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

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Abstract – A well-built banking sector is significant for a prosperous economy. The crash of the banking sector may have an unfavorable blow on other sectors. A banker shall be very cautious in lending, because banker is not lending money out of his own capital. A major portion of the money lent comes from the deposits received from the public and government share. At present NPA in the banking sector is debate topic because NPA is increasing year by year particularly in nationalized banks The Gross Non-Performing Assets (GNPAs) of Nationalized Banks as on June 2012 were Rs.73,038 crore which amount to 2.94% of Gross Advances. In this direction present paper is undertaken to study the reasons for advances becoming NPA in the Indian Commercial banks Sector and to give suitable suggestion to overcome the mentioned problem. In India Non-performing assets are one of the major concerns for banks.NPA is the best indicator for the health of the banking industry. NPAs reflect the performances of banks. .NPAs is the primary indicators of credit risk. NPAs are an inevitable burden on the banking industry. Hence the success of a bank depends upon methods of managing NPAs. The Public Sector Banks have shown very good performance over the private sector banks as far as the financial operations are concerned.

Keywords: Advances, Gross NPA, NPA, Loans, Gross NPA, Net NPA, public sector banks, private sector banks, etc.

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1. INTRODUCTION

NPA is defined as 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 1995 onwards the assets for which the interest has remained unpaid for 90 days were considered as NPA'S. For any nation, banking system plays a vital role in the development of its sound economy. Banking is an important segment of the tertiary sector and acts as a back bone of economic progress. Banks are supposed to be more directly and positively related to the performance of the economy. Banks act as a development agency and are the source of hope and aspirations of the masses. Commercial banks are the major player to develop the economy. A major threat to banking sector is prevalence of Non-Performing Assets (NPAs). NPAs reflect the performance of banks. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The NPA growth involves the necessity of provisions, which reduces the overall profits and shareholders' value (Parul Khanna, 2012). In present scenario NPAs are at the core of financial problem of the banks. Concrete efforts have to be made to improve recovery performance. The main reasons of increasing NPAs are the target-oriented approach, which deteriorates the qualitative aspect of lending by banks and willful defaults, ineffective supervision of loan accounts, lack of technical and managerial expertise on the part of borrowers (Kamini Rai, 2012).

