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Gagan Gupta
Assistant Professor, Dept.-
Commerce, SRPAAB College,
Pathankot, Punjab, India

Study of NPA – Causes, impact & management

Gagan Gupta

Abstract

In spite of the significant improvement in the banking sector and the accelerated reforms during this period, NPA still poses a threat to the banking sector. Even though there were remarkable improvement in NPA management which is evident from the decline in NPA since post-liberalization, NPA still average around 3% of total advances of all SCBs in India. There are still concerns about asset quality of banks, which is evident from the reduction in asset quality during recessionary periods. A sound management of NPA should start with strengthening the internal systems through improved credit assessment, more staffs in the loan department, regular follow-up and assessment of loan, etc. Even though external factors such as recessionary pressures etc affect the quality of assets, it can be minimized if banks improve the internal efficiency on credit management.

Keywords: Parental attitude, participation, sports, girls

Introduction

The NPA is a significant threat to the very existence of commercial banks in India. Even though, most of the recommendations mentioned in previous researches are already incorporated in the banking sector, the NPA still remains a reason to worry about. Hence a review of various facets of the NPA is found necessary to explain the incidence of NPA, its impact and management of NPA. To achieve this objective, the primary data are collected from the staff of the banks, with special reference to officers working with State Bank of Travancore (SBT).

The bankers are the best judge to evaluate the various facets of NPA since they are closely involved in lending/advances and its follow-up on a day to day basis.

Joppe (2000) ^[1] defined reliability as the extent to which the results are consistent over time and an accurate representation of the total population under study. If the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable. Carmines and Zeller (1979) ^[2] observed that the reliability concerns the extent to which an experiment, test or any measuring procedure yields the same results on repeated trials. The more consistent the results given by repeated measurements, the higher the reliability of the measuring procedure; conversely the less consistent the results the lower the reliability. Reliability is defined as the proportion of the variability in the responses to the survey that is the result of differences in the respondents (Funk *et al*, 2007) ^[3]. To sum up, reliability defines the ability of a tool to measure a concept in a consistent manner.

Cronbach's alpha is used to assess the internal consistency and reliability of a multiple item instrument. A multiple item instrument is internally consistent if its items are highly correlated. Cronbach's alpha is computed as the ratio of the true variation to the total variation (Dukes, K. A. 2005) ^[4]. The other methods used to assess the reliability includes test-retest method, equivalent forms, split halves method etc. Researchers distinguish among "test-retest" reliability, "intrarater" and "interrater" reliability, and "internal consistency". In this research, the internal consistency is measured using reliability test Cronbach's alpha. Nunnally (1978) ^[5] and Straub, D *et al* (2004) ^[6] have indicated that Cronbach Alpha scores of 0.60 to be an acceptable reliability coefficient. Funk *et al* (2007) ^[3] supported the above view and indicated that some items might carry low alphas, but are predictive of the key outcomes in the study. Cronbach alpha is calculated for each segment of questionnaire separately. The questions used were classified into three groups, namely the causes of NPA, impact of NPA and the management of NPA. The item total correlation and the corrected

Correspondence
Gagan Gupta
Assistant Professor, Dept.-
Commerce, SRPAAB College,
Pathankot, Punjab, India

Correlation if an item is deleted were calculated. SPSS 17 is used to study the reliability of the survey instrument. All the factors as well as the overall scale were seen to have Cronbach alpha above the acceptable threshold of 0.6 and above.

Table 1: Test of Reliability – Cronbach Alpha

| Si No | Area | No. of Questions | Questions | Cronbach Alpha |
|-------|-------------------|------------------|------------|----------------|
| 1 | Reasons for NPA | 17 | A5 —A15[9] | 0.807 |
| 2 | Impact of NPA | 7 | B17-B23 | 0.823 |
| 3 | Management of NPA | 13 | C25-C37 | 0.686 |
| | Overall | 37 | | 0.838 |

Source: SPSS Output – Data Analysis

Regarding the ‘reasons for NPA’, the internal reliability of 17 questions was assessed using the Cronbach alpha technique. The scale produced an alpha of 0.807. With regard to the ‘impact on NPA’, the internal reliability of 7 item scale was assessed using the Cronbach alpha technique. The scale produced an alpha of 0.823. Two questions (B15_5 and B15_6) have not been considered since the question is repeated differently in another section. It is observed that the Cronbach Alpha in the area ‘management of NPA’ is less than 0.7, ie, 0.686. It is mainly because of Question No. 27 which elucidate on the existing level of follow up of project/loans. Also, this question does not carry five point likert scales. Regular follow-up and evaluation is an important proactive measure to identify and manage NPA in banks. Since the question is relevant to the research and the Cronbach Alpha Score is close to 0.7, it is included.

Incidence of NPA – Ranking of Major Reasons

An understanding of the various reasons for NPA is necessary in order to take appropriate measures to manage it. The table no. 6.7 highlighted the ranking of various reasons for NPA based on respondents’ feedback.

