NON PERFORMING ASSETS IN INDIA

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Abstract: Non-Performing Assets (NPAs) pose a great threat on the economy of the nation because they enhance the vulnerability of the banking system of the country. Credit cycle is the radical process which drives the business cycle of the banks. Non-recovery of installments as also interest on the loan portfolio acts as a hindrance to the effectiveness of this process of the credit cycle. This situation leads to scarcity of funds in the economy which in turn leads to proliferating of interest and lending rates. This paper is an attempt to study the trend of rise in NPAs in public, private and foreign banks from 2008 to 2015 and analyze the efficiency in NPA management of these banks. This paper also studies the present scenario of NPAs in the Indian economy as a result of certain steps (i.e. demonetization and Asset Quality Review) undertaken by the Government to combat the issue of rising NPAs in the Indian economy.

Key words: NPA, NPA Classification, NPA redressal, Asset Quality Management, Demonetization.

INTRODUCTION

The banking system of a nation plays a vital role in the development of its sound economy. Performance in terms of profitability is a benchmark for any business enterprise including the banking industry (Balasubramanium, 2012). According to RBI, "terms loans on which interest or installment of principal remain overdue for a period of more than 90 days from the end of a particular quarter is called a Non-performing Asset". Several provisioning norms have been introduced which are pressurizing banks to improve efficiency and to reduce the level of NPAs in order to improve the financial health of the banking system (Malayadri&Sirisha, 2011). NPAs constitute a real economic cost to the banking system and must be put on the recovery path to release the blocked capital (Sukumar, 2005).

As per RBI guidelines, with effect from March 31, 2004, a Non-Performing Asset shall be a loan or advance where

1. Interest and/ or instalment of principal remain 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 of an Overdraft/Cash Credit (OD/CC),

3. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,

4. Interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and

5. Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

Non-recovery also affects the profitability of banks, besides necessitating maintenance of more owned funds by way of capital and creation of reserves and provisions to act as cushion for the loan losses (Radha, 2005). Bad loans or NPAs led to bankruptcy of many banks in the USA in 2008 and thus, were one of the major causes of The Great Depression at that time. In the Indian banking sector, the NPAs are generally considered to be at higher levels than those in most of the other countries and thus, have, of late, attracted the attention of public as also of international financial institutions. This has gained further prominence in the wake of transparency and disclosure measures initiated by the RBI during the recent years. This research paper aims at providing an overall view on the reasons of existence of NPAs, their treatment, the ways by which the issue could be resolved and also a few reports on the recent developments in this field.

REVIEW OF LITERATURE

BIshnoi, Devi (2017) conducted a research on the non-performing assets of the Indian Banks and stated that the effective management of NPAs is essential for preserving the economic value of banks and their stability. Their study also states that there is a negative correlation between Non-Performing Assets and real GDP growth rate for each bank group.

Collins (2011) undertook a study of the commercial banks in Kenya. This study sought to establish the effects of interest rate spread on the level of NPAs in the commercial banks in Kenya. The study used both quantitative and qualitative techniques in data analaysis to ascertain the relationship between the interest rate spread and loan non-performance. The study recommends that commercial banks in Kenya should properly assess their clients and charge interest rates accordingly as ineffective interest rate would increase the level of NPAs in the economy.

Satpal (2014) undertook a research on the problems of the NPA in the Indian banking sector and drew the inference that the NPAs affect liquidity and profitability, in addition to posing threats and survival of banks. This study exhibits that the extent of NPA is comparatively very high in PSBs as compared to private sector banks. Also, it shows that the NPAs level of Indian banks is still high as compared to foreign banks. This study has also stated that the government should reduce the mandatory lending to priority sector as this is the major problem creating area.

Joshi (2000) in his research paper identifies and explains the reasons behind the emergence of NPAs. Also, the steps have been taken by Government for their recovery have been stated. He was the view that interest earned on advances should always be more than the interest paid on deposits to ensure sound banking policy and avoidance of NPAs.

Sharma (2001) in his research paper has drawn the inference that the problem of NPAs of Indian banks remained unresolved because of improper sequencing of reforms. She suggested the proactive approach towards the legislative, infrastructural and regulatory reforms to prevent buildup of NPAs in future.

Malyadri, Srisha (2011) conducted a study on the analysis of NPAs of the public sector banks and private sector banks and private sector banks in India with special reference to the weaker sections. Over the period of study, it has been registered that the public sector banks have achieved a greater penetration compared to the private sector banks vis-à-vis the weaker sections.

