SJIF Impact Factor: 6.047 Volume:5 | November - October 2018 -19 ISSN(Print): 2250 – 2017

International Journal of Global Economic Light (JGEL)

NON-PERFORMING ASSETS IN INDIA-AN OVERVIEW

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ABSTRACT

The paper analyses the current tendency in non-performing assets (NPAs) of dissimilar categories of Indian banks viz., public sector banks, private sector banks and foreign banks. It is found that NPAs of Indian banking manufacturing as a whole are continuously rising during the period 2008-09 to 2013-14 followed by the international financial predicament. Further, the impact of ownership pattern in deciding the level of NPAs is also investigate against the kindliness that public sector banks have relatively larger level of NPAs.

KEY WORDS: *Standard asset, Doubtful asset, Public sector bank, Private sector banks*

INTRODUCTION

A nonperforming asset (NPA) refers to a classification for loans or advances that are in default or are in arrears on scheduled payments of principal or interest. In most cases, debt is classified as nonperforming when loan payments have not been made for a period of 90 days. While 90 days of non payment is the standard, the amount of elapsed time may be shorter or longer depending on the terms and conditions of each loan. Nonperforming assets are typically listed on the balance sheets of banks. Banks usually categorize loans as nonperforming after 90 days of non payment of interest or principal, which can occur during the term of the loan or at maturity.

TYPES OF NONPERFORMING ASSETS

- Overdraft and cash credit (OD/CC) accounts left out-of-order for more than 90 days
- Agricultural advances whose interest or principal instalment payments remain overdue for two crop/ harvest seasons for short duration crops or overdue one crop season for long duration crops.
- Bill overdue for more than 90 days for bills purchased and discounted.
- Expected payment is overdue for more than 90 days in respect of other accounts.
- Non-submission of stock statements for 3 consecutive quarters in case of cash-credit facility.
- No activity in the cash credit, overdraft, EPC, or PCFC account for more than 91 days.

Banks are required to classify nonperforming assets in one of three categories according to how long the asset has been non-performing: sub-standard assets, doubtful assets, and loss assets. A sub-standard asset is an asset classified as an NPA for less than 12 months. A doubtful asset is an asset that has been non-performing for more than 12 months. Losses assets are assets with losses identified by the bank, auditor, or inspector and have not been fully written off.

THE EFFECTS OF NPAs

Carrying nonperforming assets also referred to as nonperforming loans, on the balance sheet places three unrelated burdens on lenders. The non payment of interest or principal reduces cash flow for the lender, which can disrupt budgets and decrease earnings. Loan loss provisions, which are set aside to cover possible losses, reduce the capital available to provide subsequent loans. Once the real losses from defaulted loans are determined, they are written off against income.

Classification of Assets

Assets of a bank are classified in terms of its compensation status. Standard assets, substandard assets, doubtful assets and loss assets are classifications of asset quality.

For a bank, classification of assets into diverse categories should be done taking into account credit weaknesses and the extent of dependence on collateral security for comprehension of dues.

Standard asset

Standard Asset is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset should not be an NPA.A sub-standard asset would be one, which has remained NPA for a period less than or equal to 12 months.

Doubtful asset

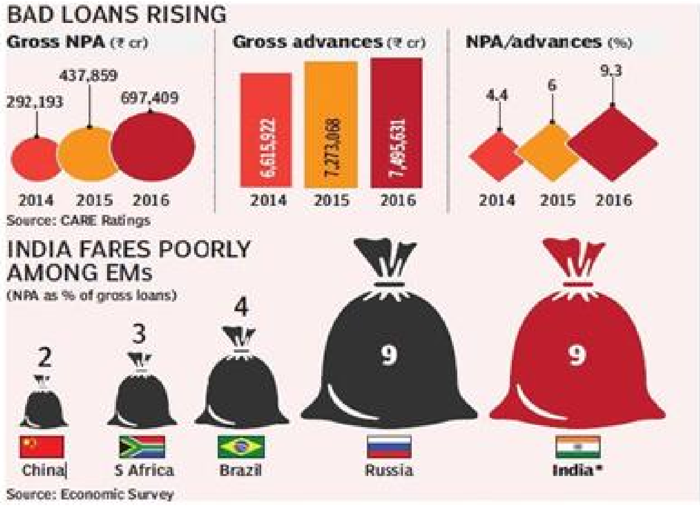
An asset would be classified as doubtful if it has remain in the sub-standard category for a period of more than 12 months.

