Management of Non-Performing – Assets in India Banking Sector – An Analytical Approach

Dr. Keshava K. G.

Principal, KWT's Divekar College of Commerce, Karwar

Introduction

Indian Banking Industry is facing one of the most significant and complex task in the management of Non-Performing Assets (NPAs). Banks have to deal with high level of NPAs which involve high provisioning. This affacts the profitability and operations of banks adversely and makes further lending increasingly difficult. An attempt is made in this paper to highlight the magnitude of NPAs in the India banking sector during the last decade. A brief discussion of the assets classification and conceptual aspects of NPAs of banks is made. The subsequent discussion is focused on the analysis of major trends in the growth of NPAs of banks during the decade from 2011 to 2021. Factors causing NPAs in the Indian banking sector have been analyzed in detail. Measures and suggestions for controlling / preventing the NPAs have been provided. The analysis in this study is focused on the magnitude of the different aspects of the problem of NPAs affecting the banking sector in the country.

Classification of Bank Assets – and NPAs

Assets which cease to generate income of a bank are called Non-Performing Assets (NPAs). They include borrowers' defaults or delays in interest or principal payments. Banking Assets have been classified into (a) standard assets (b) Substandard assets (c) Doubtful assets and (d) Loss assets as per the classification of Reserve Bank of India. Further it is observed that provision is to be made against these assets i.e.

- Standard assets (.025%)
- Substandard assets (10%)
- Doubtful assets (20% to 50%) and
- Loss assets (100%)

This classification of bank assets is based on Narasimhan Committee Report Ramachandra (2009) NPAs of Scheduled Commercial Banks Strategies for Management and Control of NPAs in Scheduled Commercial Banks in India – Banking Sector Reforms (Ed) – KS-Rudraswamy

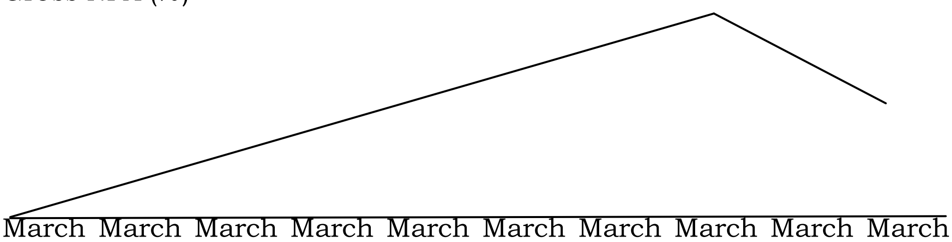
i. Standard Assets
   The loan accounts do not indicate any problem. They do not carry more than normal risks and are regular in all respects
ii. Substandard Assets
   These loan accounts are classified as NPAs for a period exceeding 2 years i.e. NPAs above two years
iii. These NPAs relate to accounts which have been identified by the banks/internal inspectors/external auditors/RBI inspectors

These NPAs accounts do not have realizable value of security. Standard assets are treated as performing assets. The other categories i.e. Substandard, Doubtful and Loss accounts are treated as NPAs.

Growth Trends of Non-Performing Assets in Banks in India – 2011-2020

There has been continuous increase in the Non-Performing Assets (NPAs) of banks in India during the major part of the decade from 2011- to 2020. The following figure indicates the trend of increasing growth of NPAs

Gross NPA (%)



March 2011 March 2012 March 2013 March 2014 March 2015 March 2016 March 2017 March 2018 March 2019 March 2020

(Source: Manjit Saha – in "The NPAs Decade: Events that, changed the face of banking sector" "Deccan Herald"-Jan 4-2021 page 10)

The details in the above figure indicate that the Gross-Non-Performing Assets (GNPA) of commercial banks was at 2.4% of gross advances at the end of March 2011. The ratio hit the peak of 11.5% by March 2018. The rise in the Gross NPAs was slow till 2015 March. However it is observed that there is steep rise in the Gross NPAs of the commercial banks then onward till they reached the peak of 11.51% in 2018. A slowdown in the growth of these GNPAs is observed during the subsequent period till March2020.

Banks in general and those in the public sector in particular are in a mess owing to the mounting Non-Performing Assets (NPAs). Public Sector Banks (PSBs) held 95% of their defaulting loan accounts. The Net NPAs of the 26 PSBs rose to 2.02 percent during 2012-13 from 1.53% in the previous fiscal. The following details are provided about the NPA position during this period by a study Vandana-Performance Problem in The Week-Feb-9-2014 page 51-52

- Public sector banks held 95 percent of the defaulting loan accounts.
- Net NPA of the 26 of the public sector banks rose to 2.02% in 2012-13 from 1.53% during the previous fiscal
- Loans worth 2,29,007 crore were at stake
- CIBIL's list of willful defaulters included companies such as Bartronics India Ltd. Sterling Biotech, Usha Industries and Koutns Ltd.
- As of September 2013 there were431 cases with laons worth Rs. 2732.86 crore in the Corporate Debt Restructuring Cell.

