

PERFORMANCE OF NON-PERFORMING ASSETS (NPAS) IN INDIAN COMMERCIAL BANKS

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ABSTRACT

In India Non-performing assets are one of the major concerns for banks. NPA is the best indicator for the health of the banking industry. NPAs reflect the performances of banks. NPAs are the primary indicators of credit risk. NPAs are an inevitable burden on the banking industry. Hence the success of a bank depends upon methods of managing NPAs. The Public Sector Banks have shown very good performance over the private sector banks as far as the financial operations are concerned. The Public Sector Banks have also shown comparatively good result. However, the only problem of the Public Sector Banks these days are the increasing level of the non performing assets. The non performing assets of the Public Sector Banks have been increasing regularly year by year. On the contrary, the non performing assets of private sector banks have been decreasing regularly year by year except some years. Generally reduction in NPAs shows that banks have strengthened their credit appraisal processes over the years and increased in NPAs shows the necessity of provisions, which bring down the overall profitability of banks. The Indian banking sector is facing a serious problem of NPA. The magnitude of NPA is comparatively higher in public sectors banks than private sector banks. To improve the efficiency and profitability of banks the NPA need to be reduced and controlled.

KEY WORDS: Gross NPA, Net NPA, public sector banks, private sector banks.

1. Introduction

For any nation, banking system plays a vital role in the development of its sound economy. Banking is an important segment of the tertiary sector and acts as a back bone of economic progress. 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. The NPA growth involves the necessity of provisions, which reduces the overall profits and shareholders' value (Parul Khanna, 2012).

In present scenario NPAs are at the core of financial problem of the banks. Concrete efforts have to be made to improve recovery performance. The main reasons of increasing NPAs are the target-oriented approach, which deteriorates the qualitative aspect of lending by banks and willful defaults, ineffective supervision of loan accounts, lack of technical and managerial expertise on the part of borrowers (Kamini Rai, 2012).

2. Literature Review

A large number of researchers have been studied to the issue of non performing asset (NPA) in banking industry .A review of the relevant literature has been described as under:-

Non Performing Assets engender negative impact on banking stability and growth. Issue of NPA and its impact on erosion of profit and quality of asset was not seriously considered in Indian banking prior to 1991. There are many reasons cited for the alarming level of NPA in Indian banking sector. 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. The accounting treatment also failed to project the problem of NPA, as interest on loan accounts were accounted on accrual basis (Siraj K.K. and P. Sudarsanan Pillai, 2012).

A Committee on Banking Sector Reforms known as Narasimham Committee was set up by RBI to study the problems faced by Indian banking sector and to suggest measures revitalize the sector. The committee identified NPA as a major threat and recommended prudential measures for income recognition, asset classification and provisioning requirements. These measures embarked on transformation of the Indian banking sector into a viable, competitive and vibrant sector. The committee recommended measures to improve “operational flexibility” and “functional autonomy” so as to enhance “efficiency, productivity and profitability” (Chaudhary, S., & Singh, S., 2012).

The main cause of mounting NPAs in public sector banks is malfunctioning of the banks. Narasimham Committee identified the NPAs as one of the possible effects of malfunctioning of public sector banks (Ramu, N., 2009).

It has been examined that the reason behind the falling revenues from traditional sources is 78% of the total NPAs accounted in public sector banks (Bhavani Prasad, G. and Veena, V.D., 2011).

An evaluation of the Indian experience in Financial Sector Reforms Published in the RBI Bulletin gives stress to the view that the sustained improvement of the economic activity and growth is greatly enhanced by the existence of a financial system developed in terms of both operational and allocation efficiency in mobilizing savings and in channelizing them among competing demands (G.Rangarajan, 1997).

It has been observed that the current banking Scenario and the need for the policy change, opines that a major concern addressed by the banking sector reform is the improvement of the financial health of banks. The Introduction of prudential norms is better financial discipline by ensuring that the banks are alert to the risk profile of their loan portfolios (S.P.Talwar (1998).

