PARADIGM OF NON PERFORMING ASSETS (NPA) IN INDIAN BANKING

Dr. Meera Mehta*

ABSTRACT

Financial sector reforms in India have brought about rapid changes in the structure of financial markets, more particularly in banks. While the primary function of borrowing and lending by banks remains the same.In recent times the banks have become very cautious in extending loans(lending). The reason being mounting non-performing assets (NPAs). An NPA is a loan asset, which has ceased to generate any income for a bank whether in the form of interest or principal repayment. An NPA account not only reduces profitability of banks by provisioning in the profit and loss account, but their carrying cost is also increased which results in excess and avoidable management attention.

The changing face of the banking industry has made it mandatory to study and to make a comparative analysis of services of Public Sector Banks and Private Sector banks. This paper is an attempt to analyze how efficiently Public and Private sector banks have been managing NPA.All the Indian banks are facing hard time managing their NPA. However, Private sector banks and foreign banks are more efficient that Public sector banks with regard to the management of non-performing assets. As has been re-confirmed by this paper as well.

Keywords—NPA, Profitability, Public Sector banks, Private Sector banks.

INTRODUCTION

The primary objective for the banks after the nationalization and globalization was to expand their branch network, improve the savings rate and spread out credits to rural, urban and the most important Small Scale Industries sector. The regulation of economic reforms initiated in 1991 by the then Finance Minister and former Prime minister Dr. Man Mohan Singh achieved this objective to a large extent. But, the liberalization policies introduced during that period unlocked the doors for the entrepreneurs to setup industries and businesses, which were mainly financed by loans from the Indian banking systems. Many of the business firms and companies failed to repay the principal as well as the interest amount (Bad Loan). A cultural change has crept in where repayment of bank loans is no longer assured. A constant follow up through watch and action are to be exercised by the operating staff. Deviation of funds and deliberate default has become more common. According to a study published in the RBI bulletin in July 1999, deviation of funds and deliberate default are found to be the major factors that have led to the growth of NPAs in public and private sector banks.

NPA IN INDIA

The following quote from the Narasimham Committee Report, 1998 clearly explains the impact of NPAs on the banks and the economy. "NPAs constitute a real economic cost to the nation in that

** Assistant Professor, Department of Commerce, Shaheed Bhagat Singh College, University of Delhi, Delhi.*

they reflect the application of scarce capital and credit funds to unproductive uses. The moneys locked up in NPAs are not available for productive use and to the extent that banks seek to make provision for NPAs or write them off, it is a charge on their profits. To be able to do so, banks have to charge their productive and diligent customers higher rate of interest. It thus, becomes a tax on efficiency. It is the customer who uses credit efficiently that subsidises the inefficiency represented by NPAs. This also raises the transaction costs in the system thus denying the diligent credit customers the benefit of lower rates, which would help them to become more efficient and competitive. NPAs, in short are not just a problem for the banks. They are bad for the economy."

NPAs are a burden on the profitability of banks as they cannot report income on such accounts and their funding costs and provision requirements are a charge on their profits. NPAs also carry 100% risk weightage and block capital for maintaining Capital Adequacy Ratio.

REVIEW OF LITERATURE

Rajaraman and Vasishtha (2002) in an empirical study provided an evidence of significant bivariate relationship between an operating inefficiency indicator and the problem loans of public sector banks and the inefficiency on the part of the borrower.

Das and Ghosh (2003) in a similar manner empirically examined non-performing loans of India's public sector banks in terms of various indicators such as asset size, credit growth and macroeconomic condition, and operating efficiency indicators.

Bhatia (1988) and Sahoo, Mishra and Soothpathy (1996) examine the predictive power of accounting ratios on a sample of sick and non-sick companies by applying the multi discriminant analysis techniques. In both the studies, the selected accounting ratios are effective in predicting industrial sickness with a high degree of precision. Pradeep Singh (2007) highlighted the banking sector reforms in the area of NPA with reference to the SARFAESI bill 2002 (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest) and establishment of Asset Reconstruction Companies in India. The study points that the banks need to maintain their NPAs at a lower level and should efficiently realize them so that they can face global challenges and maintain their liquidity and profitability.