Vallabh et al. (2007) in their research paper aims to find the fundamental factors which impact NPAs of banks. The empirical analysis assess how macroeconomic factors and bank specific parameters affect NPAs of particular category of banks. These parameters are Credit Deposit Ratio (CDR), loan exposure to priority sector, Capital Adequacy Ratio (CDR), liquidity risk and some macroeconomic factors which are GDP growth rate and excise duty. The other important finding of this paper is that banks' exposure to priority sector lending reduces NPAs.

Arora et.al. (2009) in their research paper analyzed and compared the performance of credit schemes of selected Indian banks in terms of loan disbursement and NPAs for the five years period. They found a positive relationship between total loan disbursement and total NPA outstanding of the selected banks.

Dr. Mahajan (2014) in their study have drawn comparative analysis of private, public and foreign banks in India. According to their research, though Non-Performing Assets are having a declining trend over the period of study, but still NPAs of public sector

Banks are still higher than the private and foreign banks. Top management of private and foreign sector banks is more professional, core competent in making and implementing plans for recovering funds from borrowers. With the recent ruling of the Supreme Court, SARFAESI Act, 2002, banks are confident of a faster recovery of dues.

Vibha (2009) examined the status of NPAs in scheduled commercial banks in India and found out that there is more acute problem of gross and net NPA in Indian Public sector Banks. The new private sector banks and foreign banks have also displayed an increasing trend of gross and net NPAs during 1997-2003. Thus, this paper concludes that the new private sector and foreign banks failed to prevent this problem but public sector and old private sector banks succeeded in reducing it over a period of time.

Ranjan and Dhal (2003) in their paper explored an empirical approach to the analysis of commercial banks' Nonperforming Assets in the Indian context. The empirical analysis assessed as to how banks' non-performing loans are influenced by three major sets of economic and financial factors, i.e., terms of credit, bank size induced risk preferences and macroeconomic shocks.

NPA CLASSIFICATION

Non-Performing Assets are classified into four categories:-

1) Standard Assets/Performing Assets- Standard assets are the ones in which the bank is receiving interest as well as the principal amount of the loan regularly from the customer. Here it is also very important that in this case the arrears of interest and the principal amount of loan do not exceed 90 days at the end of financial year. If asset fails to be in category of standard asset that is amount due more than 90 days then it is NPA and NPAs are further need to classify in sub categories.

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the reasonability of the dues:

1. Sub-standard Assets- According to RBI, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 month. The following features are exhibited by substandard assets: the current net worth of the borrowers / guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full; and the asset has well-defined credit weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

2. Doubtful Assets -A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values – highly questionable and improbable. With effect from March 31, 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months.

3. Loss Assets- A loss asset is one which considered uncollectible and of such little value that its continuance as a bankable asset is not warranted- although there may be some salvage or recovery value. Also, these assets would have been identified as "Loss assets" by the bank or internal or external auditors or the RBI inspection but the amount would not have been written-off wholly.

REASONS FOR AN ACCOUNT BECOMING NPA

1. Internal factors:-

1) Funds borrowed for a particular purpose but not use for the said purpose.

2) Project not completed in time.

3) Poor recovery of receivables.

4) Excess capacities created on non-economic costs.

5) Inability of the corporate to raise capital through the issue of equity or other debt instrument from capital markets. 6) Business failures.

6) Diversion of funds for expansion\modernization\setting up new projects\ helping or promoting sister concerns. 8) Willful defaults, siphoning of funds, fraud, disputes, management disputes, misappropriation etc. 9) Deficiencies on the part of the banks viz. in credit appraisal, monitoring and follow-ups, delaying settlement of payments/ subsidiaries by government bodies etc.,

2. External Factors:-

1) Sluggish legal system –

• Long legal tangles

• Changes that had taken place in labor laws

• Lack of sincere effort.

2) Scarcity of raw material, power and other resources.

3) Industrial recession.

4) Shortage of raw material, raw material\input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accidents.

5) Failures, nonpayment/ over dues in other countries, recession in other countries, externalization problems, adverse exchange rates etc.

6) Inappropriate technology (lack of Management Information System in Banks)

7) Poor credit appraisal system of banks

8) Government policies and laws like excise duty changes, Import duty changes, GST Act 2016, etc.

