Periodic Research

Non-performing Assets of Central Bank of India: An Empirical Study

Deepak Kumar
Assistant Professor,
Deptt.of Business Administration,
L.N.Mishra College of Business Management,
Muzaffarpur, Bihar,
India

Bhanu Pratap
Assistant Professor,
Deptt.of Business Administration,
L.N.Mishra College of Business Management,
Muzaffarpur, Bihar,
India

Ajay Kumar
Assistant Professor,
Deptt.of Business Administration,
L.N.Mishra College of Business Management,
Muzaffarpur,Bihar,
India

Abstract

Banks are an essential link (a source of finance) and an intermediary for the smooth functioning of our economy. Through financing and providing loans it greases the different areas of the economy. But when loans are not recovered in time, it takes the shape of Non-Performing Assets badly affecting the profitability and health of the bank. This paper focuses on the financial health of the Central Bank of India in terms of comparison of total advances, Net Profit, Gross NPA and Net NPA of Central Bank of India. The paper explicitly establishes relationship between Net Profit and Net NPA of Central Bank of India using Karl Pearson's co-efficient of Correlation. The paper highlights the valuable suggestions in terms of categorizing defaulter into different categories, strengthen the debt recovery mechanism, rescheduling of loan and advances e.t.c. The paper includes PCA (Prompt Corrective Action) to check the deterioration of the loans into Non-Performing Assets which like a panacea for management of loans.

Keywords: NPA, Gross NPA, Net NPA, PCA, Net Profit.

Introduction

The Non-performing Assets or bad loans or stressed asset is a chronic problem plaguing most of the public sector banks. The percentage of NPA recovered by the bank is significant factor reflecting the health of the bank on the balance sheet. The NPA also affect the cash flow for the banks or mobilization for the same. There has been various initiatives to check the growth of NPA and to improve the quality of asset of public sector banks. The banks are taking the stringent measures and showing resilience to recover bad loans and try to minimize the write off which is the complete sign and symbol of fiasco. The banks are putting an all out efforts and keeping an eagle eye on the MSME (Micro Small Medium Enterprises). So that it is to insure the right investment of the funds at the users end. If the end users of the fund given by banks misappropriate the funds then it is huge economic loss to the bank in terms of NPA and also for nation as whole. The government needs to tighten and strengthen the recovery mechanism. The credit deposit ratio should be improved and also in the wake of growing competition from internal and external sources is creating a situation where the professionalism and efficiency of banking institution is put to acid test. The huge accumulation of Non-Performing Asset is also a parameter reflecting the lower level of gross domestic product (GDP) of the country. So we need to overhaul the funding mechanism and have a close monitoring at all stages of the fund allocation. This way the bad loan can be minimized.

Review of Literature

Toor N.S (1994) emphasize that recovery of Non Performing Asset should follow through the process of compromise by direct interaction rather than cumbersome and expansive procedure of litigation. He mentioned that by closely and continuously monitoring it is possible to identify the problematic account at the early stage itself and effort can be taken to review the unit and put it back on the path of recovery.

Kavitha N (2012) emphasized on the assessment of Non-Performing Asset on the profitability in magnitude and impact. Credit of total Advances was in the form of doubtful assets in the past and has an adverse impact on the profitability of all public sector banks affected at very large extent which was Non- Performing Asset work with other banking and also affect productivity and efficiency of banking groups. The study observed that there is an increased in advance over the period of study.

Ray R. and Patil D.Y.(2013),As per their research paper entitled on "Management of NPA in banks:A comparative study of commercial and cooperative banks with reference to selected banks in pune." They tested

Periodic Research

hypothesis is that the occurance of NPA affects the profitability and health of the banks adversely.

Dutta A (2014): This paper studied the growth of NPA in the public and private sector banks in India, and analysed sector wise non-performing assets of the commercial banks. For the purpose of the study data has been collected from secondary sources such as report on Trend and Progress of Banking in India, RBI, Report on Currency and Finance, RBI Economic Surveys of India.

