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NON PERFORMING ASSETS IN COMMERCIAL BANKS IN INDIA: AN ANALYSIS

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ABSTRACT

The economic reforms initiated by the past prime minister of India Dr. M Singh for the purpose of expansion Indian banking and that was an essential tool to promote financial stability. Further, one important thing of financial reforms is rules and guidelines for the betterment of financial breadth of banking sector development. Particularly, the Non-Performing Assets (NPA) situation was completely mismatched and financial sector depends on different types of risks. Currently, NPA is one of the important issues that show the financial situations affecting issues, particularly unequal profitability. However, the present paper discussed profitability, liquidity and solvency positions that lead accumulation of wealth at the current study. One of the efforts made out of current study highlights the impact of NPS on Indian banking system and further, it measures capital assets ratio, management credit risk and controlling of NPAs are discussed. It suggests that problems of NPA in India achieve proper credit management elements. It accomplished that, one of the very well verse measures is credit management by adopting the good policy remedies and appropriate credit mechanism.

KEYWORDS: *NPA, Banking System, Rules, Profitability, Liquidity*

INTRODUCTION

The economic reforms started in 1991 would have been remained unfinished without the renovate of the banking sector in India. The important aspect of the banking sector reforms is to the liberalization of norms and guidelines for making the whole sector vibrant and competitive[1].

Banking crisis initiated in 1980 to 1996 over the World. According to International Monetary Fund (IMF) seventy-three percent of the associate countries have been facing very worst banking difficulties but these are developing countries. One of the major reasons was re-building up of Non-Performing Assets in the banking sector.

Stages of Structural Changes in Indian Banking System

The growth of the banking business can be elaborate in five stages.

- First stage: Banking sector is facing Series of problems in the first five decades of the twentieth Century.
- Second stage: Keep sustainable foundation for banking business it was taken place between 1949 and 1969 by arresting of Banking Companies' Regulation Act 1949.
- Third stage (1969 to 1985): 19 major commercial banks were nationalized in two stages and it reached large masses through the opening to all centers and Lead Bank Schemes.

- Fourth stage: During this phase (1985 –1991) lack of developments of people branches are disreputable and attended through various committees' enquiries.
- Last stage (till 1991): the first measure of reforms starting with Narasimham Committee report in 1991.

Meaning of Non Performing Assets

According to Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 NPA is an asset or account of a borrower, which is divided by a bank or financial institution as a sub-standard asset, distrustful asset, and loss asset[2].

Table: 1: Guidelines for Identification of Non-Performing Assets

Loans and Advances	Guidelines applicable From 31.3.2001	Guidelines applicable From 31.3.2002
Term loan interest/ installment remains overdue for more than	180 days	90 days
Overdraft / cash credit a/c	Remains out of order (!)	Remains out of order
Bills purchased and discounted remains overdue for more than	180 days	90 days
Agricultural loan interest / interest remains overdue for more than	Two harvest seasons but not exceeding two and half year	Two harvest seasons but not exceeding two and half years
Other accounts – Any account to be received remains overdue for more than	180 days	90 days

Factors Contributing to Non-Performing Assets

The below factors are contributing to NPAs as follows:

- Categorization of the amount for reconstruction to an undertaking of new projects and also for helping associated matters.
- Less branch expansion, vain supervision, worried labor relations, low technology, out dated tools and scientific drawbacks.
- Lack of power, a price increase of velocity, natural calamities leading to over dues.
- Government schemes like changes in excise taxes, poor credit, priority sector lending and outdated legal systems.
- Willful defaulters, siphoning off funds, fraud, and misuse by promoters and directors arguments.
- Barriers in finalization of action packages by the BIFR.
- The lack of proper attention limits, poor industry management, short financial investigation of borrowers.
- Needless reliance on security, the absence of record action by banks, fewer manage on loan records.
- Insufficient asset classification and the loss of loans are provisioning standards.
- Less matched connection between the financial institutions and commercial banks, these are providing long-term needs of industry and to ill-treatment of the funds.

