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Non Performing Assets of Indian Banking System and its Impact on Economy

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I. Introduction of NPA

Non Performing Assets

Assets which generate income are called performing assets and but those do not generate income are called non-performing assets. A debt obligation where the borrower has not paid any previously agreed upon interest and principal repayments to the designated lender for an extended period of time. The nonperforming asset is therefore not yielding any income to the lender in the form of principal and interest payments.For example, a mortgage in default would be considered non-performing. After a prolonged period of non-payment, the lender will force the borrower to liquidate any assets that were pledged as part of the debt agreement. If no assets were pledged, the lenders might write-off the asset as a bad debt and then sell it at a discount to a collections agency.An asset becomes non-performing when it ceases to generate income for the bank. A non-performing asset (NPA) is defined generally as a credit facility in respect of which interest and / or installment of principal has remained "past due" for two quarters or more. An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. It was, however, decided to dispense with past due".Worried over rising bad loans, a Parliamentary Panel has suo motu decided to examine the non-performing assets of the public sector banks that touched Rs 3.61 lakh crore at the end of December 2015. The combined net loss of 20 public sector banks (PSB) stood at Rs 16,272.34 crore for the fourth quarter ended March 2016 as bad loans situation worsened. PSBs registered net profit of Rs 4,063.58 crore in the corresponding quarter

NPA concept which effect from 31 March 2001. Accordingly, as from that date, a NPA shall be an advance where –

- Interest and/or installment of principal remain overdue for more than 180 days in respect of a term-loan.
- The account remains „out of order" for more than 180 days, in respect of overdraft / cash credit (OD / CC).
- The bill remains overdue for more than 180 days in the case of bill 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.
- Any amount to be received remains overdue for more than 180 days in respect of other accounts.

Objectives of the Study

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

II. Limitation of the Study

The important limitations are as follows;

- The study of non-performing assets limited to the Indian Bank and till the end of the year 2015
- The basis for identifying non-performing assets is taken from the Reserve Bank of India Publications.
- NPAs are changing with the time. The study is done in the present environment without foreseeing future developments.

Scope of the Study

The study has the following scope:

- The study could suggest measures for the banks to avoid future NPAs & to reduce existing NPAs.
- The study may help the government in creating & implementing new strategies to control
- NPAs.
- The study will help to select appropriate techniques suited to manage the NPAs and
- develop a time bound action plan to check the growth of NPAs.

III. Review of literature

Kaur K. and Singh B. (2011) in their study on Non-performing assets of public and private sector banks (a comparative study) studied that NPAs are considered as an important parameter to judge the performance and financial health of banks. The level of NPAs is one of the drivers of financial stability and growth of the banking sector. Chatterjee C., Mukherjee J. and Das (2012) in their study on Management of non-performing assets - a current scenario has concluded that banks should find out the original reasons/purposes of the loan required by the borrower. Proper identification of the guarantor should be checked by the bank including scrutiny of his/her wealth.Rai (2012) in her study on Study on performance of NPAs of Indian commercial banks find out that corporate borrowers even after defaulting continuously never had the fear of bank taking action to recover their dues. This is because there was no legal framework to safeguard the real interest of banks

Why assets become NPA?

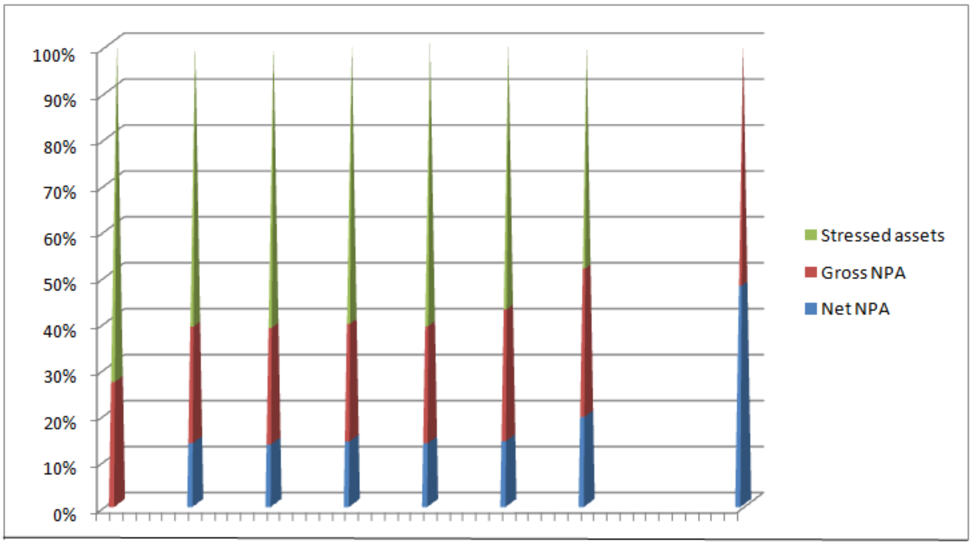
A several factors is responsible forever increasing size of NPAs in PSBs. The Indian banking industry has one of the highest percents of NPAs compared to international levels. A few prominent reasons for assets becoming NPAs are as under :

