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Impact of Asset Quality on Profitability of Banks: A Study of ICICI Bank

Digvijaysinh Ranjitsinh gohil

Abstract:

Non-performing Assets is the major challenge that majority of banks are facing since last decade. The Non-performing Assets makes negative impact on the operating efficiency of banks. ICICI Bank is one of the best performing private sector bank in the Indian Banking Sector. It has shown significant business growth since its inception. However, the bank also faces issue of NPAs. The present study aimed to analyse the impact of Non-performing Assets on the profitability of ICICI Bank. The study has used Gross NPA Ratio as independent variable while Net Profit Margin and Return on Total Assets as dependents variable. The study used regression model to quantify the impact of Gross NPAs on the Net Profit Margin and Return on Total Assets.

Keywords: Asset Quality, Non-performing Assets, Profitability

Introduction:

Non-performing assets are the major concern for the Indian Banks. When a bank offers a loan, it charges interest on the amount, which is why it is regarded as an asset to the bank. When the borrower stops paying the interest, or the principal, or both, the lender loses money. Such a loan then becomes a non-performing asset (NPA) for the bank. The banking industry in India is seriously affected by the NPA crisis with the rising number of defaulters.

As per the Reserve Bank of India (RBI), a loan is considered a “bad loan”, or an NPA when the interest due for any quarter is not fully paid within 90 days from the end of the quarter. However, this time period may vary based on the terms and conditions agreed upon by the bank and the borrower.

A commonly accepted definition of NPA is: “An asset, including a leased asset, becomes nonperforming when it ceases to generate income for the bank.”

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Meaning of NPA

NPA or Non-Performing Assets is not a desirable phenomenon in India's banking system. This is like cancer that is destroying the overall banking system in India.

The RBI has defined NPA in banking more specifically. As per the RBI Master Circular that is released on NPA, the ones listed below are counted under NPA.

Instalment/interest of a principal remains overdue for a continuous period of more than 90 days in respect of a term loan.

1. An account is 'out of order' with respect to a Cash Credit/Overdraft (CC/OD).
2. A bill remaining overdue for more than a period of 90 days.
3. The instalment of a principal or interest would remain overdue for two crop seasons in the case of crops that grow for a short duration.
4. The instalment of interest or principal that is overdue for a crop season in case of long-duration crops.
5. The amount of liquidity that is outstanding for a continuous period of 90 days.

The different types of NPA

NPAs can be classified in following ways:

Substandard NPA: That particular NPA that remains overdue for less than or equal to 12 months.

Doubtful NPA: That NPA remains in the category of Substandard NPA for equal to or less than 12 months.

Loss Assets: The Loss Assets occur when the NPA has been recognized as a loss incurred by the bank or financial institution as per the inspection done by the Reserve Bank of India (RBI).

Objectives of the study

1. To analyse Gross NPA trend of ICICI Bank during the last ten years i.e. 2011-12 to 2020-21

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2. To analyse the impact of Gross NPA on the profitability of ICICI Bank

Materials and Methods:

The study used descriptive research design to evaluate the impact of Gross NPAs on the profitability of the banks. The study used the financial data of last 10 years i.e. 2011-12 to 2020-21 for the study. The study has applied following regression model to evaluate the impact of NPAs on profitability.

$$Y_1 = \beta_0 + \beta_1 X_1 + e \text{ _____ (1)}$$

$$Y_2 = \beta_0 + \beta_1 X_1 + e \text{ _____ (2)}$$

Where Y_1 = Net Profit Margin

Y_2 = Return on Total Assets

X_1 = Gross NPA Ratio

β = Constant

Results and Discussion

1. Gross NPA Ratio of ICICI Bank

Gross NPA Ratio discloses the proportion of Non-performing Assets in comparison of Gross Advances given by the banks to its customers. The higher level of Gross NPA Ratio indicates lower quality of assets of the bank and lower level of Gross NPAs indicates good quality of bank's assets in the form of loans and advances given to their customers. Following table shows the Gross NPA Ratio of ICICI Bank during the last ten year.

Table 1: Gross NPA Ratio of ICICI Bank

Year	Gross NPAs (Rs. in Crore)	Gross Advances (Rs. in Crore)	Gross NPA Ratio (%)
2011-12	9,475.00	2,61,342.16	3.63
2012-13			

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	9,608.00	2,97,626.54	3.23
2013-14	10,506.00	3,45,911.45	3.04
2014-15	15,094.00	3,96,361.23	3.81
2015-16	26,221.00	4,48,522.04	5.85
2016-17	42,159.00	4,81,174.58	8.76
2017-18	53,240.00	5,37,811.89	9.90
2018-19	45,676.00	6,18,872.88	7.38
2019-20	40,829.10	6,76,195.77	6.04
2020-21	40,841.40	7,65,452.89	5.34
Mean			5.70
SD			2.38
COV			41.87

Source: Annual Reports of ICICI Bank

It can be observed from the above table that mean Gross NPA Ratio of ICICI Bank for the period 2011-12 to 2020-21 was 5.70 percent. The Gross NPAs Ratio of ICICI Bank was 3.63 percent in 2011-12, 3.23 percent in 2012-13, 3.04 percent in 2013-14, 3.81 percent in 2014-15, 5.85 percent in 2015-16, 8.76 percent in 2016-17, 9.9 percent in 2017-18, 7.38 percent in 2018-19, 6.04 percent in 2019-20 and 5.34 percent in 2020-21.

