IMPACT OF NPA'S ON BANKING SYSTEM WITH SPECIAL REFERENCE TO INDIAN COMMERCIAL BANKS

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ABSTRACT

Banks are considered not only the dealers in money but are considered as the most important pillar for the development of any economy. They are the warehouse of the country's wealth and have the pool of all resources essential for economic development. A progressive and growth oriented banking system is very critical for overall economic development of a country, failing which is considered as turmoil for the economy.

In case of developing countries like ours, the commercial banks are considered to be the backbone of the economy. They are a very important root of finance and are credit generators for trade and industry. Credit generation is the backbone for the efficient working of trade and industries. But the failure of same is considered as termite for Indian Banking industry. And Non Performing Asset (NPA) is one of those causes. The assets of the banks which don't perform are called Non Performing Assets (NPA) or bad debts. When customers are unable to pay either interest or part of principal or both, the loan turns into a bad loan.

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. The problem of NPA is not only adversely affecting banking industry rather whole economy. It is basically the observation of Indian trade and industries. Grant of credit is important for development of industries and trade and simultaneously for the economic development but also carries a risk which is known as credit risk. RBI issued guidelines in 1993 based on the recommendations of Narasimha Committee that reduction of NPA to be treated as 'National Priority'.

The study reviews the impact of NPA and the profitability of banks. The research focuses on the study of different aspects of NPAs and its management in Indian Banking Industry, and also points out different improvement measures in mitigating and controlling bad loans.

To achieve the above said objectives secondary sources of data are utilized, data is collected from RBI publications, Annual Report, journals and websites. Secondary data is collected from relevant sections of Provisions of banking Regulations Act, SARFEASE Act, Basel Accords and various recommendations of various committees.

The research findings emphasize the need for improvement of Indian Banking system. The analysis revealed drastic dependence of macroeconomic indicators on NPAs. The NPAs can be effectively controlled with good credit risk management, integrating visionary measures in improvement of credit evaluation and monitoring system of the banks.

Keywords: Non Performing Asset, Commercial Banks, Bad loans, credit risk management.

INTRODUCTION

The assets of the banks which don't perform, ie which don't bring any income are called Non Performing Assets or Bad Debts. Banks provide loans and advances to industries and trade so as to efficient mobilize money from income generator to borrowers, but if the borrower is unable to repay either interest or part of principal or both, the debt turns into bad debt. According to RBI, term loans on which principal's installment or interest remain unpaid for a period of more than 90 days from the end of a specific quarter is termed to be Non- performing Asset. NPAs are certainly a load on the Banking Industry, and are continuously increasing and are constantly affecting the commercial bank's profitability. The profitability and efficiency of commercial Banks is highly dependent on the ways of controlling and mitigating the effect of NPAs. Non-performing Asset are a severe pain on the profitability as commercial banks cannot have any income on such accounts, while their maintenance charges and financing cost are backed from their profits. Apart from the loss of interest payment and principal payment taken by commercial banks the load of carrying cost is the major burden. Though banks in cooperation with RBI are taking continuous measures to curb this problem but the problem is still persisting.

Provisioning Coverage Ratio: It is a contingency plan for the commercial banks to protect them from bad debts. It is a ratio which tells the amount of reserve the bank has made to cover the loan losses.

Asset Classification: Categories of NPAs

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 reliability of the dues:

1. Sub standard Assets: With effect from March 31, 2005, A sub standard asset is one which has remained NPA for a period less than or equal to 12 months. Such a valuable thing will have well defined credit impuissance's that endanger the closing (to turn into cash) of the (money owed) and are seen as the clear/separate possibility that the banks will sustain some loss, if (not having enough of something) are not (corrected or made up for past events that were mean or unfair).

2. Doubtful Assets: With effect from March 31, 2005, an asset would be relegated as dubious if it has remained in the sub standard category for a period of 12 months. An imp rest relegated as dubious has all the impotencies intrinsically in assets that were relegated as sub-standard, with the integrated characteristic that the impuissance's make amassment or liquidation in plenary, – on the substratum of currently kenned facts, conditions and values – highly disputable and improbable

3. Loss Assets: A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is 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.

