

The Non Performing Assets The X Factor In Banking Industry

¹Dr. M. Tamilselvan, Ph.D, ²Prof S. Manikandan, M.com, ³Dr. Manjula Veerabhadrapa, Ph.D, ⁴Prof. Vinod Repalli, MBA, ⁵Prof. A.Jayakumar, M.com

^{1, 2,3,4,5} Faculty of Business Studies Department, University of Technology and Applied Sciences -Ibri.

DOI: 10.47750/pnr.2022.13.508.80

Abstract

The economy of India mainly based on the growth of financial sector which is been supported by Both Private & Private Sector Banks in India. Nowadays It has been affected by NPA's. In the last decade, Indian banks made headlines often with the mounting NPAs (Non-Performing Assets) and the following mergers. Modern banks are increasingly focusing on a business stream distinct from traditional banking, which enables them to reduce their risk portfolio and maximize the efficiency of their labor and resources. When an asset does not create any income for the bank, it is referred to as a non-performing asset (NPA). The loans granted to customers are the bank's assets. The loan becomes a Bad Loan or Non-Performing Asset if the consumer does not pay either the interest or the principal. We conclude by drawing policy lessons from this discussion and suggest some measures that can be adopted to better deal with a future balance sheet related crisis in the banking sector such that the impact on the real economy is minimal.

Keywords: Non-Performing Assets, Gross Non-Performing Assets, Net Non-Performing Assets, Profitability and Mismanagement.

1. Introduction

Bank's purpose is to provide loans to businesses. This creates credit in the economy. But, with credit comes the risk of credit default. Have you heard about Banking NPA? Loans or advances provided by the banks are considered as banks' assets as banks will earn interest on them. The businesses sometimes default on the loan repayments, and this causes banking NPA (non-performing assets). What are the causes of NPA and how do they affect banks? Do they have any effect on the stock prices of the affected bank? Let us look at each of these questions and find answers.

1.1 What is NPA?

A Non-Performing Asset is a loan or advance for which the principal or interest remains overdue or in arrears for more than the prescribed time, generally 90 days. As per RBI, an asset becomes non-performing when it stops generating income for the bank.

1.1.1 Banks is required to classify NPAs further into Substandard, Doubtful, and Loss assets.

- Substandard assets: Assets that have remained NPA for a period less than or equal to 12 months.
- Doubtful assets: An asset would be classified as doubtful if it has remained in the substandard category for 12 months.
- Loss assets: These are NPAs with an extended period of non-payment. With this class, banks are forced to accept that the loan will never be repaid, and the entire amount of the loan must be written off completely.

1.2. How NPAs affect banks?

We know banks are the driving wheels of the Indian economy. They take money from the public as a deposit offering them an interest. They lend the collected money to the public and companies as loans at an interest rate higher than the interest rate offered to depositors. The difference in the interest or net interest income is used towards the functioning of the bank. When the money lent becomes uncollectible the banks come under a financial burden affecting their functioning. So, NPAs directly impact the performance of the bank

1.3 The impact of rising NPAs can be as follows:

- Rising NPAs undermine the bank's image, making the public lose trust in banks. The depositors may withdraw their deposits causing liquidity issues for banks.
- The lack of liquidity prevents banks from lending for other productive activities in the economy. The curb in investments may slow down the economy leading to unemployment, inflation, bear market, etc.
- To maintain their profit margins, banks will be forced to increase interest rates which again hurt the economy.
- What caused the NPA crisis in India?
- The Indian economy enjoyed a booming phase in 2000s. Businesses and companies borrowed extensively from the Indian banks to fund their projects. Banks funded a lot of projects in the infrastructure and power sectors which became unviable later due to multiple reasons like rising costs, 2008 recession aftereffects, etc. All these led to the impairing of balance sheet of banks with scaling NPAs by 2013. When RBI started cleansing the books of the banks, the cases of willful defaulting with thousands of cores came out. This was when the negligence of banks in assessing the creditworthiness came into light and the corruption involved in a few cases. All these factors led to the mounting NPAs in Indian Banks which almost doubled by 2021.

