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Non-Performing Assets and Indian Banking Sector: A Descriptive Study

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Abstract
Non-performing Asset (NPA) is one of the biggest problems that the banks are facing today. Ifthe proper management of the NPAs is not undertaken, it would hamper the business of the banks and it would be dangerous for the whole banking sector. In view of this, the present paper provides a survey of non-performing assets of Indian scheduled commercial banks and its impact on banks. It also suggests on how to avoid future NPAs. This study has been based on the data and information collected from a number of surveying sites.
The Indian banking industry has one of the highest amounts of NPAs compared to the international figures. According to a recent survey (2016), the amount of top twenty NPA accounts of Public Sector Banks stands at a staggering 15.4 billion rupees. The gross NPA in March 2017 was 9.3% which was very critical. These figures show the percentage of assets turning into NPAs during the period 2016-17. It occurs mainly because of non-transparent accounting policy and poor auditing practices. Today"s rapidly changing economic environment turns the market unfavourable which leads to failure of promoters to bring in their portion of equity from their own sources resulting in bad debt. Another major cause is lack of sincere corporate culture and inadequate legal provisions on foreclosure and bankruptcy. Against this backdrop, this work is undertaken with the primary objective to study the reasons behind the increment in NPA and to critically evaluate the precautionary measures to avoid future NPAs. It is expected that the findings and the concluding notes of this paper will open up new avenues for the policy makers in enforcing effective fiscal policies. Students, researchers as well as political leaders will also be benefitting substantially from this study.
Keywords:*Non-performing assets, Banking sector, Precautionary measures*

I. INTRODUCTION

Banking essentially involves intermediation - accepts the deposits and grants the loans and advances. In the traditional banking business of lending financed by deposits from customers, Commercial Banks are faced with the risk of default by the borrower in the payment of either principal or interest. This risk in banking parlance is termed as „Credit Risk‟ and accounts where payment of interest or repayment of principal is not forthcoming are treated as Non-Performing Assets. As per the Reserve Bank of India, an asset, including a leased asset becomes „non-performing‟ when it ceases to generate income for the bank. According to RBI, about 10% of loans are never paid back, resulting in substantial loss of money to the banks and when restructured and unrecognised assets are added, the total stress would be 15-20% of total loans.

A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The problem of NPAs, which was ignored till recently, has been given considerable importance after liberalization of the financial sector in India. At present NPA in the banking sector is increasing year by year mostly in nationalized banks. The prime aim of this paper is to give brief idea about the concepts of Non-Performing Assets and trends of NPA in banks of India.

A high level of non-performing assets, compared to similar lenders, may be a sign of problems. An increased level of NPA may result in suffering of lenders in lowering of profit margin, which again affects the Investors as they do not get rightful returns. As a result banks have to set higher interest rates to maintain the profit margin. As investments got stuck, it may result in unemployment.When it comes to the effect on society, we can claim that NPA related cases add more pressure to already pending cases with the judiciary. NPA crisis in India is chosen to worsen year by year, because the restructuring norms are being misused.

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.

Narasimham Committee mandated that identification and reduction of NPAs to be treated as a national priority because NPAs direct towards credit risk that a bank faces and its efficiency in allocating resources. Profitability and earnings of banks are affected due to NPA numbers. If we glance on the numbers of non-performing assets we may come to know that in the year 1995 the NPAs were Rs. 38385 crore and has reached to 154000 crore in 2011 in public sector banks and comparatively in the year 2001 the NPAs were Rs. 6410 crore and reached to Rs. 17972 crore in 2011 in private sector banks.

This is completely a descriptive paper and the paper is divided into some phases like Abstract, Introduction, Review of Literature, Reasons of NPA, Data collection and analysis, Precautionary measures, Conclusions and Reference.