WHY NPAs-

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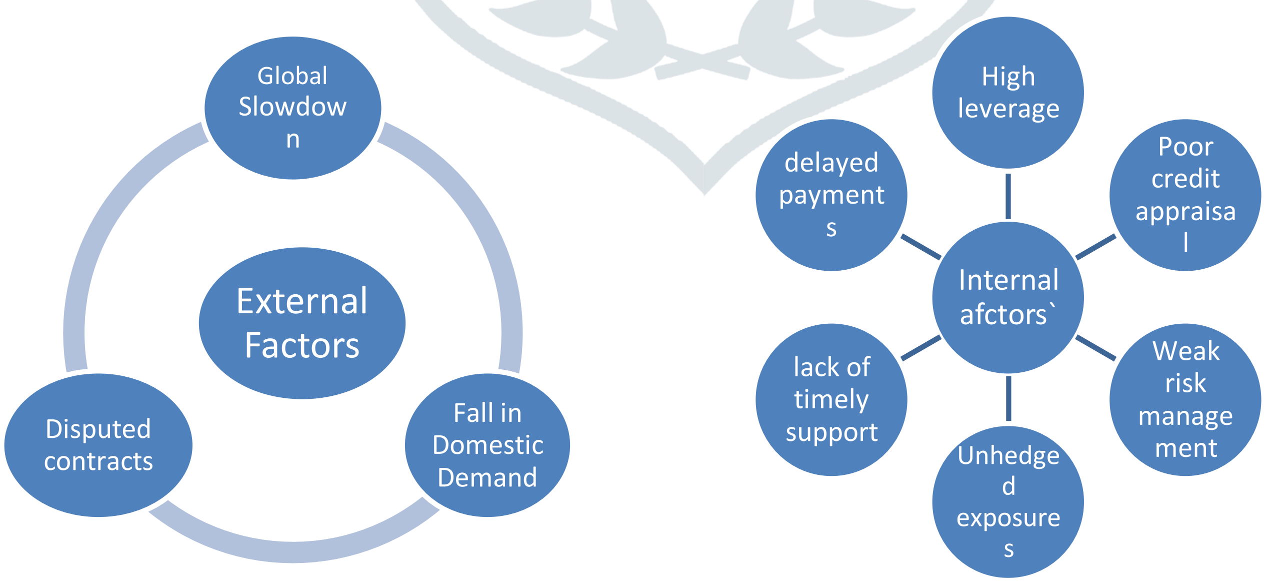

Reasons of NPAs

LITERATURE REVIEW:

The observations of **Gopalakrishnan, T.V. (2004),** elaborated in the study "Management of Non-Performing Advances" depicted the importance of NPA on bank's performance and development. Measuring the behavior of Indian Banking, especially the public sector banks during 1993-2001, the study demonstrated an expressive interdependence of NPA and macroeconomic indicators such as Inflation index, GDP, GNP, etc. The analysis is based on primary data, and author laid emphasis on improvement of existing methods of credit risk management and NPA management.The study reprise that NPA are an important factor on the income statements and efficiency of commercial banks and NPAs are the jeopardizing the commercial bank's health, profitability and soundness.

Hosmani and Hudagi (2011) did study on "Unearthing the Epidemic of Non Performing Assets with Reference to Public Sector Banks in India" an empirical and descriptive in nature which shows the trends and importance of Public Sector banks in India and discovered a minute improvement in Asset quality determined by decline in NPA %. The study concluded that management of NPA is an important characteristic to analyze the financial performance of commercial banks in terms of liquidity, profitability and economies of scale in operation and it is imperative for commercial banks to take continuous steps against mitigation of Nonperforming Assets.

Selvarajan B. and Vadivalagan, G.(2012) Across the years Indian Banking endeavors to assimilate with the world banking but has been continuously facing a lot number of obstacles due to various internal weaknesses despite high stable achievements. In a developing nation like India Banking Industry is considered to be the backbone of development but with increasing Nonperforming Assets it has proved to be a unwanted load on the economy .Non Performing Assets simply adds expenses to the credit management and are lucrative. The panic in the minds of promoters and bank managers avoid them to get involve into new projects. NPAs are not only a state of nature which is disturbing commercial banks but is a danger for overall economy's development. Non-Performing Assets are not merely non remunerative, but they add cost to the credit Management. Non Performing Assets have affected the liquidity, profitability, and competitiveness of commercial banks and progress of financial institutions and finally the psychology of the bankers and promoters with relation to nature of credit expansion and credit delivery. NPAS apart from generating profits incurs a huge cost of provisioning which takes a lot of blocking of funds, hence affecting the profits of the banks.

Pathak (2009), elaborated with descriptive research study, the essence of asset quality towards financial viability of commercial banks. The research explained that NPA is a earnest trouble to the Indian banking industry and hence to Indian Economy based on statistical data. The study enlisted the banks whose NPA is greater than the Net worth which stressed question on the credibility of credit risk management.

