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Trends of non-performing assets (NPAs) in the commercial banks of India: An analysis

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Abstract

Non-Performing Assets are a major issue and challenge for banking industry. Non-performing Assets are threatening the stability and demolishing bank's profitability through a loss of interest income, write-off of the principal loan amount itself. Amongst the various desirable characteristics of a well-functioning financial system, the maintenance of a few non-performing assets (NPA) is an important one. NPAs beyond a certain level are indeed cause for concern for everyone involved because credit is essential for economic growth and NPAs affect the smooth flow of credit. The paper outlines the concept, types, causes and impact of non-performing assets in the banking context. Moreover, the NPA scenario of Indian commercial banks for the recent years has been traced.

Keywords: Non-performing assets, commercial banks, gross NPA, net NPA

Introduction

NPA is used by financial institutions that refer to loans that are in jeopardy of default. Once the borrower has failed to make interest or principle payments for 90 days, the loan is considered to be a non-performing asset. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. Troublesome pressure from the economy can lead to a sharp increase in non-performing loans and often results in massive write-downs. With a view to moving towards international best practices and to ensure greater transparency, it had been decided to adopt the '90 days' overdue' norm for identification of NPA, from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, 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 90 days in respect of a term loan,
- The account remains 'out of order' for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
- The bill remains overdue for a period of more than 90 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 purposes, and
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.
- Non submission of Stock Statements for 3 Continuous Quarters in case of Cash Credit Facility.
- No active transactions in the account (Cash Credit/Over Draft/EPC/PCFC) for more than 91days

Objectives of the study

The study will focus on following objectives:

1. To analyse causes and impact of NPA.
2. To highlight the NPA status of Indian commercial banks in the recent years.
3. To discuss the steps taken by the RBI for reducing the NPAs.

Research Methodology

The scope of the study lies in understanding the concept, types and causes of NPA.

The study involves the usage of secondary data which have been accumulated through various journals, articles, books and websites to get the overall insights of the subject matter.

Discussion & Findings

The Gross and Net NPAs outstanding and as a percentage to Advances of the Commercial Banks in the recent years is detailed in the below mentioned tables.

Table 1: Trends in Non-Performing assets-bank group wise (Amount in Rs. Billion)

Item	Public sector banks	Nationalised banks*	SBI group	Private sector banks	Old Private sector banks	New Private sector banks	Foreign banks	Scheduled commercial banks
Gross NPAs Closing balance for 2011-12	1178	696	482	187	42	145	62	1429
Opening balance for 2012-13	1178	696	482	187	42	145	62	1429
Additions during 2012-13	1198	772	425	128	41	87	41	1368
Recovered during 2012-13	648	429	219	63	30	33	24	736
Written off during 2012-13	78	17	60	42	1	40	0	120

Closing balance for 2012-13	1650	1022	627	210	52	158	79	1940
Gross NPAs as % of gross advances** 2011-12 2012-13	3.3 4.1	2.8 3.6	4.6 5.0	2.1 2.0	1.8 1.9	2.2 2.0	2.6 2.9	3.1 3.6
Net NPAs as % of net advances 2011-12 2012-13	1.5 2.0	1.4 2.0	1.8 2.0	0.5 0.5	0.6 0.8	0.4 0.4	0.6 1.0	1.3 1.7

Source: Annual accounts of banks and off-site returns
Notes: 1*: Includes IDBI Bank Ltd. 2**: Calculated taking gross NPAs from annual accounts for respective banks and gross advances from off-site returns.

In Table1, it is seen that the gross NPA ratio at the aggregate level stood at 3.6 per cent at end March 2013 up from 3.1 per cent at end-March 2012. The deterioration in asset quality was most perceptible for the SBI Group with its NPA ratio reaching a high of 5 per cent at end-March 2013. With the gross NPA ratio reaching about 3.6 per cent by end-March 2013, the nationalised banks were positioned next to the SBI Group.