1.4 What measures are taken to tackle the NPA crisis?

- To resolve the huge NPA crisis, the Government of India (GOI) and RBI took a slew of measures and are continuing with it:
- Creation of Debt Recovery Tribunals.
- Asset Reconstruction Companies to expand
- Introduced corporate debt restructuring and the Insolvency and Bankruptcy Code.
- Introduction of the 5:25 rule or the Flexible Restructuring of Long-Term Project Loans to Infrastructure and Core Industries.
- Mission Indradhanush to bring about reforms in the public sector banks (PSBs) under which Rs 70000 core was infused to bailout PSBs
- SAMADHAN scheme introduced for asset management and debt change structure.
- Asset Quality Review in Banks.
- Lok Adalat, Credit Information Bureau are extensively dealing with NPAs and many more of NPAs.

2.0 Current Situation of Economy

Gross non-performing asset (NPA) ratio of banks fell to six-year low of 5.9% in March 2022, said Reserve Bank of India (RBI) in its financial stability report for June 2022 on Thursday. The net non-performing assets (NNPA) ratio fell to 1.7% in March 2022. Macro-stress tests for credit risk reveal that scheduled commercial banks (SCBs) are well-capitalized and all banks would be able to comply with the minimum capital requirements even under adverse stress scenarios, it added. Scheduled commercial banks (SCBs) maintained robust capital positions, with the Capital to Risk Weighted Assets Ratio (CRAR) and Common Equity Tier 1 (CET-1) Ratio of SCBs as high as 16.7% and 13.6%, respectively, in March 2022, and improving returns on assets (RoA) and returns on equity (RoE). Meanwhile, the provisioning coverage ratio (PCR) of SCBs increased to 70.9% in March 2022 from 67.6% in March 2021, the report showed. "Bank credit growth is picking up steadily, already clocking double digits. Banks have also bolstered capital and liquidity positions while asset quality has improved. Non-banking financial companies (NBFCs) remain well capitalized. Market risks are rising as spells of volatility are unleashed by foreign portfolio investment outflows and the sharp appreciation of the US dollar," as per the report.

Network analysis indicated that the total outstanding bilateral exposures among constituents of the financial system continued to grow. The share of SCBs in bilateral exposure remains the largest, although, it is lower than pre-pandemic levels.

3.0. Sick Industry growth made Banking NPA Rise

Before the financial crisis of 2008 India's economy was in a boom phase. During this period banks lent extensively to corporate in the expectation that the good times will continue in future. But future does not always play out as it had been in the past. The businesses of most of the corporate were adversely affected due to slowdown in the global economy following the financial crisis.

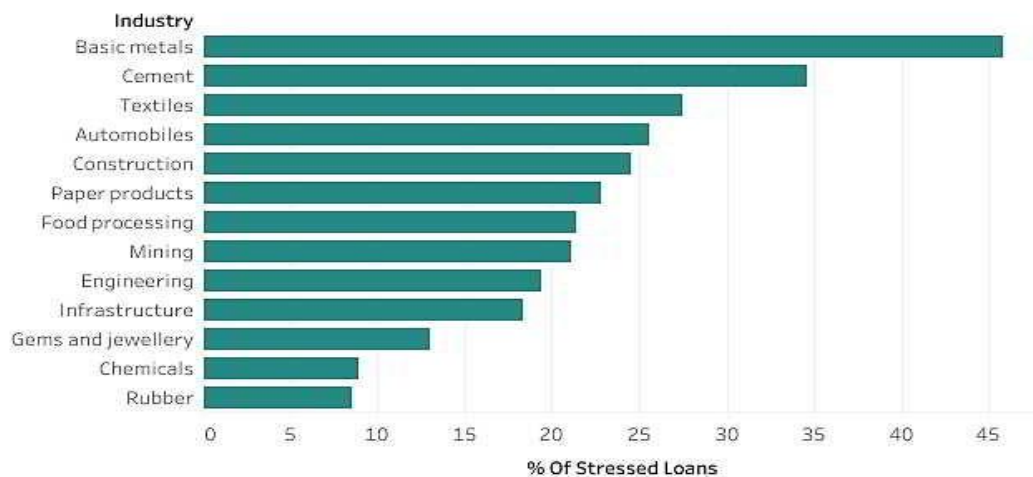
The ban in mining projects, and delay in environmental related permits affected power, iron and steel sector with added volatility in prices of raw material. All these factors weighed heavily on the earning of the corporate. Low earnings affected their ability to pay back loans. This is the one of the most important reason behind increase in NPA of public sector banks.