Above factors contributing to the public sector banks are constrained with stuffed NPAs which exhibit in lower income and higher provisioning for agricultural debts and thus will make[4] a cavity in their profit margin. In this scenario the crippling effect on banks operation, the swing asset quality is placed as one of the most important parameters in the measurement of bank's performance under the Camel’s supervisory rating system of Reserve Bank of India.

Consequences

The NPAs in the public sector banks are well above the normal level. The consequences envisaged during the past several years are many. It has become a difficult job to the banks to reduce the lending rate as a result of the presence of large NPAs.

Ultimately, this is affecting the competitiveness of the Indian banks. When the bank does not enjoy the market competitiveness naturally the credit expansion would be slumped and when it happens, the profitability gets a setback. In this way, the vicious circle operates over the time period.

In other words, a reduction in the availability of funds for further expansion was due to the unproductiveness of the existing portfolio. Occasionally it is found that the charisma of large NPAs discourages banks to accept profitable but risky proposal loan from the customers. The NPAs also affects the risk taking the ability of the banks. On the whole, it affects the reliability of the bank and faces difficulty in raising fresh capital from the market for future requirements[5].

The most important business suggestion of the NPAs is that it leads to the credit risk direction, assuming priority over other aspects of bank’s functioning. The bank’s whole equipment would thus be pre-occupied with recovery measures rather than focused on expanding the business. RBI, through various notice, predetermined guidelines to manage NPA. Thus NPA impact the performance and profitability of banks. The most notable impact of NPA is changed in banker’s sentiments which may hinder credit expansion to productive purpose. Banks may prejudice towards more risk fewer instruments to avoid and reduce the worries, which were not favorable for the growth of the economy in India[6].

NPA results in a harmful situation on profitability as follows;

- Bank interest will fall and it calculates on the proof of payment basis
- Banks profit ratio is affected adversely due to the condition of doubtful debts and consequently rejected as bad debts.
- Return on Investment (ROI) is reduced.
- The cost of capital or Interest on Loan will go up.

Growth of NPAs in Indian Banks

Table: 1: Gross and Net Non-Performing Assets (NPAs) of Scheduled Commercial Banks in India (Amount: Rs. in Billion)

Year	Advances		Non-Performing Assets (NPAs)					
			Gross			Net		
	Gross	Net	Amount	As %age of Gross Advances	As %age of Total Assets	Amount	As %age of Net Advances	As %age of Total Assets
1996-97	3016.98	2764.21	473.00	15.7	7.0	223.40	8.1	3.3
1997-98	3526.96	3255.22	508.15	14.4	6.4	237.61	7.3	3.0
1998-99	3994.36	3670.12	587.22	14.7	6.2	280.20	7.6	2.9
1999-00	4751.13	4442.92	604.08	12.7	5.5	300.73	6.8	2.7
2000-01	5587.66	5263.28	637.41	11.4	4.9	324.61	6.2	2.5
2001-02	6809.58	6458.59	708.61	10.4	4.6	355.54	5.5	2.3
2002-03	7780.43	7404.73	687.17	8.8	4.1	296.92	4.0	1.8
2003-04	9020.26	8626.43	648.12	7.2	3.3	243.96	2.8	1.2
2004-05	11526.82	11156.63	593.73	5.2	2.5	217.54	2.0	0.9
2005-06	15513.78	15168.11	510.97	3.3	1.8	185.43	1.2	0.7
2006-07	20125.10	19812.37	504.86	2.5	1.5	201.01	1.0	0.6
2007-08	25078.85	24769.36	563.09	2.3	1.3	247.30	1.0	0.6
2008-09	30382.54	29999.24	683.28	2.3	1.3	315.64	1.1	0.6
2009-10	35449.65	34970.92	846.98	2.4	1.4	387.23	1.1	0.6
2010-11	40120.79	42987.04	979.00	2.5	1.4	417.00	1.1	0.6
2011-12	46655.44	50735.59	1429.03	3.1	1.7	652.05	1.3	0.8
2012-13	59882.79	58797.73	1940.74	3.2	2.0	987.10	1.7	1.0
2013-14	68757.48	67352.32	2641.95	3.8	2.4	1426.57	2.1	1.3

Source: Reserve Bank of India. (ON848)

Notes:

1. Data for 2013-14 are provisional.

2. Data on Scheduled Commercial Banks & Public Sector Banks for 2004-05

Include the impact of conversion of a non-banking entity into a banking entity.

