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Non-Performing Assets of Commercial Banks in India

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Abstract

Gross non-performing assets (NPA) as a proportion of gross assets of India's commercial banks in the public and private sectors as well in banks owned by foreign interests have been rising for the past few years. The restructuring of loans of commercial banks permitted by the Reserve Bank of India under the corporate debt restructuring scheme enabled the banks to upgrade the loans of some of the potentially viable units from the substandard to the standard category. In view of the recent directives of the RBI—realistic assessment of the restructured assets and standardisation of the asset classification—there is a reversal of entries in some cases, which attracted higher provisioning, resulting in losses or a dip in profits of the commercial banks. Gross NPAs of all commercial banks, as a proportion of total assets are 10.8%, as of March 2018. In the case of the public sector banks, which dominate the banking sector with a share of 70% of business, the gross NPA as percent of total assets is 14.5%. Non- performing assets are one of the major concerns for scheduled commercial banks in India. The recommendations of Narasimham committee and Verma committee, some steps have been taken to solve the problem of old NPAs in the balance sheets of the banks. It continues to be expressed from every corner that there has rarely been any systematic evaluation of the best way of tackling the problem. It is necessary to trim down NPAs to improve the financial health in the banking system.

Keywords: Non Performing Assets, Public Sector and Private Sector Banks

Introduction

The commercial banks non-performing assets (NPAs) as proportion of total assets, which have been growing for past three years, reached 9.6% in Fiscal Year (FY) 2015-16 from 5% a year earlier (IMF, 2017a). The public sector banks (PSB) which dominate the banking scene to the extent of 70% in terms of share of business, have more than 80% of NPA of the entire banking system. The NPAs of PSB according to the Economic Survey for 2016-17 (Government of India, 2017) stood at a record level of 12% as of January 2017. This is officially acknowledged to be higher than in any emerging market and with the sole exception of Russia in the developed world (Government of India, 2017). There are various estimates of NPA depending on types of measurement. An Asset quality review (AQR) carried out by the banks in response to RBI directive in late 2014-15, bad loans are referred to as stressed assets (defined as a sum of gross NPA, re-structured assets and written off accounts) which were estimated to be in the range of 17.7% of gross advances in 2016 (Mohan and Ray, 2017). Regardless of different procedures of measurement, poor performance of banks has been causing concerns since late 2016. In this context, a study on the causal factors behind bad loans becomes important not only for the bank managements but also for the central bank, which is the entrusted with the responsibility of maintaining financial stability. The causal factors are divided into two broad categories: (i) macroeconomic determinants, which affect all banks without any distinction; and (ii) bank specific factors, which affect different banks differently.

Asset quality was not prime concern in Indian banking sector till 1991, but was mainly focused on performance objectives such as opening wide networks/branches, development of rural areas, priority sector lending, higher employment generation, etc. While the primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., but in recent times the banks have become very cautious in extending loans. The reason being mounting nonperforming assets (NPAs) and nowadays these are one of the major concerns for banks in India. Bankers are the custodians and distributors of the liquid capital of the country. Therefore most important function of the banking system is to mobilize the savings of the people by accepting deposits from the public. The banker becomes the trustee of the surplus balances of the public. Deposit mobilization promotes the economic prosperity by controlling the money circulation and canalizing for development and productive purposes. In order to mobilize deposits, the commercial banks undertake deposit mobilization through various deposit schemes suited to the different sections of the people. The deposits along with other sources of funds namely capital, reserves and borrowings, form the sources of funds for the banks. The lending and investment activities of the bank are based on the sources of funds.

Banks are supposed to be more directly and positively related to the performance of the economy. Banks act as a development agency and are the source of hope and aspirations of the masses. Commercial banks are the major player to develop the economy. A major threat to banking sector is prevalence of Non-Performing Assets (NPAs). NPAs reflect the performance of banks. 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.

Review of Literature

Balasubramaniam C.S. (2001) highlighted the level of NPAs is high with all banks currently and the banks would be expected to bring down their NPA. This can be achieved by good credit appraisal procedures, effective internal control systems along with their efforts to improve asset quality in their balance sheets.

Kaur (2006) in her thesis titled Credit management and problem of NPAs in Public Sector Banks, suggested that for effective handling of NPAs, there is an urgent need for creating proper awareness about the adverse impact of NPAs on profitability amongst bank staff, particularly the field functionaries. Bankers should have frequent interactions and meeting with the borrowers for creating better understanding and mutual trust.

Chaudhary K. and Sharma M. (2011) in their research stated that An efficient management information system should be developed. The bank staff involved in sanctioning the advances should be trained about the proper documentation and charge of securities and motivated to take measures in preventing advances turning into NPA.

Kumar (2013) in his study on A Comparative study of NPA of Old Private Sector Banks and Foreign Banks has said that Non-performing Assets (NPAs) have become a nuisance and headache for the Indian banking sector for the past several years. One of the major issues challenging the performance of commercial banks in the late 90s adversely affecting was the accumulation of huge non-performing assets (NPAs).

Objectives of the Study

1. To study the status of Non Performing Assets of Indian Commercial Banks in India
2. To study the impact of NPAs on Banks.
3. To know the recovery of NPAS through various channels and Recent Policy Decisions.

Methodology

The present study based on secondary data collected is mainly secondary in nature. The sources of data for this thesis include the literature published by Indian Bank and the Reserve Bank of India, various magazines, Journals, Books dealing with the current banking scenario and research papers.