II. REVIEW OF LITERATURE

Many researchers have studied the issue of NPA in banking industry in the past and published papers are available in the literature. An extensive review of the relevant literature by Vivek R Singh (2016) has been briefed below. In a study, Kumar (2013) termed NPA as a nuisance for the Indian banking sector in recent years. One of the major issues challenging the performance of commercial banks in the late 90s and adversely affecting was the accumulation of huge NPAs. Selvarajan and Vadivalagan (2013) in *A Study on Management of Non-PerformingAssets in Priority Sector reference to Indian Bank and Public Sector Banks* reported that thegrowth of Indian Bank‟s lending to priority sector is more than that of the Public Sector Banksas a whole. Singh (2013) in his paper entitled *Recovery of NPAs in Indian commercial banks*says that the origin of the problem of burgeoning NPA‟s lies in the system of credit riskmanagement by the banks. Gupta (2012) in her study *A Comparative Study of Non-PerformingAssets of SBI & Associates & Other Public Sector Banks* had concluded that each bank shouldhave its own independent credit rating agency which should evaluate the financial capacity ofthe borrowers. A paper *Study on performance of NPAs of Indian commercial banks* authored by Rai (2012) revealed that the corporate borrowers even after defaulting continuously never had the fear of bank taking action to recover their dues. This is because there was no legal framework to safeguard the real interest of banks. Chatterjee, Mukherjee and Das (2012) in their article *Management of non-performing assets - a current scenario* have concluded thatbanks should find out the original reasons/purposes of the loan required by the borrower. Kaurand Singh (2011) in their report entitled *non-performing assets of public and private sectorbanks: a comparative study* stated that NPAs are considered as an important parameter tojudge the performance and financial health of banks. The level of NPAs is one of the drivers of financial stability and growth of the banking sector. Prasad G.V.B. and Veena (2011) in their study on *NPAs Reduction Strategies for Commercial Banks in India* stated that the NPAs donot generate interest income for banks but at the same time banks are required to provide provisions for NPAs from their current profits, thus NPAs have destructive impact on the return on assets in many ways. Though a lot of work has been done on the subject, the critical evaluation of the precautionary measures against NPA has not been adequately taken care of by previous researchers.

Against this background, this work has been undertaken to study the role of non-performing assets in Indian banking sector. It considers ten leading banks of India for the purpose of analyzing the NPA status.

Non-Performing Assets

1. An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.
2. A non-performing asset (NPA) is a loan or an advance where

- Interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,
- The account remains out of order for more than 90 days in respect of an Overdraft or Cash Credit (OD/CC);
- The bill remains overdue for a period of more than 90 days in the case of bills purchased or discounted,
- The installment of principal or interest thereon remains overdue for two crop seasons for short duration crops,
- The installment of principal or interest thereon remains overdue for one crop season for long duration crops,
- The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction undertaken in terms of guidelines on securitization dated 1st February, 2006.
- In respect of derivative transactions, the overdue receivables representing positive mark-to market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

3. In case of interest payments, banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.

Reasons behind NPA

Most of the banks face NPA mainly in case of too ambitious projects without proper planning and that too because of insufficient paid up capital. Some of the biggest factors behind NPA are stated below:

- Diversification of funds to unrelated business/fraud and lapses due to diligence.
- Business losses due to changes in business/regulatory environment.
- Lack of morale, particularly after government schemes which had written off loans.
- Global, regional or national financial crisis which results in erosion of margins and profits of companies, therefore, stressing their balance sheet which finally results into non-servicing of interest and loan payments. (viz. the 2008 global financial crisis).
- The general slowdown of entire economy for example after 2011 there was a slowdown in the resulted in the faster growth of NPAs.
- The slowdown in a specific industrial segment, therefore, companies in that area bear the heat and some may become NPAs.
- Unplanned expansion of corporate houses during boom period and loan taken at low rates later being serviced at high rates, therefore, resulting into NPAs.
- Due to mal-administration by the corporates, for example, wilful defaulters.
- Due to mis-governance and policy paralysis which hampers the timeline and speed of projects, therefore, loans become NPAs. For example Infrastructure Sector.
- Severe competition in any particular market segment. Example: Telecom sector in India.
- Delay in land acquisition due to social, political, cultural and environmental reasons.
- A bad lending practice which is a non-transparent way of giving loans.
- Due to natural reasons such as floods, droughts, disease outbreak, earthquakes etc.
- Cheap import due to dumping leads to business loss of domestic companies. For example steel sector in India.

