Impact of Non-Performing Assets on Banking Industry : The Indian Perspective

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Abstract: In the developing economies, Banking and Financial part assumes enormous part in economic improvement. In India banks are confronting enormous issue of Non-Performing Assets (NPAs). The acquiring limit and productivity of the banks are fundamentally influenced due to the NPAs nearness. Notwithstanding that non-execution or non-receipt of premium and chief blocked banks cash as assets and is not accessible for further utilization of saving money business and in this way the net revenue of the banks goes down. In this association bank must mindful of the issues and recuperation enactments of NPAs. So it is vital to trim down NPAs to enhance the monetary wellbeing in the keeping money framework. In this paper, an endeavour has been made to discover the different elements in charge of the gigantic NPAs. Year wise comparison of the NPA s of leading banks is also done. Other than this causes and effect of NPAs are additionally distinguished and a few recommendations are given to lessen the NPAs of the banks.
Key Words: Non Performing Assets, Economic Development, Banking & Financial Sector

Introduction:

A **Non-performing asset** (NPA) is defined as a credit facility in respect of which the interest and/or instalment of Bond finance principal has remained ‘past due’ for a specified period of time. In simple terms, an asset is tagged as non performing when it ceases to generate income for the lender. Non-performing assets, also called non-performing loans, are loans, made by a bank or finance company, on which repayments or interest payments are not being made on time.

NPA is used by financial institutions that refer to loans that are in jeopardy of default. Once the borrower has failed to make interest or principle payments for 90 days the loan is considered to be a non-performing asset. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. Troublesome pressure from the economy can lead to a sharp increase in non-performing loans and often results in massive write-downs.

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the ‘90 days’ overdue’ norm for identification of NPA, from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, 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 91 days in respect of a term loan,
- The account remains ‘out of order’ for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
- The bill remains overdue for a period of more than 90 days in the case of bills 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 purposes, and
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.
- Non submission of Stock Statements for 3 Continuous Quarters in case of Cash Credit Facility.
- No active transactions in the account (Cash Credit/Over Draft/EPC/PCFC) for more than 91days

Classification of Non Performing Assets:

Non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the reliability of the dues:

1. Sub-standard assets: a sub standard asset is one which has been classified as NPA for a period not exceeding 12 months.
2. Doubtful Assets: a doubtful asset is one which has remained NPA for a period exceeding 12 months.
3. Loss assets: where loss has been identified by the bank, internal or external auditor or central bank inspectors. But the amount has not been written off, wholly or partly.

Sub-standard asset is the asset in which bank have to maintain 15% of its reserves. All those assets which are considered as non-performing for period of more than 12 months are called as Doubtful Assets. All those assets which cannot be recovered are called as Loss Assets.

Criteria for NPAs:

Loans don't go bad right away. Most loans allow customers a certain grace period. Then they are marked overdue. After a certain number of days, the loan is classified as a nonperforming loan. Banks usually classify as nonperforming assets any commercial loans which are more than 90 days overdue and any consumer loans which are more than 180 days overdue. For agricultural loans, if the interest and/or the installment or principal remains overdue for two harvest seasons; it is declared as NPAs. But, this period should not exceed two years. After two years any unpaid loan/installment will be classified as NPA.

Causes of NPA:

NPAS result from what are termed "Bad Loans" or defaults. Default, in the financial parlance, is the failure to meet financial obligations, say non-payment of a loan installment. These loans can occur due to the following reasons:

1. Default - One of the main reasons behind NPA is default by borrowers.

2. Economic conditions - Economic condition of a region affected by natural calamities or any other reason may cause NPA.

3. No more proper risk management - Speculation is one of the major reason behind default. Sometimes banks provide loans to borrowers with bad credit history. There is high probability of default in these cases.

4. Mis-management - Often ill-minded borrowers bribe bank officials to get loans with an intention of default.

5. Diversion of funds - Many times borrowers divert the borrowed funds to purposes other than mentioned in loan documents. It is very hard to recover from these kind of borrowers.