- Lack of proper monitoring and follow-up measures.
- Lack of sincere corporate culture. Inadequate legal provisions on foreclosure and bankruptcy.
- Change in economic policies/environment.
- Non transparent accounting policy and poor auditing practices.
- Lack of coordination between banks/FIs.
- Directed landing to certain sectors.
- Failure on part of the promoters to bring in their portion of equity from their own sources or public issue due to market turning unfavorable.
- Criteria for classification of assets

Table No.1 Net NPA.Gross NPA and stress assets till March 2016

NPA	Net NPA%	Gross NPA%	Stressed assets%
Mar-13		3.4	9.2
Sep-13	2.3	4.2	10.2
Mar-14	2.2	4.1	10
Sep-14	2.5	4.5	10.7
Mar-15	2.5	4.6	11.1
Sep-15	2.8	5.6	11.3
Mar-16	4.6	7.6	11.5
Mar-17	8.5	9.3	

The above table depict the % of Net ,Gross NPA and Stress assets during the period 2013 to 2016 the % increase continuously. It forecast that in 2017 it will reach at 8.5and 9.3 and it will be critical for banking system.



Figure;1 NPA, Gross NPA and Stress Assets of C.B.

Table No. 2 Indian banks and their NPA

Bank	NPA
PNB	5300 CR
UCO	1497CR
INDIAN OVERSEAS BANK	1425 CR
CENTRAL BANK OF INDIA	837CR
DENA BANK	663CR
14 OTHER BANK	8883CR
IDBI	1609CR

Underlying reason for NPA in India
An internal study conducted by RBI shows that in the order of prominence ,the following factor contribute to NPAs.
Internal Factor
Diversion of funds for
- Expansion/diversification /modernization
- Taking up new project
- Helping /promoting associate concerns time/cost overrun during the project implementation stage

Business Failure
Inefficiency in management
Slackness in credit management and monitoring
Inappropriate Technology/technical problem
Lack of coordination among lenders

External Factor
Recession
Input/power storage
Price escalation
Exchange rate fluctuation
Accidents and natural calamities, etc.
Changes in government policies in excise/ import duties, pollution control orders, etc.
Some other factors also affected to NPA which are mention below in detail:

Liberalization of economy/removal of restriction/reduction of tariffs
A large number of NPA borrowers were unable to compete in a competitive market in which lower prices and greater choices were available to consumers. Further, borrowers operating in specific industries have suffered due to political, fiscal and social compulsions, compounding pressures from liberalization.

Lax monitoring of credit and failure to recognize Early Warnings Signals
It has been stated that approval of loan proposal is generally thorough and each proposal passes through many levels before approval is granted. However, the monitoring of sometimes complex credit files has not received the attention it needed which meant that early warning signals were not recognized and standard assets slipped to NPA category without banks being able to take proactive measures to prevent this. partly due to this reason, adverse trends in borrowers performance were not noted and the position further deteriorated before action was taken.