Table 2: Advances and NPAs of Domestic Banks by Priority and Non-Priority Sectors* (Amount in billions)

Bank Group	**Priority Sector**			**Non-Priority Sector**			**Total**		
	Gross Advances	**Gross NPAs**	**Gross NPAs as Per Cent of Total**	**Gross Advances**	**Gross NPAs**	**Gross NPAs as Per Cent of Total**	**Gross Advances**	**Gross NPAs**	**Gross NPAs as Per Cent of Total**
Public Sector Banks									
2013	12,790	669	42.9	27,769	890	57.1	40,559	1,559	100.0
2014	15,193	792	36.5	30,712	1,375	63.5	45,905	2,167	100.0
Nationalised Banks**									
2013	8,891	405	42.2	19,170	554	57.8	28,061	959	100.0
2014	10,711	530	37.7	21,249	877	62.3	31,960	1,407	100.0
SBI Group									
2013	3,899	264	44.0	8,599	335	56.0	12,498	600	100.0
2014	4,482	261	34.4	9,463	499	65.6	13,944	760	100.0
Private Sector Banks									
2013	3,157	52	26.0	7,309	148	74.0	10,467	200	100.0
2014	3,831	61	27.0	8,287	167	73.0	13,117	227	100.0
All SCBs (Excluding Foreign Banks)									
2013	15,947	721	41.0	35,078	1,038	59.0	51,025	1,759	100.0
2014	19,024	852	35.6	38,998	1,542	64.4	58,022	2,395	100.0

Notes: 1. *: Excluding foreign banks. 2. **: Includes IDBI Bank Ltd. 3. Constituent items may not add up to the total due to rounding off.
Source: Based on off-site returns (domestic).

The Table 2 shows the NPAs of the domestic banks in the priority and the non-priority sectors in the last two years. It is seen that non-priority sector has more gross NPAs as percentage of total gross advances as compared to the priority sector.

Causes for Creation of Non-Performing Assets

There are several reasons for an account becoming NPA.

- Internal factors
- External factors

Internal factors

1) Funds borrowed for a particular purpose but not used for the said purpose.
2) Project not completed in time.
3) Poor recovery of receivables.
4) Excess capacities created on non-economic costs.
5) In-ability of the corporate to raise capital through the issue of equity or other debt instrument from capital markets.
6) Business failures.
7) Diversion of funds for expansion\modernization\setting up new projects\ helping or promoting sister concerns.
8) Wilful defaults, siphoning of funds, fraud, disputes, management disputes, mis-appropriation etc.
9) Deficiencies on the part of the banks viz. in credit appraisal, monitoring and follow-ups, delay in settlement of payments\ subsidiaries by government bodies etc.

External factors

1) Sluggish legal system -
   - Long legal tangles
   - Changes that had taken place in labour laws
   - Lack of sincere effort.
2) Scarcity of raw material, power and other resources.
3) Industrial recession.
4) Shortage of raw material, raw material\input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accidents.
5) Failures, non-payment over dues in other countries, recession in other countries, externalization problems, adverse exchange rates etc.
6) Government policies like excise duty changes, Import duty changes etc.

Impact of NPA

NPA impact the performance and profitability of banks. The most notable impact of NPA is change in banker's sentiments which may hinder credit expansion to productive purpose. Banks may incline towards more risk-free investments to avoid and reduce riskiness, which is not conducive for the growth of economy. If the level of NPAs is not controlled timely they will-

- Reduce the earning capacity of assets and badly affect the ROI.
- The cost of capital will go up.
- The assets and liability mismatch will widen.
- Higher provisioning requirement on mounting NPAs adversely affect capital adequacy ratio and banks profitability.
- The economic value additions (EVA) by banks get upset because EVA is equal to the net operating profit minus cost of capital.
- NPAs causes to decrease the value of share sometimes even below their book value in the capital market.
- NPAs affect the risk facing ability of banks.