Another major reason of rising NPA was the relaxed lending norms for corporate houses. Their financial status and credit rating were not analyzed properly. The banks were willing to accept higher leverage and less promoter

equity. They even accepted reports by the promoter's investment banks rather than doing their own analysis. Around 40% of the outstanding loans have been made to companies with interest coverage ratio less than one. Also, to stay competitive, banks were selling unsecured loans which contributed to the high levels of NPAs. Public Sector banks provide major portion of the credit to industries and it is this part of the credit distribution that forms a great portion of NPA. In the case of kingfisher airlines financial crisis, SBI provided a huge amount of loan which it is not able to recover from it.

The priority sector lending (PSL) sector has contributed substantially to the NPAs. Priority sector includes agriculture, education, housing, MSMEs. As per the estimates by the SBI, education loans constitute 20% of its NPAs.

Stressed loans across industries (in %)



Objectives of the study

- 4.0 To understand the concept of NPAs, its types.
- 4.1 To assess the impact of NPAs between public and private sector banks.
- 4.2 To analyze the recovery measures of NPAs and provide suggestions for reducing them.

(OB-1) To understand the concept of NPAs, its types.

4.0Types of NPAs

The NPAs can broadly be classified into (i) Gross NPAs, (ii) Net NPAs.

- Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on balance sheet date. It reflects the quality of loans made by banks. (Gross NPAs Ratio = Gross NPAs/Gross Advances).
- Net NPAs are those type of NPAs in which the banks deduct the provisions regarding NPAs. It shows the actual burden of banks (Net NPAs = Gross NPAs-Provision/Gross Advances-Provisions).

(OB-2)To assess the impact of NPAs between public and private sector banks

Gross bad loans of banks may rise from 6.9 per cent in September 2021 to 8.1-9.5 per cent by September 2022 if the Omicron variant strikes the economy hard, as per the financial stability report of the Reserve Bank. Rising stress level in the retail loan portfolio of banks — the mainstay of bank credit for many years now — was led by home loans, which grew in double-digits so far this fiscal. While asset quality improved, with gross non-performing assets (GNPA) and net NPA (NNPA) ratios declining to 6.9 and 2.3 per cent, respectively, in September 2021, the slippage ratio inched up during the same period as private sector banks showed a higher rate of deterioration in asset quality, as per the report. But, based on the stress tests, the report warns that the GNPA ratio may rise to 8.1 per cent by September 2022 under the baseline scenario and further to 9.5 per cent under severe stress, if the economy is hit by an Omicron wave. Within the bank groups, public sector banks' GNPA stood at 8.8 per cent in September 2021 and may deteriorate to 10.5 per cent by September 2022 under the baseline scenario, while for private-sector lenders, the same may rise from 4.6 per cent to 5.2 per cent, and for foreign banks, it may increase from 3.2 per cent to 3.9 per cent over the same period. Similarly, the overall provisioning coverage ratio moved up from 67.6 per cent in March 2021 to 68.1 per cent In September 2021.

Banks have not only improved their profitability, asset quality and capital adequacy but will also be able to comply with minimum capital requirements even in a severe stress scenario, as per the macro-stress tests. However, the same tests on non-banks indicate that a significant number of them would be hit if there are liquidity shocks and the network analysis points to increasing inter-bank exposure, raising contagion risks. In sectoral terms, the GNPA ratio for personal loans rose above its level six months ago and a year ago, said the report without offering an exact number.

The deterioration was led by housing and auto loans. The GNPA ratio for the industrial sector continues to decline, though some sub-sectors like food processing, chemical and infrastructure, excluding electricity, saw increases over their March 2021 levels.

(OB-3) To analyze the recovery measures of NPAs and provide suggestions for reducing them.

Steps to Tackle NPAs

- The problem of NPAs has been going on for a long time in India, and the government of India is taking various steps at legal, financial, and policy levels. Some of them are:

Credit Information Bureau

- A sound information system is needed to prevent the loan from falling into a bad hand. It helps maintain and share information about individual and willful defaulters.

Lok Adalats

- Lok Adalats help retrieve small loans up to 5 lakhs. Lok adalats are positive in a sense they avoid more cases in the legal system.

SARFAESI Act

- The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act allow the banks and financial institutions to recover the loan amount by auctioning the properties of the defaulter. However, the bank is required to issue a notice first, and if the borrower still fails to pay the amount, appropriate actions can be taken.