Over optimistic promoters
Promoters were often optimistic in setting up large projects and in some cases were not fully above board in their intentions. screening procedures did not always highlight these issues. often projects were set up with the expectation that part of the funding would be arranged from the capital markets which were booming at the time of the project appraisal. When the
capital markets subsequently crashed, the requisite funds could never be raised, promoter often lost interest and lenders were left stranded with incomplete/unviable projects.
Directed lending
Loans to some segment were dictated by Governments policies than commercial imperatives**.**

Highly Leveraged borrowers
Some borrowers were under capitalized and over burdened with debt to absorb the changing economic situation in the country.Operating within a protected marked resulted economic situation in the country. Operating within a protected market resulted in low appreciation of commercial/market risk.

Funding mismatch
There are said to be many cases where loans granted for short terms were used to fund long term transactions.
High Cost of Funds
Interest rates as high as 20% were not uncommon. Coupled with high leveraging and falling Denmark, borrowers could not continue to service high cost debt.
Willful Defaulters
There are a number of borrowers who have strategically defaulted on their debt service obligation realizing that the legal resource available to creditors is slow in achieving results.

NPA - Impact

The problem of NPAs in the Indian banking system is one of the foremost and the most formidable problems that had impact the entire banking system. Higher NPA ratio trembles the confidence of investors, depositors, lenders etc. It also causes poor recycling of funds,which in turn will have deleterious effect on the deployment of credit. The non-recovery of loans effects not only further availability of credit but also financial soundness of the banks.

Profitability: NPAs put detrimental impact on the profitability as banks stop to earn income on one hand and attract higher provisioning compared to standard assets on the other hand. On an average, banks are providing around 25% to 30% additional provision on incremental
NPAs which has direct bearing on the profitability of the banks.

Asset (Credit) contraction: The increased NPAs put pressure on recycling of funds and reduces the ability of banks for lending more and thus results in lesser interest income. It contracts the money stock which may lead to economic slowdown.

Liability Management: In the light of high NPAs, Banks tend to lower the interest rates on deposits on one hand and likely to levy higher interest rates on advances to sustain NIM. This may become hurdle in smooth financial intermediation process and hampers banks'business as well as economic growth.

Capital Adequacy: As per Basel norms, banks are required to maintain adequate capital on risk-weighted assets on an ongoing basis. Every increase in NPA level adds to risk weighted assets which warrant the banks to shore up their capital base further. Capital has a price tagranging from 12% to 18% since it is a scarce resource.

Shareholders' confidence: Normally, shareholders are interested to enhance value of their investments through higher dividends and market capitalization which is possible only when the bank posts significant profits through improved business. The increased NPA level is
likely to have adverse impact on the bank business as well as profitability thereby theshareholders do not receive a market return on their capital and sometimes it may erode their value of investments. As per extant guidelines, banks whose Net NPA level is 5% & above are
required to take prior permission from RBI to declare dividend and also stipulate cap on dividend payout.

Public confidence: Credibility of banking system is also affected greatly due to higher level NPAs because it shakes the confidence of general public in the soundness of the banking system. The increased NPAs may pose liquidity issues which is likely to lead run on bank by
depositors. Thus, the increased incidence of NPAs not only affects the performance of the banks but also affect the economy as a whole. In a nutshell, the high incidence of NPA has cascading impact on all important financial ratios of the banks viz., Net Interest Margin, Return on Assets, Profitability, Dividend Payout, Provision coverage ratio, Credit contraction etc., which may likely to erode the value of all stakeholders including Shareholders, Depositors, Borrowers, Employees and public at large.

IV. Findings

Because of mismanagement in bank there is a positive relation between Total Advances, Net Profits and NPA of bank which is not good. Positive relation between NPA & profits are due to wrong choice of clients by Banks. There is an adverse effect on the Liquidity of Bank.Bank is unable to give loans to the new customers due to lack of funds which arises due to NPA As per the government, the main reasons for rise in NPAs are sluggishness in the domestic growth in the recent past, slow recovery in the global economy and continuing uncertainty in global markets leading to lower exports of various products such as textiles and leather.