6. Bad lending practices

7. **Overhang component** (due to environmental reasons, natural calamities, business cycle, Disease Occurrence, etc...)

The Problems caused by NPAs:

The NPA's do not generate any interest income for banks and at the same time banks are bound to provide provisions for NPA's from current profits, that is why the efficiency of banks is also assessed by the level of return on its assets. In developing countries like India NPA's are one of the biggest hurdle in way of their socio-economic growth. The high level of NPA's affects the financial stability of banks. So, banks are required to make vigorous effort to strength their risk management system and internal control. The high level of NPA's affects the banking operations in the following ways.

- Continuous decline in interest income and providing provision for doubtful debts to write off bad debts from current profits affect the bank's profitability adversely.
- Return on Investment (ROI) also gets reduced.
- Due to inclusion of NPA's, the calculation of capital adequacy ratios also gets disturbed and cost of capital will go up.
- The overall interest income of bank will decline and will be accounted only on receipt basis.

- Cost of capital will go up to due to uncertainty in return, high risk and high level of NPA's.
- The economic value addition (EVA) by banks gets disturbed due to mismatch of assets and liabilities caused by NPA's. It is because EVA is equal to the net operating profit minus cost of capital and thus, it reduces the recycling of the funds.
- High level of NPA's do not have its impact only on banking operation but it adversely affects the other parties too.
- NPA's misallocate credit from good projects so the non performing loans epitomize bad investment and economy performs below its production potential.
- NPA's adversely affect the banking system and reduce the money stock which ultimately leads to economic contraction. It happens when many borrowers fail to pay interest and the principle amount. Banks may experience the liquidity shortages and in result these shortages can jam payments across the country.
- Depositors do not receive market returns on their savings by banks. There is also a risk of asset loss to the depositors in case of bank failure.
- Banks also redistribute losses to other borrowers by charging higher interest rate.
- Owners do not receive market return on their capital and in worst cases they loss their assets which affect the broad pool of shareholders

NPAs do not just reflect badly in a bank's account books, they adversely impact the national economy. Following are some of the repercussions of NPAs:

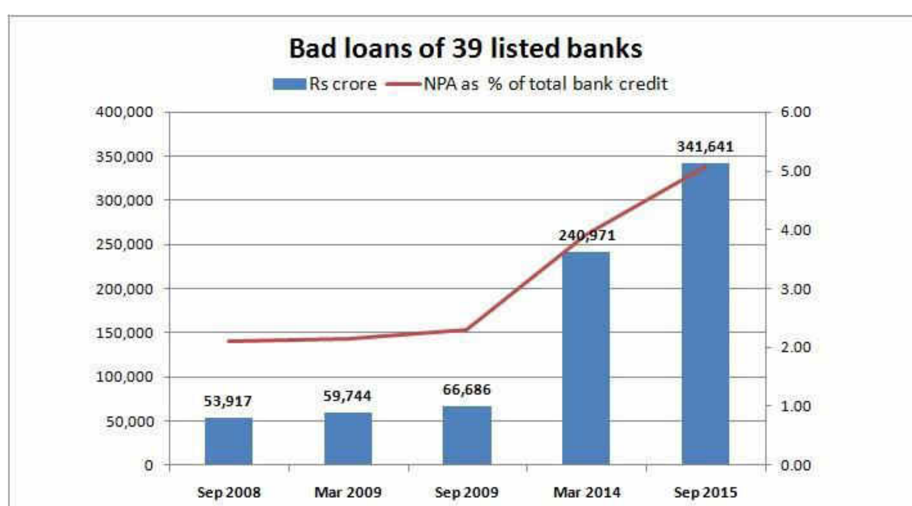
- Depositors do not get rightful returns and many times may lose uninsured deposits. Banks may begin charging higher interest rates on some products to compensate Non-performing loan losses
- Bank shareholders are adversely affected
- Bad loans imply redirecting of funds from good projects to bad ones. Hence, the economy suffers due to loss of good projects and failure of bad investments.
- When bank do not get loan repayment or interest payments, liquidity problems may ensue.