4.3. Review of Literature

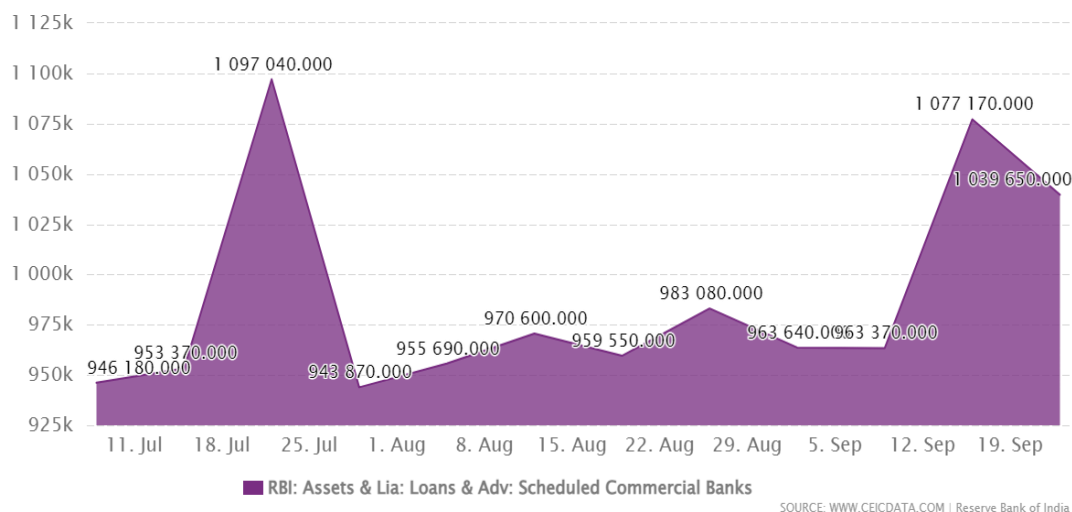
Meeker Larry G. and Gray Laura (1987) in 1983, the public was given its first opportunity to review bank asset quality in the form of non-performing asset information. The purpose of this study is to evaluate that information. A regression analysis comparing the non-performing asset statistics with examiner classifications of assets suggests that the non-performing asset information can be a useful aid in analyzing the asset quality of banks, particularly when the information is timely.

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 its entirety, starting right from the stage of their identification till the recovery of dues in such accounts.

5.0. Loans and Advances: Scheduled Commercial Banks

Reserve Bank of India: Loans and Advances: Scheduled Commercial Banks data was reported at 958,840.000 INR mn in 07 Oct 2022. This records a decrease from the previous number of 1,125,210.000 INR mn for 30 Sep 2022. Reserve Bank of India: Loans and Advances: Scheduled Commercial Banks data is updated daily, averaging 62,350.000 INR mn from Oct 1996 to 07 Oct 2022, with 1229 observations. The data reached an all-time high of 3,264,040.000 INR in 01 Apr 2016 and a record low of 0.000 INR in 10 Sep 2004. Reserve Bank of India: Loans and Advances: Scheduled Commercial Banks data remains active status in CEIC and is reported by Reserve Bank of India. The data is categorized under High Frequency Database's Monetary – Table IN.KBA003: Assets and Liabilities: Reserve Bank of India: Weekly. With effective from 11 July 2014, the treatment of liquidity adjustment facility (LAF) transactions has been changed from purchase/sale of securities to lending and deposits of funds under the balance sheet of Scheduled Commercial Banks. Repo/term repo/marginal standing facility (MSF) is now being shown under 'Loans and Advances'.

5.1. View India's Reserve Bank of India: Loans and Advances: Scheduled Commercial Banks from 18 Oct 1996 to 23 Sep 2022 in the chart:



6.0. Data Sources Data will be gathered from the secondary sources to achieve the stated objectives. It includes:

- 1) Annual reports of the bank
- 2) RBI Report on Trend and Progress of Banking in India
- 3) Manual of instructions on loans and advances
- 4) Research Papers and Published Articles

6.1. Causes for Non Performing Asset (NPA)

The primary purpose of banks is to take deposits and provide loans to the public and businesses. When a borrower takes a loan from a bank, he is obliged to pay the principal amount plus interest on that amount. However, when a borrower fails to pay the interest or the principal or both, the bank loses money. Then, the loan given by the bank is termed a Non-Performing Asset. An NPA is also known as a bad loan. We can see a rising number of bad loans in India, which is harmful to the banking sector and the economy in general.