Loss asset

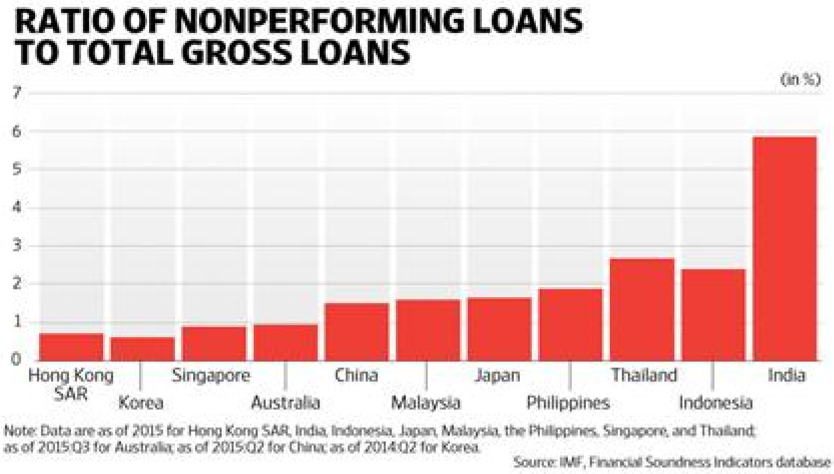
An asset that is an NPA for a period of more than 36 months is treated as a lost asset. Such asset has been identified by the bank or internal or external auditors or by the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible. Defeat assets should be written off. If loss assets are legal to remain in the books for any reason, 100 percent of the outstanding should be provided for. This means that full amount of the loss assets should be kept from some other sources like profit of the bank to meet the loss.

NON-PERFORMING ASSETS (NPA) IN INDIAN BANKS

According to the Reserve Bank of India (RBI), the gross non-performing assets in Indian banks, specifically in public sector banks, are valued at around Rs 400,000 crore (~US$61.5billion), which represent 90% of the total NPA in India,



- More than Rs. 7 lakh crore worth loans are classified as Non-Performing Loans in India. This is a huge amount.
- The figure roughly translates to near 10% of all loans given.
- This means that about 10% of loans are never paid back, resulting in substantial loss of money to the banks.
- When restructured and unrecognised assets are added the total stress would be 15-20% of total loans.
- NPA crisis in India is set to worsen.
- Restructuring norms are being misused.
- This bad performance is not a good sign and can result in crashing of banks as happened in the sub-prime crisis of 2008 in the United States of America. Also, the NPA Problem India is worst when comparing other emerging economies in BRICS.



Reasons for the Rise in NPA levels

- From 2000-2008, the Indian economy was in a boom phase and banks, especially public sector banks, started lending extensively to companies.
- However, with the financial crisis in 2008-09, corporate profits decreased and the Government banned removal projects. The situation became serious with the substantial delay in environmental permits, affecting the infrastructure sector – power, iron, and steel – and resulting in volatility in prices of raw materials and a shortage of supply.
- Another reason is the relaxed lending norms modified by banks, especially to the big corporate houses, foregoing analysis of their financials and their credit ratings.

Insolvency and Bankruptcy Code (IBC) – With the RBI's push for the IBC, the resolution process is expected to quicken while progressing to exercise control over the quality of the assets. There will be changes in the provision requirement, with the requirement for the higher proportion for provisions going to make the books better.

õ **Credit Risk Management** – This involves credit appraisal and monitoring accountability and credit by performing various analysis on profit and loss accounts. While conducting these analyses, banks should also do a sensitivity analysis and should build safeguards against external factors.

õ **Tightening Credit Monitoring** – A proper and effective Management Information System (MIS) needs to be implemented to monitor warnings. The MIS should ideally detect issues and set off timely alerts to management so that essential actions can be taken.

õ **Amendments to Banking Law to give RBI more power** – The present scenario allows the RBI just to conduct an inspection of a lender but doesn't give them the power to set up an oversight committee. With the amendment to the law, the RBI will be able to monitor large big accounts and create oversight committees.

õ **More "Hair-cut" for Banks –** For quite some time, PSU lenders have started putting aside a large piece of their profits for provisions and losses because of NPA. The situation is so serious that the RBI may ask them to create a bigger distance and thus, report lesser profits.

