JETIR.ORG ISSN: 2349-5162 | ESTD Year : 2014 | Monthly Issue
JOURNAL OF EMERGING TECHNOLOGIES AND INNOVATIVE RESEARCH (JETIR)
An International Scholarly Open Access, Peer-reviewed, Refereed Journal

A STUDY OF NON-PERFORMING ASSETS IN BANKING SYSTEM OF INDIA

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ABSTRACT

Purpose*:* The purpose of this paper is to find out the impacts of banks' NPAs(Non performing Assets) on India's economic growth. This paper also aims at analysing the varying trends of NPAs.

Design/Methodology/Approach: The paper uses ANOVA F-test on public sector of Nationalised banks and SBI group to analyse the significant result at 0.05.

Findings: The result of the analysis indicates that NPAs of Nationalised banks and SBI group have a great impact on the economic growth. The potentially weak credit system of banks caused by NPAs has a negative impact on the economy.

Originality/ Value: The paper considers fundamental and behavioural aspects of banks' NPAs.

***Keywords*:** Credit system, Economic Growth, Non-Performing Assets, Public Sector.

INTRODUCTION

An NPA(Non-Performing Asset) is an asset, including a leased asset when it ceases to generate income for the bank. With effect from 31st March 2004, NPA(Non-Performing Asset) shall be a loan or an advance where interest and / or instalment of Principal remain overdue for a period of more than 90 days in respect of term loan. The account remain out of order if outstanding balance remains continuously in excess of sanction limit or drawing power for a period of more than 90 days in respect of an overdraft / cash credit. In case, it remains less than the sanction limit or drawing power but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest deposited during the same period or the bill remains overdue for a period of more than 90 days in case of bills purchased and discounted, they will be considered NPAs(Non-Performing Assets) as loan (Reserve Bank of India, Master Circular,2009 ;Publication,2013). The Securitization Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 defined Non-Performing Assets as, "An asset which has been classified by a bank or a financial institution as sub standard, doubtful or loss assets in accordance with the direction or guideline relating to asset classification issued by RBI(Reserve Bank of India)" With effect from March 31, 2005, Sub standard assets would be one which remain NPA(Non-Performing Assets) for less than 12 months while doubtful assets remain sub standard for 12 months and loss assets when the loss identified by the bank or internal or external auditors or the RBI(Reserve Bank of India) inspection but the amount has not been written off wholly. **(RBI Publication,2013)**

However, the current situations of NPA(Non-Performing Asset)are not favourable. The Banking sector which can play a very significant role in the economic growth, ironically, is undergoing a serious threats of NPA(Non-Preforming Asset) which will invariably affect the goodwill and the profit of banks.

Consequently, the banks will lose their investment for the long run causing a slow economic growth of the country (**Rathore et al.,2014)**

There is an impact of NPAs on financial institutions since they depend on borrowing cost as a source of income. Troublesome pressure from the economy can lead to a sharp increase in NPA (Non-Performing Assets) and often results in massive write downs. India is already undergoing a slow economic growth owing to natural and economic environmental i.e. agricultural sector depending on rains , affected by natural calamities (flood, hail ,storms , frost), subsidy and liquidity constraints of finance to the poor farmers, SSI(Small scale Industries), and businesses **(M. Lokare,2014)** NAPs have added another issue of banks' liquidity crisis. The frail financial condition of banks created by NPAs have made depositors indifferent of keeping money in the banks because of the feeling of insecurity and low confidence in the banking system . NPAs have caused credit crisis.

LITERATURE REVIEW

(Ankit,2016) examined that public sector banks are facing the problem of bad loan because of lack of diligence and managerial skills to assess credit worthiness .Proper documentation , role of management and stringent legal provisions are required to deal with the situation.

(Deepak,2016) found after case study of a wilful defaulter that RBI(Reserve Bank of India) should empower the presiding officer at debt recovery tribunals to impound passports of defaulters. There should be forensic audit and the loan fund disbursed on the project to be ensured by the bank as well as no project loan should be sanctioned unless the cash flow of it is monitored.