Shafiqual Alam (2015), They have studied, "Non Performing Loan and Banking Sustainability in the Bangladesh Perspective", the study reveals that the country has been suffered from a large amount of nonperforming Loans in the banking industry mainly due to Fund diversion, Political and Board of Directors' interference, political instability engagement of corrupt bankers, aggressive banking due to fierce competition, falling in real estate business, weak monitoring and lack of coordination among related parties.

Objective of the study
1. To access the financial health or performance of the bank.
2. To study the impact of bad loan on the growth and prosperity of the banks.
3. To compare the total Advances, Net profit, Gross NPA and Net NPA of Central Bank of India.
4. To analyze the relationship between Net Profit and Net NPA of Central Bank of India.
5. To suggest the strategies and PCA to reduce bad loan.

Research Methodology
The methodology adopted in the study is based on secondary data. We have used Karl Pearson's co efficient of correlation between total Advances, Net Profit, Gross NPA of Central Bank of India and to arrive at a complete understanding of D.N.A of NPA of Central Bank of India, for a period of five years from 2012-2013 to 2016-17. The data we have taken from official website of Central Bank of India. The data source is absolutely authentic and trustworthy because it is taken from audited financial statement displayed on the website for public.

Concept of Non-Performing Asset
The major source of revenue for any bank is to appreciate the funds by allocating it for productive purposes. To achieve this objective and also as a part of responsibility it lends loan to the investors to start MSMEs (Micro Small and Medium Enterprises) . With a hope to recover the principal with interest the banks start financing project vigorously. But the debtors are not able to do the proper and timely debt servicing, result in huge accumulation of bad debt or NPA or bad loan.

The accumulated Non-Performing Asset starts reflecting in its eroding profitability and diminished income on its balance sheet. In the past the Non-Performing Asset was termed as "Past due". But from 31 March 2001 the concept of Past due has been revamped and naming it as Advance where

1. Interest and /or installment of principal remains overdue for a period of more than 90 days in respect of a term loan.
2. The account remains "Out of order" for a period of more than 90 days, in respect any type of working capital.
3. The bill remains overdue for a period of more than 90 days in case of bill purchased and discounted.
4. Interest and or installment of principal remains overdue for a two harvest season but for a period of not exceeding two and half year. In the case of an advance granted for agricultural purposes.
5. Any amount to be received remains overdue for a period more than 90 days in respect of other account. The bank should develop a channel to monitor the principal with interest to be paid by debtor during the transition period of nine days. So as not to allow it shape of NPA. The bank machinery and its operation should be agile and efficient to detect it at an early stage and necessitate correction in this regard.

Asset Classification
Banks have classified the loan asset into four categories.

Standard Asset
It is an asset in which any problem is not evident and it does not carry more than normal risk attached to the business.

Sub-Standard Asset
With effect from 31 March 2005, these are those assets which have remained as NPA for time period of 12 month or less. In case of Sub-Standard assets, the current net worth of the borrower or the current market value of the collateral is not enough to ensure recovery of Non-Performing Asset.

Doubtful Asset
A doubtful Asset is sub standard asset with an additional characteristic that their inherent weakness makes realization of dues doubtful.

Loss Asset
A loss asset is an asset identified by the bank and internal and external auditor or by RBI inspection but it is not written off in a balance sheet fully or partly. Such type of asset is of little value and its continuation as recoverable asset is not warranted. Although it is having some salvage value.

Effect of Non-Performing Asset on the performance of bank
The Accumulated Non-performing Asset has devastating impact on the banks profit in a number of ways.
1. It results in diminished income from interest.
2. It erodes current profit by giving the borrower time span of ninety days for debt services.
3. It results in shortage of paucitiy of fund for long term investment blunting the sharpness of its competitiveness.
4. The profit earned through the asset advance act as soft cushion in the case of financial and economic crisis.

Periodic Research

5. It has ultimate impact on the corporate image of the bank and in turn eroding the interest of stakeholder in the bank.