OBJECTIVES OF THE STUDY

- To find out trends in NPA Level.
- To compare the performance of public and private banks of India on the basis of NPA.
- To suggest various measures to control NPA.

ASSET CLASSIFICATION

For the purpose of NPA an asset can be classified as:

Standard Assets

Standard assets are the ones for which the bank has been receiving interest as well as the principal amount of the loan regularly from the customer.

Substandard Asset

With effect from March 31, 2005, a sub standard asset would be one, which has remained NPA for a period less than or equal to 12 months. Such an asset will have a well de fined credit check that discloses the liquidation of the debt and is categorized by the distinct probability that the banks will bear some loss, if deficiencies are not corrected.

Doubtful Asset

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the sub standard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were categorized 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.

Loss Asset

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.:

TYPES OF NPA

Gross NPAs: Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on Balance Sheet date. Gross NPA reflects the quality of the loans made by banks. It consists of all the nonstandard assets like as sub-standard, doubtful, and loss assets. It can be calculated with the help of following ratio

$$\text{Gross NPAs Ratio} = \frac{\text{Gross NPAs}}{\text{Gross Advances}}$$

Net NPAs: Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden on banks. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high.It can be calculated by following:

$$\text{Net NPAs} = \frac{\text{Gross NPAs} - \text{Provisions}}{\text{Gross Advances} - \text{Provisions}}$$

TRENDS IN NPA LEVEL

Public sector banks are the ones in which the government has a major holding. They are divided into two groups, i.e. Nationalized Banks and State Bank of India and its associates. Among them, there are 19 nationalized banks and 8 State Bank of India associates. Public Sector Banks dominate 75% of deposits and 71% of advances in the banking industry. Public Sector Banks dominate commercial banking in India.

PERFORMANCE OF PUBLIC SECTOR BANKS

TABLE-1

NPA in public sector banks

Year (End-March)	Advances		Non-Performing Assets					
	Gross	Net	Gross			Net		
			Amt	As Percentage of Gross Advances	As Percentage of Total Assets	Amt	As Percentage of Net Advances	As Percentage of Total Assets
2003-04	6619.75	6313.83	515.37	7.8	3.5	193.35	3.1	1.3
2004-05	8778.25	8489.12	483.99	5.5	2.7	169.04	2.1	1.0
2005-06	11347.24	11062.88	413.58	3.6	2.1	145.66	1.3	0.7
2006-07	14644.93	14401.46	389.68	2.7	1.6	151.45	1.1	0.6
2007-08	18190.74	17974.01	404.52	2.2	1.3	178.36	1.0	0.6
2008-09	22834.73	22592.12	449.57	2.0	1.2	211.55	0.9	0.6
2009-10	27334.58	27013.00	599.26	2.2	1.3	293.75	1.1	0.7
2010-11	30798.04	33056.32	746.00	2.4	1.4	360.00	1.2	0.7
2011-12	35503.89	38773.07	1124.89	3.2	1.9	593.0	1.5	1.0
2012-13	45601.69	44727.74	1644.62	3.6	2.4	900.00	2.0	1.3

Source:Compiled from: http://www.rbi.org.in

TREND ANALYSIS

The above table shows the value of NPAof public sector commercial banks for the last 10 years. An analysis of the above table shows that NPA in public sector banks has been on a constant rise. From 2003-2008 the Gross NPA declined as did the Net NPA. The declining trend from 2003 to 2008 of NPA was due to the implementation of Securitization Act (2002) however, after 2008 it has been increasing constantly. The percentage change in gross NPA to gross advances ratio and net NPA to net advances ratio over the years states that public sector banks makesmore provisions in gross NPA and gross advances.