According to another study – "Ashwini Mahajan- in "Revival Can Curb NPAs in Deccan Herald July-4-2015 page 10" Non-Performing Assets (NPAs) of Indian banks reached 4.43 percent in the quarter ending March 2015 as per the Reserve Bank of India report. Gross NPAs of all the scheduled commercial banks was at 5% of the total advances in Setp. 2015 according to another study – S Narendra – in "Non-Performing assets disaster can vitiate banking system – Deccan Herald – January 28 – 2016 page 11

A recent note by the Reserve Bank of India has warned that bad loan could be record high as observed in a study – Anna Purna Singh – - PSB's bad loans could be record high warns RBI – Deccan Herald-January 12 – 2021 page 9. The study has observed that India's Public Sector bnaks' bad loans could raise above 16% by September (2021) this year from 9.7% in the same period last year and in the worst case scenario it could even touch nearly 18%. The RBI's has brought out a half yearly report on the health of the economy. The central banks in its stress lest conducted on PSU banks and their private counterpart has found that the bad loans of private sector banks are significantly lower than their public counterparts. The stress tests indicate that the gross NPA ratio of all scheduled commercial banks may increase from 7.5% in September 2020 to 13.5% by next September under the baseline scenario. RBI has observed that among the bank groups public sector banks' gross NPA ratio of 9.7% in September 2020 may increase to 16.2% by September next under the baseline scenario. The gross NPA ratio of private banks and foreign banks may increase from 4.6% and 2.5% to 7.9% and 5.4% respectively over the same period accordingly the RBI. It is further stated by the RBI that in the stress scenario the gross NPA ratios of public banks, private sector banks and foreign banks may rise to 17.6%, 8.8% and 6.5% respectively by September (2021).

Factors Causing Growth of Non - Performing Assets in Banks – Indian Express

Indian banking system now is facing challenges of an open economy which earlier was working in a closed economy. The banking system now is under a combination of directed lending and social banking resulting in relegating the profitability and competitiveness to the background. The net result has been the unsustainable Non-Performing Assets and the consequent higher effective cost of banking services.

Poor governance practices incompetence and absence of good work culture are also factors contributing to the problem of NPAs in the Indian banking system. There has been a significant increase in the NPAs in case of corporate loans due to gross economic miss management, scams and worst crony capitalism slowdown in the economy worsened the situation for the corporate loans – Ashwini mhajan (2015)-Revival can curb NPAs – Ihid p 10. NPAs have ballooned because of large scale indiscriminate lending during the beginning of last decade – Manjit Saha (2021) – The NPA decade – Events that changed the face of banking sector – in Deccan Herald – January 4 2021 page 10.

It is observed that one of the factors causing NPAs in Indian banks is the incidence of willful defaults of the borrowers. Banks have identified 3005 companies and individuals as willful defaulters - Vandana (2014) – Performance problem – in The Week 0 Feb-9-2014 p 81. Despite the existence of adequate regulatory provisions to deal with willful defaulters it is found that public sector banks (PSBs) have not been aggressive. Managerial failures of Public Sector Banks have contributed to the rising NPAs in Indian banking system. A study by Krishna Kumar (2016) –N- V. (2016 in Resolve NPA crisis with bank mergers –Deccan Hearld-May-10-2016 P-10 has observed.

In our country many of the NPAs can be attributed to an entrenched corrupt banker-businessman nexus. Moreover promoters have borrowed from several banks by offering the same collateral. Date analysis on big loans to 3 companies to public sector banks is sufficient to indicate the depth of the rut in the system. Bad loaning problem in banks arises from many reasons like tax of credit appraisals defaults of loans due to economic cycle and adverse interest rate environment etc.

Restructuring of the debts of numbers of business entities has also been a cause for mounting NPAs in banks. In restructuring the terms of the loan are eased up and the borrower gets more time to put his house in order. The tenure / moratorium are extended or the interest rate is reduced depending upon the restructuring plan. Experience has shown that much of the deferred debt comprising of restructuring eventually become NPAs. The restructuring mechanism is misused by companies. There is a tendency of large quantum of restructured loan turning bad. According to a study (Vandana-2014)- performance problem – Ibid p 52. "While historically 20 percent of restructured loans used to become NPAs this time numbers would shoot up to 25 – 30 percent.

Major Factors Causing NPAs

Major factors contributing to the NPAs of banks in India are indicated here. They are largely caused by management deficiencies, government's socio-economic policies and the economic environment in general.