õ **Stricter NPA recovery –** It is also discussed that the Government needs to amend the laws and give more authority to banks to recover NPA rather than play the game of "wait-and-watch."

õ **Corporate Governance Issues** – Banks, mainly the public sector ones, need to come up with proper guidance and framework for actions to senior level positions.

õ **Accountability** – Lower level executives are often made accountable today; however, major decisions are made by senior level executives. Hence, it becomes very important to make senior executive answerable if Indian banks are to tackle the problem of NPAs.

The banks should also consider "**raising capital"** to address the problem of NPA.

Using unclaimed deposits – Similar to provisions for untaken dividends, the government may also create a provision and transfer unclaimed deposits to its account. These funds in return can be transferred to banks as capital.

1.Monetization of assets held by Banks – In this case, banks with retail franchisees should create value by auctioning a bank declaration association rather than running it themselves as an insurance company. The current set-up blocks capital inflows and doesn't generate much wealth for the owners.

2.Make Cash Reserve Ratio (CRR) attractive – At present, the RBI asks Indian banks to preserve a certain limit on CRR on which the RBI doesn't pay interest and hence, banks lose out a lot on interest earnings. If the CRR is made more financially rewarding for banks, it can reduce capital requirements.

3.Refinancing from the Central Bank – The US Federal Reserve spent $700 billion to purchase stressed assets in 2008-09 under the "Troubled Asset Relief Program." Indian banks can adopt a similar arrangement by involving the RBI directly or through the creation of a particular Purpose Vehicle (SPV).

4.Structural change to involve private capital – The payment structure and accountability of banks create a problem for the market. Banks should be governed by a board while aiming to reduce the government's stake and making the financial institutions attractive to private investors. With the possible solutions above, the problem of NPAs in Indian banks can be effectively monitored and controlled, thus allowing the banks to achieve a clean balance sheet.

HOW TO SOLVE ISSUE OF RISING NON-PERFORMING ASSETS IN INDIAN PUBLIC SECTOR BANKS

The Indian banking system is stressed with non-performing assets (NPAs). According to the Reserve Bank of India's Financial Stability Report of December 2017, they currently stand at 10.2 per cent of all property, while stressed assets, which are believed to be NPAs in effect, stand at 12.8 per cent.

i) Public Sector Banks:

Public Sector Banks (PSBs) constitute over 70 per cent of the banking system and are in a state of crisis. Participants believed that fundamental reforms tended to happen when crisis hit and this was an opportune moment for such reforms and expressed optimism that this was likely under this government.

Privatisation:

Nationalisation of banks in the 1970s was undertaken by then Prime Minister Indira Gandhi. The "original sin" as it was called, was considered necessary at the time, given the collusion between industry and finance then.. That said, the umbilical cord connecting the PSBs to politicians and bureaucrats, which in turn stems from the ownership structure of PSBs, has led to several inefficiencies including (i) disempowered boards, (ii) muted incentives for senior management to effect organisational change, (iii) cloning of PSBs and the resultant systemic risks due to continual bureaucratic meddling, (iv) external vigilance enforcement causing paralysed decision-making, on the one hand, and widespread frauds and endemic corruption, on the other hand, (v) opacity at various levels, as well as (vi) distortions in human resource management. Diversified market ownership could bring market discipline to PSBs. Options for privatisation include the following:

Bank Holding Company structure: The bank holding company (BHC) structure recommended by the P.J. Nayak Committee, among others, involves divesting the government's shareholding to below 52 per cent and routing it through a holding company. This one level of distance would not help unless the BHC was itself professionally managed.

Sovereign Wealth Fund: Rather than the proceeds of privatisation going to the Consolidated Fund of India, a sovereign wealth fund could be created which is professionally managed. This could help "trickle down" good governance practices to PSBs.

Hive off social sector lending vehicle: The political economy of privatisation remains complex, at least in part because of social sector lending programmes routed through PSBs. Accordingly, it may be useful to consider hiving off all agricultural and social sector lending into a separate entity which may be government owned and controlled and allow the corporate lending part of the PSBs to be privatised.

