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IMPLICATIONS OF NON-PERFORMING ASSETS IN THE BANKING SECTOR

Abstract

NPA means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI. NPA are those loans given by a bank where the borrower defaults or delays interest or principal payment.

The dreaded NPA rule says when interest or other dues to the bank remains unpaid for more than 90 days; the entire bank loan automatically turns as "NPA". The recovery of loan has always been a problem for banks. NPA are threatening the stability and demolishing bank's profitability through a loss of interest income and write-off of the principal loan amount itself.

This paper focuses upon the implications of NPAs in the banking sector. A comparative analysis of public sector banks vis-à-vis private sector banks has been undertaken – For the purpose of this study six banks have been randomly chosen (3 each from the private and public sectors). Data has been collected from the annual reports of the banks. It is found that banks need to monitor standard assets to avert any account from becoming a NPA. Today, the success of banks depends on the methods of managing NPA's and keeping them within a tolerance level. Banks are not allowed to book any income from NPA's; also they need to make provisions for NPA's which impacts profitability adversely. With the introduction of international norm of income recognition, asset classification and provisioning in the banking sector, managing NPA has emerged as one of the major challenges facing banks.

Besides, resorting to legal remedies for recovery of their dues, banks have also utilized the services of the Debt Recovery Tribunals (DRT).

Keywords: NPA, Banks, Profitability, Asset, Income.

Introduction

Prior to 1991, the Indian financial institutions followed the traditional way of accounting procedures. The system pertaining to repayments of principal amount and periodical interest was such that the banks or any financial institutions used to credit the interest and debit the borrowers accounts on a particular date or as per the given specified period, irrespective of whether the borrower paid the interest or not. There were no prompt actions taken those days for the recovery of such principal or interest amount.

Recovery of interest and principal amount were initiated at the end of every financial year or at the time of expiry of documents. All the borrowers' accounts were treated alike till the recovery procedures like filing suit for outstanding interest and loan installment were initiated. Another issue in the traditional concept was the limitation period i.e., the debt instruments expire once in every three years, if timely actions were not taken then the financial institutions or banks will have to incur losses.

In the year 1991-92 the new system of accounting came into existence which classified the assets into different categories. The banks had to adopt the revenue recognition principle. Banks in India have traditionally been saddled with very high NPAs. The banking sector was heading for a crisis in 2001 with NPAs crossing Rs.64000crores in one month. Banks burdened with huge NPAs faced uphill tasks in recovering them due to archaic laws and procedures. Realizing the gravity of the situation the government was quick to implement the recommendations of Narasimhan committee leading to the enactment of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act.

While gross NPA reflects the quality of the loans made by banks, net NPA shows the actual burden of banks. Now it is increasingly evident that the major defaulters are the big borrowers coming from the non- priority sector. Public sector banks figure prominently in the debate not only because they dominate the banking industry, but also since they had much larger NPAs compared to the private sector banks. Today the situation has marginally changed. The NPAs in books have reduced drastically in public sector banks, as public sector banks are entering into 'compromise write offs' in order to report better numbers. For the recovery of NPAs a broad framework has evolved for the management of NPAs under which several options are provided for debt recovery and restructuring.

Review of Literature

Many published literature is available in the area of Non- Performing Assets and a large number of researchers have studied the issue of NPA in banking industry.

Kaur and Singh (2011) in their study on non-performing assets of public and private sector banks (a comparative study) concluded that NPAs are an important parameter to judge 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. The financial institutions are nowadays facing a major problem of managing the Non-Performing Assets (NPAs) and these assets are proving to become a major setback for the growth of the economy.

Satpal (2014) in his study on Non- Performing Assets in Public and Private Sector Banks in the New Age of Technology (a comparative study) found that 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 lended. The NPAs level of Indian banks is still high as compared to the foreign banks. The study revealed that it is not at all possible to have zero NPAs and the bank management should speed up the recovery process.

Priyanka Mohnani and Monal Deshmukh (2013) in their study on Non- Performing Assets on selected Public and Private Sector Banks opined that it is very necessary for banks to keep the level of NPA as low as possible. It is also felt that NPA is one kind of obstacle to the growth and development of banks and affects the performance of banks negatively and therefore, the management of NPA is necessary.

Statement of the Problem

NPAs are an inevitable burden on banking industry. The banking sector has been facing the serious problems of rising NPAs. Banks need to monitor standard assets to arrest any account becoming a NPA. The recovery of loan has always been a problem for banks. In the past, after factoring different attributes of a loan like who has borrowed, their record, whether the industry is cyclical, banks would classify their loans as good, doubtful or bad. This would provide a clearer perspective of the extent to which banks may have to strive to recover the loans. Various studies have shown that the incidence of NPA is comparatively higher in public sector banks. To improve the efficiency and profitability, the NPA has to be scheduled. It is highly impossible to have zero percent NPA and banks need to find measures to control NPA. Today, the success of the banks depend on the methods of managing NPAs and keeping them within a tolerance level.

Objectives of the Study

- To study the implications of NPAs in the banking sector.
- To make a comparative analysis of NPAs of public and private sector banks.
- To compare the Gross NPAs and Net NPAs of both public sector and private sector banks.

