Impact of Non-Performing Assets in Context of Indian Banking System

Dr Minaxi Jariwala

Professor, Shah N. H. Commerce College Valsad, India

Abstract: ***Non-performing Asset is one of the prevalent problems of Indian Banking sector. For the past three decades, the banking system has several outstanding achievements to its credit. Many banks are facing the problem of NPAs which hampers the business of the banks. Non-performing assets are a drain to the banks. Various research studies have been conducted to analyze the root causes of NPA. The following study tries to understand the concept of NPA, its causes and impact on profitability. The problem of NPA impacts profitability, Liquidity and results in credit loss. Unless and otherwise proper remedial measures are taken the quantum of non-performing assets cannot be reduced and the bank will incur losses to a great extent.***

Keywords: NPA, Bank, Profitability, Lending

1. Introduction to NPA

NPA is defined as a loan or 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 interest remains due for a period of four quarters (180 days) should be considered as NPAs. Subsequently, this period was reduced, and from March 31, 2004 onwards when interest or principle payments due to a bank remains unpaid for more than 90 days, the entire bank loan automatically turns a non performing asset. 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. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. Hence, NPA"s are negative assets for a bank and only contribute to the loss.

2. Meaning

Action for enforcement of security interest can be initiated only if the secured asset is classified as Nonperforming asset. Nonperforming asset means an asset or the account of the borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the direction or guidelines relating to assets classification issued by RBI .An asset, including a leased asset, becomes non performing when it ceases to generate income for the bank.

A non-performing asset (NPA) is a loan or an advance where;
Interest and / or installment of principal remain overdue for a period of more than 12 months in respect of a Term Loan. The account remains 'out of order' for a period of more than 180 days, in respect of an overdraft/ cash Credit (OD/CC), The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted, Interest and/ or installment 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 180 days in respect of other accounts.

3. Type of NPA

1**) Gross NPA**:- Gross NPAs is the sum total of all loan assets that are classified as NPAs as per RBI guidelines as of Balance Sheet date. Gross NPA reflects the quality of the loans made by banks. It consists of all the nonstandard assets like as substandard, doubtful, and loss assets.

2**) Net NPA**:-Net NPAs are those types of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden of banks. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to thecentral bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high.

Categories of NPA Standard Assets:

1) **Standard assets** are the ones in which the bank is receiving interest as well as the principal amount of the loan regularly from the customer. Here it is also very important that in this case the arrears of interest and the principal amount of loan does not exceed 90 days at the end of financial year. If asset fails to be in category of standard asset that is amount due more than 90 days then it is NPA and NPAs are further need to classify in sub categories. Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the reliability of the dues:
2) **Sub Standard 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 month. The following features are exhibited by substandard assets. the current net worth of the borrowers / guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full; and the asset has well-defined credit weaknesses that jeopardise the liquidation of the debt and are characterized by the distinct possibility that

the banks will sustain some loss, if deficiencies are not corrected.

3) **Doubtful Assets:** 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 .With effect from March 31, 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months.
4) **Loss Assets:** A loss asset is one which 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. Also, these assets would have been identified as „loss assets" by the bank or internal or external auditors or the RBI inspection but the amount would not have been written-off wholly.

Reasons for NPAs in Banks

An account does not become an NPA overnight. It gives signals sufficiently in advance that steps can be taken to prevent the slippage of the account into NPA category. An account becomes an NPA due to causes attributable to the borrower, the lender and for reasons beyond the control of both. An internal study conducted by the RBI shows that in the order of prominence, the following factors contribute to NPAs.

Internal Factors

- Diversion of funds
- Time/cost overrun during the project implementation.
- Inefficient management.
- Strained labor relations.
- Inappropriate technology/technical problems.
- Product obsolescence, etc.
- Poor credit Appraisals, monitoring and follow up, improper SWOT analysis on the part of banks.

External Factors

- Recession.
- Input or power shortage.
- Price escalation.
- Exchange rate fluctuation.
- Accidents and natural calamities.
- Changes in government policy such as excise, import and export duties, pollution control order etc.
- Willful defaulters have been there because they knew that legal recourse available to the lenders is time consuming and slow.
- Sickness of the industry also leads to gradual erosion of the liquidity and units start failing to honour its obligations for the loan payments. Heavy funds are locked up in these units.
- Political tool-Directed credit to SSI and Rural sectors has been there
- Manipulation by the debtors using political influence has been a cause for high industrial bad debts.