PERFORMANCE OF PRIVATE SECTOR BANKS

TABLE-2

NPA in Private Sector Banks

Year (End-March)	Advances		Non-Performing Assets					
	Gross	Net	Gross			Net		
			Amt	As Percentage of Gross Advances	As Percentage of Total Assets	Amt	As Percentage of Net Advances	As Percentage of Total Assets
2003-04	1195.11	1151.06	59.83	5.0	2.4	19.86	1.7	0.8
2004-05	1274.20	1236.55	45.82	3.6	1.6	23.53	1.9	0.8
2005-06	2325.36	2300.05	40.52	1.7	1.0	17.96	0.8	0.4
2006-07	3252.73	3218.65	62.87	1.9	1.1	31.37	1.0	0.5
2007-08	4124.41	4067.33	104.40	2.5	1.4	49.07	1.2	0.7
2008-09	4547.13	4468.24	138.54	3.1	1.7	62.52	1.4	0.8

2009-10	4877.13	4783.58	140.17	2.9	1.6	52.34	1.1	0.6
2010-11	5450.14	6128.86	145.00	2.7	1.3	34.00	0.6	0.3
2011-12	6475.28	7363.23	141.15	2.2	1.1	30.00	0.4	0.2
2012-13	8860.23	8733.11	155.53	1.8	1.0	39.00	0.4	0.3

Source:Compiled from: http://www.rbi.org.in

TREND ANALYSIS

The above table shows the value of NPA of private sector banks for the last 10 years. An analysis of the above table shows that NPA in private sector banks has a decreasing trend. The Net NPA as percentage to Net Advances in 2003-04 stood at 1.7% which came down to 0.8% in 2005-06 however, this could not be contained for long as can be seen from the figures of the subsequent years. Since 2011 the Net NPA is showing a constant decline and by the end of 2013 it stood at 0.4%.

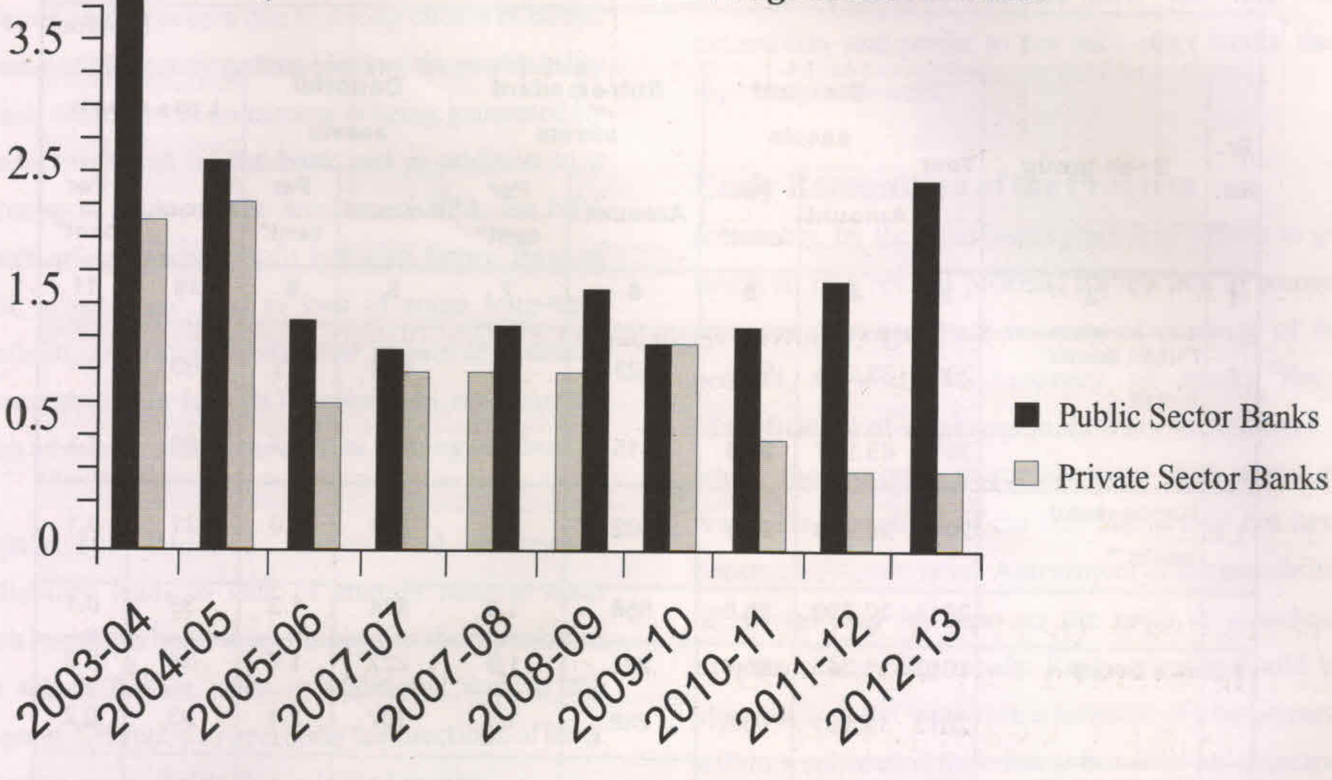
COMPARISON OF PUBLIC SECTOR BANK AND PRIVATE SECTOR BANKS ON THE BASIS OF NET NPAs AS PERCENTAGE OF ADVANCES OF BANKS