Current Status of NPAs in Banking:

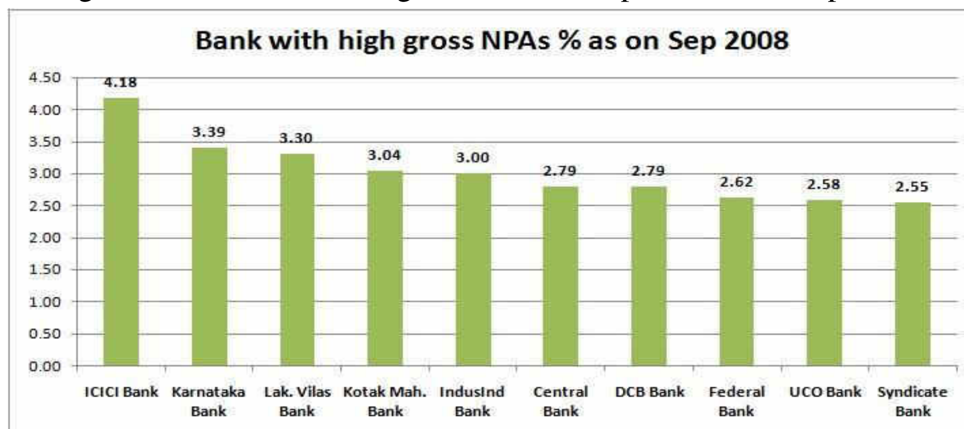
For years, Indian lenders, especially state-run banks, were engaged in volume game to balloon their balance sheets and appease their promoter (the government). That has been so ever since nationalisation of these banks happened in two stages (beginning 1969). Governments often treated these banks as their extended arms and used them for populist measures. There used to be competition among sarkari banks to flag their total business number on front-pages of national newspapers but very little attention was paid to the quality of assets. Every outgoing chairman passed the buck to his successor.

"That was a time (2011-2013) when everyone rushed to give money to corporations, no matter what the credit perception was. Everyone expected a miraculous pick-up in the economy," recalled a former banker with a nationalised bank who now works as a consultant.

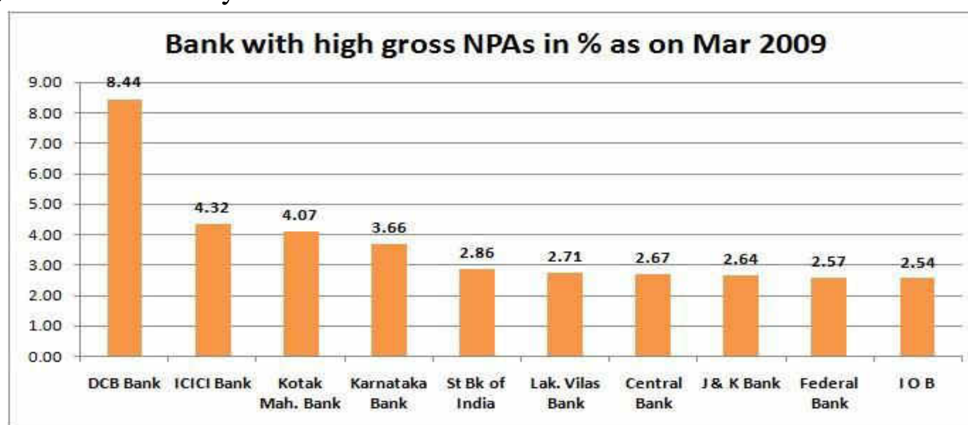
First post takes a look at how the NPA pictures of India's government-owned banks have evolved so far:



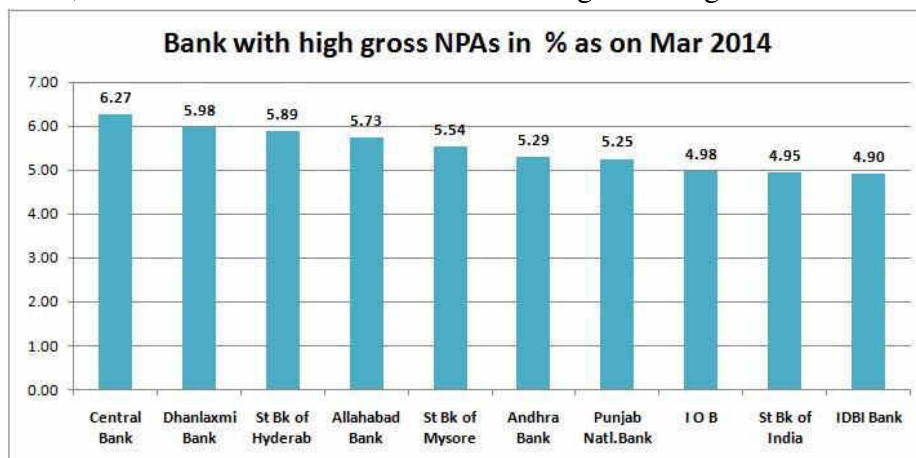
From Rs 53,917 crore, Indian banks gross non-performing assets (GNPAs) in September 2008 (just before the 2008 global financial crisis broke out following the collapse of Lehman Brothers), the bad loans have now grown to Rs 3, 41,641 crore in September 2015. In other words, the total GNPAs of banks, as a percentage of the total loans, has grown from 2.11 per cent to 5.08 percent.



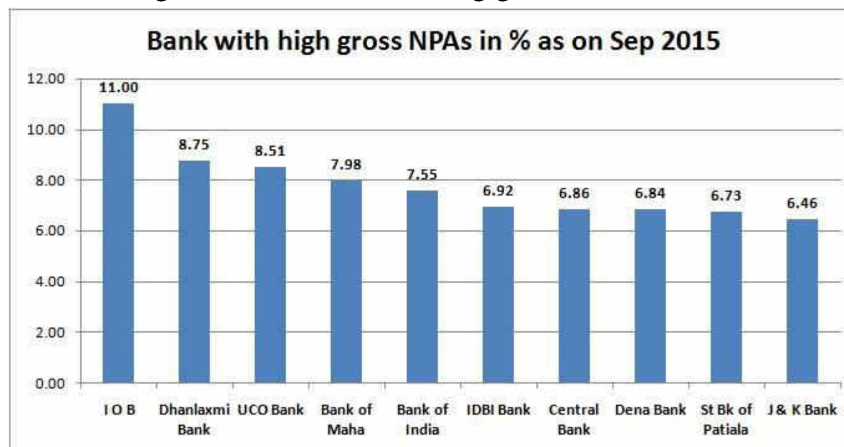
Surprisingly, in the pre-crisis period, private banks topped the list of banks with highest NPAs (see the chart). A quick look at the top ten NPA scorers in September 2008 shows ICICI Bank at the top.
This was followed by small and medium-sized private sector banks such as Karnataka Bank, Lakshmi Vilas Bank, Kotak Mahindra and IndusInd Bank. Among the few sarkari banks that figure in the list are Central Bank, Uco Bank and Syndicate Bank.



By March 2009, a few months before the Congress-led UPA II assumed power, the scene began changing gradually. More state-run banks began appearing in the picture. The country's largest lender by assets, State Bank of India (SBI) and Indian Overseas Bank found place in the list of top NPA scorers. Still private sector lenders figured prominently in the list with ICICI and DCB Bank leading the pack. To be sure, there is no direct link between the ascension of UPA-II and the increase in the NPA picture, but this is when the state-run banks began feeling the heat of NPAs.



Things had worsened to a great extent by March 2014, incidentally, months before the **Narendra Modi** government assumed power at the Centre with a landslide victory over the Congress-led UPA government. The bad loan troubles of government banks began to hit hard despite the best efforts by banks to cover up possible NPA stock to restructured loan category. The list now is dominated mostly by public sector banks, with eight out of ten banks being government owned.