Gross NPA and Net NPA

Gross NPA

It may be defined as irrecoverable advance for bank has made provision and still soon in the balance sheet as account receivable subjected to lot of uncertainty.

Net NPA

Net NPA are obtained from Gross NPAs after deduction of the following

1 Interest due but not received
2 Claim received from credit guarantor and kept in suspense account pending final settlement.
3 Part payment received and kept in suspensions
4 Total provision held

The reduction in the magnitude of NPA plaguing the banks is necessary to improve profitability of banks and satisfy the capital adequacy norms as per Basel Accord Consequences of Non-Performing Asset

Liquidity

As the money gets blocked in advances there is shortage of funds in the bank for lending or for other purposes provoking banks to borrow money from outside sources. For short term it adds additional cost to the bank. Another cause of high Non-Performing Asset is the difficulties the bank face in performing their function.

Credit Loss

As the stressed asset start piling up the revenue flow from this asset start declining. So, the bank is not able to do proper and timely debt servicing, losing its credibility in the eyes of creditors like Reserve bank of India. It also damages the reputation and the brand image of the bank. Peoples trust in the bank start diminishing affecting its profitability and growth.

Involvement of Management

The management of the bank spends a lot of time and effort in managing Non-Performing Assets. Sometime, a chunk of work associated with Non-Performing Asset is so huge that the bank has to appoint special staff for handling Non-Performing Asset. If things would have been smooth then the effort and the time of management of the bank would have been productively utilized elsewhere.

Profitability

When the money gets blocked in unproductive investment due to wrong selection of client, it has several negative outcomes. First of all there is an opportunity cost because the same funds and profit would have been invested elsewhere enhancing the productivity and profitability of the funds. Secondly the reduction in profitability leads to lower Return on Investment (ROI) which adversely affect current earning of the bank.

Prompt Corrective Action

RBI's Prompt corrective action after their regulator revised the rules for the framework in April. "The RBI, vide their their letter dated june 13, 2017 has put the bank under Prompt Corrective Action in view of high Net NPA and negative ROA. PCA will help in improving overall performance of bank", Central Bank said.

For year 2017, Central bank reported a Net loss of Rs. 2439 Crore up from Rs. 1418 Crore in financial year 2016. Gross NPA to Gross Advances ratio rose to 17.81% as of March 2017 from 11.95% a year ago. Net NPA rose 10.20% of Net advances from 7.36% a year ago.

PCA can include curbs on expansion, exposure and dividend payment. In extreme case PCA framework provides the RBI with powers to force merger and even wind up on non compliant bank on bad loan ratio, the RBI said the first threshold will be triggered if banks Net NPA ratio crosses 6%. A Net bad loan ratio of more than 12% and the fall in CET1 (Common Equity Tier 1), Capital below the limit will invite the extreme action of winding up or merger.

According to the RBI norms regulatory action will be taken if a banks' capital to risk asset ratio falls below 7.75%. If the ratio falls below 3.625% the bank could be candidate for merger and may even be wound up. If CET 1 capital falls below 5.125 % and Net NPA are between 9% and 12 % the RBI will slab restriction on dividend payment, remittances of profit and branch expansion. The promoter then will have to bring in more capital and the bank will have to make high promising.

Table-1
Total Advances Compared with Net Profit, Gross NPA and Net NPA of Central Bank of India   (Rs. in Crore)

Year	Total Advances	Net Profit	Gross NPA	Net NPA
2012-13	171935.84	1014.96	8456.18	4987.55
2013-14	177315.17	(1262.84)	11500.01	6648.56
2014-15	188477.53	606.45	11873.06	6807.45
2015-16	180009.58	1418.19	22720.88	13241.80
2016-17	139398.76	2439.10	27251.33	14217.83

