Adverse Effects of NPA in Banking Sector – A Study

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Abstract

The role of the banking sector in economic transformation is significant as banks play a vital role in providing the desired financial resources to the needy sectors. Bank itself posses the controlling power of the economy. The flow of money person to person, business to business, country to country just due to the banking system. Banks fuels the economical vehicle to run smoothly, and also said as the backbone of the economy. NPA's Non-performing assets are the assets of the banks which are not performing, banks to run the economy also provide short-term and long-term loans to the industries, individuals, farmers, a bank also gives loan against the home, vehicles and many more. In some cases, the borrower unable to pay the interest amount on time as well as unable to return the principal amount too, in that case, bank declares that amount as nonperforming.

The bank also runs the recovery scenario for that amount, the impact of NPA on the profitability of banks brings a dent on the balance sheet of the bank, but until then the amount is nonperforming. High Non-Performing Assets are the foremost problem for the banking system for any economy, that shakes the whole banking system of the country. The confidence level of the investor, Depositors, Stack holders also effects. This also causes the rotation of money. On Performing Assets not only reduces the profit of the Bank but also increases the Loss. Also, banks also providing 25 % to 30% additional provision on Non-Performing Assets which directly impact the Profitability of the Bank. Not in the Banking sector, but shareholders need their money in safe hands, Shareholders are interested in the enhancement of investment and market capitalization.

High Non-Performing Assets reduces the confidence level of the investor which significantly impact the Share price of the Bank in this situation, banks stop payout of dividend to the shareholders, which was not in the interest of the investor. The poor performance of the Bank due to increases in Non-Performing Assets not only lower the sentiments of the investor but the bank also loses the faith of Public, this directly affects the deposits into the bank. According to the Reserve Bank of India (RBI), the gross non-performing assets in Indian banks, specifically in public sector banks, are valued at around Rs 400,000 crore (~US$61.5 billion), which represents 90% of the total NPA in India, with private sector banks accounting for the remainder.

Key words: banking sector, NPA, gross NPA, loans, industries, corporate, businesses.

Introduction

Assets which generate income are called performing assets and but those do not generate income are called non-performing assets. A debt obligation where the borrower has not paid any previously agreed upon interest and principal repayments to the designated lender for an extended period of time. The nonperforming asset is therefore not yielding any income to the lender in the form of principal and interest payments. For example, a mortgage in default would be considered non-performing. After a prolonged period of non-payment, the lender will force the borrower to liquidate any assets that were pledged as part of the debt agreement. If no assets were pledged, the lenders might write-off the asset as a bad debt and then sell it at a discount to a collection's agency. An asset becomes non-performing when it ceases to generate income for the bank.

A nonperforming asset (NPA) is defined generally as a credit facility in respect of which interest and / or installment of principal has remained "past due" for two quarters or more. An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. It was, however, decided to dispense with past due. Worried over rising bad loans, a Parliamentary Panel has suo motu decided to examine the nonperforming assets of the public sector banks that touched Rs 3.61 lakh crore at the end of December 2015. The combined net loss of 20 public sector banks (PSB) stood at Rs 16,272.34 crore for the fourth quarter ended March 2016 as bad loans situation worsened. PSBs registered net profit of Rs 4,063.58 crore in the corresponding quarter.

NPA concept which effect from 31 March 2001. Accordingly, as from that date, a NPA shall be an advance where –

§ Interest and/or installment of principal remain overdue for more than 180 days in respect of a term-loan.

§ The account remains „out of order" for more than 180 days, in respect of overdraft / cash credit (OD / CC).

§ The bill remains overdue for more than 180 days in the case of bill purchased and discounted.

§ Interest and / or installment 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 purpose.

§ Any amount to be received remains overdue for more than 180 days in respect of other accounts.

Objective:

This paper intends to explore the NPA of the banking sector and how it affects the economy and the negative role played by the businesses in the growth of NPA

How much NPA do Banks hold?

