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# The Impact Of Capital Adequacy Ratio And NPA's On The Profitability Of The Raddi Sahakara Bank Niyamitha, Dharwad

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***Abstract***

Capital Adequacy ratio and NPAs are the determinant of Credit risk management.First will discuss about the term "credit risk" describes the risk associated with lending money to a customer who fails to pay the money. If the customer defaults on the loan, the bank will be at threat of losing money since it won't get the principle and interest from the borrower.Nonetheless, the goal of credit risk management is to lower risk by using CRM tools, customer analysis, etc. from Good CRM Losses can be avoided by urban cooperative banks. For this Research paper, the focus has been on urban banks because the researcher has visited a lot of urban cooperative banks, many of which do not have a CRM department. In this research paper the dependent variables are ROA and ROE, while the independent variables include the capital adequacy ratio, non-performing assets etc.In order to examine the relationship between two variables, this study used Pearson correlation.NPA and ROA have a negative relationship. Additionally, negatively connected are NPA and ROE. ROE and CAR have a favorable correlation.

Key Words: Credit Risk, Credit risk Management, ROA, ROE,NPA, CAR

## Introduction

Banks' main stream of income is lending to consumers; without lending, they would make very little money. Consequently, banks will be involved in money lending, which carries risk in the event that the borrower defaults. credit risk is therefore visible in all banks and financial institutions.

The objective of credit risk management is to reduce risk. CRM will handle all types of credit risk through the use of the following tools: customer evaluation, credit standard setting up, borrower credit score checking, customer record upkeep, loan review, etc. But few financial ratio like CAR, NPA ,ROA and ROE will give clear picture about the performance of bank

Let's analyze through this case study that how CAR and NPA affects The Raddi Cooperative Bank’s profitability, Dharwad.

## Review of Literature

### Capital Adequacy Ratio

According to Sebayang (2020)These days, banks boast about their strong performance. Therefore, a bankthat operates exceptionally well should also have a high and stable Return on Equity (ROE). Banking companies frequently release information about the financial performance of their institutions.Thus, the primary goal of Sebayang (2020) is to examine how CAR affects ROE.

A higher capital adequacy ratio suggests a greater capacity to withstand losses without becoming bankrupt. The capital adequacy ratio compares the risk-weighted assets of a bank to two forms of capital: tier I and tier ii capital. Capital adequacy ratio is calculated from this formula

$$\text{CAR} = \frac{\text{Tier i Capital} + \text{Tier ii capital}}{\text{Risk weighted Assets}}$$

### Non-Performing Asset

A loan or advance is referred to as a non-performing asset when the principal or interest payment has been past due for a period of 90 days.According to Das & Uppal (2021) when a borrower doesn't pay back their main debt amount, loans and advances become non-performing assets.The bank will not be able to recover its principal amount and its interest revenue would drop as a result of non-performing assets. The several asset classifications, or categories of non-performing assets, such as loss, substandard, and doubtful assets, are discussed in this article. The combination of these three assets will result in their non-performance(RBI). This study indicates that profitability and NPA are negatively correlated. A large percentage of non-performing assets (NPA) results in carrying cost(Batra S 2003) which reduce bank profitability.

**ROA AND ROE**

**According to** Constantina&Ilie (2021), the two indicators of a bank's profitability are ROA and ROE. A bank's return on assets (ROA) shows how profitable it is compared to its total assets.To calculate ROA formula, divide net income by total assets

$$\text{ROE} = \frac{\text{Net Income}}{\text{Share Holder's Equity}}$$

## Objective

1) To study the impact of Capital adequacy ratio and NPA on profitability of The Raddi Co-operative bank, Dharwad

## Research Methodology

Sources of Data: Researcher have collected 5 years Annual Report of The Raddi Co-operative Bank

**Questionnaire Design and Development**

Let's talk about the quantity of questions. A total of 27 questions, including open-ended, yes/no, and Likert scale questions, were included in my research. The first section deals with demographic parameters; the second portion deals with creditworthiness and KYC rules; the third part includes tools for quantifying and assessing credit risk.