Source:-Annual Report of CBI

Periodic Research

Figure 1
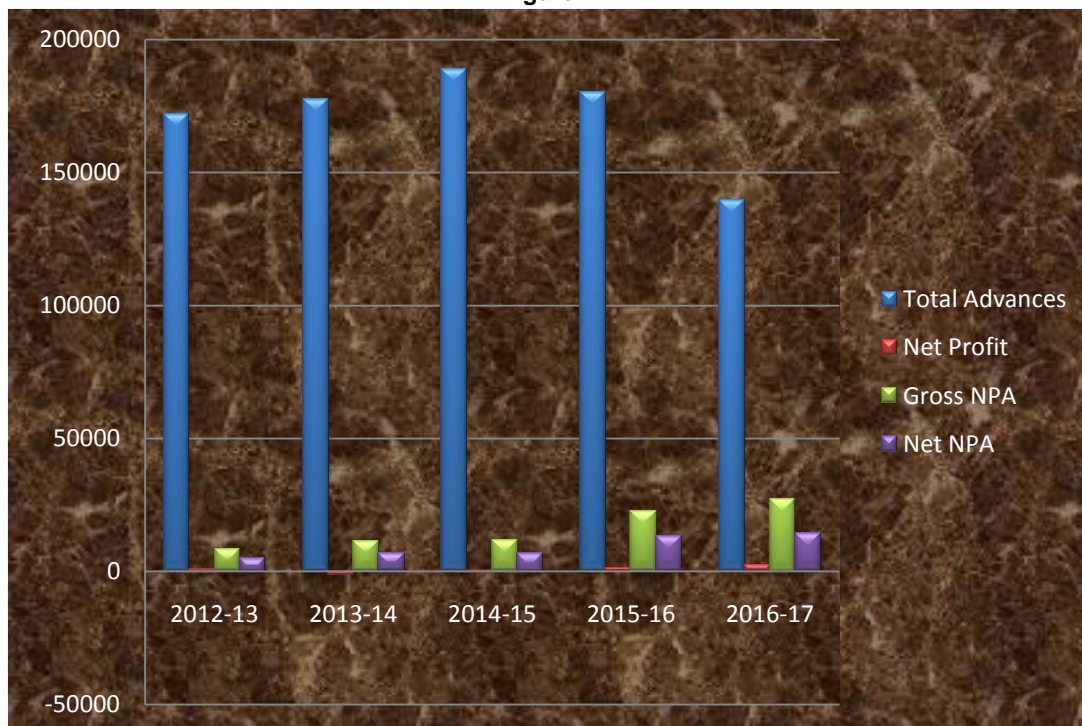
By Using the correlation we want to determine whether there is any relation between Net Profit and Net NPA of CBI or not

Formula

$$r = \frac{N\sum dxdy - \sum dx \sum dy}{\sqrt{(\sum dx^2 - (\sum dx)^2)} \times \sqrt{(\sum dy^2 - (\sum dy)^2)}}$$

Calculation of Correlation between net profit and net NPA of CBI

Year	Net Profit (X)	dx=X-A A=843.17	dx^2	Net NPA (Y)	dy=Y-A A=9180.63	dy^2	dxdy
2012-13	1014.96	171.79	29511.8	4987.55	-4193.08	17581919.88	-720329.21
2013-14	-1262.84	-2106.01	4435278.12	6648.56	-2532.07	6411378.48	5332564.74
2014-15	606.45	-236.72	56036.35	6807.45	-2373.18	5631983.31	561779.16
2015-16	1418.19	575.02	330648	13241.8	4061.17	16493101.76	2335253.97
2016-17	2439.1	1595.93	2546992.56	14217.83	5037.2	25373383.84	8039018.59
Total	∑X=4215.86	∑dx=0.01	∑dx²=7398466.83	∑Y=45903.19	∑dy=0.04	∑dy²=71491767.27	∑dxdy=15548287.25

By putting the above calculated values in formulae we get

$$r = \frac{5*15548287.25 - (0.01)(0.04)}{\sqrt{(5*7398466.83 - (0.01)^2)} \ \sqrt{(5*71491767.27 - (0.04)^2)}}$$

r=0.67

As we observe the Karl Pearson's co-efficient of correlation (r) is 0.67 which is the reflection of moderate positive correlation between Net Profit and Net Non-Performing Asset. If we observe the table minutely it is evident that net profit is declining for the first three consecutive years with reference to the first year during the same period Advances are increasing which is a clear reflection of poor management of Central Bank of India. If we look at the profit figure of 2013-14 which is negative showing the complete fiasco of management while in the succeeding year there are signs of improvement with respect to the previous years of dismal performance.