Recapitalise, Reform and then privatise: PSBs in their current state of impaired balance sheets are unlikely to find any takers. By the same token, recapitalising PSBs repeatedly creates moral hazard issues. Recapitalisation and governance reform can enhance market valuations of PSBs and should lead to a path for privatisation without accusations of "selling off the family silver."

"Bad Bank": The idea of a single bad bank where the NPAs of all PSBs may be transferred as a silver bullet to clean up PSB balance sheets must be rejected. Currently, 11 of 21 listed PSB banks are under RBI's prompt corrective action framework and simply consolidating all NPAs would create an additional level of complexity.

Governance reforms: Privatisation is, however no panacea. There are multiple other governance reforms that must be undertaken in PSBs.

Nayak Committee: Should privatisation not be on the table, the government should back the recommendations of the Nayak Committee. Presently, only lip service is being done to them by way of example, the Bank Boards Bureau (BBB) uses the nomenclature of the Nayak Committee but none of its substantive governance reforms have been implemented..

Penalise for wrongdoing: Although vigilance mechanisms exist, lax enforcement means that wrongdoing is rarely penalized. For instance, the Chairman of Syndicate Bank who was bribed by the promoters of Bhushan Steel was in jail for barely a few months and has not been convicted as yet.

Rotation of staff: The Punjab National Bank fraud demonstrates the extent of operational and risk management failures in PSBs. Improvements to HR practices can help mitigate egregious behaviour like frauds. For instance, PSBs tend to man the business verticals with the brightest talent and less competent staff in the inspection and supervision roles.

ii) RBI governance and regulation

The RBI as a regulator has had qualified success in the face of structural impediments, including limited control over PSBs. RBI's internal governance as well as its regulation of NPAs needs improvement.

Subsidiarisation: The RBI may consider the Bank of England model of subsidiarising its prudential regulatory and supervision functions (the Prudential Regulatory Authourity and the Financial Conduct Authority). However, the recognition that lost synergies from such separation contributed to the global financial crisis demands caution.

Strengthening supervisory capacity: RBI lacks supervisory capacity to conduct forensic audits and this must be strengthened with human as well as technological resources.

Preventing Ever greening: RBI regulations have permitted banks to "ever-green" and in effect delay the recognition and therefore resolution of NPAs. RBI regulations must take away incentives of banks to kick the can down the road and "extend and pretend". This has led to a seizure of new lending and the caving in of credit culture.

iii) Reengineering of banking systems

Secondary Market: A vibrant secondary market for NPAs is crucial. The lack of transparency in price of the assets is holding this back, as is the lack of autonomy in PSBs and the fear of vigilance action.

Concurrent Audit: There is a real rot in the internal and concurrent audit systems of banks. The latter is intended to red flag risks in real time, but has failed and must be shored up.

Diagnostics for wilful default: Banks need better permanent diagnostics to get to the bottom of wilful defaults. This can happen though (a) market intelligence; (b) funds flow analysis; and (c) financial analysis. Most promoters do not have sufficient "skin in the game" and rely entirely on bank borrowing.

Using technology for maker-checker: Currently, the maker-checker systems require human intervention and are therefore prone to capture and corruption. The use of Artificial Intelligence for the supervision of financial transactions could prevent financial fraud. In addition, linking Core Banking Systems (CBS) with Finacle technology (as recently required by RBI) is crucial.

Combine with low tech – ears on the ground: Business intelligence must use traditional means-speaking to people in the industry; supplier and customers can be an invaluable source of financial information.

iv) intense Spots

Amidst the gloom, the functioning of the Insolvency and Bankruptcy Code (Code) is cause for optimism. The Code was passed an implemented in 13 months, which is faster even when compared to Singapore's amendments to its insolvency law. The Code is also being implemented in full speed- 50 per cent of all NPAs are currently being resolved through the Code, another 25 per cent will soon be. The judiciary has been following the (very tight) timelines prescribed by the Code.

Banks have the most NPAs

According to the rating agency CARE, as of June 2017, State Bank of India leads the list of scheduled banks with the highest NPAs with Rs.1,88,068crores of stressed assets. Punjab National Bank and IDBI Bank follow suit with Rs.57,721crores and Rs.50,173 crores of gross NPAs respectively.

However, among Indian banks, IDBI Bank, which has 24.11% gross NPAs tops the list for lending institutions with the highest exposure to liabilities. Indian Overseas Bank has 23.6% NPAs while fellow private lenders like Kotak Mahindra Bank and HDFC fare better with only 2.58% and 1.24% gross NPAs. State Bank of India, which is saddled with most stressed assets in absolute terms, has a gross NPA ratio of 9.97%.

