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A STUDY ON THE NON PERFORMING ASSETS OF BANKS IN INDIA

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ABSTRACT

Among all functions, primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., however in recent times the banks have become very cautions in extending loans. The reason of such an initiative is the problem pertaining to non-performing assets (NPAs). 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. This paper is going to study on the NPAs of banks in India with highest Npa's and also highlighting the causes, factors affecting NPA's based on conceptual background.

Key Words: - NPAs, NPA classification, Types of NPA, Factors responsibility for high rates of NPA

Introduction

NPA is defined as an advance where payment of interest or repayment of installment of principal (in case of term loans) or both remains unpaid for a certain period. In India, the definition of NPAs has changed over time. According to the Narasimham Committee Report (1991), those assets (advances, bills discounted, overdrafts, cash credit etc.) for which the

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interest remains due for a period of four quarters (180 days) should be considered as NPAs. Subsequently, this period was reduced, and from March 1995 onwards the assets for which the interest has remained unpaid for 90 days were considered as NPAs. An NPA is defined as a loan asset, which has ceased to generate any income for a bank whether in the form of interest or principal repayment.

Conceptual Framework of NPA

2.1. Non - Performing Asset (NPA) Non Performing Asset means an asset of account of borrower, which has been categorized by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions relating to asset classification issued by RBI. Prior to 31st March, 2004 an NPA was defined as a credit facility in respect of which the interest or instalment or principal has remained past due for a specified period of time which was 180 days. Due to the improvement in payment and settlement system, recovery climate, up gradation of technology and to match with international banking practices it has been decided with past due concept, with effect from March 31st 2004.

In accordance with the latest asset classification norms, a non-performing asset (NPA) shall be a loan or an advance, where:

- Interest and /or instalment of principal remain overdue for a period of more than 90 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,

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- Interest and/ or instalment 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 purpose, and
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

2. Causes for Creation of Non-Performing Assets

2.1 External causes: Natural calamities and climatic conditions, Recession, changes in Government policies changes in economic conditions, Industry related problems, Impact of liberalization on industries, Technical problems.

2.2. Internal causes: Internal defaulters, Faculty projects, Most of the project reports are ground realities, proper linkages, product pricing etc. Some approach for the "heck" of starting a venture, with poor knowledge of product risks, over depended on poorly paid killed workers and technicians, Building up pressure for sanctions, Inept handling by banker's lack of professionalism and appraisal standards, Non-observance of system, procedures and non insistence of collaterals etc, Lack of post sanction monitoring, unchecked diversions.

Review of Literature This section provides an overview of some of the existing literature with regard to the NPA. This literature review helps me to better understanding of both research topics and of the existing gap:

3.1. Meeker Larry G. and Gray Laura (1987) in 1983, the public was given its first opportunity to review bank asset quality in the form of non-performing asset information. The purpose of this study is to evaluate that information. A regression analysis comparing the

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nonperforming asset statistics with examiner classifications of assets suggests that the nonperforming asset information can be a useful aid in analyzing the asset quality of banks, particularly when the information is timely.

3.2. Toor N.S. (1994) stated that recovery of non-performing as-sets through the process of compromise by direct talks rather than by the lengthy and costly procedure of litigation. He suggested that by constant monitoring, it is possible to detect, the sticky accounts, the incipient sickness of the early stages itself and an attempt could be made to review the unit and put it back on the road to recovery.

3.3. S.N. Bidani (2002) Non-performing Assets are the smoking gun threatening the very stability of Indian banks. NPAs wreck a bank's profitability both through a loss of interest income and write-off of the principal loan amount itself. This is definitive book which tackles the subject of managing bank NPAs in it"s entirely, starling right from the stage of their identification till the recovery of dues in such ac-counts.

3.4. Paul Purnendu , Bose, Swapan and Dhalla, Rizwan S. (2011) In this paper we attempt to measure the relative efficiency of Indian PSU banks on overall financial performances. Since, the financial industry in a developing country like India is undergoing through a very dynamic pace of restructuring, it is imperative for a bank to continuously monitor their efficiency on Non Performing Assets, Capital Risk-Weighted Asset Ratio, Business per Employee, Return on Assets and Profit per Employee. Here, Non-Performing Assets is a negative financial indicator. To prove empirically, we propose a framework to measure efficiency of Indian public sector banks.

3.5. Khedekar Pooja S. (2012) - A strong Banking Sector is essential for a flourishing economy. Indian banking sector emerged stronger during 2010-11 in the aftermath of global financial meltdown of 2008-10 under the watchful eye of its regulator. The level of NPA's act as an indicator showing the credit risks & efficiency of allocation of resource. NPA involves

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the necessity of provisions, any increase in which bring down the overall profitability of banks. An excessive rise in interest rates over the past 18 months has led to a sharp increase in nonperforming assets. This not only affects the banks but also the economy as a whole. This paper deals with understanding the concept of NPA, the causes and overview of different sectors in India.