The above table indicates that the NPAs are increasing in absolute terms both in gross and net terms. But their percentage of total advances is declining and it had come down to 2.5 and 1.1 percent in gross and net terms respectively in 2010-11. However, there is a slight increase in it n later years[7].

Risks of NPAs and Its Management

Credit Risk of Bank

The risk is intrinsic and completely not inevitable in the banking sector. The risk is considered to be a latent loss of an asset and portfolio is likely to suffer as a result of various reasons. It is around for centuries and thought to be the dominant financial risk today. The risk can be defined as the risk of erosion of value due to simple default and non-payment of the debt by the borrower. The degree of risk is reflected in the borrower's credit rating, the premium it pays for funds and market price of the debts.

Credit Risks of NPAs

The almost all of the public sector banks are unable to visualizing the risk they are ready to face in the emerging global economic scenario. The risk management gear to adopt a widen renovate the system by the banks in this changing scenario. The second review document on the New Basle capital accord on banking supervision has given a stress on the risk management aspect of the banks by introducing a more risk sensitive standardized approach towards capital adequacy. In spite of the strict recommendations advised by RBIs apprehension of the sufficient watchfulness of the banking sector by adopting instructions, it clearly shows about the readiness of the banks to dynamically pursue effective credit risk management instrument by visualizing the extent of credit risk management to restrain the growth of increasing NPAs in nationalized banks. The concept of recovering debts through Debt Recovery Tribunals has become a splendid breakdown. The concept of establishing Asset Reconstruction Company (ARC) has deeply benefited to the banks in included the NPAs at a manageable level.

Management of Credit Hazards

The credit hazard is one of the very important uncertainty classes for monetary agencies and banks in India. There is no fluid market for trading the credit uncertainty. However, the bank may swiftly to credit for another credit of the same rating to reduce its revelation to one party[8].

Identification and Determination of Credit default Risk

In order to appraise the credit default risk to the worried bank and it has to check the following five C's from the borrower.

- Cash flows incredible the earning ability of the borrower.
- Collateral - the corporeal assets of the borrowers who intend to credit facilities.
- Character – the organization effectiveness of the particular parties.
- Conditions - the loan covenants to protect the lender's concern
- Capital – with referring to the shock absorbers to suck up income shocks.

Credit Default Swap

It is a two-sided financial agreement in which buyer pays an intermittent fee articulated in permanent basis points on the speculative amount in return for a hovering payment reliant on the non-attendance of a third party reference credit. The flow of payments is selected to mirror the loss incurred by creditors of the reference credit in the event of its non-payment.

Credit Limited Notes (CLN)

It is recognized as credit swaps in which buyer makes intermittent payments of a fixed percentage of the reference assets to the seller in excess of the life of the swap. Then the seller agrees reimbursement in the case of credit default for the reasons viz., bankruptcy, delinquency and credit rating down grade[9].

Actions to Manage NPAs Hazards

It knows ahead of doubt that NPAs in the bank have to be kept at the lowest level. Two cleft approaches viz., Precautionary Management and Restorative Management would be necessary for controlling NPAs.

Preventive Management of NPAs in India

Credit Appraisal and Risk Management: One of the main solutions was to overcome the problem of NPAs to adopt good credit measurement and risk controlling measure. Further, one the important issues are to adopt appropriate credit strategy in banks.

Organizational Reallocate: Internal factors leading to NPAs the accountability for including the same respite with the bank themselves[10].

To Controlling the Dependence on Interest: The banks are deeply depends on lending and investments. The banks in the developed countries do not crook their shoulder upon this income but eighty-six percent of earnings of Indian banks are accounted for interest and the rest of the income is fee-based.