2. REVIEW OF LITERATURE:

A large number of researchers have been studied to the issue of non-performing asset (NPA) in banking industry .A review of the relevant literature has been described as under: - Non Performing Assets engender negative impact on banking stability and growth. Issue of NPA and its impact on erosion of profit and quality of asset was not seriously considered in Indian banking prior to 1991. There are many reasons cited for the alarming level of NPA in Indian banking sector. Asset quality was not prime concern in Indian banking sector till 1991, but was mainly focused on performance objectives such as opening wide networks/branches, development of rural areas, priority sector lending, higher employment generation, etc. The accounting treatment also failed to project the problem of NPA, as interest on loan accounts were accounted on accrual basis (Siraj K.K. and P. Sudarsanan Pillai, 2012). A Committee on Banking Sector Reforms known as Narasimham Committee was set up by RBI to study the problems faced by Indian banking sector and to suggest measures revitalize the sector. The committee identified NPA as a major threat and recommended prudential measures for income recognition, asset classification and provisioning requirements. These measures embarked on transformation of the Indian banking sector into a viable, competitive and vibrant sector. The committee recommended measures to improve "operational flexibility" and "functional autonomy" so as to enhance "efficiency, productivity and profitability" (Chaudhary, S., & Singh, S., 2012). The main cause of mounting NPAs in public sector banks is malfunctioning of the banks. Narasimham Committee identified the NPAs as one of the possible effects of malfunctioning of public sector banks (Ramu, N., 2009). It has been examined that the reason behind the falling revenues from traditional sources is 78% of the total NPAs accounted in public sector banks (Bhavani Prasad, G. and Veena, V.D., 2011). An evaluation of the Indian experience in Financial Sector Reforms Published in the RBI Bulletin gives stress to the view that the sustained improvement of the economic activity and growth is greatly enhanced by the existence of a financial system developed in terms of both operational and allocation efficiency in mobilizing savings and in channelizing them among competing demands (G.Rangarajan, 1997). It has been observed that the current banking Scenario and the need for the policy change, opines that a major concern addressed by the banking sector reform is the improvement of the financial health of banks. The Introduction of prudential norms is better financial discipline by ensuring that the banks are alert to the risk profile of their loan portfolios (S.P.Talwar (1998). The Reserve Bank of India has also conducted a study to ascertain the contributing factors for the high level of NPAs in the banks covering 800 top NPA accounts in 33 banks (Baiju, S. and Tharril, G.S. (2000)). The study has found that the proportion of problem loans in case of Indian banking sector always been very high. The problem loans of these banks, in fact, formed 17.91 percent of their gross advances as on March 31, 1989. This proportion did not include the amounts locked up in sick industrial units. Hence, the proportion of problem loans indeed was higher. However, the NPAs of Indian Banks declined to 17.44 percent as on March 31, 1997 after introduction of prudential norms. In case of many of the banks, the decline in ratio of NPAs was mainly due to proportionately much higher rise in advances and a lower level of NPAs accretion after 1992. The study also revealed that the major factors contributing to loans becoming NPAs include diversion of funds for expansion, diversification, modernization, undertaking new projects and for helping associate concerns. This is coupled with recessionary trend and failure to tap funds in the capital and debt markets, business failure (product, marketing, etc.), inefficient management, strained labourrelations, inappropriate technology/technical problems, product obsolescence, recession input/power shortage, price escalation, accidents, natural calamities, Government policies like changes in excise duties, pollution control orders, etc. The RBI report concluded that reduction of NPAs in banking sector should be treated as a national priority issue to make the Indian banking system stronger, resilient and geared to meet the challenges of globalization (Parul Khanna, 2010).

3. CATEGORIZATION OF NON - PERFORMING ASSETS (NPA):

According to the RBI guidelines, banks must classify their assets on an on-going basis into the following four categories:

- **Standard assets:** Standard assets service their interest and principal installments on time although they occasionally default up to a period of 90 days. Standard assets are also called performing assets. They yield regular interest to the banks and return the due principal on time and thereby help the banks earn profit and recycle the repaid part of the loans for further lending.

- **Sub-standard assets:** Sub-standard assets are those assets which have remained NPAs (that is, if any amount of interest or principal installments remains overdue for more than 90 days) for a period up to 12 months.

- **Doubtful assets**: An asset becomes doubtful if it remains a sub-standard asset for a period of 12 months and recovery of bank dues is of doubtful.

- **Loss assets**: Loss assets comprise assets where a loss has been identified by the bank or the RBI. These are generally considered uncollectible. Their realizable value is so low that their continuance as bankable assets is not warranted.

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.

3.1 Asset classification categories of NPAS:

1. Standard assets

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 do 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.

3. Doubtful assets

A loan 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.

Provisioning norms for NPAS

After a proper classification of loan assets the banks are required to make sufficient provision against each of the NPA account for possible loan losses as per prudential norms. The minimum amount of provision required to be made against a loan asset is different for different types of assets. The details of the provisioning requirements as per the RBI guidelines are furnished below:

In terms of RBI circular No RBI/2004/254/DBOD No BP.BC.NO 97/21.04.141/2003-04 dated 17.06.2004, the Reserve Bank of India has decided that with effective from March 31, 2005, a general provision of 10 percent on total outstanding should be made without making any allowance for ECGC guarantee cover and securities available.

4. CHARACTERISTICS OF PRIVATE BANKING SECTOR:

Private Banks have played an important role in the economic development. The bank loans in India are provided to trade and industry. The main features of Private Banks are:

1. Encourage savings:

Banks collect the small savings scattered in different parts of the country. These savings are used in trade and industries. Thus banks collect savings one hand and put them in productive uses from the other.