(Ghosh,2014) found that with decrease in economic growth, the NPA(Non-Performing Asset) level increases. When the volatility is increasing globally, Indian banks are being able to keep NPA(NonPerforming Asset) level at a declining trajectory. Developed and developing countries have already managed to curb NPA(Non-Performing Asset) level from the high of 2008-09 at the time of global recession while it is still rising in India and high growth rate of CDR(Corporate Debt Restructuring) is difficult to manage NPA(Non-Performing Asset).

(Lokare,2014) discussed the causes of NPA rise owing to the neglect of proper credit appraisal. There was a lack of follow up and supervision. Global Financial Recession broke out in 2008 and during 200609 there was an indirect spillover of the crisis in the entire Financial Institutions which sustained till 2010 as great economic slowdown, however, the gap between growth of credit rate and NPA improved which showed the sign of Asset quality in 2012. The government changed the policies and faced the challenges of Infrastructural bottlenecks and diversion of funds.

(Rathore et al.,2016) revealed that banks had the wrong choice of clients and there was a poor correlation between banks and NPA(Non-Performing Asset). Economic environmental factors were responsible for the rise in NPA(Non-Performing Asset). The measures such as no loan to new clients should be taken but they leave a scope for the researchers to find out the way for the new clients.

(Zahoor, Jagadeeshwaran,2013) noticed the level of NPA(Non-Performing Asset) upward trend with different growth rates. There was a significant difference between gross and net NPA(NonPerforming Asset) of Nationalized banks. They enumerated the causes and effects of rising NPA (Non- Performing Asset)and its cure.

METHODOLIGY

The secondary data were collected between 2004 and 2012 of NPA(Non-Performing Asset) which show an increasing trend during the period taken for the study. It attempts to get a clear insight of NPA(Non-Performing Asset) in Indian banking sectors. The Priority and the Non -Priority Sectors of Public Sector Banks(Nationalised and SBI Group) banks are analysed by source of data from the RBI(Reserve Bank of India) Publication, (2013), the Department of Banking Supervision @ https://m.rbi.org.in. ANOVA F-Test was conducted on public sector's NPAs of Nationalised bank and State Bank of India group with the figures of 2004, 2008 and 2012 at the significance level of 0.05.

ANOVA (F-TEST)

Percentage

Non-Performing Assets (in Public Sector)

Nationalised Banks State Bank of India Group

2004 1.1 1.45

2008 0.83 0.63 2012 0.29

0.05

Step 1: Sum Mean of all data

(2004)X=1.28

(2008)X= 0.73

(2012)X=0.17

€X = 2.18

Average X= 2.18/3

= 0.72

Step 2: Squares of errors

2004 (Vi-X)^2+(Vii-X)^2

(1.11-1.28)^2 +(1.45-1.28)^2

0.03 + 0.03

0.06

2008 (Vi-X)^2 +(Vii-X)^2

(0.83-0.73)^2+(0.63-0.73)^2

0.01 + 0.01

0.02

2012 (Vi-X)^2 +(Vii-X)^2

(0.29-0.17)^2 +(0.05-0.17)^2

0.01 + 0.01

0.02

Sum of all €(0.06+0.02+0.02)=0.10

Step 3: Sum of squares treatment

2[(1.28-0.72)^2 +(0.73—0.72)^2+(0.17-0.72)^2]

2(0.31 + 0.0001 + 0.30

=12.2

Step 4:

Mean squares

12.2/2(Degree of Freedom i.e. one less group)

=0.61

Value of F= 0.61/0.033*

=18.48

*0.10/3 Sum of squares errors/(Degree of Freedom i.e. total variables of all groups-total no. of groups) p-value

=0.02057

RESULTS AND DISCUSSION

Indian economy was going through high growth phase during 2006-11 and there was a rapid credit growth. The infrastructure sector contributed fifty per cent share in investment followed by Metal of twenty one per cent, Industries of fifteen per cent , textile eleven per cent and Telecom two per cent by 2008 and the NPA(Non-Performing Asset) was thirty per cent, thirteen per cent , ten per cent , five per cent and two per cent respectively. **(K.Ramesh, M.lokare,2014)**

The corporate profits decreased. The government banned mining projects. There was a delay in environmental permits affecting the infrastructural sectors – power, iron, steel resulting in volatility in prices of raw materials and shortage of supply due to sudden credit constraints.**(Ghosh,2014)**