3.6. Selvarajan B. and Vadivalagan, G. (2012) over the few year's Indian banking, attempts to integrate with the global banking has been facing lots of hurdles in its way due to certain inherent weakness, despite its high sounding claims and lofty achievements. In a developing country, banking is seen as an important instrument of development, while with the demanding Non-Performing Assets (NPAs), banks have become burden on the economy. Non-Performing Assets are not merely non remunerative, but they add cost to the credit Management. The fear of Non-Performing Assets permeates the psychology of bank managers in entertaining new projects for credit expansion. Non-Performing Assets is not a dilemma facing exclusively the bankers; it is in fact an all pervasive national scourge swaying the entire Indian economy. Non Performing Asset is a sore throat of the Indian economy as a whole. Non Performing Assets have affected the profitability, liquidity and competitive functioning of banks and developmental of financial institutions and finally the psychology of the bankers in respect of their disposition towards credit delivery and credit expansion. NPAs do not generate any income for the banks, but at the same time banks are required to make provisions for such NPAs from their current profits. Apart from internal and external complexities, increases in NPAs directly affects banks' profitability sometimes even their existence.

3.7. Veerakumar, K. (2012) The Indian banking sector has been facing serious problems of raising Non-Performing Assets (NPAs). Like a canker worm, NPAs have been eating the banking industries from within, since nationalization of banks in 1969. NPAs have choked off quantum of credit, restriction the recycling of funds and leads to asset-liability mismatches. It

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also affected profitability, liquidity and solvency position of the Indian banking sector. One of the major reasons for NPAs in the banking sector is the 'Direct Lending System' by the RBI under social banking motto of the Government, under which scheduled commercial banks are required to lend 40% of their total credit to priority sector. The banks who have advanced to the priority sector and reached the target suffocated on account of raising NPAs, since long. The priority sector NPAs have registered higher growth both in percentage and in absolute terms year after year. The present paper is an attempt to study the priority sector advances by the public, private and foreign bank group-wise, target achieved by them and a comparative study on priority and nonpriority sector NPAs over the period of 10 years between 2001-02 and 2010-11. This paper also aims to find out the categories of priority sector advances which contribute to the growth of total priority sector NPAs during the period under study.

3.8. Murthy, K. V. Bhanu Gupta, Lovleen.(2012) One of the major reasons cited for this state of health of banking industry has been the persistence of 'Non-performing Assets' (NPAs). In this study the focus is on the impact of liberalization on the non-performing assets of the four banking segments, namely, public sector, old private sector, new private sector and foreign banks by studying the overall trends in NPAs. We have used the Structure- Conduct-Performance (S-C- P) approach that shows the relationship between competition and conduct, concentration and growth in NPAS. Our results show that on an average across the banking industry segments, average non-performing assets in the past 11 years have been declining at the rate of 13% p.a. compounded growth rate. The old private sector banks' nonperforming assets have reduced at the rate of 11.98% and that of public sector banks have declined at the rate of 18% and foreign banks at 11.4%. Though new private sector banks and the foreign banks seem to be more efficient but their conduct does not show consistency and stability.

3.9. Joseph, Mabvure Tendai Edson, Gwangwava (2012) The purpose of the study was to find out the causes of non-performing loans in Zimbabwe. Loans form a greater portion of the total assets in banks. These assets generate huge interest income for banks which to a large extent determines the financial performance of banks. However, some of these loans usually fall into non-performing status and adversely affect the performance of banks. In view of the critical role banks play in an economy, it is essential to identify problems that affect the performance of these institutions. This is because non-performing loans can affect the ability of banks to play their role in the development of the economy. A case study research design of CBZ Bank Limited was employed. Interviews and questionnaires were used to collect data for the study. The paper revealed that external factors are more prevalent in causing non-performing loans in CBZ Bank Limited. The major factors causing nonperforming loans were natural disasters, government policy and the integrity of the borrower.

3.10. Debarsh and Sukanya Goyal (2012) emphasized on management of non-performing assets in the perspective of the public sector banks in India under strict asset classification norms, use of latest technological platform based on Core Banking Solution, recovery procedures and other bank specific indicators in the context of stringent regulatory framework of the RBI. Nonperforming Asset is an important parameter in the analysis of financial performance of a bank as it results in decreasing margin and higher provisioning requirements for doubtful debts. The reduction of non-per-forming asset is necessary to improve profitability of banks and comply with the capital adequacy norms as per the Basel Accord.3 3.11. Kavitha. N (2012), emphasized on the assessment of non-performing assets on profitability its magnitude and impact. Credit of total advances was in the form of doubtful assets in the past and has an adverse impact on profitability of all Public Sector Banks affected at very large extent when non-performing assets work with other banking and also affect productivity and efficiency of the banking groups. The study observed that there is increase in advances over the period of the study.