2. Financing of trade and industry:

Banks provide finance to trade and industry. Modern trade and industry requires capital in huge quantum. Additional resources are raised from the public by banks and these resources are used for making loans and advances to industry and trade.

3. Security of loans:

Private Banks guarantee loans taken by industrial and business units from national and international sources. It helps industrial and business units in getting loans from these sources.

4. Personal credit:

Banks provide consumer loans to the customers on the basis of personal credit. These loans are provided to purchase consumer goods.

5. Financial assistance:

Private Banks provides the financial assistance to new enterprises and through new innovations the economy gets a continuous momentum. Credit and financial facilities are provided by these institutions.

TABLE 3: Loan performance of Indian private banks 2006-07 to 2010-11(in crore)

Banks	2007	Percentage	2011	Percentage
Axis Bank	36,876.46	9.25	142,407.83	17.12
ICICI	195,865.60	49.17	216,365.90	26.01
IDBI	62,470.82	15.6	157,098.07	18.88
HDFC	46,944.78	11.78	160,831.41	19.33
IndusInd Bank Ltd.	11,084.20	2.78	26,165.65	3.14
Kotak Mahindra Bank	15,573.44	3.9	41,241.95	4.95
Yes Bank	6,289.73	1.57	34,363.64	4.13
South Indian Bank	7,918.91	1.98	20,488.73	2.46
Ing Vysya Bank	11,976.17	3.006	23,602.13	2.83
CITI Union	3,329.23	0.83	9,255.46	1.11
TOTAL	398,329.34		831,820.77	
AVERAGE	39,832.93		83,182.08	

(Source: annual report of banks)

Table 1 shows the loan performance of Indian Private Banks during 2007 to 2011. At the end of the year 2007, the amounts of total loans of selected private banks were ₹ 398329.34 crore. However, after 5 years, it reached to ₹ 831820.77 crore in 2011. It increased by 108% in 5 years. It was a great achievement for these selected private banks. The overall achievement was an increased by 286.17% in case of Axis Bank, 10.46% of ICICI Bank, 151.47% for IDBI Bank, 242.55% for HDFC Bank, 136.06% of Indusland Bank, 164.8% for Kotak Mahindra Bank, 446.34% for YES Bank, 158.73% for South Indian Bank, 97% for ING Vysya Bank, 178.006% for CITI Union Bank. The total amount of loans granted increased by 108.8% in the period of 5 years. In some banks the amount of loans had increased but the overall performance was not good. People will not prefer loans from these banks because of high interest rates.

CONCLUSION:

Finally it can conclude that the banks can avoid sanctioning loans to the non-creditworthy borrowers by adopting certain measures. Banker can constantly monitor the borrower in order to ensure that the amount sanctioned is utilized properly for the purpose to which it has been sanctioned. The banker should get both the formal and informal reports about the goodwill of the customer. If he had already proven as a defaulter then there is no question of sanctioning loan to him. The banker also has to educate the borrowers regarding the effects and consequences of defaulting. By considering all the above factors the banker can reduce the non-performing assets in a bank. The use of technology like Core Banking Solutions in Apex bank should make more reachable to all borrowers. At last the problem of NPAs has been a major issue for the banking industry. The RBI which is the apex body for controlling level of non-performing assets have been giving guidelines and getting norms for the banks in order to control the incidents of faults. Reduction of NPAs in banking sector should be treated as national priority item to make the Indian Banking system more strong, vibrant and geared to meet the challenges of globalization.

NPAs reflect the overall performance of the banks. The NPAs have always been a big worry for the banks in India.The Indian banking sector faced a serious problem of NPAs. . A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and liquidity of banks. The extent of NPAs has comparatively higher in public sectors banks. To improve the efficiency and profitability, the NPAs have to be scheduled. Various steps have been taken by government to reduce the NPAs. It is highly impossible to have zero percentage NPAs. But at least Indian banks should take care to ensure that they give loans to creditworthy customers.

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