Composition of NPAs of Public Sector Banks between 2004-2012

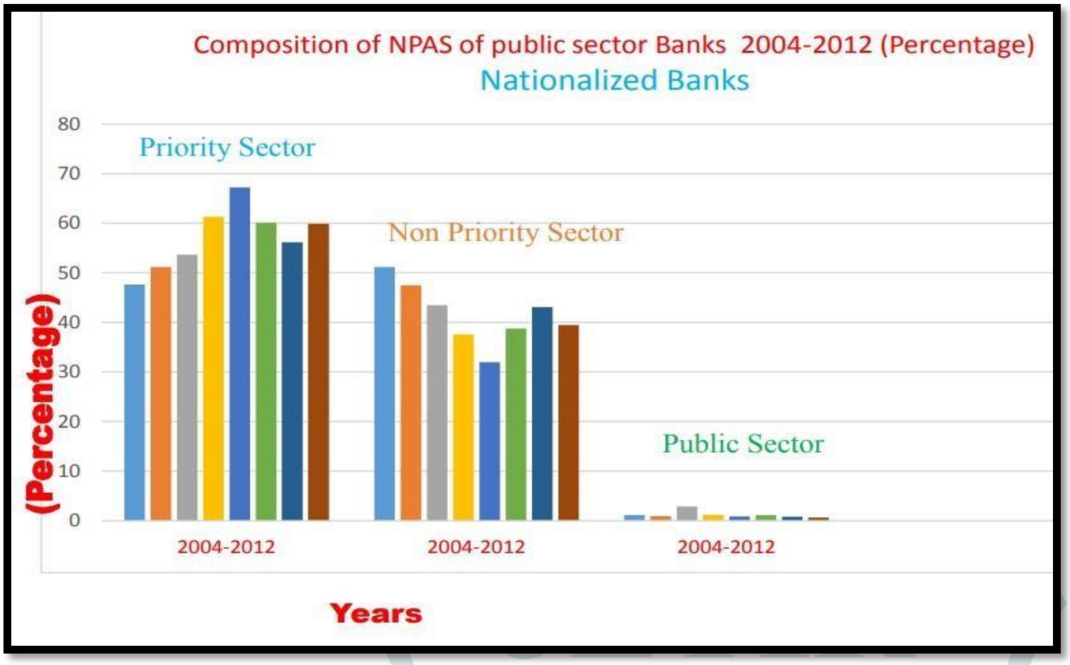
Table.1

Composition of NPAS of public sector Banks 2004-2012 (Percentage)									
Banks	2004	2005	2006	2007	2008	2009	2010	2011	2012
A. Nationalized Banks									
(i) Priority Sector	47.64	51.17	53.66	61.28	67.21	60.10	56.13	59.90	48.34
(ii)Non Priority Sector	51.14	47.49	43.48	37.55	31.96	38.76	43.08	39.47	51.37
47.54(iii) Public Sector	1.11	0.88	2.87	1.17	0.83	1.13	0.79	0.64	0.29
B, SBI Group									
(i) Priority Sector	47.07	47.39	54.95	57.15	58.49	47.26	50.11	55.32	52.33
(ii)Non Priority Sector	51.48	51.48	44.10	41.36	40.88	51.75	48.77	44.66	47.62
(iii) Public Sector	1.45	1.13	0.95	1.50	0.63	0.99	1.12	0.02	0.05
C. Public Sector Banks (A. + B)									
(i) Priority Sector	47.54	49.98	54.07	59.92	63.85	54.89	53.84	58.09	49.46
(ii)Non Priority Sector	51.24	49.06	43.68	38.80	35.39	44.04	45.25	41.52	49.85
(iii) Public Sector	1.22	0.96	2.25	1.25	0.75	1.08	0.91	0.39	0.19

Source:-*RBI*

In Nationalised Banks, NPA has been rising since 2004 and reached the highest in 2008. However, it declined in 2009-10 but again rose in 2011 and fell down in 2012 in the Priority Sector. In the NonPriority Sector NPA shows a fall between 2004 and 2008, bur it shot up sharply from 2009 -2012 except 2011 .In the Public Sector it rose in 2006 and 2009 respectively but depicted a constant decline afterwards.