Latest steps undertaken by RBI for NPA redressal in India are:-

1. Amendments to SARFAESI Act, 2002- The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 or SARFAESI Act Amendments have been made in 2016 because of "Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016". It was a change long awaited. The amendment has resulted in adding new definitions to SARFAESI, widened the scope of debts and secured creditors and conferred upon RBI new powers in relation to making of policies. The key features of the amendments made to the Act are as follows:-

- The Court and the Tribunals shall not interfere in the Secured Creditors taking possession of the securities offered by the borrower under SARFAESI Act, 2002.

- The Bill further provides that the District Magistrate has to assist in the recovery process of the secured creditors and complete the above process within 30 days.
- The amendment further proposes hire-purchase and financial lease under the ambit of SARFAESI Act, 2002.
- It also provides non-institutional buyers besides institutional buyers for investment in security receipts. Once implemented, the Act enables the banks to take over the management of a company, by converting outstanding debt into equity shares and holding majority stake (51% or more) in the company.

2. Bad Bank- The proposed 'bad bank' would be a centralized agency that would take over the largest and most difficult stressed loans from public sector banks in order to help clean their balance sheets, and would take politically tough decisions to reduce debt, providing an impetus to further lending to spur economic activity. It is now time to consider a different approach, the economic survey had said, outlining how could the problem of the Twin Balance Sheet — banks and corporate — be solved.
PARA (Public Sector Asset Rehabilitation Agency) would purchase specified (large) loans from banks and then work them out, either by converting debt to equity and selling the stakes in auctions or by granting debt reduction. Once the loans are off the books of the public sector banks, the government would recapitalize them, restoring their financial health and allowing them to get back to making new loans.
Similarly, once the financial viability of the over-indebted enterprises (such as the large, over-indebted infrastructure and steel firms) is restored, they will be able to focus on their operations, rather than their finances. And they will finally be able to consider new investments.

3. Prompt Corrective Action- As the financial health of banks had deteriorated over the last three years, the Reserve Bank of India (RBI) revised the norms for prompt corrective action early last month, and has promptly imposed those norms on a couple of public sector lenders. PCA norms allow the regulator to place certain restrictions such as halting branch expansion and stopping dividend payment. It can even cap a bank's lending limit to one entity or sector. Other corrective action that can be imposed on banks include special audit, restructuring operations and activation of recovery plan. Banks' promoters can be asked to bring in new management, too. The RBI can also supersede the bank's board, under PCA. There are two type of restrictions, mandatory and discretionary. Restrictions on dividend, branch expansion, directors' compensation, are mandatory while discretionary restrictions could include curbs on lending and deposit.
The provisions of the revised PCA framework have become effective from April 1, 2017 based on the financials of the banks for the year ended March 31, 2017. The framework will be reviewed after every three years.

4. Banking Regulation (Amendment Bill), 2017- The Banking Regulation Act may be amended to give RBI more powers to monitor bank accounts of big defaulters. The amendment in the banking law will enable setting up of a committee to oversee companies that have been the biggest defaulters of loans. RBI wants stricter rules for joint lenders' forum (JLF) and oversight committee (OC) to curb NPAs. While the present law allows the government to direct RBI to carry out inspection of a lender, there is no provision for setting up oversight committees. Also, there could be changes in the laws, which will bar a bank to extend loans to a defaulting company that has failed to repay to other banks.

OBJECTIVES OF THE STUDY

1. NPAs in Public, Private and Foreign Banks: A comparative analysis

Database and Methodology- The present study is secondary data based and is collected from various journals, annual reports of RBI and 'Statistical tables relating to Banks in India' on RBI's Website. The study period is limited from 2008-09 to 2014-15. The research design that will be used here is 'Descriptive Research'. The data is shown as in the following table:-

Table-1: Non-Performing Assets of Public, Private and Foreign Banks as a percentage of Net Advances

Year	Public Banks		New Private Banks		Foreign Banks	
	Total NPAs	Net NPAs (%)	Total NPAs	Net NPAs (%)	Total NPAs	Net NPAs (%)
2008-09	449.57	0.9	138.54	1.4	64.44	1.8
2009-10	599.26	1.1	140.17	1.1	71.33	1.8
2010-11	746.00	1.2	145.00	0.6	50.00	0.6
2011-12	1178.39	1.5	145.68	0.4	62.97	0.6
2012-13	1656.06	2.0	158.61	0.4	79.77	1.0
2013-14	2272.64	2.6	245.42	0.7	115.65	1.1
2014-15	2784.68	2.9	341.06	0.9	107.71	0.5

