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Non-Performing Assets of Commercial Banks in India - A Study

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Abstract**--** Non-Performing Assets are one of the major concerns for banks in India. Non-Performing Assets reflect the performance of Banks and high level of NPAs implies that there are large numbers of credit defaults that affect the profitability and net worth of banks and also erodes the value of the asset. Granting of credit for economic activities is the prime duty of banking. Apart from raising resources through fresh deposits, borrowings and recycling of funds received back from borrowers constitute major part of funding credit dispensation activity. Lending is generally encouraged because it has the effect of funds being transferred from the system to productive purposes, which results into economic growth. However lending also carries a risk called credit risk, which arises from the failure of the borrower. Non-recovery of loans along with interest forms a major hurdle in the process of credit cycle. Thus those loan losses affect the banks profitability on a large scale. Though complete elimination of such losses is not possible, but banks can always aim to keep the losses at a low level.

Keywords-- *Non- Performing Assets, NPA, Scheduled Commercial banks, Narasimham committee*

I. INTRODUCTION

Non-Performing assets also known as non-productive assets, constitute integral part of bank's operations. When loans are not repaid, the banks generally loses both its income stream, as well as its capital. The level of non-performing loans is recognized as a critical indicator for assessing banks credit risk, asset quality and efficiency in allocation of resources to productive sectors. Non-performing asset has emerged since over a decade as an alarming threat to the banking industry in our country sending distressing signals on the sustainability and endurability of the affected banks. The positive results of the chain of measures affected under banking reforms by the Government of India and RBI in terms of the two Narasimham Committee Reports in this contemporary period have been neutralized by the ill effects of this surging threat. Despite various correctional steps administered to solve and end this problem, concrete results are eluding[1,2,3].

It is a sweeping and all pervasive virus confronted universally on banking and financial institutions[5]. The severity of the problem is however is acutely suffered by Nationalised Banks, followed by the SBI Group, and the all India financial institutions.

Narasimham Committee that mandated identification and reduction of NPAs to be treated as a national priority because NPA direct toward credit risk that bank faces and its efficiency in allocating resources. Profitability and earnings of banks are affected due to NPA numbers. If we glance on the numbers of non-performing assets we may come to know that in the year 1995 the NPAs were Rs. 38385 crore and reached to 71047 crore in 2011 in Public sector banks and comparatively in the year 2001 the NPAs were Rs. 6410 crore and reached to Rs. 17972 crore in 2011 in Private sector banks [4,6].

The banking system in India comprises commercial and cooperative banks, of which the former accounts for more than 90 per cent of banking system's assets. Besides a few foreign and Indian private banks, the commercial banks comprise nationalized banks (majority equity holding is with the Government), the State Bank of India (SBI) (majority equity holding being with the Reserve Bank of India) and the associate banks of SBI (majority holding being with State Bank of India). These banks, along with regional rural banks, constitute the public sector (state owned) banking system in India The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management. Deposit mobilization promotes the economic prosperity by controlling the money circulation and canalizing for development and productive purposes. In order to mobilize deposits, the commercial banks undertake deposit mobilization through various deposit schemes suited to the different sections of the people. [9,10]The deposits along with other sources of funds namely capital, reserves and borrowings, form the sources of funds for the banks. The lending and investment activities of the bank are based on the sources of funds. Bankers are the custodians and distributors of the liquid capital of the country. Therefore most important function of the banking system is to mobilize the savings of the people by accepting deposits from the public. The banker becomes the trustee of the surplus balances of the public.

Non-Performing Assets are 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 [11,12]. A high level of nonperforming assets, compared to similar lenders, may be a sign of problems.

II. REVIEW OF LITERATURE

The available literature relating to NPAs is in the form of committee reports, text books, research publications and research reports. However, review of relevant research papers published since and a brief review of all other available committee reports, text books and research reports relevant to the study area have been presented chronologically under different categories – committee reports, text books, research publications and research reports.