Causes Responsible for Rising NPAs

The banking sector has been facing the serious problems of the rising NPAs. In fact public sector banks are facing more problems than the private sector banks. The NPAs in public sector banks are growing due to external as well as internal factors. One of the main causes of NPAs in the banking sector is the Directed loans system under which commercial banks are required to supply 40% percentage of their credit to priority sectors.

The huge amount of loan granted under these schemes was totally unrecoverable by banks due to political manipulation, misuse of funds and non-reliability of target audience of these sections. Loans given by banks are their assets and as the repayments of several of the loans were poor, the quality of these assets was steadily deteriorating. In India the scope for branch expansion in rural and semi urban areas is vast and also necessary. Increasingly, NBFCs operating at such places are coming under regulatory pressure and are likely to abandon their intermediation role. These branches find priority sector financing as the main business available especially in rural/semi-urban centers. Operational restructuring of banks should ensure that NPAs in the priority sectors are reduced, but not priority sector lending. This will remain a priority for the survival of banks. Any decisions about insulating Indian banks from priority sector financing should not be reached until full-scale research is undertaken, taking into account several sources including records of credit guarantee schemes.

Impact of NPAs on the Operations of Banks

NPA impact the performance and profitability of banks. The most notable impact of NPA is change in banker's sentiments which may hinder credit expansion to productive purpose. Banks may incline towards more risk-free investments to avoid and reduce riskiness, which is not conducive for the growth of economy. Profitability NPA means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the prodigality of bank decreases not only by the amount of NPA but NPA lead to opportunity cost also as that much of profit invested in some return earning project/asset. So NPA does not affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity. Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.

Liquidity

Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to Borrowing money for shortest period of time which 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

Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now days, banks have special employees to deal and handle NPAs, which is additional cost to the bank. Credit Loss If a bank is facing problem of NPA, then it adversely affects the value of bank in terms of market for credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting in their money in the banks.

Trends in NPAs : The trends in gross NPAs to gross advances of commercial banks can be analysed for three time periods: (i) 1996–97 to 2000–01; (ii) 2001–02 to 2007–08; and (iii) 2008–09 to 2017–18. Table 1 provides these details. It may be observed from Table 1 that the share of NPAs to total advances was relatively high in the 1990s, possibly because there was no back-up of legislative measures for recovery of loans. The share was even higher at 20% for some of the years in the early phase of the reform period. The second phase was characterised by the setting up of Debt Recovery Tribunals, enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, and the establishment of Asset Reconstruction Companies (ARC) to offload bad loans at a discount.3 In the third phase, the strategy for restructuring of corporate debt was undertaken. Thus, it is interesting to note that the share of NPAs in gross advances declined over different time periods.

Table 1: Average NPAs to Gross Advances

Sl No	Period	NPAs as % of GA
1	1996–97 to 2000–01	12.8
2	2001–02 to 2007–08	5.7
3	2008–09 to 2017–18	5.1

Source: For the first period, data are taken from RBI Bulletin (2013)

Recent Policy Decisions : The RBI has taken important steps to clean up the balance sheets of commercial banks during 2015–16, insisting on a more

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vigorous asset quality review and providing a realistic picture of NPAs and provisioning ratios for the existing stock of restructured loans that are showing signs of stress. In order to prevent banks from liberally restructuring loans, the RBI cautioned that units not found viable would henceforth be treated as substandard assets for the purpose of provisioning, culminating in the 15% norm prescribed for substandard assets. Thus, the twin factors—reclassification of the NPAs and the hike in provisioning ratios—triggered ripples in the operations of commercial banks

Personal visits should be made after sanction and disbursal of credit and further close monitoring of the operations of the accounts of borrowed units should be done periodically. Managers under credit monitoring and recovery department should have dynamism in their work. Many managers say that "we do not fear to negotiate but we do not negotiate out of fear. Such fear leads to arbitrary negotiation, which fails. Frequent discussions with the staff in the branch and taking their suggestions for recovery of dues. Assisting the borrowers in developing his/her entrepreneurial skill will not only establish a good relation between the borrowers but also help the bankers to keep a track of their funds. RBI may initiate actions against defaulters like, publishing names of defaulters in News papers, broadcasting media, which is helpful to other banks and financial institutions. As a part of curative measures, bankers may resort to Compromise Settlement or One Time Settlement. Lok Adalats and Debt Recovery Tribunals are other ways for the recovery of dues. It has been observed that Banks these days are highly resorting to SARFAESI Act for the management of NPA.

Conclusion

The Non-Performing Assets have always created a big problem for the banks in India. It is just not only problem for the banks but for the economy too. The money locked up in NPAs has a direct impact on profitability of the bank as Indian banks are highly dependent on income from interest on funds lent. This study shows that extent of NPA is comparatively very high in public sectors banks. Although various steps have been taken by government to reduce the NPAs but still a lot needs to be done to curb this problem. NPAs reflect the overall performance of the banks. The NPAs have always been a big worry for the banks in India. The Indian banking sector faced a serious problem of NPAs. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and liquidity of banks. The extent of NPAs has comparatively higher in public sectors banks. To improve the efficiency and profitability, the NPAs have to be scheduled. Various steps have been taken by government to reduce the NPAs. It is highly impossible to have zero percentage NPAs. But at least Indian banks should take care to ensure that they give loans to creditworthy customers. The government has been pumping capital into the public sector banks to tide over the crisis. As per press reports, the government infused more than `81,000 crore capital in public sector banks in the past 15 years. It is also planned to infuse another `70,000 crore over the next four years in a phased manner. Be that as it may, the capital gets eroded with higher provisioning for bad debts and losses thereof.

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