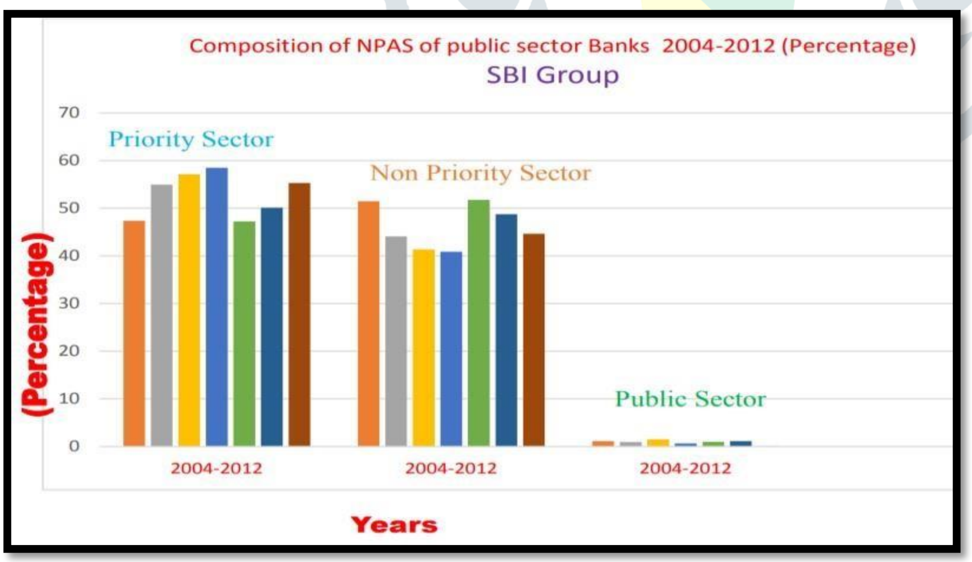
Fig.1 Composition of NPAs of the Nationalised Banks(2004-2012)



Source: RBI website

In SBI(State Bank of India) Group, the rise and fall trend of NPA is reflected. It increased from 2004 to 2008 but dipped in 2009. After rising in 2010-11 it again decreased in 2012. Non -Priority Sector is just reverse to Priority Sector where it is downward in 2008 but went up in 2009. It fell in 2010-11 but rose in 2012. In Public Sector also it was found fluctuating. It was low between 200406 and rose in 2007.After falling down in 2008-09 it rose in 2010 and again fell in 2011 but increased in 2012.

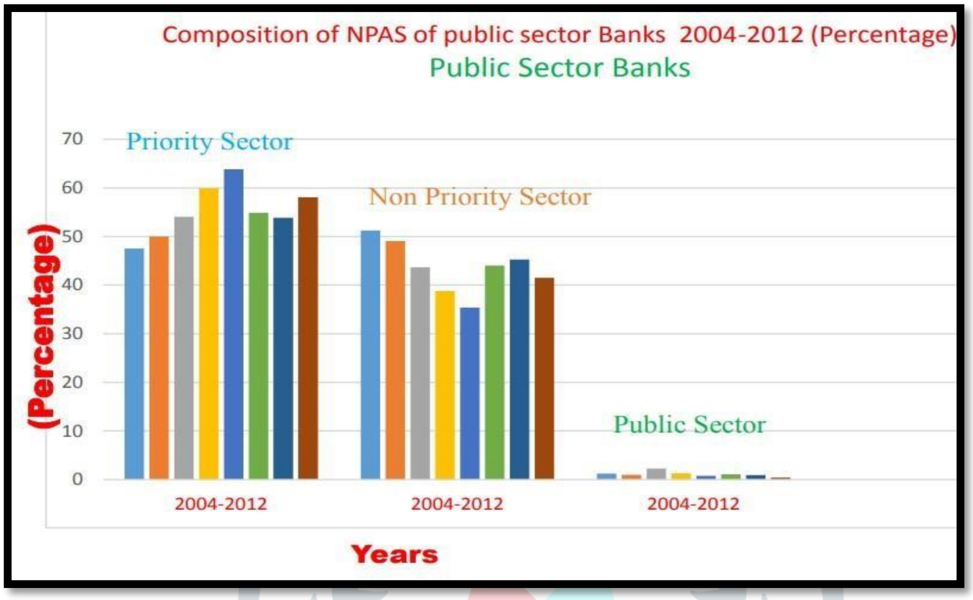
Fig.2 Composition of NPAs of SBI Group(2004-2012)