Joseph, Mabvure Tendai Edson, Gwangwava(2012) the study emphasizes to determine different reasons of nonperforming assets in Zimbabwe. Advances and loans are the major portion of total assets of commercial banks. Since these attract a major portion of interest income for banks which is a major part in the profitability of banks, hence determining their financial efficiency. However a major chunk of these advances and loans comes under Non performing status and greatly affects the commercial bank's performance The purpose of the study was to find out the causes of non-performing loans in Zimbabwe. Loans form a greater portion of the total assets in banks. These assets generate huge interest income for banks which to a large extent determines the financial performance of banks. However, some of these loans usually fall into non-performing status and adversely affect the performance of banks. In view of the critical role banks play in an economy, it is essential to identify problems that affect the performance of these institutions. This is because non-performing loans can affect the ability of banks to play their role in the development of the economy. A case study research design of CBZ Bank Limited was employed. Interviews and questionnaires were used to collect data for the study. The paper revealed that external factors are more prevalent in causing non-performing loans in CBZ Bank Limited. The major factors causing nonperforming loans were natural disasters, government policy and the integrity of the borrower.

Dong, H. (2002) explicated the decline of credit quality in Public sector banks and development institutions. The research is a comparative analysis on the basis of regional and cross country experience in dealing with impaired assets during money crisis. The study suggested the incorporation of Asset Reconstruction as a sole tool to manage Nonperforming Assets. The author recommended to have functional independence for ARCs, removal of laws that protects the defaulting companies for management of Indian Banking System.

Sikdar and Makkad (2013) the paper conducted a study on the role of NPA in risk framework of selected Indian commercial banks and try to put forward the different means of explaining credit risk from existing levels of bank NPAs. Further, study focuses the important steps taken and courses enforced by major Indian commercial banks, within the public and private sector, towards retrieval of advances and loans which fall into NPA category. The basis for the present paper is extensive study of annual publications on performance of public sector and private sector commercial banks by the Indian Banks Association (IBA). Apart from this, annual reports of commercial banks for the year ending March 2012 have been incorporated for study purpose. The research conclude that problem of NPAs can be resolved only with proper credit management and risk control mechanism.

In another major study focused on comparing NPA in Asian markets, **Batra, S. (2003)** made an eloquent attention on inclining levels of NPAs in Indian Banking. The author reviewed that credit risk management involves important implications on NPAs over other sides of bank's functioning.

Paul Purnendu, Bose, Swapan and Dhalla, Rizwan S.(**2011**) conducted a study to measure the efficiency of Indian PSU Banks on the financial performance. It is mandatory for commercial banks in India which is a developing nation that the banks keep themselves under continuous pace of restructuring of Nonperforming Assets, capital risk weighted asset ratio, return on assets. In the study Non performing Asset proved to be a negative financial indicator.

A study titled"Changing Dynamics in Asian Non-Performing Loan" **Vassiliou,L.(2004)** assessed different NPL determination methods in Asian Countries. The research confirmed that most Asian countries use Corporate Debt Restructuring (CDR), formation of AMCs and securitization to control and mitigate the high levels of NPAs. The study reflected the role of SARFAESI Act and National Company Law Tribunal in management of NPA and how formation of AMCs helps in managing NPLs.

Srinivas K T (2013) stress on pinpointing Non Performing Assets in Commercial banks of India. This study enumerates different reasons due to which different loans and advances into NPAs and also gave proper suggestion to overcome the said problem

Shri R.Gandhi (RBI) 2015 Asset quality is an essential factor to scale the health of the banks. Asset quality is a significant scale to measure the health of banks. During the period, the 'restructured but standard advances as a percentage of gross loans increased considerably from 1.14% in March 2008 to 5.87% in March 2014. In the last few years or so, the Net Non-Performing Asset Ratio as well Gross Non-Performing Asset Ratio of Indian commercial banks have been showing a decreasing trend due to many issues, and mainly due to the credit risk management techniques followed by banks. There has been a gradual loss in the asset quality

As such, the overall stressed advances remained opulent with considerable increase in the recent period working out to 10.67% for the banking system as at the end of September 2014. According to Shri. R Gandhi, the growth in NPAs was much higher than the growth in advances during the last four years. In addition, the ratio of restructured standard assets to gross advances grew to 6.44 per cent as at the end of March 2015 from 5.87 per cent of gross advances as on March 2014. The total stressed assets (i.e., NPAs plus Restructured Assets) as on March 2015 were 11.06 per cent of gross advances.

