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Management of Non-performing Assets in the Banking Sector of India

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Abstract
The Indian Banking Sector has been the growth engine of our Economy. The Banking Sector of India is characterised by high share of Public Sector commercial Banks. An NPA is defined as loan asset which ceases to generate any income for Banks, whether in the form of interest or principal repayment. NPAs directly impacts on the liquidity, rate of return, profitability and credit growth of banks. So, Management of NPAs is the biggest challenge for Indian banking sector. Managing NPAs at lowest level has become paramount importance for banking Sector of India as our country is facing problems of slowdown of economy in recent years. It is also significant for better performance of Banks in particular and the growth of economy as a whole. If ever increasing level of NPAs is not properly managed, it may cause financial and economic degradation/slowdown. To reduce the level of NPAs, several measures have been taken by the Government and RBI. We can reduce the level of NPAs through efficient monitoring mechanism and controlling measures. The Banks should regularly monitor the borrowers to ensure that the sanctioned loan amount has been properly utilized. SAFAERI Act 2002, DRTs, ARCs, Lok Adalats, and IBC (Insolvency and Bankruptcy Code, 2016) as recovery legal channels may play an important role in faster recovery of NPAs. **NPAs cannot be brought down at zero level but can be narrowed down with strategic management.** Thus, the aim of this paper is to study the concept, trends and causes of NPAs in the banking sector of India and to suggest measures for strategic management of NPAs.

Keywords: NPA, Banking Sector, RBI, Recovery Measures

INTRODUCTION

The Banking Sector of India is playing a significant role in financing process and extending the credit facilities to all segments of the economy to meet consumption and investment demand. The Indian Banking Sector has been the growth engine of our economy. With these objectives, 14 banks were nationalised in 1969 & 6 banks in 1980. The Banking Sector of India is characterised by high share of public Sector commercial Banks. The Performance of public sector commercial banks represents the performance of overall Indian banking sector. Between 1969 to 1991, the number of branches grew significantly and they witnessed a large deposit and credit growth. Dating back to economic meltdown of 2008-09, performance of Indian Banking Sector became envy of the world. In 2009, India recorded the lowest NPA nation among the top G-20 nations. Since, global financial crisis of 2008-09, the trembling bad loans are continuously damaging to the financial performance of Indian commercial banks. *There was a worst hit to Indian banking sector due to mounting NPA in 2017. IMF also reveals that India stands fifth with respect to NPAs across the world.*

The key challenges to Banking Sector of India include low financial depth, high share of NPAs and high concentration of PSBs. The rising NPAs in Public Sector Commercial Banks have been the biggest issue since NPAs has direct impact on the liquidity, rate of return, profitability and credit growth of banks. NPAs have adversely affected the performance of Banking Sector of India in the eyes of public/shareholders which may reduce their confidence and may lead to failure of banks.

The Banking Sector of India saw the far reaching reforms in the post 1991 period. In spite of financial reforms (1991) & Banking Reforms (1998), Liberalisation & Privatisation as well as utmost care/ measures taken by the government and RBI, many assets/ loans of commercial Banks are converted into bad loans. Such assets or loans referred to No-performing Assets (NPAs).

An NPA is defined as loan asset which ceases to generate any income for banks, whether in the form of interest or principal repayment.

Management of NPAs is the biggest challenge for Banking Industry of India. The issue of mounting NPAs is giving the feeling of extreme nervousness to Banking Sector of India. *Thus, managing/controlling NPAs at lowest level has become paramount importance for Indian banking Sector in recent years. If ever increasing level of NPAs is not properly managed/controlled by Indian Banking Sector, it may cause financial and economic degradation/slowdown.*

REVIEW OF LITERATURE

The comparative studies available on NPAs have helped us to evaluate NPAs and its management in Indian Banking scenario.

Mohan, B. and Rajesh, K. (2004) pointed out the significant role played by the prudential norms in the management of NPAs of commercial banks. The authors recommended for strengthening the Debt Recovery Tribunals (DRTs) to deal with defaulters diligently. The emphasis of this study was mainly on strengthening regulatory measures to manage NPA in Indian banking sector.

Vassiliou, L. (2004) evaluated various NPL resolution techniques in Asian countries. The study confirmed that most countries applied techniques like forming ARCs, Corporate Debt Restructuring (CDR) Committee and Scrutinizing to manage the increased level of NPAs. The study highlighted the significant role played by ARC, SARFAESI Act and National Company Law Tribunal in the management of NPAs.