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4. Objectives of the Study

The study will focus on following objectives:

- To study the concept on non- performing assets and its relevance in the banking sector.
- To understand the concept of non-performing assets
- To understand the reasons for high growing of NPA'S
- To understand the total levels of NPA'S pertaining to banking sector in India.

5. Research Methodology

The scope of the study lies in understanding the concept and classification of NPA. Moreover the reason for the high non-performing assets in Indian banks has been highlighted. The study mainly uses secondary data which have been accumulated through various journals, articles, books and websites to get overall insights of the subject matter.

6. Asset Classification and Provisioning Norms

a) Standard Assets– These are those assets which do not create any problem while paying interest/ instalments of the principal. It usually carries more than normal risk attached to the business. Banks are required to keep 0.25% of advances as a provision under this category of asset.

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b) Substandard Assets– Those assets which has remained non - performing for a period less than or equal to 12 months. Generally, banks are required to make 10% on total outstanding balance & 10 % on unsecured exposures as provisions.

c) Doubtful Assets – Assets remained in the sub-standard category for a period of 12 months. 100% to the extent advance not covered by realizable value of security. In case of secured portion, provision may be made in the range of 20% to 100% depending on the period of asset remaining sub-standard.

d) Loss Assets – These assets are those where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. Generally 100% of the outstanding balance is kept as a provision.

7. Types of NPA

7.1. Gross NPA: Gross NPA 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 like as sub-standard, doubtful and loss assets. It can be calculated with the help of following ratio: Gross NPAs Ratio = Gross NPAs/Gross Advances.

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7.2. Net NPA: Net NPAs are those types of NPAs in which the banks have deducted the provision regarding NPAs. Net NPA shows the actual burden of banks. It can be calculated by following: Net NPAs= Gross NPAs-Provisions/Gross Advances-Provisions.

8. CAUSES FOR NPA

The banking sector has been facing the serious problems of the rising NPAs. Some of the main causes of NPA are Ineffective recovery, Wilful defaults, Natural calamities Industrial sickness, Sluggish Legal System, Unfavourable Business Cycle, Defective lending process, Inappropriate technology, Poor Quality Management, Managerial deficiencies and Absence of Monitoring and Follow up.

9. Impact of NPA

NPA is a double edge weapon. On one hand, it does not generate income for the banks, and at the other banks are required to make provisions for such NPAs from their current profits. 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 doesn't affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity. Further, the recovery process adds to the woe of time for the employees and management. Apart from internal and external complexities, increases in NPAs directly affects banks' profitability sometimes even their existence.

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8. Factors Responsible for High rates of NPA

1. Inadequate follow up by the bank.
2. Weak judicial framework for executing collateral.
3. Poor selection of borrowers and poor collection procedures.
4. Socio-political pressures for financing some people/activities by way of target fulfilling.
5. Under the government schemes. Inadequate information on borrowers.
6. Misallocation of credit or mismanagement and divergence of funds and delay in release of credit. Time/cost overruns during project implementation.
7. Internal dispute.

8. TABLE SHOWCASING THE PRESENT STATUS OF NPA'S IN COMMERCIAL BANKS IN INDIA

Advances and NPAs of Domestic Banks by Priority and Non-Priority Sectors *									
(Amount in Billion)									
Bank Group	Priority Sector			Non-Priority Sector			Total		
	Gross Advances	Gross NPAs	Gross NPAs as Per Cent of Total	Gross Advances	Gross NPAs	Gross NPAs as Per Cent of Total	Gross Advances	Gross NPAs	Gross NPAs as Per Cent of Total
Public Sector Banks									
2013	**12,790**	**669**	**42.9**	**27,769**	**890**	**57.1**	**40,559**	**1,559**	**100.0**
2014	**15,193**	**792**	**36.5**	**30,712**	**1,375**	**63.5**	**45,905**	**2,167**	**100.0**
Nationalized Banks**									
2013	**8,891**	**405**	**42.2**	**19,170**	**554**	**57.8**	**28,061**	**959**	**100.0**
2014	**10,711**	**530**	**37.7**	**21,249**	**877**	**62.3**	**31,960**	**1,407**	**100.0**
SBI Group									
2013	**3,899**	**264**	**44.0**	**8,599**	**335**	**56.0**	**12,498**	**600**	**100.0**
2014	**4,482**	**261**	**34.4**	**9,463**	**499**	**65.6**	**13,944**	**760**	**100.0**