Source: SBI

Overall, In Public Sector Banks(including Nationalised Banks and SBI Group), NPA in the Priority Sector showed an increase from 2004-08 but decreased in 2009-10 and after rising in 2011 it again fell in 2012. In the Non-Priority Sector, NPA declined from 2004-2008 but shot up in 2008-10 and after decreasing in 2011, it rose sharply in 2012. In the Public Sector, it was upward in 2006 and 2009 but remained low in 2004-05, 2007-8 and 2010-12.

Fig.3 Composition of NPAs of Public Sector Banks(2004-2012)



Source: MSME

Hence, it is inferred from the data between 2004 and 2014 that Non-Priority Sector had a great impact on NPA than the Priority Sector and the high trend got severe in 2009 and 2012. The rise in NPA in the Nationalised banks saw an upward trend of growth with some variations**(Zahoor, Jagdeeeshwaran, 2013).**

The condition of public sector banks in view of NPA(Non-Performing Asset) has been deplorable. NPA(Non-performing Asset) was accumulated massively. It all happened because of the leniency of the banks in extending credit **(Ankit,2016)** under the influence of some influential borrowers and the blind faith on them for their credential beyond the collateral merely or on the basis of LOU(Letter of Undertaking) , the big corporate houses and foregoing analysis of their financial and credit ratings

The breach of faith has shaken the entire banking system for NPA(Non-Performing Asset), reducing the credit capacity which has adversely affected the credit worthy borrowers. It has caused a great impact on industry, agriculture and MSMEs(Micro Small and Medium Enterprises) causing a slow growth of the economy.**(Deepak,2016)**

NPA(Non-Performing Asset) has a great impact on the profitability and credibility of the banks. It has suppressed the confidence among depositors, for they started withdrawing their money for the lack of security. Furthermore, saving account interest rate has come down. The credit liquidity to industries and MSMEs(Micro Small and Medium Enterprises)has shrunk and hence infrastructural investment has been hampered because of the insecurity among the investors, poor recycling and paucity of the fund.

Now, there is a slight improvement in reduction of NPAs(Non-Performing Assets). The RBI(Reserve Bank of India) has taken bold initiatives after a couple of events that broke the backbone of banking system .The system needed an overhaul, reconstructions of which reducing the number of Public sector banks to twelve from twenty seven by merger including subsidiary banks of SBI(State Bank of India) into one is a giant leap towards managing NPA(Non-Performing Asset) crises. It is praiseworthy to create a special bank which can buy NPA(NonPerforming Asset), and close monitoring of NBFCs(Non- Banking Financial Companies) by RBI (Reserve Bank of India), firm determination to recover NPA(Non-Performing Assets) through auction of collateral from the willful defaulters and setting a standard norms to maintain NPA(Non-Performing Asset) ,capital adequacy ratio, checking creditworthiness and goodwill of borrowers and credit rating of banks by credit rating agencies can help NPA(Non-Performing Asset) maintain a reasonable liquidity and

NBFC(Non Banking Financial Companies) to extend loan and advances to MSMES(Micro Small and Medium Enterprises), potential Industrial sectors and agriculture to boost up GDP(Gross Domestic Product) and uplift the economy from slump down. The study reveals the reasons behind the increase of NPAs(Non-Performing Assets) and the remedies to reduce it.

The non-recovery of loan affects credit and financial strength of the banks. The situations can be controlled by the following recommendations:

Banking Sector Reforms, 1998 by Narasimham Committee has the recommendations to improve the asset quality as follows**: (Gauran,2010)**

(a) The ratio of non-performing assets to the total assets should be reduced.

(b) All 'loan assets in the doubtful and loss categories should be identified and their realizable value determined. The assets could be transferred to an Asset Reconstruction Company which would issue NPA(Non-Performing Asset) Scrap Bonds.