6.2. Reasons for the rising Non-Performing Assets in the Indian banking sector

It is seen that the Indian banking sector is going through severe problems due to rising NPAs. However, the problems related to bad loans in public sector banks are much more than in private banks. Some important reasons are:

1. Credit boom: At the time of the credit boom in the year 2003-2004, it was seen that the problem of rising NPA was increasing rapidly. During this period, the world economy and the Indian economy were flourishing. Seeing this scenario, many Indian firms borrowed huge amounts to take advantage of the opportunities and grow their businesses.
2. Tightened Monetary Policy: During that time, the Reserve Bank of India tightened the monetary policy in the country. It increased the repo rate and reserve repo rate. Rising cases of NPAs were still prevalent even after those steps were taken.
3. Stalled Judiciary & Legislative Procedures: The courts in India gave judgments that were not in favor of businesses. The judgments negatively affected businesses, specifically the mining, power and steel divisions. Furthermore, the businesses had to face problems regarding the acquisition of land because of which many projects got stalled due to which the repayments have been not done by many current NPA defaulters.
4. Intentional Defaults: It is also observed that many borrowers are totally competent to pay the loan, but they are deliberately not paying. Such people must be identified, and appropriate measures should be taken to recover the money lent to them.
5. Poor Credit Appraisal System: The lack of proper credit appraisal is another factor for the rise in NPAs. Because of poor credit appraisal, sometimes the bank gives loans to those who cannot pay back the loan.
6. Natural Calamities: Natural calamities are also a factor creating an alarming rise in NPAs in public sector banks. India is hit by one or the other major natural calamity very often that causes failure of repayment of loans by the borrowers. Generally, the farmers are dependent on rainfall for their crops. However, the irregularity in rainfall reduces the production level of the farmer, and as a result, he is unable to repay the loan.

7.0 Conclusion

The government of India and RBI has taken number of initiatives to reduce the level of bad loans NPAs but they are still very high as compared to the international standards. In order to reduce them, banks must develop an

efficient management system and the staff involved in sanctioning the advances should be trained about the proper documentation. Banks should conduct proper inspection and credit appraisal before approving a project and then carry out regular monitoring to ensure that the amount must be utilized for the purpose for which it has been given. NPAs wear out the capital of the banks and also become their financial strength. It is both a political and financial issue. Bad loans are a huge problem for Indian banks as it directly impacts their profitability. Other sectors are also affected because of the failure of banks. Therefore, banks and financial institutions must take the necessary steps to tackle the NPA issue. They must ensure fair and effective retrieval of loans which enables the smooth functioning of the banking sector. The banks must be active in adopting policies that help prevent NPAs.

References:

1. Tiwari, C.K., & Sontakke, R. (2013). Non-performing assets: A cause of concern for banks. *ASM's International E- Journal of Ongoing Research in Management and I.T.*, 1-6.
2. Dr. D.Paul Dhinakaran, (2017) "Passengers impression towards Tamilnadu State Transport corporation" *A Journal of road Transport*, I(X), 1-10.
3. Yadav, Sushma. (2014). NPAs: Rising trends and Preventive Measures in Indian banking sectors. *International Journal of Advance Research in Computer Science and Management studies*, 2(1), 129-141.
4. Dhinakaran, D. P., & Rajarajan, M. (2014). Passengers' Perception towards Service Quality in Tamilnadu State Transport Corporation (Kumbakonam) Limited, Kumbakonam. *Asia Pacific Journal of Research*,(ISSN: 2320-5504,) Volume I, Issue XIII, 170-181.
5. Reserve Bank of India. (2017). Report on Trend and Progress of Banking in India 2016-17. Retrieved from www.rbi.org
6. Goyal, K. (2010). Empirical study of non-performing assets management of Indian public sector banks. *Asia Pacific Journal of Research in Business Management*, 1(1), 114-131.
7. Dhinakaran, D. P., & Rajarajan, M. (2013). Bus Operations of Service Quality in Tamil Nadu State Transport Corporation Limited, Kumbakonam. *Asian Journal of Management*, 4(1), 6-11.