4. Review of Literature

Chirag and Hiral (2019) In there study on "A comparative Study of management of NPA in selected public and private sector bank in India "The present study is based on the secondary data and the researcher had apply various statistical and mathematical tool like graph and tabulation.The study conclude that public sector bank is facing more problem of NPA as compare to private sector Bank.

Alagarsam & Ganapathy (2017) Conduct study on "Performance of Non Performing on State Bank of India". The present study is based on the secondary data and the researcher had apply various statistical and mathematical tool like graph and tabulation.The study Conclude that the growth rate in lending money is decreasing and the gross NPA & Net NPA ratio are increasing year by year. The foreign bank are able to manage the NPAs of public sector banks and are need to observe the same from foreign bank and bank should get free from the intervening of government.

Shah & Sharma (2016) Conduct study on "A Comparative Study Of NPA IN ICICI Bank And HDFC Bank". The present study is based on the secondary data and the researcher had apply various statistical and mathematical tool like tabulation , percentage& graphical .Conclude that it is not possible to eliminate totally the NPA in the banking sector but can only be minimized. On the other hand banker has to appoint those legal expert and and has to take necessary action and follow up of advance to avoid NPA.

Rao (2014) Mentioned in his study on the topic of "An Analysis on the Performance of Private and Public Sector Banking System." The present study is based on the secondary data and the researcher had apply various statistical and mathematical tool like tabulation & graph .The study conclude that the performance of HDFC is better than the SBI and Overall analysis states that financial performance of HDFC is better than SBI. From the analysis it was found that NPA"s, Net profit margin, Net Interest margin & Return on equity is better than SBI but with regards to share value performance SBI share value is better in the market as compared to HDFC.

Research Methodology

This chapter presents the brief outline of various dimensions of the research, tools and techniques and methods used to achieve various research objectives has been discussed.

Research Design

The methodology for this research is designed considering the above facets. In order to accomplish the stated objectives, the researcher will utilize a combined approach that embraces features of both descriptive and analytical research designs.

Material and Methods

For this study, secondary data was collected.

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

a) Annual reports of the bank.
b) RBI Report on Trend and Progress of Banking in India.
c) Manual of instructions on loans and advances.
d) Research Papers and Published Articles.

5. Findings

Impact of NPAs on Banks: The efficiency of a bank is not reflected only by the size of its balance sheet but also by the level of return on its assets. So, NPAs impact banks in the following manner:

Reduces earning capacity of the assets: NPAs reduces the earning capacity of the assets and as a result of this return on assets get affected.

Adversely affects capital adequacy ratio:NPAs carry risk weight of 100% (to the extent it is uncovered). Therefore they block capital for maintaining Capital adequacy. As NPAs do not earn any income, they are adversely affecting "Capital Adequacy Ratio" of the bank.

Incurrence of additional cost: Carrying of NPAs require incurrence of Cost of Capital Adequacy, Cost of funds in NPAs and Operating cost for monitoring and recovering NPAs.

Reduces EVA: While calculating Economic Value Added (EVA =Net operating profit after tax minus cost of capital) for measuring performance towards shareholders value creation, cumulative loan loss provisions" on NPAs are considered as capital. Hence, it increases cost of capital and reduces EVA.

Low yield on advances: Due to NPAs, yield on advances shows a lower figure than actual yield on "standard Advances". The reasons that yield are calculated on weekly average total advances including NPAs.