Data Collection and Analysis

<u>Sources of Data</u>

The data collected is mainly secondary in nature. The sources of data for this paper include the literature published by Indian Bank and the Reserve Bank of India, various magazines, journals, books and the official website of RBI dealing with the current banking scenario and research papers.

<u>Limitations</u>

Sufficient data of some of the banks out of the 10 banks are not available. That"s why we are limited to the data of top 5 banks for further analysis.

Non-Performing Assets in Indian Scheduled Commercial Banks:

S No.	Banks	Total Advances (Rs. in crores)	Gross NPA (Rs. in Crores)
1.	State Bank of India	1,193,325	93,137
2.	Canara Bank	311,615	30,480
3.	Bank of India	274,391	43,935
4.	Bank of Baroda	269,115	35,604
5.	Union Bank of India	242,935	25,560
6.	Central Bank of India	185,719	25,107
7.	Allahabad Bank	145,328	18,769
8.	Corporation Bank	142,787	15,726

9.	Punjab National Bank	356,958	55,003
10.	United Bank of India	70,781	10,104

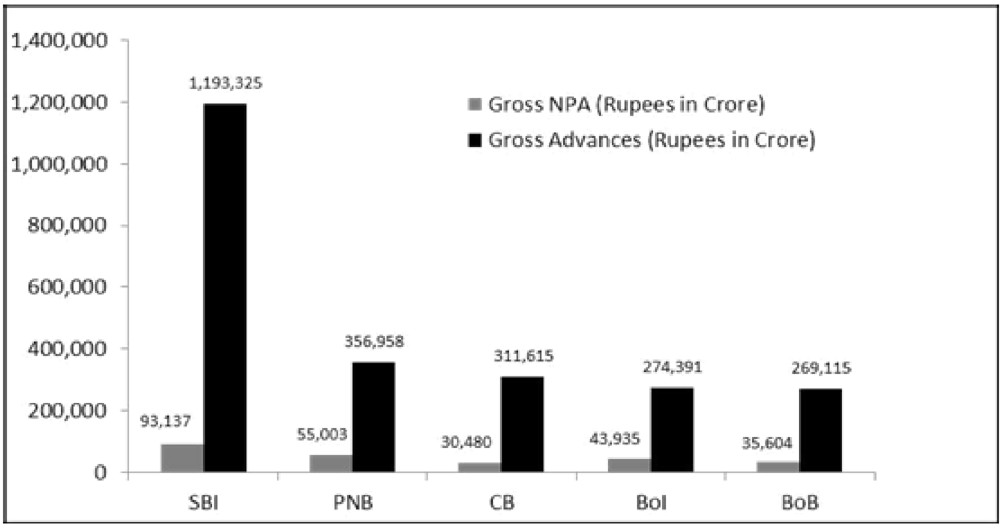
Table 1: Top 10 NPA affected banks in India

Banks having highest amount of Gross NPA
Ratio Analysis:
The relationship between two related items of financial statement is known as ratio.
1. <u>Gross NPA Ratio</u>
Gross NPA Ratio is the ratio of gross NPA to gross advances of the Bank. Gross NPA is the sum of all loan assets that are classified as NPA as per RBI guidelines, the ratio is to be counted in terms of percentage as follows:

Table 2 Gross NPA in Leading Banks*(As On 30th June, 2016)*

BANKS	Gross NPAs	Gross Advances	Gross NPA Ratio*
State Bank of India	93,137	1,193,325	7.80
Punjab National Bank	55,003	356,958	15.40
Canara Bank	30,480	311,615	9.78
Bank of India	43,935	274,391	16.01
Bank of Baroda	35,604	269,115	13.23

Gross NPA Ratio = (Gross NPA/ Gross Advances) × 100



**SBI: State Bank of India, PNB: Punjab National Bank CB: Canara Bank, BoI : Bank of India,BoB: Bank of Baroda*

Figure 1: Highest amount of Gross NPAs in Leading Banks

Interpretation:
The above table indicates the quality of Credit portfolio of the banks. High gross NPA ratio indicates the low Credit portfolio of bank and vice-versa. We can see from the above table the Bank of India has higher gross NPA ratio of 16.01 which means Bank of India has lowest Credit Portfolio and SBI has highest Credit Portfolio.