The Reserve Bank of India has also conducted a study to ascertain the contributing factors for the high level of NPAs in the banks covering 800 top NPA accounts in 33 banks (RBI Bulletin, July 1999). The study has found that the proportion of problem loans in case of Indian banking sector always been very high. The problem loans of these banks, in fact, formed 17.91 percent of their gross advances as on March 31, 1989. This proportion did not include the amounts locked up in sick industrial units. Hence, the proportion of problem loans indeed was higher. However, the NPAs of Indian Banks declined to 17.44 percent as on March 31, 1997 after introduction of prudential norms. In case of many of the banks, the decline in ratio of NPAs was mainly due to proportionately much higher rise in advances and a lower level of NPAs accretion after 1992. The study also revealed that the major factors contributing to loans becoming NPAs include diversion of funds for expansion, diversification, modernization, undertaking new projects and for helping associate concerns. This is coupled with recessionary trend and failure to tap funds in the capital and debt markets, business failure (product, marketing, etc.), inefficient management, strained labour

relations, inappropriate technology/technical problems, product obsolescence, recession input/power shortage, price escalation, accidents, natural calamities, Government policies like changes in excise duties, pollution control orders, etc. The RBI report concluded that reduction of NPAs in banking sector should be treated as a national priority issue to make the Indian banking system stronger, resilient and geared to meet the challenges of globalization (Parul Khanna, 2012).

3. Concept of NPA

The Non Performing Asset (NPA) concept is restricted to loans, advances and investments. As long as an asset generates the income expected from it and does not disclose any unusual risk other than normal commercial risk, it is treated as performing asset, and when it fails to generate the expected income it becomes a “Non Performing Asset”. In other words, a loan asset becomes a Non Performing Asset (NPA) when it ceases to generate income, i.e. interest, fees, commission or any other dues for the bank for more than 90 days. A NPA is an advance where payment of interest or repayment of instalment on principal or both remains unpaid for a period of two quarters or more and if they have become ‘past due’. An amount under any of the credit facilities is to be treated as past due when it remain unpaid for 30 days beyond due date.

It is also called as Non Performing Loans. It is made by a bank or finance company on which repayments or interest payments are not being made on time. A loan is an asset for a bank as the interest payments and the repayment of the principal create a stream of cash flows. It is from the interest payments that a bank makes its profits. Banks usually treat assets as non-performing if they are not serviced for some time. If payments are late for a short time, a loan is classified as past due and once a payment becomes really late (usually 90 days), the loan is classified as non-performing (B.Selvarajan & G. Vadivalagan, 2013).

NPA usually refers to non-performing assets and the lenders consider it as those assets that are not fetching benefits to them. The word is not new to the bankers. It is regular but disguised loan asset.. An asset becomes nonperforming when it ceases to generate income for the bank. Prior to 31st March, 2004 a nonperforming asset was defined as a credit facility in respect of which the interest or instalment of principal has remained past due for a specified period of time which was four quarters. Due to the improvements in payment and settlement system, recovery climate, up gradation of technology in the banking system, etc., it has been decided to dispense with past due concept, with effect from March 31st 2004(Chandan Kumar Tiwari & Ravindra Sontakke, 2013).

4. NPAs Classification

NPA have been classified into following four types:-

- (i) **Standard Assets:** A standard asset is a performing asset. Standard assets generate continuous income and repayments as and when they fall due. Such assets carry a normal risk and are not NPA in the real sense.
 - (ii) **Sub-Standard Assets :** All those assets (loans and advances) which are considered as non-performing for a period of 12 months.
 - (iii) **Doubtful Assets:** All those assets which are considered as non-performing for period of more than 12 months.
 - (iv) **Loss Assets :** All those assets which cannot be recovered.
- These assets are identified by the Central Bank or by the Auditors.

Types of NPA

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

$$\text{Gross NPAs Ratio} = \text{Gross NPAs} / \text{Gross Advances}$$

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. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the banks have to make certain provisions against the NPAs according to the central bank guidelines.