TABLE-3 NET NPAs AS PERCENTAGE OF NET ADVANCES OF BANKS

	PUBLIC SECTOR BANKS	PRIVATE SECTOR BANKS
2003-04	3.1	1.7
2004-05	2.1	1.9
2005-06	1.3	0.8
2006-07	1.1	1.0
2007-08	1.0	1.2
2008-09	0.9	1.4
2009-10	1.1	1.1
2010-11	1.2	0.6
2011-12	1.5	0.4
2012-13	2.0	0.4

Source:Compiled from: http://www.rbi.org.in

COMPARISON BETWEEN THE BANKS
(on the basis of net NPA as a % age to net advances



From the above it is clearly observed that initially public sector banks succeeded in reducing their net NPA against net advances. This decreasing trend continued till 2008-09 and since then it has been increasing constantly one possible reason for this upward trend since 2009 is the financial crisis of 2009. In case of private sector bank it has reduced in 2005-06 then it got stable it increased marginally in 2008-09 to 1.4%. However, when compared to public sector banks the private sector banks have managed to contain their net NPA against net advances and they successfully brought it down to 0.4%in 2013 as against 2.0%in public sector banks.

The reason that private sector banks are doing better than the public sector banks might be that the advances given by public sector banks are much more than private sector banks.

TABLE-4: ASSETS CLASSIFICATION OF PUBLIC SECTOR AND PRIVATE SECTOR BANKS

Classification of Loan Assets - Bank Group-wise (As at end-March)

(` billion)

Sr. No.	Bank group	Year	Standard assets		Sub-standard assets		Doubtful assets		Loss assets	
			Amount	Per cent*	Amount	Per cent*	Amount	Per cent*	Amount	Per cent*
1	2	3	4	5	6	7	8	9	10	11
1	Public sector banks	2012	38,255	97.0	623	1.6	490	1.2	60	0.1
		2013	43,957	96.4	815	1.8	761	1.7	68	0.1
1.1	Nationalised banks**	2012	26,909	97.5	402	1.5	268	1.0	21	0.1
		2013	30,396	96.8	558	1.8	424	1.3	35	0.1
1.2	SBI Group	2012	11,345	95.9	221	1.9	222	1.9	39	0.3
		2013	13,561	95.6	258	1.8	337	2.4	33	0.2
2	Private sector banks	2012	9,629	98.1	52	0.5	104	1.1	29	0.3
		2013	11,384	98.2	64	0.6	112	1.0	32	0.3
2.1	Old private sector banks	2012	2,287	98.2	18	0.8	17	0.7	7	0.3
		2013	2,679	98.1	23	0.9	23	0.8	6	0.2
2.2	New private sector banks	2012	7,342	98.1	34	0.4	87	1.2	22	0.3
		2013	8,705	98.2	41	0.5	89	1.0	25	0.3

Source:Compiled from: http://www.rbi.org.in

Table-4 shows that standard asset of Public Sector Banks are decreasing and on the contrary all the other types of asset i.e. Sub-standard, Doubtful and Loss Asset are increasing every year. This proves that public sector banks have notsucceeded in reducing NPA over the years. The rise in sub-standard ratio as major proportion indicates that there is a high scope of up gradation or improvement in NPA recovery in initial stage because it will be very easy to recover the loan at a minimum duration of default.The above table clearly states that there is a rise in the standard assets of the Private Sector Banks over the years which compensates the fall in the other three types of assets. The percentage of Sub-Standard asset is highest in the year 2013. The percentage of doubtful asset has reduced to a great extent amongst all. Thus, the private sector banks have managed to reduce their doubtful assets.