Finding and Conclusion

1. There is a moderate positive correlation between Net Profit and Net Non-Performing Asset which indicates bad management of assets.
2. Bank is not in a position to allocate the fund to new customer because of the crisis of funds that arises due to Non-Performing Asset.
3. Gross Non-Performing Asset and Net Non-Performing Asset of Central Bank of India are

Periodic Research

increasing as well continuously with every passing year.

4. Gross Non-Performing Asset and Net Non-Performing Asset of Central Bank of India are showing an increasing trend with every passing year.

5. There is paucity of Funds for investment.

6. For the first three years, the Net Profit is declining which is reviving tremendously for the next two succeeding years with respect to Net Profit.

7. Net Non-Performing Asset is continuously increasing and ultimately reflected in positive correlation

From the table no., it is clear that corresponding Gross Non-Performing Asset and Net Non-Performing Asset is increasing for the above mentioned three time periods.

In 2015-16 and 2016-17 total advances has declined significantly but Net Profit has increased substantially. If we look at the figures of Gross Non-Performing Asset and Net Non-Performing Asset both of them are increasing.

From the 2014-15 next two consecutive years total Advances has declined where as the Net Profit for this period is in ascending order along with Net Non-Performing Asset, which verifies and authenticates the worked out positive co-efficient of correlation of 0.67.

The improvement in the net profit margin for the last three financial years also reflects right selection of customer, who are doing debt servicing properly and timely. Even if the Advances for the corresponding time period is declining. Good management of skill of bank can be taken as another factor attributed to the success.

Suggestions

1. The bank should categories the defaulter into three categories based on risk threshold specified by Reserve Bank of India and take prompt corrective action(PCA) accordingly to recover Non-Performing Asset.

2. Bank should strictly adhere to the criteria required for differentiating good customer and bad customer before the Advances are sanctioned.

3. The debt recovery mechanism of the bank should be strengthening and if required services of specialist and professional consultant should be taken in this regard.

4. Rescheduling of the loan or Advances should be done, if a particular customer has a valid and genuine reason for not paying the amount as per the schedule.

5. Little amount waiver of interest should be done if the customer or the client is confronted with the some of the other problems which is justified.

6. There should be rationally selected borrowers and follow-up with collateral acting as deterrence in case of failure to do the debt servicing.

7. Bank should work on improving relationship between banks and borrowers. Trust and commitment is essential components of sustainable relationship between the two parties backed up by the sincerity from the both side.

8. Banks should adopt short term legal mechanism like compromises, OTS, Write Off, up gradation and cash recovery.

9. Making use of Branch wise recovery Budgets.

10. The Bank should constitute committees like AMC or ARC specially dedicated to the management of bad loans.

References

A comparative analysis of NPAs of selected Commercial Banks in India, Vol.3, No.1, June 2013,ISSN:2277-4637(O), ISSN:2231-5470(P)

Annual Report 12-13 of Central Bank of India.

Annual Report 13-14 of Central Bank of India.

Annual Report 14-15 of Central Bank of India.

Annual Report 15-16 of Central Bank of India.

Annual Report 16-17 of Central Bank of India.

Empirical Study on Non-Performing Assets of Bank, Vol.2, Issue 1, January 2014

Goyal, K.A and Joshi, V.(2012). Indian Banking Industry: Challenges and Opportunities. International Journal of Business Research and Management, IJBRM, 11

Gupta,S.P, Business Statistics

Indian Express, June 13, 2017

www.Banking scenario. In

www.rbi.gov.in