Procedure For NPA Identification:-

1) **Internal Checks and Control:**Since high level of NPAs dampens the performance of the banks identification of potential problem accounts and their close monitoring assumes importance. Though most banks have Early Warning Systems (EWS) for identification of potential NPAs, the actual processes followed, however, differ from bank to bank. The EWS enable a bank to identify the borrower accounts which show signs of credit deterioration and initiate remedial action. Many banks have evolved and adopted an elaborate EWS, which allows them to identify potential distress signals and plan their options beforehand, accordingly.
2) **Management Resolution of NPAs:** A reduction in the total gross and net NPAs in the Indian financial system indicates a significant improvement in management of NPAs. This is also on account of various resolution mechanisms introduced in the recent past which include the SRFAESI Act, one time settlement schemes, setting up of the CDR mechanism, strengthening of DRTs. From the data available of Public Sector Banks as on March 31, 2003, there were 1,522 number s of NPAs as on March 31, 2003 which had gross value greater than Rs. 50 million in all the public sector banks in India. The total gross value of these NPAs amounted to Rs. 215 billion. The total number of resolution approaches (including cases where action is to be initiated) is greater than the number of NPAs, indicating some double counting. As can be seen, suit filed and BI FR is the two most common approaches to resolution of NPAs in public sector banks. Rehabilitation has been considered/ adopted in only about 13% of the cases. Settlement has been considered only in 9% of the cases. It is likely to have been adopted in even fewer cases. Data available on resolution strategies adopted by public sector banks suggest that Compromise settlement schemes with borrowers are found to be more effective than legal measures. Many banks have come out with their own restructuring schemes for settlement of NPA accounts. State Bank of India, HDFC Limited, M/s. Dun and Bradstreet Information Services (India) Pvt. Ltd. and M/s. Trans Union to serve as a mechanism for exchange of information between banks and FIs for curbing the growth of NPAs incorporated credit Information Bureau (India) Limited (CIBIL) in January 2001. 3) Willful Defaulters: RBI has issued revised guidelines in respect of detection of willful default and diversion and siphoning of funds. As per these guidelines a willful default occurs when a borrower defaults in meeting its obligations to the lender when it has capacity to honor the obligations or when funds have been utilized for purposes other than those for which finance was granted. The list of willful defaulters is required to be submitted to SEBI and RBI to prevent their access to capital markets.

Preventive Measure for NPA

Focus on Cash flows: While financing, at the time of restructuring the banks may not be guided by the conventional fund flow analysis only, which could yield a potentially misleading picture. Appraisal for fresh credit requirements may be done by analyzing funds flow in conjunction with the Cash Flow rather than only on the basis of Funds Flow.

Timeliness & Adequacy of response: Longer the delay in response, grater the injury to the account and the asset. Time is a crucial element in any restructuring or rehabilitation activity. The response decided on the basis of techno-economic study and promoter s commitment, has to be adequate in terms of extend of additional funding and relaxations etc. Under the restructuring exercise, the package of assistance may be flexible and bank may look at the exit option.

Early Recognition of the Problem: Invariably, by the time banks start their efforts to get involved in a revival process, it too late to retrieve the situation- both in terms of rehabilitation of the project and recovery of bank"s dues.

Multiple Financing: During the exercise for assessment of viability and restructuring, a Pragmatic and unified approach by all the lending banks / FIs as also sharing of all relevant information on the borrower would go a long way toward overall success of rehabilitation exercise, given the probability of success/failure.

References

[1] A Jaiswal, C. (2016, June) A Comparative Study Of Financial Performance Of SBI And ICICI Bank In

India. International Journal Of Scientific Research In Computer Science And Engineering, 4(3), 1-6.

[2] Alagarsam, T., &Ganapathy, D. S. (2017, August) Performance of Non-Performing On State Bank of India. International Journal of Advance Research in Management and Social Science, 6.

[3] Chirag&HiralA comparative Study of management of NPA in selected public and private sector bank in india.International Journal of Research in Humanities, Arts and Literature 403-418

[4] Dixit, D. (2016) Performance Analysis Of private Sector And public Sector Bank Reference to ICICI Bank and State Bank of India. International Journal of Applied Research, 443-449.

[5] Vaibhavi Shah, S. S. (2016, February) A Comparative Study Of NPA IN ICICI Bank And HDFC Bank. Abhinav National Monthly RefereedJournalOf Research In Commerce & Management, 5(2).

[6] Rao, D. K. (2014, April - June) An Analysis On The Performance Of Private And Public Sector Banking System. International Journal Of Business And Administration Research Review, 2(5), 104.

Web sites

[7] http://www.differencebetween.net/business/differencebetween-gross-npa-and-net-npa/#ixzz5EyPKuQrj

[8] www.rbi.org.in