Any asset which stops giving returns to its investors for a specified period of time is known as Non-Performing Asset (NPA). Indian Banking industry is seriously affected by Non-Performing Assets. More than Rs. 7 lakh crore worth loans are classified as Non-Performing Loans in India. This is a huge amount. The figure roughly translates to near 10% of all loans given. This means that about 10% of loans are never paid back, resulting in substantial loss of money to the banks. When restructured and unrecognised assets are added the total stress would be 15-20% of total loans. NPA crisis in India is set to worsen. Restructuring norms are being misused.

This bad performance is not a good sign and can result in crashing of banks as happened in the sub-prime crisis of 2008 in the United States of America. Also, the NPA problem in India is worst when comparing other emerging BRICS Economies. In India banking sector has played pivotal role in our nation building. After Liberalisation of the economy the banking sector has faced severer challenges, but due to its solid foundation and management it has withered all the subsequent challenges including 2008 sub-prime crisis. But the recent problem has been grave. In the case of public sector banks, the bad health of banks means a bad return for a shareholder which means that government of India gets less money as a dividend. Therefore it may impact easy deployment of money for social and infrastructure development and results in social and political cost.NPAs related cases add more pressure to already pending cases with the judiciary one. In this paper it has been discussed in details with best possible solutions.

Higher NPA impact the revenue strength of the banks and also lose the confidence level of consumers and depositors, banks are back boon to the Financial economy of every country.

Changes in Interest Rates

Higher NPA reflects the reduction of interest rate on the deposit into banks, only poor public directly impact the consequences of Higher NPA's of the bank.

Levies of charges for every operation

Looking at the above scenario, the bank is recovering their losses by levies charges on those operations which were free of cost like –

- Withdrawal limit from ATM
- Withdrawal number of times
- Cash deposits in other branches
- Internet transaction charges

NPA Affects growth

As stated earlier the credit growth to the industrial sector was higher as compared to the GDP growth and over credit growth during the period 2006-11. As a result, the proportion of NPAs in industrial sector was much higher vis-à-vis other sectors. Consequently, in the later phase, banks were reluctant to fund the needs of industrial sector hampering its growth. In fact, in some cases like that of the Micro, Small and Medium Enterprises (MSME) industry, credit actually shrank.The slowdown in growth in post-demonetization period also resulted in reduced profitability of the manufacturing sector which further prompted the banks to stall the credit growth to the industrial sector. In the long term, the shortage of funds to the industrial sector will affect the growth of the industrial sector.

After 2014-15, the credit growth to the industrial sector is least as compared to the credit growth to the agriculture and service sector. The continuous shrinking of credit to industrial sector is detrimental to not only industries but overall economy as well.It is clear that infrastructure accounted for biggest chunk of NPAs. Because of massive amount of NPA in infrastructure, the banks are now reluctant to fund this sector. As the infrastructure is one of the most important sectors in economy which fuels the growth of other sectors, draining of resources to infrastructure may hamper the growth of Indian economy.Among the other sectors, food processing also accounted for 5.3% of total NPAs. Food processing is one of the most employment intensive industries and its growth also pushes the growth of agriculture. Any loss to the food processing industry will ultimately percolate to the employment as well as agriculture sector.Other sectors will also directly or indirectly affect the overall economic scenario due to the exposure to the bad loans. Hence, the issue of NPA must be resolved on urgent basis.

NPA & consumer sentiment

The problem of NPAs in the Indian banking system is one of the foremost and the most formidable problems that had impact the entire banking system. Higher NPA ratio trembles the confidence of investors, depositors, lenders etc. It also causes poor recycling of funds, which in turn will have deleterious effect on the deployment of credit. The non-recovery of loans effects not only further availability of credit but also financial soundness of the banks.

Profitability: NPAs put detrimental impact on the profitability as banks stop to earn income on one hand and attract higher provisioning compared to standard assets on the other hand. On an average, banks are providing around 25% to 30% additional provision on incremental NPAs which has direct bearing on the profitability of the banks.

Asset (Credit) contraction: The increased NPAs put pressure on recycling of funds and reduces the ability of banks for lending more and thus results in lesser interest income. It contracts the money stock which may lead to economic slowdown.