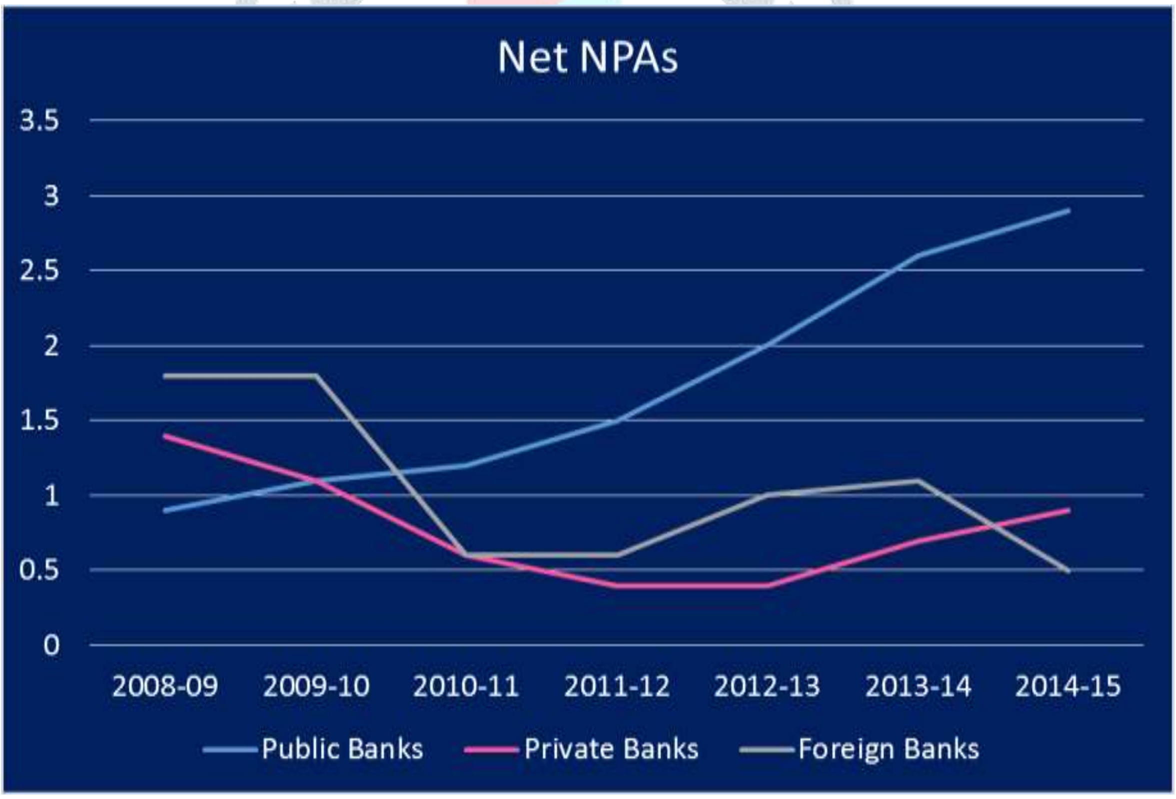

Chart-1: A comparative analysis of NPAs of public, private and foreign banks as a percentage of Net Advances

Findings- The above graph shows the amount of Non-Performing Assets as a percentage of Net Advances during the period of 2008-09 to 2014-15. During the year 2008-09 the Net NPAs of Private Banks and Foreign Banks were more than the Public Banks because of The Great Depression of 2008. It was so because Private and Foreign Banks had provided high amount of loans to the non- priority sector and big businesses which faced a major setback at that time. From the period of 2009-10 to 2014-15 we can see that the NPAs of both private and foreign banks declined and became much lesser than that of the public banks because both of these banks improved their' Asset Quality Management'. Also Public Sector Banks are lagging behind private and foreign banks both in the mount of deposits and advances growth.

Experts claim that NPA of public banks is on the rise because banks are recognizing loans as bad loans at a slower pace. Also, both private and foreign Banks are utilizing their assets more efficiently because of which their assets are giving better performance.

2. NPAs present scenario-

Database and Methodology- This study is about present scenario of NPAs in India and the data for the quarters ranging from March-May 2016 to June-August 2017 are collected from the RBI annual report and Care Ratings report.