Questions were posed to The Raddi Co-Operative bank's CEO in Dharwad for this research paper. The questions concerned their management of credit risk, evaluating a customer's creditworthiness, Basel norms, whether or not they are adhering to them, as well as credit scoring, risk pricing, standards, and credit scoring strategies. On a Likert scale, each of these variables was included. There were 5 to 1 ratings in this likert scale Questionnaire.Strongly disagree was coded as 1, and strong agree was coded as 5. Strongly agree and agree are the most common comments Researcher has received from this specific bank which indicates good credit risk management is there in Raddi Sahakara Bank, Dharwad

**Table 1**

| The Raddi Co-Operative Bank,Dharwad | | | | | |
|---|---|---|---|---|---|
| Year | ROE | ROA | NPA | CAR | ROE |
| 2018-19 | 20.96% | 0.76% | 8.76% | 22.21% | 20.96% |
| 2019-20 | 6.10% | 0.81% | 14.82% | 20.95% | 6.10% |
| 2020-21 | 9.27% | 1.02% | 9.05% | 19.97% | 9.27% |
| 2021-22 | 10.82% | 7.81% | 9.42% | 21.01% | 10.82% |
| 2022-23 | 14.93% | 7.90% | 8.90% | 18.90% | 14.93% |

(Source : 5 years Annual Report of Raddi Co-operative Bank, Dharwad)

1**) Correlation Between NPA and ROA**

| | *NPA* | *ROA* |
|---|---|---|
| NPA | 1 | -0.36908 |
| ROA | -0.36908 | 1 |

**Analysis**:In the Pearson Correlation result, the connection between the same variable will be 100%, denoted by a 1. There is a negative correlation (-0.36908) between ROA and NPA. A higher return on asset causes a lower non-performing asset (NPA).Das & Uppal (2021)Substandard asset, doubtful asset, and loss asset are the three categories of non-performing assets.If an asset is an NPA for a duration shorter than or equal to a year, it is considered a substandard asset.

Comparably, a doubtful asset that has been an NPA for longer than a year and a loss asset where the loss has already been identified but the amount has not been written off. therefore, therefore because of NPA operating cost will increase and profitability will reduce.

**2) Correlation Between NPA and ROE**

| | *ROE* | *NPA* |
|---|---|---|
| ROE | 1 | -0.66856 |
| NPA | -0.66856 | 1 |

**Analysis**:Both ROA and ROE serve as indicators of a bank's profitability. Thus, ROE and NPA are related in the same way that NPA and ROA are related. The relationship between ROE and NPA is inverse (-0.66856). Gowda (2019)A rise in ROE causes the NPA to fall.Hence,Researcherfound a significant negative correlation between NPA and ROE through this case study examination of Raddi Cooperative Bank, Dharwad

**3) Correlation Between CAR and ROE**

| | *CAR* | *ROE* |
|---|---|---|
| CAR | 1 | 0.301726 |
| ROE | 0.301726 | 1 |

**Analysis**: According to Sebayang (2020), higher the CAR leads to higher the ROE. The amount of capital that is held in reserve and not put to use is denoted byCAR.A good CAR will entice investors or shareholders to make investments, increasing profitability.so increase in capital adequacy ratio leads to increase in the Return on Equity of the Raddi urban cooperative bank.Ultimately, a positive correlation (0.301726) between CAR and ROE is found by Pearson correlation analysis.

## Conclusion

This article aims to investigate the effects of the capital adequacy ratio and non-performing assets (NPA) on the profitability of The Raddi Sahakara Bank in Niyamitha, Dharwad. Determinants of credit risk management include the capital adequa ratio and the NPA ratio. A bank that has effective credit risk management has one where NPA is lower and CAR is higher. Researchers used questioners to gather responses, and the positive results showed that Raddi Bank complies with all laws and regulations, among other things. Raddi Bank's final decision is to analyse clients prior approving loans. This analysis may include credit score analysis, loan approval in accordance with credit standards, and maintaining a minimum of 12% of CAR, among other things.

In addition to this questionnaire, the researcher has examined the Pearson correlations between NPA and ROE, NPA and ROA, and CAR and ROE. According to Pearson correlation there is a negative correlation between ROA and NPA as well as ROE and NPA.Conversely, there was a positive link found between ROE and CAR. Thus,increase in ROA and ROE leads to decrease in NPA. Rising ROE in this case causes an increase in CAR. Thus, Researcher can ultimately determine that The Raddi sahakara Bank Niyamitha, Dharwad has strong profitability and good Credit risk management.

## Scope For Further Research

This study examined the case study of Raddi Sahakara Niayamitha Bank; hence, a larger sample size and other banks may be included in the next research article. As only Pearson correlation was examined in this study's. so regression analysis and T-test ,other tests are possible for next research paper.

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