Rao, B. (2004) emphasized the need for more proactive measures to manage NPAs of banks. The study recognized that the alarming level of NPA deteriorated the bank's profitability. The initiatives taken by RBI such as DRTs, ARCs, CDR etc influenced the level of NPA to some extent. The study holds that the key to successful management is the presence of a sound credit appraisal system to ensure the quality of the loan portfolio.

Kakker, R. (2005) studied "Role of Asset Reconstruction Company (ARC) in NPA Management". The study concluded that ARC's with statutory/ regulatory powers are likely to emerge as nodal resolution agencies coexisting with CDR mechanisms for management of NPAs.

Meenakshi Rajeev, H P Mahesh (2010) studied banking sector reforms and NPAs in Indian Commercial banks to examine the trends of NPAs from different dimensions. It was observed that NPAs in priority sector is still higher than that of the non priority sector due to socio economic objectives of banks.

Gopi and Paulraj (2015) mentioned in their study about the factors that are adding to NPAs are improper credit, poor loan management policy, business failures, poor recovery of receivables, industrial recession and adverse exchange rates etc. if the proper management of the NPAs isn't attempted, it would hamper the productivity of the banks.
Rathore (2017) suggested that the bank employees for NPA management ought to be experienced, very much qualified and prepared with the goal that they can comprehend the issues of recuperation and manage them successfully.

After studying various research papers and articles as mentioned above, with regard to NPAs we observed that -

a. The problem of NPAs has arisen in Public Sector Commercial Banks due to lending in Primary Sectors and Social Sectors.
b. The problem of NPAs is more prevalent and serious in Public Sector Banks rather than Private Sector Banks.
c. Proactive measures and sound credit appraisal by efficient employees can help in reducing the mounting problems of NPAs.

Many of the measures taken by RBI & Government as stated above have influenced the level of NPAs however the level of NPAs is still alarming in banking sector which is really a reason to be worried about.

NEED OF THE STUDY

The problem of NPAs is not only hampering to developing countries like India but also to the advanced countries like Japan. The mounting NPAs in Indian commercial banks are major concern to the economic growth of our country and smooth flow of credit. The level of NPAs particularly in Indian Public Sector Banks is alarming. In the context of the said situation and slowdown of Indian Economy in recent years, there is an urgent need to study the management of NPAs in Banking Sectors of India.

OBJECTIVES OF THE STUDY

Our study aims to achieve the following objectives-

- To understand the concept of NPAs.
- To analyse the trends of NPAs.
- To identify the causes of NPAs.
- Measures/Management of NPAs.

RESEARCH METHODOLY

Our study is based on secondary data & informations collected from RBI Bulletin, Annual Reports of Banks, books, journals, magazines, research papers and published articles as well as news of NPAs published in Economic Times. Our study entitled "management of NPAs in Banking Sector of India" is the both descriptive and analytical rather than statistical.

ANALYSIS OF MANAGEMENT OF NPAs

Concept of NPAs

The concept of NPAs originated when RBI introduced prudential norms on the recommendations of Narashiman Committee. According to prudential norms laid down by RBI, "if interest or instalments of principal is not paid more than 180 days (from March 31, 2004, it has been decided to adopt 90 days overdue norm for identification of NPAs) it is considered as Non-performing Assets". In simple words, when loans/assets of Banks fail to generate income on due date, the assets is treated as non-performing assets.

To elaborate the concept of NPAs we have also taken into consideration the various types of Assets and NPAs as mentioned below -

Classifications of Assets-

Standard Assets- Standard Assets are those assets on which the bank receives interest as well as the principal amount of loan on regular basis from the borrowers/customers.

Substandard Assets- If an asset remains nonperforming for a period less than or equal to 12 months, then it would be considered as substandard assets.

Doubtful Assets- If an asset remains Non-performing for a period more than 12 months or remains substandard category for 12 months, it is called Doubtful Assets.

Loss of Assets- A loss of Assets is those where loss has been identified by the internal auditor of the Banks or by RBI Inspector/ External Auditor but the amount has not been written off wholly.