Table 3: Management wise Classification of major reasons for NPA

| Si No | Reasons | Senior Management | | Middle Management | | Junior Management | |
|-------|---|-------------------|------|-------------------|------|-------------------|------|
| | | Mean | Rank | Mean | Rank | Mean | Rank |
| 1 | Willful default by the clients or customers | 6.50 | 1 | 5.64 | 1 | 2.00 | 5 |
| 2 | Diversification of funds for other purposes | 6.50 | 1 | 5.30 | 2 | 6.00 | 2 |
| 3 | Lack of supervision and follow up | 3.78 | 3 | 5.20 | 3 | 5.00 | 3 |
| 4 | Inadequate or defective credit appraisal | 3.11 | 4 | 3.34 | 4 | 7.00 | 1 |
| 5 | Economic slowdown & recessionary trends | 4.30 | 2 | 3.10 | 5 | 1.00 | 6 |
| 6 | Political influence | 2.22 | 5 | 3.02 | 6 | 4.00 | 4 |
| 7 | Higher rates of interest | 1.67 | 6 | 2.46 | 7 | 5.00 | 3 |

Source: Primary Data

The senior and middle level management ranked willful default and diversification of funds as the main reason for the NPA. On the other hand, the lower level management staff rated inadequate credit appraisal standards as the main cause for the NPA. The lower level management ranked diversification of funds as second most important reasons for the NPA. The senior management ranked economic slowdown and recessionary pressures as the second most important reasons for the NPA. The financial crisis resulted in a great leap on NPA and affected the quality of assets significantly. The observations of senior management rating economic slowdown as a major reason for NPA support findings of Siraj, KK and Pillai, PS (2011) [7] and the

Table 2: Ranking of major reasons for NPA

| SI No | Reasons for NPA | Mean Scores | Rank |
|-------|--|-------------|------|
| 1 | Willful default by the clients or customers | 5.5625 | 1 |
| 2 | Diversification of funds for other purposes | 5.4875 | 2 |
| 3 | Lack of supervision and follow up | 5.0253 | 3 |
| 4 | Inadequate or defective credit appraisal | 3.5000 | 4 |
| 5 | Economic slowdown leading to recessionary trends | 3.1500 | 5 |
| 6 | Political influence | 2.9744 | 6 |
| 7 | Higher rates of interest | 2.5000 | 7 |

Source: Primary Data

It is generally perceived and reported in literatures that the major causes for NPA are willful default, diversion of funds, lack of proper credit appraisal, sluggish legal system, change in government policies, political influence, economic slowdown, etc. The analysis revealed that willful default by the clients is the most significant reason for the incidence of NPA with a mean score of 5.56. The diversification of funds for other purposes is ranked second with a mean score of 5.48. An important inference based on the analysis is that the customer-specific reasons are considered as the major reasons for the NPA. The lack of supervision and follow-up is ranked third with a mean score of 5.02. The fourth major reason is the inadequate or defective credit appraisal system followed by the banks. The economic slowdown and recessionary trends, political influence and higher rates of interest were ranked fifth, sixth and seventh in the order respectively. A major inference drawn from the analysis is that the incidence of the NPA is contributed by a mix of bank specific, customer specific and macroeconomic factors. An understanding of these actors is necessary for effective management of NPA. A further classification of the causes of NPA based on the management levels is indicated here.

comments of Sinha (2011) [8], Deputy Governor RBI that the fallout of financial crisis contributed to up-trending of NPAs and was amplified by the aggressive lending during the boom period.

Impact of NPA

This section evaluates banker’s the feedback on the various impacts of NPA. It is rightly said that the NPA has virus effect on the economy. It affects borrowers, lenders, society and economy as a whole. As rightly pointed out by Prasad and Veena (2011) [9], the efficiency of a bank is not always reflected only by the size of its balance sheet but also the level of return on its assets. The non performing assets result

in corrosion in asset quality, reduce the income generating capacity of banks, increase requirement for provisioning towards credit losses, force banks to go for high interest bearing funds for operations, etc. In a nutshell, the NPA affects the overall functioning of the bank and finally the psychology of the bankers in respect of their disposition towards credit delivery and credit expansion.

Management of NPA

The post-liberalization period saw many remarkable changes in the regulatory framework which is intended to improve the efficiency of the banking sector and to upgrade it with international standards. The management of NPA requires both proactive and curative measures. The proactive measures include a sound and effective credit risk management system, effectiveness in loan assessment, follow up and supervision etc, which intends to reduce the instances of NPA. While the curative measures concentrate of reducing NPA in balance sheet using various modes of recovery.

Conclusion

The analysis highlighted banker's perception on the incidence of NPA and its management. The analysis indicates the need to incorporate more proactive measures in managing NPA. The regulatory authorities have introduced significant measures in the post-millennium period that includes SARFAESI Act etc. Even though these measures are significant and to a greater extent helped the banks to reduce their level of NPA, the generation of fresh NPA particularly its increased trend during financial crisis highlights the need for effective credit risk management mechanism.

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