Imperceptible and Borderline NPAs Under Check: The imperceptible and borderline accounts require quick investigation and remedial measures, so that they do not bend down into NPAs categories. The auditors of the banking companies must examine all unwanted accounts in respect of accounts enjoying credit limits beneath bring to a halt points, so that new sub-standard assets can be reserved under check[11].

Restorative Management

The restorative measures are considered to maximize the recoveries so that bank funds privileged up in NPAs are released for reprocessing.

The Central government and RBI have taken steps for a noticeable occurrence of fresh NPAs and creating the legal and controlling environment to facilitate the recovery of obtainable NPAs of banks. They are:

Debt Recovery Tribunals (DRT)

Debt Recovery Tribunal was setup in the central government and it has amended the recovery of debts due to banks and financial institutions Act in January 2000.

As a result of the Narasimham Committee on banking sector reforms has recommended that transfer of sticky assets of banks to the Asset Modernization Company?

The Report of the Working Group on Restructuring Weak Public Sector Banks under the chairmanship of M S Verma reported that reformation sick public sector banks have also viewed the construct separation of NPAs and its transfer subsequently to the ARF is an important element in an extensive reformation policy for sick banks[13].

Corporate Debt Restructuring (CDR)

It is one of the most important methods to give good remedial measures for the declining the NPAs. The main objective is to assure a shrewd and clear device for reorganizing the corporate debts to realistic corporate bodies to amplify by contributing factors outside the limit of BIFR, DRT, and other official benefit proceedings.

The Mechanism of the CDR

It is one of the deliberate ways, based on this issue lone and loaners agreed to the particular issue. It is not applying to depositors account and it has come under one bank as an alternative way it covers up various banking accounts with the outstanding contact covers up to Rs. 20 crores.

Flow of Information of Debtor

The RBI has introduced in a place of a system for annual details of loan defaulters of financial institutions and the RBI also publishes list of bank borrowers along with banks and financial institutions in loan recovery of funds have filed as on every year ending. Furthermore, itserve as a watchfulness list at the same time as considering a request for new or supplementary credit limits from defaulting borrowing units and also from the directors, proprietors and partners of these entities[15].

Loan Recovery Action against Large NPAs

The RBI had already directed the Public Sector Banks to evaluate all cases of NPAs which amount is Rupees more than one crore and should be lodge criminal cases against loan defaulters. The executive body was requested to reframe the loan defaulter's accounts of more than one crore with special care to fix staff responsibility in individually.

Loan Information Branch

The loan or credit information circulation issue is possible through the newly headed Credit Information, Bureau of India Limited (CIBIL) body [16]. It was started in January 2001, by SBI, HDFC, and two foreign associates. It will controlling those who take benefit of lack of system information distribution most leading organizations to receive the large amount as against same loan possessions such as property, land, immoveable assets etc which have no measures to contributed the increment of NPAs of financial institutions or banks.

CONCLUSIONS

NPAs situations are the very sole subject of banking sector major concerns and other non-banking intermediaries also. The breakdown of the Indian banking system may have an unpleasant impact on other sectors[17]. However, it is an urgent necessary condition to development of banking system inIndia and it very necessary step to reducing financial chaos and suggest appropriate steps to resolving NPAs problems, and to building a healthy recovery for loans and investors in this issues banking sector should carry on their functioning without stress.

The current study pointed that, the level of NPAs in public and private sector as well as foreign banks in India. The present paper is based on the secondary data collected from the annual reports from selected banks. It is unnecessary to mention, that a durable solution to the problem of NPAs can be achieved only with proper credit assessment and risk management instrument. In a situation of liquidity, the interest of the banking system to increase the credits may compromise on asset quality, raising concern about their adverse selection in addition to the stock of NPAs[18]. It is very needful that the banking system is to be equipped with suitable norms to minimize the risk, if not completely to avoid the difficulties of NPAs. The responsibility for comprising factors leading to NPAs rests with banks themselves.

It is one of the needy steps to a restructuring of the bank or financial organization and improvement in financial deepening and modernization of appropriate skills for up gradation of credit wordiness and one more thing is staff efficiency, these are a most important thing to solve the present willful defaulter's system in India and world too.

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