Types of NPAs

NPAs have been classified into two types:

Gross NPAs: Gross NPAs are the sum total of all loan assets. Gross NPAs consists Substandard, Doubtful and Loss of Assets. It reflects the quality of the loan made by Banks and it is calculated with the help of Gross NPAs ratio.

Gross NPAs Ratio = Gross NPAs/Gross Advances

Net NPAs- Net NPAs refers to those types of NPAs in which the banks have deducted the provision regarding NPAs from Gross NPAs. Net NPAs shows the actual burden of the Banks. It is calculated as under-

Net NPAs=Gross NPAs - Provision/Gross Advance- Provision.

Trends of NPAs

The trends of Gross NPAs and Net NPAs of Commercial Banks have been analysed by undermentioned table-

Gross and Net NPAs of Commercial banks (Rs. in crores)

Year	Gross NPA (Amount)	Net NPA (Amount)
2001	70861	35554
2002	68717	29692
2003	64812	24396
2004	59373	21754
2005	51097	18543
2006	50486	20101
2007	56309	24730
2008	68328	31564
2009	84698	38723
2010	97900	41700
2011	142903	65205
2012	194053	98694
2013	263372	142656
2014	323345	176093
2015	324015	175841
2016	611947	349815
2017	791790	433125

Source: Reserve bank of India, statistical tables relating to banks in India

The above table shows that trends of gross and Net NPAs of Commercial Banks from the year 2001 to 2017. The **Net NPAs** started to decline from 2001 to 2005 i.e. 35554 to 18543 respectively. The main reason of this improvement is the setting up of the Asset Reconstruction Corporation of India LTD (**ARCIL**). It has provided a major boost to banks to recover their NPAs. We can see the significant increase in Net NPAs from 2006-2017 i.e. 20101 to 433125 respectively. The significant increase in NPAs from 2006 to 2017 in Banking Sector of India is due to hardening of interest rates of banks which might have made the repayment of loans difficult for some borrowers. The intensity of incremental NPAs is mainly due to high level impaired assets in Public Sector Banks. The impaired assets of Banking Sectors have translated into a slowdown in industrial credit and restricted banks ability to meet international capital requirements. The growth in NPAs of Indian banks has largely followed a lagged cyclical pattern with regard to credit growth, the pro-cyclical behavior of the banking system, wherein asset quality can get comprised of high credit growth and this can result in the creation of NPAs for banks in the later years.

Causes of NPAs

The Banking Sector of India is facing mounting problems of NPAs more in Public Sector Banks as compared to Private Sector banks. So, it would be desirable to discuss in brief the reasons/causes by which the NPAs are rising. The causes of rising NPAs can be classified as-

A. **Internal Factors**:

i. The **diversion of funds** for expansion/modernisation/setting up new projects.
ii. **Managerial Deficiency** caused by wrong selection of Borrowers.
iii. **Business Failure** caused by inappropriate technology, over optimistic projects, outdated products or obsolescence of machinery etc.
iv. **Strain Labour Relation.**
v. **Delay in release of funds/subsidy** by the Government.
vi. **Wilful Defaults and Fraud** by borrowers.
vii. **Over-borrowing** in anticipation of demand.
viii. **Delay in Project completion and implementation.**

B. **External Factors**: In addition to Internal Factors, the NPAs are also caused by External Factors which are as follows:

i. **Recession**/Shortage of Raw Materials and Power, Natural Calamities and Price Escalation.
ii. **Sluggish Legal System**
iii. **Adverse Government Policy**/Improper Regulations/Guidelines of RBI.
iv. **Poor recovery** of Bills and delay in payment.

Measures/Management of NPAs

The trends of NPAs in Indian Banking Sector indicate variations in the absolute amount during the year 2001-2017. **The mounting NPAs is caused by unsound credit appraisal, ineffective monitoring and control, slow recovery of NPAs as well as inadequate legal provisions.** Although, various steps have been taken by the Government and RBI to recover/reduce NPAs but still stringent operation has to be done to curb the rising NPAs in Banking Sectors. It is not at all possible to bring down the level of NPA at zero, since NPAs is instantaneous repercussion of financial illness but can be narrowed down with strategic measures/management of NPAs.