It can be calculated by following:

$$\text{Net NPAs} = \text{Gross NPAs} - \text{Provisions} / \text{Gross Advances} - \text{Provisions}$$

5. Analysis of NPAs of public and private sector banks

Source: RBI annual financial report, NPA of public & private sector banks in Table 1.
 Comparison of Gross NPAs and Net NPAs of Public Sector & Private Sector Banks

| Years | Public Sector Bank | | Private Sector Bank | |
|---------|--------------------|-------------|---------------------|-------------|
| | Gross NPAs(%) | Net NPAs(%) | Gross NPAs(%) | Net NPAs(%) |
| 2001-02 | 11.09 | 5.82 | 9.64 | 5.73 |
| 2002-03 | 9.36 | 4.54 | 8.08 | 4.95 |
| 2003-04 | 7.80 | 3.00 | 5.85 | 2.80 |
| 2004-05 | 5.50 | 2.00 | 6.00 | 2.70 |
| 2005-06 | 3.60 | 1.30 | 4.40 | 1.70 |
| 2006-07 | 2.70 | 1.10 | 3.10 | 1.00 |
| 2007-08 | 2.20 | 1.00 | 2.30 | 0.70 |
| 2008-09 | 2.00 | 0.94 | 2.36 | 0.90 |
| 2009-10 | 2.20 | 1.09 | 2.32 | 0.82 |
| 2010-11 | 2.40 | 1.20 | 1.97 | 0.53 |
| 2011-12 | 3.30 | 1.70 | 1.80 | 0.60 |