In view of the importance of NPAs management in banks and in the process of reducing NPAs, large number of studies has been carried out by researchers, on the concept, type, impact, reasons and measures for NPAs in banking industry. Several research studies have been made by academicians, research institutions, Government, working groups and committees appointed by the RBI related to the commercial banks in general and also specific studies pertaining to individual banks focusing on NPAs. Research Students from various institutions and universities have also made significant contribution to this literary wealth.

III. COMMITTEE REPORTS

Tandon Committee Report (1975) In the background of the new approach to lending after the Nationalisation of the 14 Major Commercial Banks in 1969, with the emphasis shifting from security-oriented approach to production- related lending, so that banks should keep in close touch with the operations of the borrowers so as to ensure that the borrowed funds were properly utilized if the desired objectives were to be achieved. It was considered necessary in view of the unprecedented inflation in 1973-74 and in the context of the imbalance in the demand for and supply of bank credit and the need to curb the use of bank credit for hoarding commodities in short supply.

The Reserve Bank of India constituted a Study Group popularly known as Tandon Committee in July, 1974 for framing guidelines for commercial banks for follow –up and supervision of bank credit for ensuring proper end-use of funds. The Study Group was asked to make recommendations for obtaining periodical forecasts from the borrowers of their business or production plans and credit needs, suggest an information system for the flow of data from the borrowers to the financing banks and from the latter to the Reserve Bank.

Chore Committee Report (1979) Reviewed the operation of the cash credit system of lending, particularly with reference to the gap between the sanctioned credit limits and the extent of their utilization. The Committee was required to suggest modifications in the system with a view to making it more amenable to the judicious and rational management of funds by commercial banks. The Committee was also authorized to suggest and recommend alternative types of credit facility so as to ensure greater credit discipline and use of credit limits for increasing production.

This Committee observed that the system of lending should have certain attributes so that it works effectively. The banks should be amenable to rational management of funds by banks. The banks should be able to relate credit limits to changes in output and productive activity. The system should be amenable to credit control measures by the Reserve Bank of India. The system should be convenient in terms of operation both to the banks and their customers.

The Committee indicated that the gap between the sanctioned limits and their utilization is not unique in India only. The gap arises as the credit limits are fixed on the basis of peak level requirements. Sometimes the utilization is low due to the tendency on the part of some of borrowers to inflate their credit requirements while submitting their applications as they need not to pay any commitment charge for the unutilized portion of the limit.

Pendharkar Group Report (1978) recognized the need for classifying advances into different categories, to index the overall quality of the asset portfolio. This was the starting point for the introduction of the health coding system of bank loan portfolio by the Reserve Bank of India in 1985. This system provided information regarding the health of individual advances, the quality of credit portfolio and the extent of advances causing concern in relation to total advances. It was considered that such information would be of immense use of bank management for control purposes.

Basel Group Report (1988) adopted weighted risk assets which assigns weights to both on an off balance exposure of a bank according to their perceived risk, as the method of measuring capital adequacy and set the minimum standard at 8 percent to be achieved by the end of 1996.

Narasimham Group Report (1991) led to the erroneous belief that there was little worry about a low capital base of the banks. The lack of proper disclosure norms led to the problem being kept under cover. Poor internal controls raised serious doubts about the integrity of the system. All this was reflected in the need for higher spreads that pointed to the inefficiency of the system. By 1990, there was a cause for serious concern on account of poor financial condition of public sector commercial banks and financial institutions. The Government appointed a high level committee headed by M. Narasimham, Ex-RBI Governor, to examine all aspects relating to the structure, organization, functions and procedures of the financial system. The Committee made certain recommendations relating to Capital Adequacy Norms, Prudential Norms, Revaluation of the Assets, SLR, CRR, etc.

IV. REVIEWS

Jain Vibha (2007) detailed on commercial banks, various aspects relating to NPAs, methods of reduction of NPAs in PSBs during 1997-2003 etc. Discussion was made on recovery measures and different types of risks pertaining to credit management and the solutions for resolving the problems of NPAs in South and Far East Asian Nations, initiatives and solutions taken in India.