2. Return on Net Worth of ICICI Bank

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Table 2: Return on Net Worth of ICICI Bank

Year	Net Profit (Rs. in Crore)	Net Worth (Rs. in Crore)	Return on Net Worth (%)
2011-12	6,465.26	60,405.24	10.70
2012-13	8,325.47	66,705.96	12.48
2013-14	9,810.48	73,213.33	13.40
2014-15	11,175.35	80,429.36	13.89
2015-16	9,726.29	89,735.58	10.84
2016-17	9,801.09	99,951.07	9.81
2017-18	6,777.47	1,05,158.94	6.44
2018-19	3,363.30	1,08,368.04	3.10
2019-20	7,930.81	1,16,504.41	6.81
2020-21	16,192.68	1,47,509.19	10.98
Mean			9.85
SD			3.42
COV			34.73

Source: Annual Reports of ICICI Bank

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It can be observed from the above table that the Return on Net Worth of ICICI bank was 10.7 percent in 2011-12, 12.48 percent in 2012-13, 13.4 percent in 2013-14, 13.89 percent in 2014-15, 10.84 percent in 2015-16, 9.81 percent in 2016-17, 6.44 percent in 2017-18, 3.1 percent in 2018-19, 6.81 percent in 2019-20 and 10.98 percent in 2020-21. The average Return on Net Worth of ICICI Bank during this period was 9.85 percent with the standard deviation of 3.42 and Coefficient of Variation 34.73 percent.

3. Return on Total Assets of ICICI Bank

Table 3: Return on Total Assets of ICICI Bank

Year	Net Profit (Rs. in Crore)	Total Assets (Rs. in Crore)	Return on Total Assets (%)
2011-12	6,465.26	4,73,647.00	1.36
2012-13	8,325.47	5,36,794.68	1.55
2013-14	9,810.48	5,94,641.58	1.65
2014-15	11,175.35	6,46,129.29	1.73
2015-16	9,726.29	7,20,695.10	1.35
2016-17	9,801.09	7,71,791.45	1.27
2017-18	6,777.47	8,79,189.16	0.77
2018-19	3,363.30	9,64,459.15	0.35
2019-20	7,930.81	10,98,365.15	0.72

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0-21	16,192.68	12,30,432.68	1.32
Me			1.21
SD			0.45
CO			37.15
V			

Source: Annual Reports of ICICI Bank

It can be observed from the table that the Return on Total Assets of ICICI Bank was 1.36 percent in 2011-12, 1.55 percent in 2012-13, 1.65 percent in 2013-14, 1.73 percent in 2014-15, 1.35 percent in 2015-16, 1.27 percent in 2016-17, 0.77 percent in 2017-18, 0.35 percent in 2018-19, 0.72 percent in 2019-20 and 1.32 percent in 2020-21. The mean Return on Total Assets of ICICI Bank during this period was 1.21 percent with the standard deviation of 0.45 and Coefficient of Variation of 37.15 percent.

Impact of Gross NPA Ratio on Profitability of Bank:

The study used simple regression model to evaluate the impact of Gross NPA Ratio on the profitability of bank. The Gross NPA Ratio is the independent variable while Net Profit Margin and Return on Total Asset are the dependent variable of the study.

Result of Regression analysis for impact of Gross NPA Ratio on Return on Net Worth and Return on Total Assets

Table 4: Regression Statistics

	Impact of Gross NPA Ratio on Return on Net Worth	Impact of Gross NPA Ratio on Return on Total Assets
Multiple R	0.714453	0.685759
R Square	0.510444	0.470265
Adjusted R Square	0.449249	0.404048
Standard Error	2.537907	0.346256

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Observations		10	10
Significance F (ANOVA)		0.020257	0.028586

Table 5:

Result of regression analysis for impact of Gross NPA Ratio on Return on Net Worth

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	15.68604	2.175845	7.209171	9.16E-05
Gross NPA Ratio (%)	-1.0251	0.354936	-2.88814	0.020257

Table 6:

Results of regression analysis for impact of Gross NPA Ratio on Return on Total Assets

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	1.942327	0.296858	6.542948	0.00018
Gross NPA Ratio (%)	-0.12905	0.048425	-2.66494	0.028586

It can be observed from the table 4 that the total variance in Return on Net Worth is explained by changes in Gross NPA Ratio is 44.92 percent while total variance in Return on Total Assets is explained by changes in Gross NPA Ratio is 40.40 percent. The Regression equation can be formed as under:

$$Y_1(\text{Return on Net Worth}) = 15.68604 - 1.0251 X_1 + e \quad (1)$$

$$Y_2(\text{Return on Total Assets}) = 1.942327 - 0.12905 X_1 + e \quad (2)$$

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Conclusion:

The results of the study indicate that there is significant impact of Gross NPA Ratio on the Return on Net Worth and Return on Total Assets of the bank. Which shows that banks should employ strategic policy to reduce the level of NPAs in the bank. However, it is also observed that the level of Gross NPA Ratio in the ICICI Bank is lower than the average rate of the banking sector. The NPAs in the bank can be reduced by Using data analysis and technologically upgraded frameworks to identify the warning signs early, formulation of Mechanisms to identify hidden NPAs, development of internal skills for efficient credit assessment, conducting forensic audits to understand the intent of the borrower. Moreover, to bring transparency, banks have been asked to issue a list of borrowers whose debts have been waived, stringent action should be taken against the traitors who did not return the loan intentionally so that such incidents do not happen in the future.

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