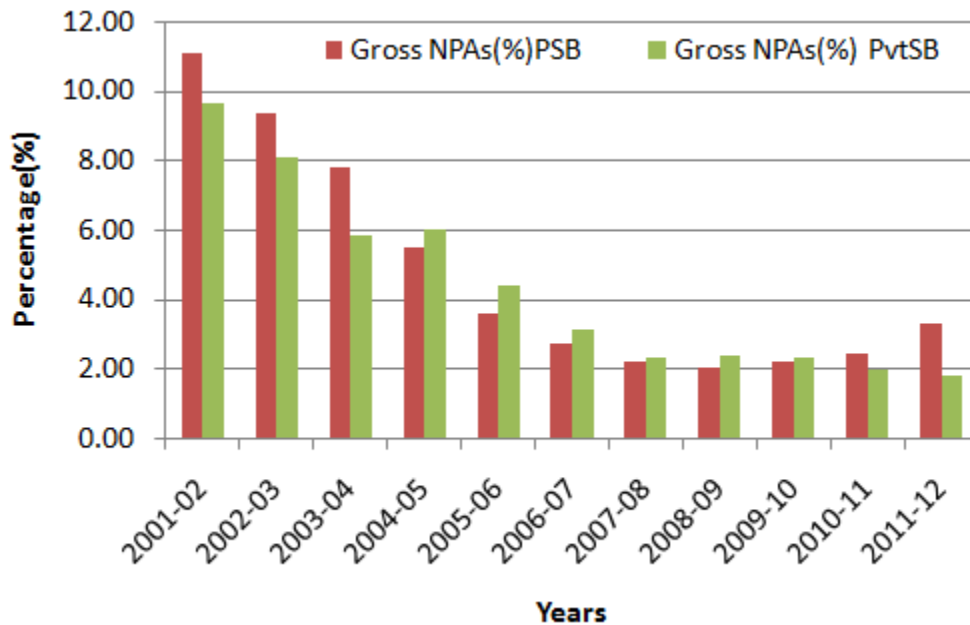


Fig.1 Comparison of Gross NPAs of public and private sector banks

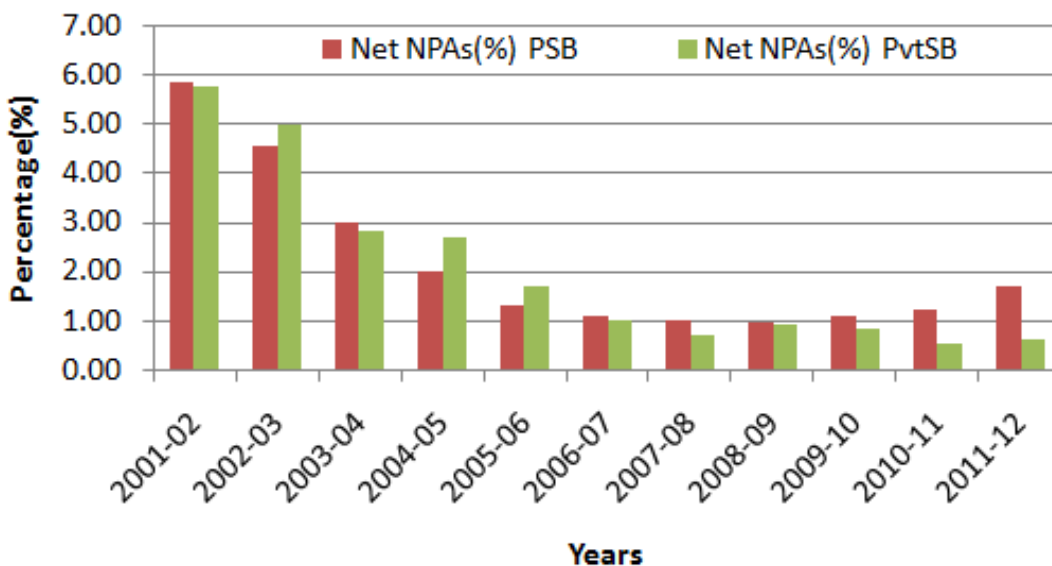


Fig.2 Comparison of Net NPAs of public and private sector banks

The studies have been carried out using the RBI reports on banks (Annual Financial Reports) information /data obtain from banks and discussion with bank officials. The public sector and private sector banks showed a declining trend in gross and net NPAs over the period of study as shown in Table-1 but public sector banks has higher NPA compare to Private sector banks. The reason for it is that private sector banks have a secured loan policy as compared to public sector banks.

It has been observed that gross NPAs as absolute and in percentage terms with gross advances of public sector banks have declined from 11.09% to 2.00% in the period of 2001-02 to 2008-09, whereas gross NPAs as percentage with gross advances of Private sector banks have declined from 9.64% to 2.30% in the period of 2001-02 to 2007-08 as shown in fig.1. On the other hand net NPAs of public sector banks in absolute and in percentage terms has also come down from 5.82% to 0.94% in the period of 2001-02 to 2008-09. But comparatively in private sector banks net NPAs as absolute and in percentage term to net

advances have also come down from 5.73% to 0.70% in the period of 2001-02 to 2007-08 as shown in fig.2. Again gross NPAs of public sector banks in absolute and in percentage terms has started increasing from 2.00% to 3.30% from the period of 2008-09 to 2011-2012 whereas gross NPAs of private sector banks has started declining from 2.30% to 1.80% from the period of 2007-08 to 2011-12 except 2008-09(2.36%) and 2009-10(2.32%). On the other side net NPAs of public sector banks in absolute and in percentage terms has increased from 0.94% to 1.70% from 2008-09 to 2011-12. On the contrary net NPAs of private sector banks has declined from 0.70% to 0.60% from 2007-08 to 2011-12 except 2008-09(0.90%) and 2009-10(0.82%). So even after implementation of prudential norms in early nineties and serious concern raised by government about growing size of NPAs, public sector banks paid least attention to all these warnings, which subsequently lead to turning fresh loans of banks into non performing category. So falling ratio of NPAs in terms of advances is not a true indicator of performance of public sector banks in the field of NPAs. In fact, growing size of gross NPAs in absolute form has been real cause of worry.

6. 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 (G.V. Bhavani Prasad & D. Veena, 2011).

Most significant sources of NPAs are directed loans supplied to the “micro sector” are problematic of recoveries especially when some of its units become sick or weak. Public sector banks 7 percent of net advances were directed to these units (M. Karunakar et al, 2008). Poverty elevation programs like IRDP, RREP, SUME, SEPUP, JRY, PMRY etc., failed on various grounds in meeting their objectives. 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.