IMPACT OF NPA

Profitability: NPA means blocking of money due to bad asset, which occurs due to wrong choice of client. Because of the money getting blocked the profitability of bank decreases as no income is being generated by the asset financed by the bank and in addition to it provision is made on the amount of NPA. So NPA doesn't affect current profit but also future flow of profit, which may lead to loss of some long-term beneficial opportunities. Another impact of decrease in profitability is low ROI (return on investment), which adversely affects the current earning of a bank.

Liquidity: Blocked money and decreased profitability leads to lack of enough cash at hand which results in borrowing money for short period of time which further leads to additional cost to the company. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.

Involvement of Management: NPA results in the additional indirect cost in terms of time and efforts of management which a bank has to bear. Time and efforts of management in handling and managing NPA would have been diverted to some profitable activities, which would have given good returns. Now-a-days banks have separate departments to deal and handle NPAs, which is an additional cost for the bank.

Credit Loss: Banks facing the problem of NPA get adversely affected in terms of the value of the bank in the credit market. It loses its good will; brand image and creditworthiness which may have a negative impact on the customers of the bank.

PREVENTIVE MEASURES FOR NPA

Forensic Audit : It refers to picking up the money trail and coming out with information that can be used as legal evidence. Lenders now use this tool extensively and prefer to not take other banks' data regarding borrowers.

Early Recognition of the Problem

Invariably, by the time banks start their efforts to get involved in a revival process, it's too late to recover from the situation- both in terms of recovery of the project as well as recovery of banks dues. Identification of weakness in the very beginning, i.e. when the account starts showing first signs of weakness regardless of the fact that it may not have become NPA, is crucial. Assessment of the possibility of revival may be done on the basis of a techno-economic feasibility study. Restructuring should be attempted where, banks are convinced of a turnaround within a scheduled time frame but after an objective assessment of the promoter's intention. In respect of totally unviable units as decided by the bank, it is better to wind up/ sell-off such units as early as possible, so as to recover whatever is possible through legal means before the financial position becomes worse.

Identifying Genuine Borrowers with Real Intent

Identifying borrowers with genuine intent from those who are non- serious with no commitment or stake in revival is challenging for the bankers. Here the role of investigating officials at the branch level is paramount as they are the ones who have intelligent inputs with regard to borrower's sincerity, and capability to achieve turnaround. Based on this assessment, banks should decide as promptly as possible whether it would be worthy to commit additional finance. A "Special Investigation" of all financial transaction or business transaction; books of account may help the banks to determine the real factors that contributed to sickness of the borrower. Banks may also appoint a penal of technical experts with proven expertise and track record of preparing techno-economic study of the project of the borrowers.

Borrowers having genuine problems due to temporary mismatch in fund flow or sudden requirement of additional fund may be accommodated at the branch level, and for this purpose a specific limit to such type of cases should be decided. This will deviate the route for additional funding through the controlling offices in deserving cases, and help avert many genuine borrowers accounts slipping into NPA category.

Timeliness and Adequacy of Response

Longer the delay in response, greater is the injury to the account and the asset. Time is a crucial element in any financial restructuring or rehabilitation activity. The response determined on the basis of techno-economic study and promoters commitment, has to be satisfactory in terms of extending additional funding and relaxations etc. under the rearrangement exercise. The package of assistance may be flexible, and bank may look at the various exit options.

Focus on Cash Flow

While financing, assessment for fresh credit requirements may be done by evaluating funds flow in conjunction with the Cash Flow rather than only on the basis of Funds Flow.