1. Slackness on the part the credit management of the personal in detecting and preventing diversion of funds during the post disbursement stage.
2. Inadequacy of funds of the defaulting borrowers.
3. Use of working capital for acquiring fixed assets there by disturbing the working capital cycle and blocking the funds in fixed assets.
4. Bank officials yielding to external pressure for loans and the ineffectiveness of the Board to check in time.
5. Change in government policies towards loaning by banks on socio-economic compulsions and considerations.
6. Recession and other adverse economic environment affecting the borrower's capacity to repay loans.
7. Priority sector ending and lending under sponsored schemes of the government.
8. Ineffective monitoring over use of funds by the borrowing units.
9. Banks facing complicated legal formalitives for credit recovery.

Import of Growing NPAs On Banking Business

Banks with high level of NPAs are forced to incur carrying cost of non-income yielding assets. Other consequences of the growing NPAs on the banking business relate to;

- There will be a reduction in internal income of banks.
- High level of provisioning has to be made.
- NPAs will cause stress on profitability and on capital adequacy.
- Banks will experience gradual decline in their ability to meet steady increase in cost.
- There will be a steady erosion of capital resources of banks.

Policies and Measures Needed for Controlling and Preventing Non-Performing Assets in Banks.

It is necessary for banks to follow a consistent policy of reducing Non-Performing Assets (NPAs) and to restore the operational health of their institutions. The policy should guide the bank management in arresting fresh inflows of NPAs and in reducing the existing NPAs. The management and the officials should develop a culture of doing away with NPAs.

An appropriate credit appraisal and credit monitoring system should have to be evolved by the banks. Bank management should identify branches with sizeable NPAs and trained personnel should be employed there. Operational efficiency of the bank should be given top priority by strengthening organizational structure. Internal supervision in the bank should be improved. Training of bank personnel should be given importance in matters relating to credit operations.

There is need for reinforcing financial viability through better credit management. Bank should set up Recovery Cells and task force to deal with the existing NPAs.

Reserve Bank of India's Guidelines for Controlling Non-Performing Assets by Banks

Reserve Bank of India and Indian Banker's Association have taken the following measures for controlling NPAs.

- Compromise Settlement Schemes
- Legal Process Lok-adalats
- Debt Recovery Tribunals (DRTS)
- Circulation of Information on defaulters
- Recovery action against willful defaulters of large amount

Reserve Bank of India has issued the following additional guidelines to control NPAs

- One Time Settlement - OTS
- Asset Reconstruction Companies - ARCs
- Corporate Debt Restructuring - CDB

There is need for enhancing the earning capacity of banks to overcome the NPAs problem. This involves improving the productivity of the bank's manpower, imbibing profit consciousness among bank personnel and ensuring effective utilization of banks of laying emphasis on operational efficiency by strengthening organizational structure, up gradation of internal supervision, quality of training for bank personnel, reinforcing financial viability through better credit management and economy of expenditure.

Conclusion

Banking sector in India is facing a serious problem of Non-Performing Assets (NPAs). The magnitude of NPAs is comparatively higher in Public Sector Banks (PSBs) compared to the private sector banks and foreign banks. The incidence of NPAs needs to be prevented and minimized through selection of right borrowers, viable economic activity, adequate finance and timely disbursement and correct end use of funds and timely recovery of loans. Revivals of the economy curb the NPAs. Revival of manufacturing particularly can improve the condition of industry which can help them repay their loans more promptly. Government is making efforts in the right direction. It is trying to control inflation and promote manufacturing. With the success of the efforts of the government the confidence of the economy can be revived, inflation can be controlled; interest rates can be reduced and can thus improve the repayment of loan – Principle and interest. Thus the incidence of NPAs can be controlled in the banking sector.

C. Raghu and T P Byatagaiah (2009) – Measures to Deal with Problem of Non-Performing Assets – Banking Sector Reforms – Issues and Imperatives.

References

1. Vandana (2014) –m Performance Problem – The Week Feb-9-2014 P – 51-52
2. Ramachandra (2009) – NPAs of Scheduled Commercial Banks – Strategies for Management and Control of NPAs in Scheduled Commercial Banks in India – in Banking Sector Reforms – Iuuses and Imperatives - K C Rudraswamy
3. Ashwini Mahajan (2015) - Revival can Curb NPAs – in Deccan Herald – July 4 – 2015 P- 10
4. Narendra (2016) – Non – Performing Assets – Disaster can vitiate Banking System – Deccan Herald - Jan 28 – 2016 P 11
5. Annapurna Singh (2021) - PSBs Bad Loans could be record high - Warns RBI – Deccan Herald – 12-2021 – P 21
6. Manjit Saha (2021) – The NPA decade – Events that changed the face of banking sector - Deccan Herald – Jan – 4 – P10
7. Krishnakumar. N.V. (2016) – Resolve NPA Crisis with bank mergers - Deccan Herald - May – 10 -2016 P 10
8. C Raghu and TP Byatagaiah (2009) – Measues to Deal with the Problems Non – Performing Assets – Banking Sector Reforms – Issues and Imperatives (Ed)