(c) The banks with high ratio for NPA(Non-Performing Asset) should issue bonds backed by Government Guarantee.

(d) The interest subsidy element in credit for the private sector should be totally eliminated. Interest rate on loans under lakh should be deregulated.

(e) An independent loan review mechanism specially for large borrowed accounts and systems to identify potential Non-Performing Assets (NPA) should be set up.

(f) The special tribunals should be set up to speed up the process of recovery of loans. An ARF(Asset Reconstruction Firm) should be established to take over from banks and financial institutions a portion of their bad and doubtful debts at a discount.

(g) Not less than 50% provision on assets should be made

(h) Additional provision for 90 day loan and charging of interest monthly was made to strengthen their balance sheets. 25% yearly prudential norms guaranteed by state government for assets in default was created for more than two quarters

(i) Ever greening policy (making fresh advances, setting interest dues and classification of loans as NPAs(Non performing Asset)) was avoided

(j) Credit risk management, loan review mechanism, enhance credit and appraisal skills of staff was initiated to arrest the growth of NPA(Non-Performing Asset)

(k) Loan to Agriculture and SSI sectors was granted on commercial considerations and credit worthiness of borrowers

(l) Interest rates up to Rs 2 lac should not exceed PLR(Prime Lending Rate)

However, the NPA level has come down for the first time after seven years. The cover ratio of NPA has increased from 28.3% to 60.5% and the capital adequacy ratio to 14.3% which is above the standard. Due to substantial delay in the permit of industrial and structural programmes on time. The problem of NPA in the public sector bank sustains. The problem of governance and social responsibility Leniency of RBI(Reserve Bank of India), Zero Risk Management and Corrupt Officials are also the causes of poor conditions of Asset quality and rising NPA.

However, the Banks have created the following provisions to deal with this problem. **(RBI, Master Circular, 2009)**

- Full disclosure of loan details on website of the bank concerned.
- To set up system of whetting loan applications committee. Do transparency in transaction.
- To empower presiding officer at debt-recovery tribunals to impound the passport of defaulters.
- To make forensic audit of annual review of accounts.
- To disclose maturity pattern of loan, investment deposits, deposits , borrowings, foreign currencies assets and liabilities, movements in NPA(Non-Performing Asset), lending to sensitive sectors as defined from time to time.
- To set up risk management system, statistical risk management techniques •

- To revise operative manuals and update
- To set up EDP(Executive Development Programme) Audit cell, effective management reporting system, segregation of banking activities, training in credit , treasury, risk and IT(Information and Technology) management.
- To identify weak banks and potential weak banks
- To conduct bank specific restructuring programmes to reduce cost of operation , improve income level through Financial Restructuring Authority • To synchronize license and call notice
- To set up RIDF(Rural Infrastructure Development Fund)

Mutual funds and corporates will undertake FRAI (Federation of retailer Association of India)and IRS(Indian Revenue Service) to hedge interest rate.

Besides, no project loan should be sanctioned unless its cash flow can be monitored.

Debt should be converted to equity under strategic debt restructuring scheme.

Intangible such as brands as collateral should not be accepted.

High value debit operations in the account (outflows) must be verified if payment related to the business activities of the borrower.

Credit operations (inflows) to be checked if sale proceeds are being routed through the account. RTGS(Real Time Gross Settlement), NEFT(National Electronic Fund Transfer)for details of all transactions related to diversion of funds or transfer, obtain list of debtors for realizing book debt and check current account with other banks.

CONCLUSION

Based on the study it is concluded that the banking sector is grappling with NPA(Non-Preforming Asset) crises. The corrupt practices to extend credit to the big borrowers without any credit rating and valuation of collateral, not following RBI's(Reserve Bank of India) guidelines , hiding the profits of bank through window dressing etc. led a huge accumulation of NPAs. Investors and depositors have insecurity of investing and keeping saving deposits. They are unsure to get back their money at the time of urgent need. It is a fiasco for not only the banking system but also those sectors which depend on banks for credit because of paucity of credit liquidity.