Operational Definitions

Gross NPA

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 non standard assets as sub- standard, doubtful and loss assets. It can be calculated with the help of the following ratio:

Gross NPAs Ratio= Gross NPAs/ Gross Advances

Net NPA

Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden of banks. Net NPA is obtained by deducting items like interest due but not recovered, part payment received and kept in suspense account from Gross NPA. It can be calculated with the help of the following ratio:

Net NPAs= Gross NPAs-Provisions/ Gross Advances- Provisions

Loan Assets

Loan Assets are classified into two groups-

Performing Assets

An asset which is not non-performing is called a performing asset. In other words, an asset is considered a performing asset, if interest is serviced (i.e., received) promptly and there is nothing irregular in the account.

- **Standard Assets**

Standard assets are those assets which do not disclose any problem and which do not carry more than normal risk attached to the business.

Non-Performing Assets

A non-performing asset is an asset which ceases to generate income for the bank. In other words, a non-performing asset means a credit facility (i.e., term loan, cash credit and overdraft, bills purchased and discounted and other accounts) in respect of which the interest and/or installment of principal is delayed and not received before a stipulated time.

- **Sub-Standard Assets**

These are the assets which have ceased 'to perform' but which have not completed a period of 12 months after getting classified as Non Performing Assets and there is no threat to recovery on account of erosion in the realizable value of security or due to non-availability of security or due to other factors, to the extent that the account is to be classified either as doubtful assets or as loss assets.

- **Doubtful Assets**

These are the accounts, which have completed a period of 12 months after getting classified as Non Performing Assets. They have to be further classified into three sub categories for the purpose of provisioning.

a) Less than one year (DA-1)

b) Between 1 and 3 years (DA-2) and

c) Above 3years (DA-3)

Further, each doubtful asset is bifurcated into secured portion and unsecured portion for provisioning purpose.

- **Loss Assets**

A loss asset is one where loss has been identified by the bank or by internal or external auditors or by the RBI inspector. A NPA shall be treated as Loss asset, if it is uncollectible due to any of the following reasons:-

- Serious credit impairment via fraud etc.,
- Value of security is negligible, i.e., less than 10% of the liability, due to erosion in value of security.

Research Methodology

This study is a descriptive research and relies on data sourced from the annual reports of banks. Information has also been retrieved from relevant websites and reference books. The data collected has been tabulated, analyzed and presented in graphical form. A comparative analysis of NPA of 3 public sector banks, i.e., State Bank of India, Punjab National Bank, Bank of Baroda and 3 private sector banks- ICICI bank, HDFC bank, AXIS bank has been undertaken. Data pertaining to a period of 5 years from financial year 2009 to 2013 has been chosen for the purpose of this study.

Analysis and Findings

The average GNPA and NNPA of SBI is highest among all three public sector banks chosen for the purpose of the study. Bank of Baroda has the lowest percentage of GNPA to gross advances. (refer figures 1 and 2)

It is found that the GNPA and NNPA of ICICI Bank is highest compared to the other private sector banks,i.e., HDFC bank and Axis bank during the period under study. GNPA of ICICI bank and HDFC bank has remained constant during the period under study. However, the percentage of GNPA to gross advances of Axis bank has been fluctuating. (refer figures 3 and 4)

Gross NPA in public sector banks is comparatively higher than private sector banks. The percentage of GNPA to gross advances shows a gradual increase in the case of public sector banks. The percentage of NNPA of public sector banks has also increased from 3.19% in 2009 to 5.73% during the year ending 2013. (refer figure 5)

In the case of private sector banks it is observed that the percentage of NNPA to net advances has gradually decreased from 3.12% in 2009 to 1.18% in 2012. There is a slightly marginal increase in 2013 at 1.29%. (refer figure 6)

It is therefore found that the management of NPA of private sector banks is better than that of public sector banks as there is a percentage decrease in NPA to total assets. In order to ensure better management of NPA, public sector banks can avoid sanctioning loans to the non creditworthy borrowers by adopting certain measures. They need to make a careful appraisal of the project which involves checking the economic viability of the project. Firstly, they must consider the return on investment on a proposed project. If the calculated return is sufficiently higher than the credit amount they can sanction the loan. Secondly, they can constantly monitor the borrower in order to ensure that the amount sanctioned is utilized properly for the purpose of which it has been sanctioned. This involves the post sanction inspection by the banks. Thirdly, they should get both the formal and informal reports about the goodwill of the customers. If he had already proven as a defaulter then there is no question of sanctioning loan to him. Fourthly, the banks should persuade customers to pay the interest regularly and encourage them in timely repayment of installments.