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Private Sector Banks									
2013	**3,157**	**52**	**26.0**	**7,309**	**148**	**74.0**	**10,467**	**200**	**100.0**
2014	**3,831**	**61**	**27.0**	**8,287**	**167**	**73.0**	**13,117**	**227**	**100.0**
All SCBs (Excluding Foreign Banks)									
2013	**15,947**	**721**	**41.0**	**35,078**	**1,038**	**59.0**	**51,025**	**1,759**	**100.0**
2014	**19,024**	**852**	**35.6**	**38,998**	**1,542**	**64.4**	**58,022**	**2,395**	**100.0**

Notes: 1. *: Excluding foreign banks.
2. **: Includes IDBI Bank Ltd.
3. Constituent items may not add up to the total due to rounding off.

Source: Based on off-site returns (domestic).

10 banks with high gross NPAs

Bank ▼	Gross NPA
Bank of India	7.55
Bank of Maha	7.98
Central Bank	6.86
Dena Bank	6.84
Dhanlaxmi Bank	8.75
IDBI Bank	6.92
Indian Overseas bank	11
J & K Bank	6.46
UCO Bank	8.51
United Bank	8.9

As % of total loans on Sep 30, 2015

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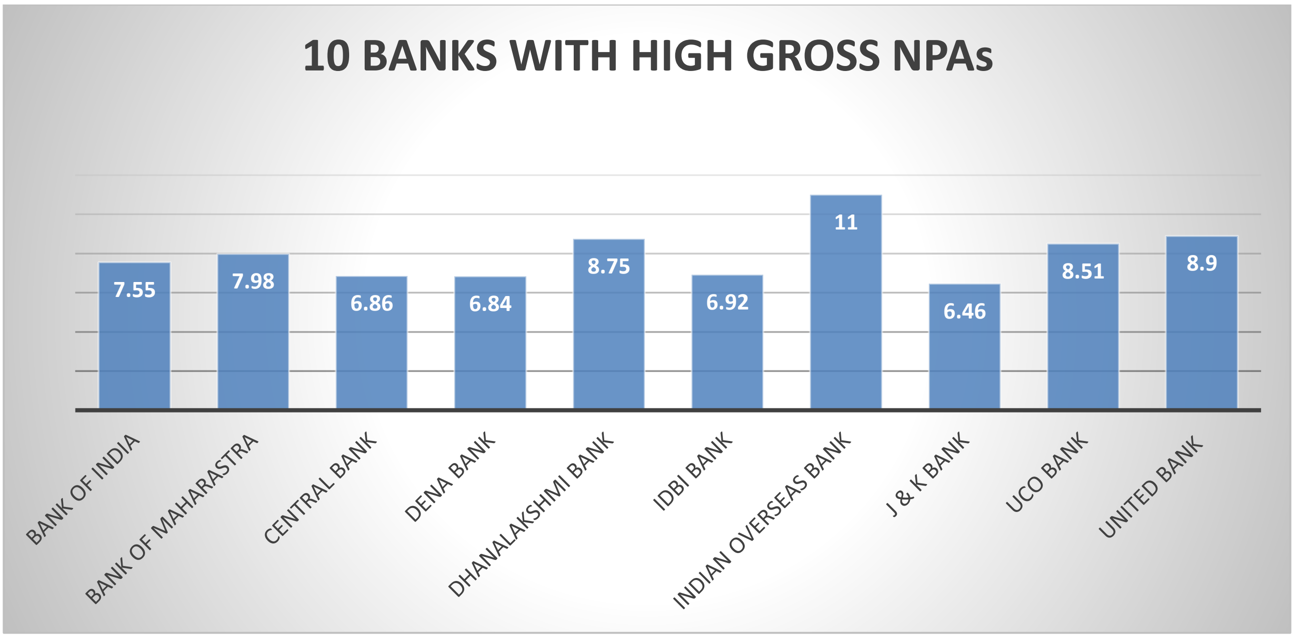

9. Conclusion

The paper reveals the NPA and its scenario in all the scheduled commercial banks during the decade. It even depicts the various reasons, factors and its implications towards the growth of NPA. NPAs reflect the overall performance of the banks. A high level of NPA is a poor indicator of bank performance. The NPA growth involves the necessity of provisions, which reduces the overall profits and shareholders' value. Careful steps by the bankers like selection of right borrowers, viable economic activity correct end use of funds and timely recovery of loans are absolutely necessary pre conditions for preventing or reducing the incidence of new NPAs which will enhance the credibility of the banks and attain the objective of the sound financial system for its existence.

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