Twenty months into the Modi government rule, it wouldn't be an exaggeration to say that state-run banks are on the verge of a crisis due to their high NPAs, which constitute over 90 percent of the total bad loans of the industry. Many of them have reported losses on account of huge NPAs in the December quarter, surprising analysts. Investors are dumping shares of these banks while there is a sense of uncertainty prevailing on the extent of troubles in the banking sector.

Nine out of 10 most stressed banks in the sector are government banks. The RBI has given a deadline of March 2017 for all banks to clean up their balance sheets, which also require these lenders to set aside huge chunk of capital in the form of provisions. RBI governor Raghuram Rajan has given a clear message to banks to deal with the NPA problem upfront, instead of postponing it and worsening it.

But, there is also huge capital implication on these banks on account of high NPAs too. Banks need to set aside money (known as provisions) to cover their bad loans. The onus to keep government banks stay afloat lies with the government, which is the owner of these banks that control 70 per cent of the banking industry assets. Experts have opined that the government's promised capital infusion in these banks is inadequate. Finance minister, Arun Jaitley, has to work out ways to bring in solutions in the long term. For now, all eyes are on the Union budget for a roadmap.

Views of RBI Governor (Dr. Raghuram Rajan):

- Regarding NPA recovery Rajan said, "We have to improve the efficiency of the recovery system, especially at a time of economic uncertainty like the present. Recovery should be focused on efficiency and fairness – presenting the value of underlying assets and jobs where possible, even while redeploying unviable assets to new uses and compensating fairly. All this should be done while ensuring that contractual priorities are met. The system has to be tolerant of genuine difficulties while coming down on
- A high level of non-performing assets compared to similar lenders may be a sign of problems, as may a sudden increase. However this needs to be looked at in the context of the type of lending being done. Some banks lend to higher risk customers than others and therefore tend to have a higher proportion of non-performing debt, but will make up for this by charging borrowers higher interest rates, increasing spreads. A mortgage lender will almost certainly have lower non-performing assets than a credit card specialist, but the latter will have higher spreads and may well make a bigger profit on the same assets, even if it eventually has to write off the non-performing loans

Conclusion:

Reduction in the level of NPAs is a primary task for the banks operating in India. Simultaneously loan recovery methods have to be improved upon and strengthened. Financial inclusion should be implemented in a sustainable way. For this suitable business and delivery models will have to be developed.

Competition among banks and with the rest of the financial sector will increase. New banks are proposed to be licensed shortly. There is a need for decisive changes in the banking structure to enable it to grow in size, resources efficiency and inclusivity.

The asset quality of banks is an important indicator of their financial health. It also reflects on the efficacy of their credit risk management and recovery environment. Not surprisingly, the asset quality of banks decreased significantly in last three to four years .The level of stressed assets (both NPAs as well as restructured assets) went up. Banks should strengthen their due diligence and also follow whatever guidelines the RBI and the Government have formulated to mitigate this pressing problem. Credit appraisal and post-loan monitoring are other crucial steps which need to be improved upon.

The report makes a number of suggestions to spruce up the loan recovery system. It should focus on fairness and efficiency and try to preserve the value of underlying assets and safeguard jobs. Credit data must be shared and large exposures across banks monitored closely. There is an urgent need for accelerating working of debt recovery tribunals and asset reconstruction companies.

Suggestions and Recommendations:

1. Adequate Human Resources:

Generally the manpower provided to the banking branches for NPA management is not adequate in relation to the task assigned to them. There is a need to give proper and skilful manpower to the branches for NPA management. There is a fallacy that NPA management is nothing but recovery of banks dues. However this is not correct. NPA management needs involvement and understanding on the part of staff on continuous basis so that there is focused attention on recovery. Further, the employees looking after NPA management should be experienced, well qualified and trained so that they can understand the problems of recovery and deal with them effectively.