Management Effectiveness

The general perception among borrowers is that it is lack of finance that leads to sickness and NPAs. But this may not be true all the time. Management's effectiveness in handling adverse business conditions is a very important aspect as it affects the borrowing unit's fortunes. A bank may commit for an additional finance to an ailing unit only after studying the viability of the project in context to quality of management. Where the default is due to a deep rooted problem, an investigative audit should be carried out by a consultant appointed as early as possible to examine this aspect. The investigative audit report must then be used as the basis for any future action.

- During the assessment of viability and restructuring, a pragmatic and unified approach by all the lending banks/ FIs as also sharing of all relevant information on the borrower would go a long way towards the overall success of rehabilitation exercise, given the probability of success/failure.

- In some default cases, where the unit is still working, the bank should make sure that it seizes the cash flows (there is a tendency among the borrowers to switch bankers once they default, this way they avoid forfeiting their cash flows), and ensure that such cash flows are used only for the purpose ofworking capital. For this purpose, there should be regular flow of information among syndicate members. A bank, which is not part of the syndicate, may not be allowed to extend credit facilities to such defaulting clients. Current account facilities may also be denied be to such clients and violation may attract action. The Credit Information Bureau of India Ltd. (CIBIL) may be very useful for exchange of meaningful information of defaulting borrowers once the setup becomes fully operational.

- Corporate Debt Restructuring mechanism has been institutionalized in 2001 to provide a timely and transparent system for restructuring of the corporate debt of Rs. 20 crore and above with the banks and FIs on a voluntary basis and outside the legal framework. Under this system, banks may greatly benefit in terms of restructuring of large standard accounts (potential NPAs) and viable sub-standard accounts with consortium/multiple banking arrangements.

CONCLUSION

Non-Performing Assets (NPA) are a key concern for the banks in India.They are the best indicators of the financial health of an economy. But the mounting levels of NPAs in PSB in comparison to the private banks are disturbing. The decline in NPA of the private banks indicates that banks have strengthened their credit appraisal processes. However, an increase in NPA of the PSB points at the necessity for provisions which brings down the profitability of the banks. Therefore,what needs to be done is to arrest fresh accretion and contain it to the barest minimum by preventing slippage through effective proactive steps at the right time rather than being reactive

BIBLIOGRAPHY

A.V. ArunaKumari (2002), "Economic Reforms and Performance of Indian Banking: A Cross Structural Analysis", Indian Economic Panorama, A Quarterly Journal of Agriculture, Industry, Trade and Commerce, Special Banking Issue, pp.19-21.

A.K. Trivedi (2002), "Economic Reforms and Banking Scenario: An Analysis", Indian Economic Panorama, A Quarterly Journal of Agriculture,Industry, Trade and Commerce, Special Banking Issue, pp.6-8

Chandrasekhar, C.P. 2009. How sound is Indian banking. The Economic and Political Weekly. May, pp. 8 International Journal of Innovation, Management and Technology, Vol. 2, No. 3, June 2011 255

Dr. Vibha Jain: Non-Performing Assets in commercial Banks: Regal Publication, New Delhi, 1st Edition 2007p p78-79

[5] Hallinan, Joseph T. (2003), "Bigger Banks. Better Deals?", Wall Street Journal - Eastern Edition, Vol. 242, Issue 84, pp.D1-D3

Reserve Bank of India, master circular on prudential norms on income recognition. Asset classification and provisioning.

Subramanium, K. 1997. Banking Reforms in India. TMH Publishing Co. Ltd., New Delhi.

Sagar R. Dave, performance evaluation in Indian banking.

WELLS Fargo and Co. (2003), "Big Banks Report Strong Gains, Led by Wells Fargo, Bank One", Wall Street Journal - Eastern Edition, Vol. 242, Issue 80, p.C5

Question 366, Written Answers to Questions, Parliamentary sessions, 09.08.91, [36] Rime, Bertrand and Stiroh, Kevin J. (2003), "The Performance of Universal Banks: Evidence from Switzerland", Journal of Banking and Finance; Vol. 27, Issue 11, pp.2121-51.