Liability Management: In the light of high NPAs, Banks tend to lower the interest rates on deposits on one hand and likely to levy higher interest rates on advances to sustain NIM. This may become hurdle in smooth financial intermediation process and hampers banks’ business as well as economic growth.

Capital Adequacy: As per Basel norms, banks are required to maintain adequate capital on risk-weighted assets on an ongoing basis. Every increase in NPA level adds to risk weighted assets which warrant the banks to shore up their capital base further. Capital has a price tag ranging from 12% to 18% since it is a scarce resource.

Shareholders’ confidence: Normally, shareholders are interested to enhance value of their investments through higher dividends and market capitalization which is possible only when the bank posts significant profits through improved business. The increased NPA level is likely to have adverse impact on the bank business as well as profitability thereby the shareholders do not receive a market return on their capital and sometimes it may erode their value of investments. As per extant guidelines, banks whose Net NPA level is 5% & above are required to take prior permission from RBI to declare dividend and also stipulate cap on dividend payout.

Public confidence: Credibility of banking system is also affected greatly due to higher level NPAs because it shakes the confidence of general public in the soundness of the banking system. The increased NPAs may pose liquidity issues which is likely to lead run on bank by depositors. Thus, the increased incidence of NPAs not only affects the performance of the banks but also affect the economy as a whole.

In a nutshell, the high incidence of NPA has cascading impact on all important financial ratios of the banks viz., Net Interest Margin, Return on Assets, Profitability, Dividend Payout, Provision coverage ratio, Credit contraction etc., which may likely to erode the value of all stakeholders including Shareholders, Depositors, Borrowers, Employees and public at large.

Impacts of NPA

Unplanned expansion of corporate houses during boom period and loan taken at low rates later being serviced at high rates, therefore, resulting into NPAs. The problem of NPAs in the Indian banking system is one of the foremost and the most formidable problems that had impact the entire banking system. Higher NPA ratio trembles the confidence of investors, depositors, lenders etc.

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RBI noted that the recognition of past bad loans has “neared completion” in the reported fiscal year on the back of the asset quality review exercise undertaken by the central bank in 2015 and the subsequent implementation of the framework for resolution of stressed assets in February 2016.

The framework that had made it mandatory for banks to identify signs of incipient stress in loan accounts and classify these assets as Special Mention Account (SMA), immediately on default, was revised in June 2016 to provide banks a window to resolve these toxic accounts without taking them into administration.

Types of Non-Performing Assets (NPA)

Standard Assets

Standard Assets brings regular income to the organization, Such an asset should not be an NPA because of the risk of borrower fails. In some scenario, standard assets are leaded to get fixed income, if the borrower fails to make repayment regularly and on time, the standard assets said to be NPA.

Sub Standard Assets

The assets which repayment is due for more than 90 days but less than 1 year. Earlier credit card users would get 120 days before being classified as NPAs, as per new amendment if the minimum card payment is not paid within 90 days, it would be treated as sub-standard assets.

Doubtful asset

Doubtful assets speak itself and explain the meaning, in this category if substandard assets remain unpaid for more then 12 months. Going further, doubtful assets are those advances that have a considerable list of defaults or are regularly failing to comply with the norms of "standard asset".

Loss Assets

When the performance of the assets across all the levels of substandard and doubtful category and audit team also declared the loss of the asset, An asset as NPA for a period of more than 36 months is treated as a lost asset.

Why Assets fall into Non-Performing Assets (NPA)

The biggest reason behind NPA is "not taking the assets seriously ". If the lender lends money to the borrower, the main scenario behind is open a new loan account and the concept of competition bring the companies or banks' balance sheet into the black hole. In the same way, the borrower not bothers in return and treat the loan as a liability, what would be the credit rating if you fail to pay your installment, this is out of the question. Not every company performance is bad, its all about the economic condition and changing business Environment.

Steps of Pulling out Banks from Non-Performing Asset (NPA)

The Government of India making lots of changes and making things transparent to keep the level of NPA under control and also trying to get it reduced, some of the major steps which are required to implement to improve the Banking situation.

Bank must think conservative

Its high time bank has to think conservative if the banks only think of distributing loans and increasing the numbers just to take some benefits in the form of subsidy from the Government of India, they are also increasing the number of NPA.