This has been detrimental for the big industries , Micro small and Medium Enterprises and the Primary sectors which have adversely affected the growth of Indian economy with low share in GDP(Gross Domestic Product) due to the credit constraints caused by NPAs in banks. It seemed a slight improvement in reducing NPA(Non-Performing Asset) in recent years but every time a new issue comes up. Hence, RBI(Reserve Bank of India) has to come forward with strict regulations about the norms of terms of credit, role of rating agencies, training and outsourcing of managerial staff to boost operation and managerial efficiency, professionalism and integrity of bank staff**(Ankit,2016),**merger of a half dozen of the Nationalised banks reduced to twelve including subsidiaries of the state Bank of India etc. Besides, NPA(Non-Performing Asset) can be wiped out by cleaning the balance sheet of the bank , overseeing accounting and auditing work properly. The government should issue equity shares by selling bad loans when there is expansion of economy and constitute an NPA regulatory body which can oversee the ways of extending credit by the banks and suggest the methods of controlling whopping NPAs(Non-Preforming Assets) and means of recovering it.The Body should be entrusted with guarantee of making up NPAs(Non-Performing Assets) of the banks. The banks should decide the criteria in uniformity and impartiality of extending credit to different categories of borrowers such as businessman,farmers,Corporate, MSMEs(Micro Small and Medium Enterprises) , informal sector etc. .There should be no financial constraints in these sectors caused by NPAs (Non-Performing Assets) which may lead to stagnation of growth . NPAs(NonPerforming Assets) free credit can play a great important role in improving productivity and the economic growth of India.

NBFC's (Non Banking Financial Companies) NPA is proposed to be transferred to a newly formed special NPA company to save NPA of 25 big NBFCs. The special company would buy their NPAs. Due to IL & FS(Infrastructural Leasing and Financial Services limited) scam and DHFL(Dewan Housing Finance Limited) insolvency, 50 top NBFCs(Non Banking Financial

Companies) are put under surveillance and they are directed by RBI to maintain their financial standard. NBFCs will take loan from banks once NPA is recovered and grant home loan and auto loan to customers to boost up the economic growth. Hence, the liquidity problem of NBFCs and banks will be made easy also by lowering down Repo rate.

RECOMMENDATIONS

It was found that the Non-Priority Sector accumulated a huge amount of NPA compared to Priority Sector since 2009.The reasons may be economic, natural and social environment but what could have been done was also ignored and the wrong policy of banking system may be held responsible for this severe situation. A little initiative has been taken towards holding NPA(Non-Performing Asset) to grow up further otherwise it would not have increased from hundreds of crore to thousands of crore during the period. It is unbelievable that one after another bank is getting bankrupt. The measures taken by the government such as merger of eight Nationalised banks should have been executed much earlier to strengthen the banks and maintain by reconstruction. Banks should maintain capital adequacy ratio on Basel III accord. Moreover , the lacklusture attitude of NPA(Non Preforming Asset) recovery from the wilful defaulters became a threat to internal reconstruction of the banking system.**(Deepak,2014**)The lesson is also not learnt from the past incidents of NPA(Non-Preforming Asset) crises . The private and cooperative banks functionary was ignored which again gave a big blow to the depositors and the Indian economy as a whole because many projects came to a standstill**.** Coal and Mining power and environment sectors which fully depend upon infrastructure have collapsed because there is no credit extension to industries , small businesses infrastructure for investment. Depositors and investors withdrew their assets in the fear insecurity. The study is limited to examine the NPAs of Public Sector in Priority and Non-Priority Sectors. It needs to investigate the private sector banks' NPAs in Priority and Non Priority Sector and oversee the RBI(Reserve Bank of India) regulatory functions, overhaul the financial institutions, implementation of initiatives of strictly adhering to the norms in functionary of banks , improvement in the efficiency of the managerial staff and the entire banking sector in India to minimise NPAs(Non-Performing Assets) in future.

As per literature review NPA(Non-Performing Asset) has not witnessed a significant improvement in public banks. Therefore, It is suggested that the government's initiatives and plans are very important to manage NPA(Non-Performing Asset) for the infrastructural growth of telecom, power and MSMEs(Micro Small and Medium Enterprises) by empowering banks and NBFCs(Non Banking Financial Companies) to meet the genuine demand of credit for the growth of GDP(Gross Domestic Product) of the Indian economy.

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