7. Impact of NPA on the operations of banks

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 productivity 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 lead 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 (C.S. Balasubramaniam, 2011).

8. Measures to Control NPAs

In present scenario NPAs are at the core of financial problem of the banks. Concrete efforts have to be made to improve recovery performance. Measures required to be undertaken are mainly two fold. Banks should make efforts first to avoid fresh addition on NPAs by their effective presentation appraisal and secondly to recover the amount from accounts which have already turned bad.

Preventive Measures: Most of the bankers feel that genuine viability problem of the borrowing units, weakness in credit appraisal system, absence of effective monitoring and supervision of loan account, absence of credit information sharing among the banks etc. are some of the significant causative factors of high level of NPAs internal to the banks.

- So for preventive the fresh inflow of funds into the non-performing category, banks should reformulate their credit appraisal techniques.
- Proper evaluation of the loan application may help in detecting the unviable projects at the first instance.
- Full information about unit, industry, its financial stake, management etc. should be collected.
- Industrial cell should be established at the bank level, which would have complete information about the industry and its prospects in future.
- Proper credit monitoring should be equally emphasized. There should be proper flow of information from the units regarding their financial area, annual accounts, stock reports etc., which would enable the banker to know the need based credit requirement of borrower and warning signals for taking quick remedial action.
- Banks should inspect the progress of the project or the business. Separate monitoring department should be established in large branches for periodical review of accounts, comparative risk analysis and compliance of terms and conditions of sanction. Equal emphasis should be given for monitoring of standard assets also.
- Banks should be equipped with latest credit risk management techniques to protect the bank funds and minimize insolvency risks. Banks should develop credit derivatives markets to avoid these risks. There should be regular outflow of senior bank officers from all public sector banks for specialized training in training institute to equip them with latest procedures and practices.

Curative Measures: Besides making efforts to stop the fresh additions of NPAs banks have to take steps to recover the amount from assets, which have already slipped into NPAs category. Significant causative factors highlighted were slow recovery of legal cases, wilful default induced by officially announced loan waiver schemes etc. the Indian legal system is sympathetic towards the borrowers and works against the banks interest.

- Despite most of their loans being backed by security, banks are unable to enforce their claims on the collateral, when the loans turn non-performing and therefore loan recoveries have been insignificant.
- The Narshimham Committee on financial system (1991) has recommended the establishment of Debt Recovery Tribunals (DRT) for the speedy recovery of the assets from NPAs category. On the basis of recommendations 22 DRTs were established by passing the bill on Recovery of Debt due to Banks and Financial Institutions Act 1993. But the performance of DTRs for the past years has not been found satisfactory or up to the mark.
- The Act has some limitations, which must be removed to make its effective implementation.
- At present one presiding officer is handling at least 80-90 cases per day. It is suggested that DRT Act may be amended to enable the central government to appoint additional presiding officers for speedy disposal of recovery cases.
- One of the major factors accounting for delay in disposing of application by DRT is the delay caused due to refusal by defendants to accept the summons, and at times due to change in address too.
- DRT may be empowered to order service of summons by hand, registered post and by publications simultaneously. Attachment of immovable property of borrower is not admitted due to service of summons.
- Enforcement of security and obtaining court decree take unduly long time, it encourages wilful default and ultimately the banks may be compelled to write off loans. Wilful default should be declared a criminal offence.
- Government should not go for mass waiver of interest/ instalments as it sends unhealthy signals to the borrower. During 1990-91 there was a massive waiver of rural debt amounting to over Rs. 15000 crore and Rs. 65000 crore in 2008. These types of activities put a premium on wilful default and dishonesty. It lowers the repayment ethics.
- In case of government sponsored schemes government should assist in recovery. It may be noted that suggestions enumerated will go a long way in reducing the NPAs. This will only considerably improve the profitability of the banks, improve the quality of assets, but also make the Indian "Banking system stringent, resilient and geared to meet the challenges of globalisation (Mohan Kumar & Govind Singh, 2012).

9. Conclusion

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.

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