Loan process restructuring

Bank has to tighten their scanner of selection of borrower not only through credit rating but also have to investigate the previous performance of the company and the members of the company, whether anybody is being defaulter in their past performance. That will not only save the bank but also the shareholder confidence.

Relying less on Restructuring of Loan

Why banks wait for the Loan for converting into NPA, and allow the borrower to restructure the loan, this act cause loss for the bank and have a greater chance of getting the Laon into Non-Performing Asset (NPA), rather then relying on restructuring bank needs to take the proper examination before releasing the Loan.

The increase of non-performing assets is always a problem to the banks and it has a direct impact on the profitability of banks. The bank and government must take steps to effect the process of recovery from bad loans and other problems related to bad loans. This paper reflects about the causes and impact of non-performing assets, and this article picturizes the comparative analysis between private sector banks and public sector banks with regard to gross NPA. The banks and government must adopt a various adequate policy to reduce the NPA. The banks must take precautionary measures before the borrower obtain a loan, which the borrower can affect to create a bad loan to banks. The author concludes by the suggestion to reduce NPA and formal methods to control the NPA. The bank must provide loans to those who have better creditworthiness so if then only the bad loans can prevent.

Conclusion

Because of mismanagement in bank there is a positive relation between Total Advances, Net Profits and NPA of bank which is not good. Positive relation between NPA & profits are due to wrong choice of clients by Banks. There is an adverse effect on the Liquidity of Bank.Bank is unable to give loans to the new customers due to lack of funds which arises due to NPA As per the government, the main reasons for rise in NPAs are sluggishness in the domestic growth in the recent past, slow recovery in the global economy and continuing uncertainty in global markets leading to lower exports of various products such as textiles and leather.Advances provided by banks need to be done pre-sanctioning evaluation and post disbursement control so that NPA can decrease.

Good management needed on the side of banks to decrease the level of NPA. Proper selection of borrowers & follow ups required to get timely payment. Non-performing assets are a drain to the banks. The banks in India are adopting various strategies to reduce the non-performing assets in their banks and they are also adopting various methodologies by which further addition to NPA portfolio is minimized In the real sense, in case there is a recovery in principal and installments due in respect of the loans granted to the banks are received 100%, the question of non-performing assets do not arise. However, there is no such ideal bank where the NPA is nil. ery camps: Bank personnel jointly approach the defaulting borrowers for repayment at a place and time convenient to both the parties. These are more suited to small loans. Normally the borrowers who had availed small loans will be more in number in rural and semi urban areas rather than urban and metro centers.

As such, the banks instead search areas rather than urban and metro centers. As such, the banks instead of conducting the recovery camps at their branches, they usually conduct such recovery camps in centres like panchayat board offices, court buildings, government department buildings etc such recovery camps so that the borrowers find it convenient to attend the recovery camps.

Under certain circumstances, the manager in charge of the bank branches along with some branch officials go to each visit each house of the borrowers and recover the installments due in respect of loans availed by them. This type of recovery camp will be successful in case an advance notice is served on the borrowers mentioning the date of recovery camps.To reduce the absolute amount of non performing assets, Government of India along with Reserve Bank of India are announcing one time settlement schemes periodically for the past few years. When the borrowers are alive and when the borrowers are farmers, small entrepreneurs etc and they find it very difficult to pay their dues for various reasons like bad health and fall in their business ventures, , however, they have the inclination to repay their debts to the banks, this type of practice is very much helpful to the borrowers and the lending institutions. Surely the banks are in a position to lose certain portion of their loan amount when they are conducting one time portion of their loan amount when they are conducting one time settlement schemes.

The debt recovery tribunal act was passed by Indian Parliament in 1993 with the objective of facilitating the banks and financial institutions for speedy recovery of dues in cases where the loan amount is Rs. 10 lakhs and above. The time limit envisaged under the act is not being adhered to in disposing off the suits because of inadequate infrastructure and shortage of recovery personnel with the DRTs. Nonetheless, the DRT act and subsequent amendment in 2000 have provided a great improvement over the normal legal forum.

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