The measures/management of NPAs can broadly be studied under following heads:-

A. Preventive Measures – Preventive measures prevent the standard assets to turn into substandard assets by robust appraisal system at the time sanctioning of loan and proper follow-up. This measure mainly includes-

i. Identifying/selecting genuine borrowers.
ii. Periodical visit to the borrowers enterprises for verification of stock, plant and machinery.
iii. Quarterly scrutiny of financial statements.
iv. Implementing Sound Credit appraisal system.
v. Early recognition of recovery problems of dues.
vi. Appointment of skilled, trained and dynamic Managers under credit and monitoring/recovery departments.

B. Corrective Measures- Corrective measures focus on reducing and minimizing the outstanding NPAs. These measures mainly include various recoveries or write-off measures. In this regard, measures have been taken by RBI to recover NPAs. Some of them are as follows:

i. CIBIL (Credit Information Bureau of India Limited) was incorporated in 2001 with the purpose of sharing information between Banks and leading institutions to borrow huge amount against the same assets and properties.
ii. Circulation of periodical list of wilful defaulters of Banks (outstanding credit Rs. 1 crore and above) by RBI against whom Banks have filed suits for recovery of funds.
iii. Scrutinizing and Reconstruction of Financial Assets and Enforcement of Securities Interest *Act*, 2002 (*SARFAESI Act*) to auction residential or commercial properties (of Defaulters) for recovery of loans.
iv. One time settlement sch**eme** to recover NPAs upto Rs. 10 crore.

v. Debt Recovery Tribunals (DRTs), 1993 to file suit for recovery over Rs. 10 lakh and above.

C. Measures taken by the Government

The Government has taken following measures to deal with rising NPAs in Banking Sectors of India.

i. **Appointment of Nodal Officer** in Banks for recovery at their head office for each debt recovery tribunals (DRTs).
ii. Direction to State Level Bankers Committee to be proactive in resolving the issue of NPAs.
iii. Recapitalisation of Banks by infusing adequate capitals.
iv. Implementation of insolvency and bankruptcy code 2016 for fast recovery of loans.

On the basis of the study, we have observed that SARFAESI Act, DRTs, IBC is the most effective and stringent recovery measures taken by RBI and the Government to reduce NPAs.

RECOMMENDATIONS/SUGGESTIONS

For managing and reducing NPAs in Indian Banking Sector, we have made the following recommendations/suggestions:-

i. Developing a reliable data information system.
ii. Establishing a continuous sound and monitoring and control system (based on feedback mechanism).
iii. Rigorous screening process and revision of existing credit appraisal in the light of RBI regulations.
iv. Regular follow-up with the customers to ensure non-diversion of fund.
v. Review of Loan Account at regular intervals.
vi. Adoption of One Time Settlement Scheme or Compromise settlement Scheme, Recovery Tribunals and Lok Adalats, IBCs for quick recovery of loans.
vii. Enforcement of Computerised banking system and technology in urban and rural branches to resolve the problem of NPAs quickly.
viii. Appraisal of Credit Proposals, Sanction and Disbursement of loans by skilled, trained and dynamic employees.
ix. Adoption of vertical stressed Assets management system to segregate monitoring from sanctioning roles in high value loans and entrust monitoring of these loans to specialised monitoring agencies.
x. Introduction of Forensic Audit in Banks for ascertaining the end use of funds.

Conclusion: From the above study, we come to the conclusion that the problem of NPAs is a serious issue for Banking Sector of India, as it has direct impact on the profitability, liquidity and the credit growth of banks in particular and the growth of economy as a whole. In spite of several measures taken by the Government and RBI to reduce the level of NPAs, however the level of NPAs in commercial banks is still alarming. We can reduce/manage the level of NPAs through efficient monitoring and controlling mechanism. The Bank needs to be proactive in the selection of borrowers/customers while sanctioning the loans and should be careful in appraisal of new projects. The Banks should regularly follow up the borrowers to ensure that the sanctioned amount of loan has been properly utilized. We have observed that recovery legal channels have given positive results during last two years in reduction of NPAs, Record recovery of loans and credit growth in Scheduled Commercial Banks particularly in PSBs. Existing measures have not been enough to tackle the challenging issue of NPAs in Banking Sector of India. Thus, we should also focus on better governance, developing corporate bond market, recapitalization to stimulate the banking sector, lower entry barriers and efficient debt recovery mechanism for robust banking system and managing NPAs. The level of NPAs in Indian Commercial Banks cannot be brought down at zero level but can be narrowed down with constant and effective monitoring as well as by strategic and efficient management system.

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