Conclusion

One of the main causes of NPAs in the banking sector is the directed loans system under which commercial banks are required to supply a prescribed percentage of their credit (40 percent) to priority sectors. Loans to weaker sections of society under state subsidy schemes have led borrowers to expect that like a non refundable state subsidy, bank loans need not be repaid. Directed loans supplied to the "micro sector" are problematic of recoveries especially when some of its units become sick or weak. Nearly 7 percent of PSB's net advances were directed to these units. Clearly, these units are one of the most significant sources of NPAs, rather than bank mismanagement. The Narasimham Report (II) recommended that the directed credit component should be reduced from 40 to 10 percent. As the directed credit component of the priority sectors arises from loan schemes requiring Government approval of beneficiaries, banks selection standards with regard to eligible borrowers are being interfered with. The nexus of subsidies should be eliminated from bank loan schemes. The other reasons for increasing NPAs may be attributed to economic slow down as there is a general slackening of economic activities in India both in manufacturing and in services sectors. Over a period of time many companies defaulted on their loans. Imposing high rate of interest also will increase the cost of fund availability and the credit users are going to suffer. Banks are required to maintain their interest margin. A high rate of increase of interest may dilute the quality of assets of the banking sector. Weak supply and demand, high borrowing and extreme competition lead to loan defaults. The three forth of the top most banks loans are advanced to certain sectors.

Table 1

Gross and Net NPA of Public Sector Banks

(Rs. in crores)

Year	SBI	PNB	BOB									
	GNPA	% GNPA	NNPA	% NNPA	GNPA	% GNPA	NNPA	% NNPA	GNPA	% GNPA	NNPA	% NNPA
2009	16,346	3.01	9,552	1.76	2,965.33	1.55	1,552.59	1.09	1,842.92	1.2	602.32	0.34
2010	19,535	3.09	10,870	1.72	3,356.24	1.68	1,678.52	1.12	2,400.69	1.25	652.26	0.38
2011	25,326	3.28	12,346	1.63	4,379.39	1.79	2,038.63	1.23	3.152.50	1.36	790.88	0.35
2012	39,676	4.44	15,818	1.82	8,719.62	2.93	4,454.23	1.52	4,464.75	1.53	1,543.64	0.54
2013	51,189	4.75	21,956	2.1	13,465.79	4.27	7,236.50	2.35	7,982.58	2.4	4,192.02	1.28
Average	30,414.4	3.71	14,108.4	1.81	6,577.27	2.44	3,392.09	1.46	3,968.69	1.55	1,556.22	0.58

Percentage Gross NPA of Public Sector Banks

Figure 1

www.sbi.co.in www.pnbindia.in www.bankofbaroda.co.in www.moneycontrol.com

Percentage Net NPA of Public Sector Banks

Figure 2

www.sbi.co.in www.pnbindia.in www.bankofbaroda.co.in www.moneycontrol.com

Table 2

Gross and Net NPA of Private Sector Banks

(Rs. in crores)

Year	ICICI Bank	HDFC Bank	AXIS Bank									
	GNPA	% GNPA	NNPA	% NNPA	GNPA	% GNPA	NNPA	% NNPA	GNPA	% GNPA	NNPA	% NNPA
2009	9,649	3.96	4,553	2.09	1,988	1.12	627	0.63	897	1.15	327	0.4
2010	9,480	4.36	3,841	2.12	1,816	1.09	392	0.31	1,318	0.98	419	0.4
2011	10,034	4.47	2,407	1.11	1,694	1.05	296	0.2	159	1.01	41	0.26
2012	9,475	3.62	1,860	0.73	1,999	1.02	352	0.2	1,806	0.94	472	0.25
2013	9,607	3.22	2,230	0.77	2,334	0.97	468	0.2	2,393	1.06	704	0.32
Average	9,649	3.93	2,978.2	1.36	1,966.2	1.05	427	0.31	1,314.6	1.03	392.6	0.33

Percentage Gross NPA of Private Sector Banks

Figure 3

www.icicibank.com www.hdfcbank.com www.axisbank.com www.moneycontrol.com

Percentage Net NPA of Private Sector Banks

Figure 4

www.icicibank.com www.hdfcbank.com www.axisbank.com www.moneycontrol.com

Table 3

Gross NPA and Net NPA of Public and Private Sector Banks

(Rs. in crores)

Year	Public Sector Banks				Private Sector Banks			
	GNPA	% GNPA	NNPA	% NNPA	GNPA	% GNPA	NNPA	% NNPA
2009	21,154.25	5.76	11,706.91	3.19	12,534	6.23	5,507	3.12
2010	25,291.93	6.02	13,206.8	3.22	12,614	6.43	4,652	2.83
2011	32,857.89	6.43	15,175.51	3.21	11,887	6.53	2,744	1.57
2012	52,860.37	8.9	21,824.77	3.88	13,280	5.58	2,684	1.18

2013	72,637.37	11.42	33,384.52	5.73	14,334	5.25	3,402	1.29

Percentage Gross NPA of Public and Private Sector Banks

Figure 5

www.sbi.co.in *www.pnbindia.in* *www.bankofbaroda.co.in* *www.icicibank.com* *www.hdfcbank.com* *www.axisbank.com* *www.moneycontrol.com*

Percentage Net NPA of Public and Private Sector Banks

Figure 6

www.sbi.co.in *www.pnbindia.in* *www.bankofbaroda.co.in* *www.icicibank.com* *www.hdfcbank.com* *www.axisbank.com* *www.moneycontrol.com*

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