It should also be noted that India's bad loans problem could hold economic growth to ransom. Data collected by the Ministry of Statistics and Programme Implementation (MOSPI) and compiled by the World Bank reveals that economic growth tapers off with a spike in the bad loan ratio. While economic output has been laggard over the past few quarters owing to disruptive policies such as demonetisation and the implementation of the goods and services tax (GST), the lacklustre performance of India Inc has pulled down banks with greater defaults from corporate clients. The gross NPA ratio has spiked from 5.884% in 2015 to 9.6% in 2017 while economic growth has slumped in the corresponding period.

Possible reasons for NPAs

- Diversification of funds to unrelated business/fraud.
- Lapses due to diligence.
- Business losses due to changes in business/ regulatory environment.
- Lack of morale, particularly after government schemes which had written off loans.
- Global, regional or national **financial crisis** which results in erosion of margins and profits of companies, therefore, stressing their balance sheet which finally results into non-servicing of interest and loan payments. (For example, the 2008 global financial crisis).
- The general slowdown of entire economy for example after 2011 there was a slowdown in the Indian economy which resulted in the faster growth of NPAs.
- **The slowdown in a specific industrial segment**, therefore, companies in that area bear the heat and some may become NPAs.
- Unplanned expansion of corporate houses during boom period and loan taken at low rates later being serviced at high rates, therefore, resulting into NPAs.
- Due to **mal-administration** by the corporate, for example, wilful defaulters.
- Due **to mis governance** and policy paralysis which hampers the timeline and speed of projects, therefore, loans become NPAs. For example Infrastructure Sector.
- **Severe competition** in any particular market segment. For example Telecom sector in India.
- Delay in land acquisition due to social, political, cultural and environmental reasons.
- A bad lending practice which is a non-transparent way of giving loans.
- Due to **natural reasons** such as floods, droughts, disease outbreak, earthquakes, tsunami etc.
- Cheap import due to dumping leads to business loss of domestic companies. For example Steel sector in India.

Impact of NPAs

- Lenders suffer lowering of profit margins.
- Stress in banking sector causes less money available to fund other projects, therefore, negative impact on the larger national economy.
- Higher interest rates by the banks to maintain the profit margin.
- Redirecting funds from the good projects to the bad ones.
- As investments got stuck, it may result in it may result in unemployment.
- In the case of public sector banks, the bad health of banks means a bad return for a shareholder which means that government of India gets less money as a dividend. Therefore it may impact easy deployment of money for social and infrastructure development and results in **social and political cost**.
- Investors do not get rightful returns.
- **Balance sheet syndrome** of Indian characteristics that is both the banks and the corporate sector have stressed balance sheet and causes halting of the investment-led development process.
- NPAs related cases add more pressure to already pending cases with the judiciary.

VARIOUS STEPS TAKEN TO TACKLE NPAs

NPAs story is not new in India and there have been numerous steps taken by the GOI on legal, financial, policy level reforms. In the year 1991, Narsimham committee recommended many reforms to tackle NPAs. Some of them were implemented.

- The Debt Recovery Tribunals (DRTs) – 1993
- Credit Information Bureau – 2000
- LokAdalats – 2001
- Compromise Settlement – 2001
- SARFAESI Act – 2002
- ARC (Asset Reconstruction Companies)
- Corporate Debt Restructuring – 2005
- Joint Lenders Forum – 2014
- Mission Indradhanush – 2015
- Asset Quality Review – 2015
- Sustainable structuring of stressed assets (S4A) – 2016
- Insolvency and Bankruptcy code Act-2016
- Pubic ARC vs. Private ARC – 2017

Bad Banks – 2017

Economic survey 16-17, also talks about the formation of a bad bank which will take all the stressed loans and it will tackle it according to flexible rules and mechanism. It will ease the balance sheet of PSBs giving them the space to fund new projects and continue the funding of development projects.

CONCLUSION

The need of the hour to tackle NPAs is some urgent corrective measures. This should include Technology and data analytics to identify the early warning signals. Mechanism to identify the unseen NPAs. Development of interior skills for credit estimation. Forensic audits to realize the target of the borrower.

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