banking stability indicator (BSI), an important indicator of soundness and resilience of the banking industry, has shown that the risks to the banking sector remain high on ground of the deterioration of asset quality. Though scheduled commercial banks as a whole showed credit growth between March and September 2017, the performance of the public-sector banks has been consistently dismal. In the year 2018, the gross NPAs of Indian Banks

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Early Warning mechanisms, banks may strengthen credit monitoring to flag the customer accounts that have the probability of going bad. An alternative suggestion may also be to make governance structure of banks more accountable to ensure prevention of such defaults. The government in recent years has also taken steps for preventing NPAs by enforcing Insolvency & Bankruptcy Code since 2016.

Hence, it is recommended that PSU banks need to increase internal monitoring of credit and liquidity risk measures, achieve diversification of the revenue sources and infusion of equity capital into the PSU banks.

References


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