Table-2: Present scenario of NPAs in India

Quarter	NPAs(₹crore)	NPA ratio	Growth in NPAs(q-o-q)
March-May 16	571,841	7.69	8.5
June-Aug 16	618,109	8.42	8.1
Sept-Nov 16	651,792	8.81	5.4
Dec-Feb 16	677,443	9.18	4.0
March-May17	711,312	9.06	5.0
June-Aug17	829,338	10.21	16.6

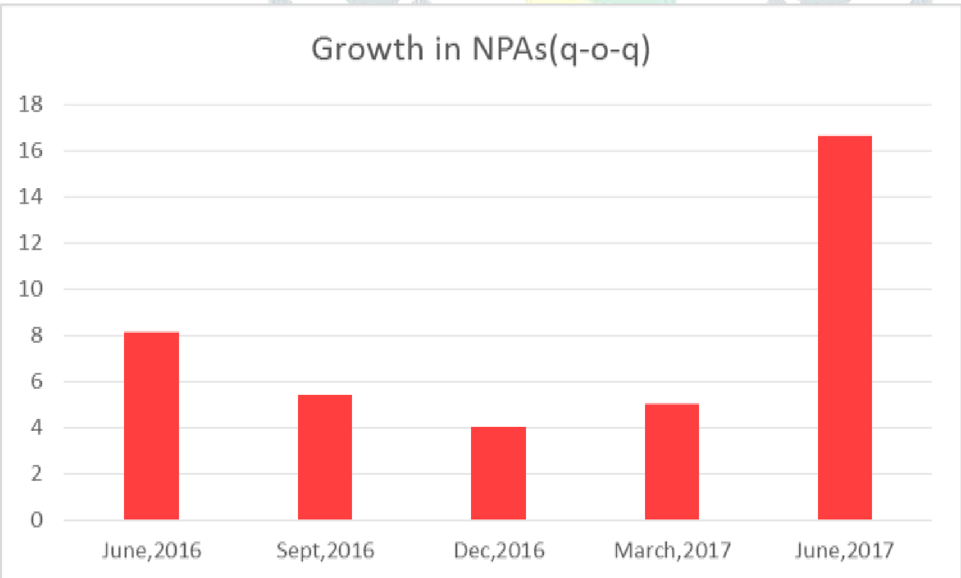

Chart-2: The growth of NPAs in the Indian economy from June, 2016 to June, 2017

Findings- The above table and graph depicts that there was a decreasing trend in NPAs from June, 2016 to Dec, 2016. But in the first two quarters of 2017, NPAs started showing an increasing trend which finally reached a record high value of ₹829,338 in the quarter June, 2017. This phenomenon occurred due to the following two reasons:-

1) **Asset Quality Review-** Asset Quality Review (AQR) of banks was undertaken by RBI because it believed that asset qualification was not being done properly and that banks were resorting to ever greening of accounts. Before the implementation of Asset Quality Review, banks were postponing the recognition of many of their band loans. Thus, under this RBI had given the ultimatum to banks to review their quality of all the Non-Performing Assets till the end of the second quarter of 2017 i.e. April-May. Because of this, NPAs showed a record high growth of 16.6% in June 2017.

2) **Demonetization Impact**- As a result of demonetization of notes of ₹500 and ₹1000 denomination, banks were successfully able to recover many of their bad loans. This effect can be seen in the diagram 1.2 which depicts that NPA growth was the lowest in the quarter in which demonetization took place i.e., Oct-Dec 2016 which was 4.1%. Demonetization not only led to recovery of bad loans of banks but also resulted in pooling of surplus funds with them. Therefore, banks started providing loans to various retail investors without authenticating their credibility properly. This led to a rise in the growth of NPAs in the following quarter i.e., Jan-March 2017 by 5% and a record breaking rise of 16.6% in the quarter April-June 2017.

CONCLUSION

The NPA is one of the biggest problems that the Indian Banks are facing today. If the proper management of the NPAs is not undertaken it would hamper the business of the banks. If the concept of NPAs is taken very lightly it would be dangerous for the Indian banking sector. The NPAs would destroy the current profit, interest income due to large provisions of the NPAs, and would affect the smooth functioning of the recycling of the funds

Banks also redistribute losses to other borrowers by charging higher interest rates. Lower deposit rates and higher lending rates repress savings and financial markets, which hampers economic growth. Also we can conclude that, Public sector banks are more efficient than private sector & foreign banks with regard to the management of nonperforming assets. Even among private sector bank, old private sector banks are more efficient than new private sector banks.

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