2. Net NPA Ratio

The net NPA Percentage is the ratio of NPA to net advances in which the provision is to be deducted from the gross advances. The provision is to be made for NPA account. The formula for that is given below.

Table 3 Net NPA Ratio in Leading Banks*(As On 30th June, 2016)*

Banks	GNPA	Net NPA	Provision	Gross Advance	Net Advance	Net NPA (%)
SBI	93,137	64,445	28692	1,193,325	1,164,633	5.53
PNB	55,003	35,223	19,780	356,958	337,178	10.44
Canara Bank	30,480	18,863	11,617	311,615	299,998	6.28
Bank of India	43,935	26,996	16,939	274,391	252,452	10.69
Bank of Baroda	35,604	19,409	16,195	269,115	250,920	7.73

$$\text{Net NPA Ratio} = \frac{(\text{Gross NPA} - \text{Provision})}{(\text{Gross Advances- Provisions})} \times 100$$

Gross NPA – Provision = Net NPA

Gross Advances – Provision = Net Advances

Interpretation

The above table indicates the quality of Non-Performing Assets of the banks. High Net NPA ratio indicates the low Credit portfolio & risk of bank and vice-versa. We can see from the above table the Bank of India has higher Net NPA ratio of 10.69, whereas SBI showed lower ratio with 5.53 and hence, Bank of India has lowest Credit Portfolio and SBI has the highest.

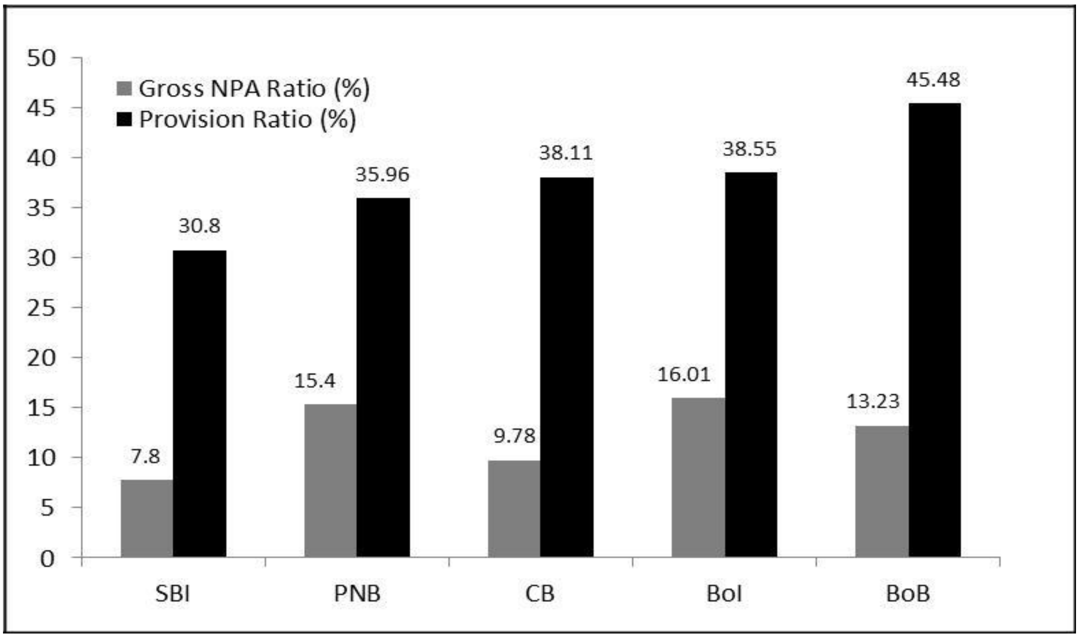
3. Provision Ratio

Provisions are to be made for to keep safety against the NPA, and it directly affects on the gross profit of the Banks. The Provision Ratio is nothing but total provision held for NPA to gross NPA of the Banks. The formula for that is given below.