Research Methodology:

The data sources used are secondary source of data. The data for Gross NPA ratio and Gross Loans of Indian Commercial Banks for the years 2005-2018 have been taken from official website of Reserve bank of India**.**

Data Analysis:

Data collected from the secondary sources are analyzed by bar Graphs and line charts.

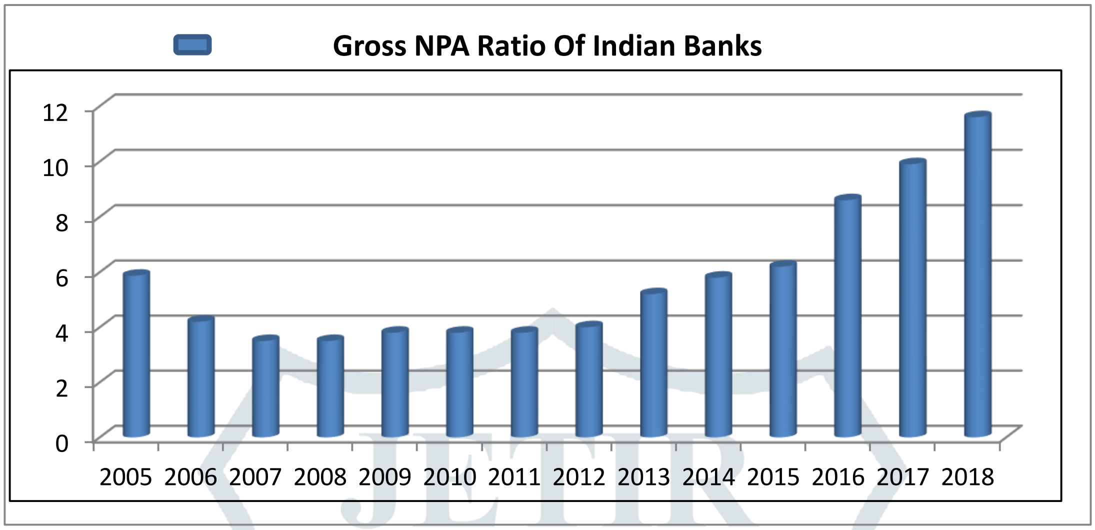

Figure 1- Gross NPA ratio of Indian Banks

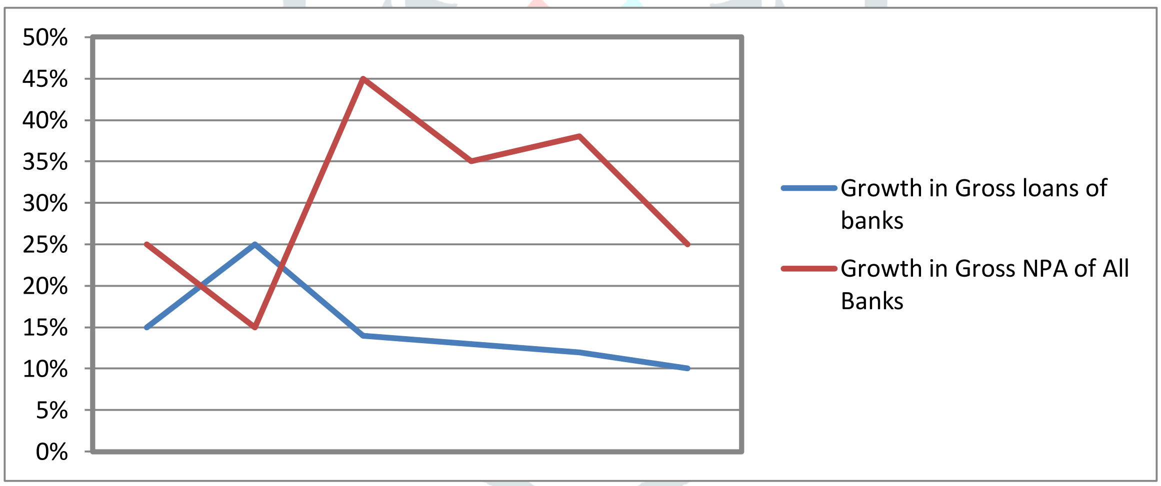

Figure 2 – Gross Loans and Gross NPA across the years

The increase in stressed assets has adversely impacted the profitability of the banks. The annual return on assets has come down from 1.09 per cent during 2010-11 to 0.78 per cent during 2014-15. Considering the effect it has on both capital and liquidity position of the bank, there is an immediate need for banks to mitigate their stressed assets and brush out their Financial Statements lest they become a parasite for Indian Economy. The trend shows an increasing trend in the Gross NPA ratio from 20015 to 2018, being highest in 2018.