Suggestion

Advances provided by banks need to be done pre-sanctioning evaluation and post disbursement control so that NPA can decrease. Good management needed on the side of banks to decrease the level of NPA. Proper selection of borrowers & follow ups required to get timely payment.Non performing assets are a drain to the banks. The banks in India are adopting various strategies to reduce the non performing assets in their banks and they are also adopting various methodologies by which further addition to NPA portfolio is minimized In the real sense, in case there is a recovery in principal and installments due in respect of the loans granted to the banks are received 100%, the question of non performing assets do not arise. However, there is no such ideal bank where the NPA is nil. Except banks which were originated recently, all banks are prone to have some portion of their loans and advances as non performing advancesThe following are some strategies by which banks are trying to curtail non performing assets to a great extent:

Recovery camps:

Bank personnel jointly approach the defaulting borrowers for repayment at a place and time convenient to both the parties. These are more suited to small loans. Normally the borrowers who had availed small loans will be more in number in rural and semi urban areas rather than urban and metro centers. As such, the banks instead search areas rather than urban and metro centers. As such, the banks instead of conducting the recovery camps at their branches, they usually conduct such recovery camps in centres like panchayat board offices, court buildings, government department buildings etc such recovery camps so that the borrowers find it convenient to attend the recovery camps. Under certain circumstances, the manager in charge of the bank branches along with some branch officials go to each visit each house of the borrowers and recover the installments due in respect of loans availed by them. This type of recovery camp will be successful in case an advance notice is served on the borrowers mentioning the
date of recovery camps

Preference of claims:

Banks should expeditiously and properly claim indemnity from organizations like Deposit Insurance and Credit Guarantee Corporation called DICGC, Export Credit Guarantee Corporation called ECGC, Credit Guarantee Fund Trust for small scale industries, Insurance Companies etc and invoke Government/other personal guarantees to recover loan
dues and reduce non performing assets.

Compromise proposals :

Compromise routes are adopted by banks, where borrowers experience certain genuine difficulties and where normal recovery is not possible. It involves certain sacrifices on the part of the banks on the principle of "one bird at hand is worth two in the bush". Such proposals can be taken up considering the history of the borrowed account, security available, net worth of the borrower/guarantor, time value of offer made etc

Technical write off :

Normally banks decide writing off small loans which have become bad and the recovery is not at all possible in those accounts under any circumstances on account of the facts that the borrower might have been expired; he has no means to repay the loan at any cost and there may be huge losses in respect of the properties etc. This is for the sole purpose of servicing such non performing accounts.

One time settlement scheme::

To reduce the absolute amount of non performing assets, Government of India along with Reserve Bank of India are announcing one time settlement schemes periodically for the past few years. When the borrowers are alive and when the borrowers are farmers, small entrepreneurs etc and they find it very difficult to pay their dues for various reasons like bad health and fall in their business ventures, , however, they have the inclination to repay their debts to the banks,this type of practice is very much helpful to the borrowers and the lending institutions. Surely the banks are in a position to lose certain portion of their loan amount when they are conducting one time portion of their loan amount when they are conducting one time settlement schemes.

Suit filing:

Filing of suit is taken up as a last resort when all other remedies to recover non performing assets fail. Banks can initiate recovery proceedings with or without intervention of the courts of law. To Expedite the process; banks should be alert and proactive in all stages of the proceedings. i.e. preparation of plaint, service of summons, written statements, trial of the suit, obtaining decree copy, praying for interim relief, execution of decrees, attachment of the property, arrest of the defendants, if needed etc.

Debt recovery tribunals:

The debt recovery tribunal act was passed by Indian Parliament in 1993 with the objective of facilitating the banks and financial institutions for speedy recovery of dues in cases where the loan amount is Rs. 10 lakhs and above. The time limit envisaged under the act is not being adhered to in disposing off the suits because of inadequate infrastructure and shortage of recovery personnel with the DRTs. Nonetheless, the DRT act and subsequent amendment in 2000 have provided a great improvement over the normal legal forum

Lok adaltes :
It is a legal forum for expeditious settlement of loan dues on consensus arrived between the bank and the borrowers mediated by the Lok Adalat
Securitization Act.:
The securitization and financial assets and enforcement of security interest – SARFAESI act 2002 aims to empower banks as secured creditors to take possession, manage and sell the securities without the intervention of court/tribunal. It also aims at Asset Reconstruction by securitization or reconstruction company. However, loan with balance below Rs. 1 lakh unsecured loans and loans against collateral of agricultural land are exempted from the purview of this act.

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