2. Awareness & Training Camps for Borrowers:

It is generally observed that the awareness at borrower's level regarding non-performing assets, its impact on banks profitability is very less. There is not much of interaction with the bank officials also. The borrowers therefore have no knowledge or information on many things which are in their interest. It is therefore suggested that the branches should arrange training cum awareness camps at ¾ places in their area of operation once in a year and educate the borrowers on various issues. This will help both the borrowers and the bank in improving communication/interaction with the borrowers and simultaneously improve the recovery atmosphere

3. **Preference of Claims:**

Banks should expeditiously and properly claim indemnity from organizations like Deposit Insurance and Credit Guarantee Corporation called DICGC, Export Credit Guarantee Corporation called ECGC, Credit Guarantee Fund Trust for small scale industries, Insurance Companies etc and invoke Government/other personal guarantees to recover loan dues and reduce nonperforming assets.

4. Technical Write Off:

Normally banks decide writing off small loans which have become bad and the recovery is not at all possible in those accounts under any circumstances on account of the facts that the borrower might have been expired; he has no means to repay the loan at any cost and there may be huge losses in respect of the properties etc.

5. One Time Settlement Scheme:

To reduce the absolute amount of nonperforming 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 settlement schemes forming accounts.

6. Compromise Proposals:

Compromise routes are adopted by banks, where borrowers experience certain genuine difficulties and where normal recovery is not possible. It involves certain sacrifices on the part of the banks on the principle of "one bird at hand is worth two in the bush". Such proposals can be taken up considering the history of the borrower account, security available, net worth of the borrower/guarantor, time value of offer made etc.

7. Government Programmers- Improvement in Implementation:

Government sponsored programmers, such as SGSY, PMRY, SJSRY etc, which are implemented for the benefit of rural/urban poor people , have not been effective . Particularly the recovery under these programmers is very poor, this is because there is no proper identification of borrowers and the activities to be financed, quality assets are not given, the training is inadequate and the forward/backward linkages are absent.

8. Incentive for Prompt Repayment Appreciation for Loyalty: Some customers are really loyal to the banks and make timely payment irrespective of any personal financial problems. Such borrowers may be given incentive in the form of concession in rate of interest and or priority in receiving credit. The branches may keep list of such valued customers with them and invite them on special functions or meetings of the bank.

9. Coordination with Farmer's Clubs/NGOs/Social Organizations:

Banks face difficulties in identifying proper borrowers, ascertain their intention, find out the scope for the activities to be financed, verify utilization of loans and finally follow up for recovery. This is the risk the banker has to take while giving credit. Banks can take assistance of Farmer's clubs NGOs or social organizations in the area for various purposes mentioned above. can take initiative in establishing farmers club in the area if they are not already there.

10. Improvement in Recovery Act:

The present recovery act is not very effective and the branches do not get any benefit of this act for improving recovery, it is suggested that the act should be amended on the lines M., P. State Recovery Act or any other State government to make it more effective and banker friendly.

11. Suit Filing:

Filing of suit is taken up as a last resort when all other remedies to recover nonperforming assets fail. Banks can initiate recovery proceedings with or without intervention of the courts of law. To expedite the process, banks should be alert and proactive in all stages of the proceedings. i.e. preparation of plaint, service of summons, written statements, trial of the suit, obtaining decree copy, praying for interim relief, execution of decrees, attachment of the property, arrest of the defendants, if needed etc.

Debt Recovery Tribunals:

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

Lok Adalats:

It is a legal forum for expeditious settlement of loan dues on consensus arrived between the bank and the borrowers mediated by the Lok Adalats.

Securitisation Act:

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) aims to empower banks as secured creditors to take possession, manage and sell the securities without the intervention of court/tribunal. It also aims at Asset Reconstruction by securitization or Reconstruction Company. However, loan with balance below Rs. 1 lakh unsecured loans and loans against collateral of agricultural land are exempted from the purview of this act.

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