Rakesh Mohan (2009) opined that, since the beginning of reforms a set of micro-prudential measures have been stipulated aimed at imparting strength to the banking system as well as ensuring safety. With regard to prudential requirements, income recognition and asset classification (IRAC) norms have been strengthened to approach international best practice. Despite tightening norms, there has been considerable improvement in the asset quality of banks. Improvement in the credit appraisal process, upturn of the business cycle, new initiatives for resolution of Non-Performing Loans(NPLs) and greater provisioning and write off of NPLs enabled by greater profitability, have kept incremental NPLs low.

Gupta (2012) in her study A Comparative Study of Non-Performing Assets of SBI & Associates & Other Public Sector Banks had concluded that each bank should have its own independence credit rating agency which should evaluate the financial capacity of the borrower before credit facility and credit rating agencies should regularly evaluate the financial condition of the clients

Singh (2013) in his paper entitled Recovery of NPAs in Indian commercial banks says that the origin of the problem of burgeoning NPA's lies in the system of credit risk management by the banks. Banks are required to have adequate preventive measures in fixing pre- sanctioning appraisal responsibility and an effective post-disbursement supervision. Banks should continuously monitor loans to identify accounts that have potential to become non-performing.

Mehta.L, Malhotra.M (2014) evaluated that NPA is a main threat for the Banks in India. Non-performing assets must be managed properly for the healthy environment of Indian banks.in their research paper they discussed the positive impact of priority sector lending's on NPAs. Recession was considered as a one of the reason for the continuous increase in the NPAs.

A. Categories of NPAs and Problem Identification

Banks are required to classify nonperforming assets further into the following three categories based on the period for which the asset has remained nonperforming and the realisability of the dues:

1. Substandard Assets
2. Doubtful Assets
3. Loss Assets

a. Substandard Assets

With effect from 31 March 2005, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. In such cases, the current net worth of the borrower guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full. In other words, such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

b. Doubtful Assets

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub¬ standard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values ¬highly questionable and improbable.

c. Loss Assets

A loss asset is one 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. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

B. Research gap in Literature

The different aspects of literature related to Non-Performing Assets of researchers over the years have been collected and used for this study, but there is a huge time gap existing for the comprehensive research on quality aspects of Non-Performing Assets. Most of the research and studies are being done on causes, impact and management aspects of NPAs.

V.OBJECTIVES AND LIMITATIONS

A. Objectives of the Study

1. To study the status of Non Performing Assets of Indian Scheduled Commercial Banks in India
2. To study the impact of NPAs on Banks.
3. To know the recovery of NPAS through various channels.
4. To make appropriate suggestions to avoid future NPAs and to manage existing NPAs in Banks.

B. Limitation of the Study

The important limitations are as follows;

1. The study of non-performing assets of SCBs is limited to the Indian Banks and till the end of the year 2014.
2. The basis for identifying non-performing assets is taken from the Reserve Bank of India Publications.
3. NPAs are changing with the time. The study is done in the present environment without foreseeing future developments.

VI. EXPERIMENTAL STUDY

The following data collected from dbie.rbi.org.in

Table 1: Gross Advances and Gross NPAS of SCBs (Amount in Rupees Billion)

Year	Gross Advances	Gross NPAs (Amount)	Gross NPAs (Percentage)
2001-02	6809.58	708.61	10.4
2002-03	7780.43	687.17	8.8
2003-04	9020.26	648.12	7.2
2004-05	11526.82	593.73	5.2
2005-06	15513.78	510.97	3.3
2006-07	20125.1	504.86	2.5
2007-08	25078.85	563.09	2.3
2008-09	30382.54	683.28	2.3
2009-10	35449.65	846.98	2.4
2010-11	40120.79	979	2.5
2011-12	46655.44	1370.96	2.9
2012-13	59882.79	1931.94	3.2
2013-14	68757.48	2641.95	3.8

Source: dbie.rbi.org.in

The above table depicts the amount of Gross Advances, Gross NPA and the percentage of Gross NPA during the period of 2001-02 to 2013-14. The amount of advances of has increased from Rs. 6810 Billion in 2001-02 to Rs. 68757 Billion in 2013-14. The amount of gross NPA has increased from Rs. 708.61 billion in 2001-02 to Rs. 2642 billion in 2013-14. Similarly, NPA percentage is also showing the rising trend from 2.3 in 2007 to 3.8 in 2013.