Banks	Total Provision	Gross NPAs	Provision Ratio*
State Bank of India	28,692	93,137	30.80
Punjab National Bank	19,780	55,003	35.96
Canara Bank	11,617	30,480	38.11
Bank of India	16,939	43,935	38.55
Bank of Baroda	16,195	35,604	45.48

* $\text{Provision Ratio} = \frac{\text{Total Provision}}{\text{Gross NPAs}} \times 100$

Table 4 Provision Ratio in Leading Banks



**SBI: State Bank of India, PNB: Punjab National Bank CB: Canara Bank, BoI : Bank of India, BoB: Bank of Baroda*

Figure 2 Gross NPA Ratios and Provision Ratios in Leading Banks

Interpretation:

This Ratio indicates the degree of safety measures adopted by the Banks. It has direct bearing on the profitability, Dividend and safety of shareholders‟ fund. If the provision ratio is less, it indicates that the Banks has made under provision. The highest provision ratio is showed by Bank of Baroda with 45.48 % .The lowest provision ratio is showed by state Bank of India with only 30.80%.

III. FINDINGS:

1. Credit Portfolio is lowest in Bank of India and highest in State Bank of India amongst all the 10 banks taken for the study.
2. The highest provision ratio is showed by Bank of Baroda with 45.48 % and the lowest provision ratio is showed by state Bank of India with only 30.80% amongst all the 10 banks taken for the study.

Precautionary Measures to avoid future NPAs:

NPAs story is not new in India and there have been several steps taken by the Government Of India on legal, financial, policy level reforms. In the year 1991, *Narsimhamcommittee*recommended many reforms to tackle NPAs. Some of them like *Corporate Debt Restructuring – 2005, SARFAESI Act – 2002, Compromise Settlement – 2001, LokAdalats – 2001,* were implemented but did not worked for longer duration.

Some precautionary measures are suggested below. They are:

1. RBI should revise existing credit appraisals and monitoring systems.
2. Credit appraisal and post –loan monitoring are crucial steps which need to concentrate by all the public sector banks.
3. Banks should improve upon and strengthen the loan recovery methods.
4. There must be regular follow-up with the customers at regular intervals and it is the duty of banker to ensure that there is no diversion of funds.
5. Frequent discussions with the staff in the branch and taking their suggestions for recovery of dues.
6. Banks should evaluate the SWOT analysis of the borrowing companies i.e. how they would face the environmental threats and opportunities with the use of their strength and weakness, and what will be their possible future growth in concerned to financial and operational performance.
7. If the delinquencies are due to reasons beyond the control of borrower which are namely draughts, floods, or other natural calamities, the banker should suitably restructure the loans taking into account the genuine difficulty of the borrowers.

IV. CONCLUSIONS

NPA is one of the biggest problems that the banks are facing today. If proper management of the NPAs is not undertaken it would hamper the business of the banks. The NPAs would destroy the current profit, interest income due to large provisions of the NPAs, and would affect the smooth functioning of the recycling of the funds.

Analysis of the available data of past years reveals that the NPAs in different banks have increased drastically. The RBI has also been trying to take a number of measures but the ratio of NPAs is not decreasing of the banks. The bank must have to find out the measures to reduce the evolving problem of the NPAs.

The government should also make more provisions for faster settlement of pending cases and also it should reduce the mandatory lending to priority sector as this is the major problem creating area. So the problem of NPA needs lots of serious efforts otherwise NPAs will keep killing the profitability of banks which is not good for the growing Indian economy at all.

The reduction of the NPAs would help the bank to boost up their profits, smooth recycling of funds in the nation. This would help the nation to develop more banking branches and developing the economy by providing the better financial services to the nation.

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