Dr. Raghuram Rajan, Governor(RBI) ,there are two opposite approaches to stress due to loans and advances. Firstly is to cover the loan current and wait in hope that time will cure the disease and will bring the project on track. Sometimes this wait is worth but most of the times the slow growth due to which stress sustains. Due to bulk of unpayable debt, the promoters are losing interest due to which they losses their interest in fixation of problems and the project goes into losses.A second way out is instead of covering the loans current try to keep stressed out project on line with proper operations. The best option to do this is to write off the existing loans since they are granted, by doing this promoters may built in confidence and might bring more equity and more stakeholders like local government get involved in the project which will altogether help in the reincarnation of the project and hence will bring it on line.

But for proper operation such as writing off the granted loans or restructuring commercial banks will have to identify assets as Non performing Assets (NPAs). And this classification of assets will behave as analgesic for performing the operation to bring the project on its correct line. If the commercial banks simply want to pretend that all is ok with the advances they have granted they can cover it but for further strict action they require to classify the assets ass NPA.

Dr.Raghuram G Rajan, , said for those who want banking industry to start lending in a proper way should first focus on cleaning up of this industry. For this following steps can be taken

Firstly, banks should find loan stress and try to disclose it we want banks to recognize loan distress and disclose it, Classification of loan is a part of healthy accounting process, since reflects the actual picture of loans. With this is provisioning can also be done which will ensure the commercial banks to act as buffer to absorb likely losses in near future. If the losses arise in future the banks need not to abruptly declare the losses instead they can write back provisions to profits and thus the bank balance sheet then shows a actual and fair picture of the banks soundness for which actually a balance sheet is actually meant for. But until the industry shows some sudden and drastic transformation the balance sheet of banks will tend to show a falsify image.

Secondly, banks should show a real and actual figure about the project's fund generating capacity

Thirdly, even after restructuring and having a bulk of NPAs commercial banks should continue lending to profitable projects.

The RBI's Approach

The first job is to take prompt steps for resolution and fair recovery for lenders and to collect, store and disseminate data on all borrowers' credit exposures including Special Mention Accounts, for this RBI generated a database Central Repository of Information on Large Credits (CRILC) that involve all advances above Rs 50 millions, which is being shared by all commercial banks. The CRILC includes all the status of each loan depicting whether it was performing, going to be NPA or already an NPA. The database will help the commercial banks to find early warning signs of stress in a borrower such as habitual delayed payments to a segment of lenders.

The second job is to coordinate the creditors through a Joint Lender's Forum(JLF) once such early warnings are seen. The JLF was to coordinate the lenders through a Joint Lenders' Forum (JLF) once such early signals were seen. In JLF high valued accounts which are delinquent are referred to a committee consisting of senior executives of a company's lenders, which takes relevant decisions on how a loan can be recovered.The third step is to provide incentives to the commercial banks for helping them in quick decision making.

The banks will now be required to classify 'Special Mention Accounts" into three sub categories: SMA 0- Principal or interest not overdue but showing incipient signs of stress.

SMA 1-Principal or interest overdue-31-60 days

SMA 2- Principal or interest overdue-61-90 days

CONCLUSION

1. Due to the mismanagement of banks there is a positive relation between NPAs Total loans granted, and Net profit which is harmful for Indian banking Industry hence to Indian Economy.
2. The poor credit risk management affects badly on the liquidity of commercial bank.
3. Commercial banks are unable to capture a new target customer due to unavailability of surplus funds since that is struck in NPAs
4. Commercial banks should grant loans and advances after scrutinizing the credibility of the borrowers
5. To avoid cases of defaulters, it is recommended to educate the customers the consequences of defaulting.
6. Though amount of NPA can never be zero but still Commercial banks need to speed up their recovery phase.
7. RBI should take and introduce some more measures and tools to curb the lending limits as to improve the condition of Indian Banks.
8. The commercial banks need to guard against growing credit concentration risks especially in sectors which had witnessed excessively high growth.
9. Prevention of NPAs should be undertaken by the usage of judicious underwriting
10. Asset quality diagnosis systems should be enhanced so as to quickly find out warning signals of the defaulters.

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