Table 2: Net Advances and Net NPAS of SCBs (Amount in Rupees Billion)

Year	Net Advances	Net NPAs (Amount)	Net NPAs (Percentage)
2001-02	6458.59	355.54	5.5
2002-03	7404.73	296.92	4
2003-04	8626.43	243.96	2.8
2004-05	11156.63	217.54	2
2005-06	15168.11	185.43	1.2
2006-07	19812.37	201.01	1
2007-08	24769.36	247.3	1
2008-09	29999.24	315.64	1.1
2009-10	34970.92	387.23	1.1
2010-11	42987.04	417	1.1
2011-12	50735.59	652	1.3
2012-13	58797.03	986	1.7
2013-14	67352.32	1426.57	2.1

Source: dbie.rbi.org.in

The above table shows the amount of Net Advances, Net NPA and the percentage of Net NPA during the period of 2001-02 to 2013-14. The amount of advances has increased from Rs. 6458.59 billion in 2001-02 to 67352.32 billion in 2013-14. Further, the amount of NPA has also increased from Rs. 355.54 billion to Rs1426.57 billion during the period (2001-02 to 2013-14).The percentage of Net NPA has first declined from 5.5 in 2001-02 to 1.0 in 2007-08. Then it has increased to 2.10% in 2013-14.

Table 3: Showing NPAs recovered by SCBs through Lok Adalats (Amount in Crore)

Item	2008	2009	2010	2011	2012	2013	2014
Number of Cases Referred	1,86,535	5,48,308	7,78,833	6,16,018	4,76,073	8,40,691	16,36,957
Amount Involved	2142	4023	7235	5254	1700	6600	23200
Amount Recovered	176	96	112	151	200	400	1400
% of Amount recovered	8.2	2.4	1.55	2.87	11.8	6.1	6.2

Table 3 is showing NPAs of commercial banks recovered through Lok Adalats during the study period of 2008 to 2014. From the analysis of the table, it is clear that the number of cases referred to Lok Adalats for the recovery of NPAs of commercial banks has increased largely in 2014 as compared to 2008. However, if we look at the amount recovered by Lok Adalats during the study period, it shows a continuous decline from 2008 to 2009 and then it shows improvement from 2010 to 2014, but it is much less than the other recovery channels. These Lok Adalats are only successful in recovering 1400 crore out of 23200 crore means only 6.2% of the total amount involved in NPAs of the commercial banks. Due to its inefficiency in recovering, the amount involved in NPAs, the commercial banks resorting to others means of recovery

Table 4: Showing NPAs recovered by SCBs through DRTs (Amount in Crore)

Item	2008	2009	2010	2011	2012	2013	2014
Number of Cases Referred	3728	2004	6019	12872	13,365	13408	28258
Amount Involved	5819	4130	9797	14092	24,100	31000	55300
Amount Recovered	3020	3348	3133	3930	4100	4400	5300
% of Amount recovered to Total Amount	51.9	81.1	32.00	27.89	17.00	14.1	9.5

Table 4 is showing NPAs of commercial banks recovered through DRTs during the study period of 2008 to 2014. From the analysis of the table, it is clear that the number of cases for the recovery of NPAs referred to DRTs is increasing through the study period and also the amount involved in these cases and the amount recovered through DRTs has increased. DRTs shows their efficiency in 2008-09 where it recovers 81.1pc of the total amount involved in NPAs and in later years also the amount recovered by DRTs is quite significant. This is the basic reason why the commercial banks are approaching DRTs for the recovery of their NPAs as compared to Lok Adalats in which the percentage of recovered amount of NPAs is very low. Though we can say that there is a slight decrease in the percentage of amount recovered by DRTs of the NPAs of commercial banks, though these are a significant recovery channel for the commercial banks.

Table 5: Showing NPAs recovered by SCBs through SARFAESI Act (Amount in Crore)

Item	2008	2009	2010	2011	2012	2013	2014
Number of Cases Referred	83,94 2	61,760	78,366	1,18,642	1,40,991	1,90,537	1,94,707
Amount Involved	7263	12067	14249	30604	35300	68100	94600
Amount Recovered	4429	3982	4269	11561	10100	18500	24400

% of Amount recovered to Total Amount	61.0	33.0	30.00	37.78	28.6	27.1	25.8

Table 5 is showing NPAs of commercial banks recovered through SARFAESI Act during the study period of 2008 to 2014. From the analysis of the table, it is clear that the number of cases referred to SARFAESI Act and the amount of NPAs involved is increased largely during the study period. This is done because of the efficiency of SARFAESI Act in recovering these NPAs of commercial banks. From the table it is clear that the SARFAESI Act is able to recover 25.8% of the amount of NPAs of the cases referred to it in the year 2014. In 2008 recovery percentage was quite higher 61.0% this act has emerged as a blessing in disguise for the commercial banks as now they are using this act largely in recovering their NPAs in order to increase their profitability.

VII. IMPACT AND FACT FINDINGS

A. Impact

NPA impact the performance and profitability of banks. The most notable impact of NPA is change in banker's sentiments which may hinder credit expansion to productive purpose. Banks may incline towards more risk-free investments to avoid and reduce riskiness, which is not conducive for the growth of economy. If the level of NPAs is not controlled timely they will:

1. Reduce the earning capacity of assets and badly affect the ROI. The cost of capital will go up.
2. The assets and liability mismatch will widen.
3. Higher provisioning requirement on mounting NPAs adversely affect capital adequacy ratio and banks profitability.
4. The economic value additions (EVA) by banks get upset because EVA is equal to the net operating profit minus cost of capital.
5. NPAs causes to decrease the value of share sometimes even below their book value in the capital market.
6. The assets and liability mismatch will widen

B. Findings

1. Gross NPAs of scheduled commercial banks have increased from Rs. 708 Billion in 2000- 01 to Rs 2642 Billion in 2012-13.
2. Net NPAs of scheduled commercial banks have increased from Rs. 355 Billion in 2000- 01 to Rs. 986 Billion in 2012-13.
3. NPAs as a Percentage of Net Advances which was lowest 1.0 % in 2007-08 & 2008-09 and highest 5.5 % in 2001-02. It was 2.2 % in 2013-14.
4. The average Percentage of Net NPAs during 2001-02 to 2013-14 was around 2.0%
5. Number of Cases Referred to Lok Adalat was 1,86,535 in 2008 and reached to 16,36,957 in 2014
6. Rs. 2535 crores of NPAs of SCBs recovered through Lok Adalat during 2008 to 2014 Rs. 27231 crores of NPAs of SCBs recovered through DRTs during 2008 to 2014
7. Rs. 77241 crores of NPAs of SCBs recovered through SARFAESI Act during 2008 to 2014
8. Ineffective recovery, wilful defaults and Defective lending process are the important factors which are responsible for the rise of NPAs in banks.
9. NPAs reduce the earning capacity banks and badly affect the ROI

CONCLUSION

The Non-Performing Assets have always created a big problem for the banks in India. It is just not only problem for the banks but for the economy too. 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 lent. This study shows that extent of NPA is comparatively very high in public sectors banks. Although various steps have been taken by government to reduce the NPAs but still a lot needs to be done to curb this problem. The NPAs level of our banks is still high as compared to the foreign banks. It is not at all possible to have zero NPAs. The bank management should speed up the recovery process. The problem of recovery is not with small borrowers but with large borrowers and a strict policy should be followed for solving this problem. The government should also make more provisions for faster settlement of pending cases and also it should reduce the mandatory lending to priority sector as this is the major problem creating area. So the problem of NPA needs lots of serious efforts otherwise NPAs will keep killing the profitability of banks which is not good for the growing Indian economy at all.

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