Legal mechanisms for recovery of dues by banks

The present set-up provides an effective and expeditious mechanism to the banks and financial institutions to recover their dues. A brief synopsis of the existing mechanism in this regard is given below:-

1) *The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002* – The Act empowers Banks / Financial Institutions to recover their non-performing assets without the intervention of the Court, through acquiring and disposing of the secured assets in NPA accounts with outstanding amount of Rs. 1.00 lakh and above.
2) *Recovery of Debts Due to Banks and Financial Institutions (DRT) Act:* The Act provides setting up of Debt Recovery Tribunals (DRTs) and Debt Recovery Appellate Tribunals (DRATs) for expeditious and exclusive disposal of suits filed by banks / FIs for recovery of their dues in NPA accounts with outstanding amount of Rs. 10 lakhs and above. Government has, so far, set up 33 DRTs and 5 DRATs all over the country.
3) Lok Adalats: Section 89 of the Civil Procedure Code provides resolution of disputes through ADR methods such as Arbitration, Conciliation, Lok Adalats and Mediation. Lok Adalat mechanism offers expeditious, in-expensive and mutually acceptable way of settlement of disputes. Government has advised the public sector banks to utilize this mechanism to its fullest potential for recovery in Non-performing Assets (NPAs) cases.

Among the various channels of recovery available to banks for dealing with bad loans, the SARFAESI Act and the Debt Recovery Tribunals (DRTs) have been the most effective in terms of amount recovered.

Table 3: NPAs of SCBs Recovered through Various Channels (Amount in billions)

Year	No.	Recovery Channel	Lok Adalats	DRTs	SARFAESI Act	Total
2012-13	1	No. of cases referred	8,40,691	13,408	1,90,537	10,44,636
	2	Amount involved	66	310	681	1,058
	3	Amount recovered*	4	44	185	232
	4	3 as per cent of 2	6.1	14.1	27.1	21.9
2013-14	1	No. of cases referred	16,36,957	28,258	1,94,707	18,59,922
	2	Amount involved	232	553	946	1,731
	3	Amount recovered*	14	53	244	311
	4	3 as per cent of 2	6.2	9.5	25.8	18

Notes : 1. *: Refers to amount recovered during the given year, which could be with reference to cases referred during the given year as well as during the earlier years. 2. DRTs: Debt Recovery Tribunals.

Steps for recovery of NPAs

To improve the health of the financial sector, to reduce the NPAs, to improve asset quality of banks, and to prevent slippages, Reserve Bank of India (RBI) has issued instructions which stipulate that each bank-

- To have a Board approved loan recovery policy.
- To put in place an effective mechanism for information sharing for sanction of fresh loans/ad-hoc loans/renewal of loans to new or existing borrowers.
- is required to have a robust mechanism for early detection of signs of distress including prompt restructuring in the case of all viable accounts;
- to have a loan recovery policy which sets down the manner of recovery of dues, targeted level of reduction (period-wise), norms for permitted sacrifice/waiver, factors to be taken into account before considering waivers, decision levels, and reporting to higher authorities;
- monitoring of write-off/waiver cases;
- valuation of properties including collaterals accepted for their exposures;
- taking recourse to legal mechanisms like SARFAESI Act, 2002, DRTs and Lok Adalats.
- To review NPA accounts of Rs. 1 crore and above by Board of Directors and top 300 NPA accounts by Management Committee of the Board.

While Banks do provide for "write-offs" in their annual accounts to take into account for losses on account of not realizable NPAs, it has to be remembered that it comes at the cost of capitalization by an equivalent amount and thus affect the performance and financial health of the Bank directly in the long run. The answer lies in prudent lending, being in constant touch with the creditors, close monitoring and follow up on the timely action.

RBI measures to control NPAs in recent times

Over the last few months, RBI has brought in various reforms in order to control the growing NPAs both for the banks and the non-banking financial companies (NBFCs).

i) Increase in FDI cap for ARCs

The RBI, in order to promote the business of asset reconstruction in India, increased foreign direct investment (FDI) cap on asset reconstruction companies (ARCs) to 74% from 49% under the automatic route. It also allowed the foreign institutional investors (FIIs) to participate in the equity of the ARCs, however, the maximum shareholding by FII cannot exceed 10% of the paid up capital of the ARC.

ii) Framework for Distressed Assets

This is one such framework, through which the RBI has tried to bring in a number of changes in order to stabilise the current stressed out situation in the economy. It has concentrated more on early recognition of stressed assets as requires the banks and financial institutions to route the assets through three classes of special mention accounts-SMA (SMA-0, SMA-1 and SMA-2) before finally classifying it as a NPA. It also requires the all lenders with respect to the borrower classified under SMA-2 to form a joint lenders forum (JLF) whereby they are to formulate a corrective action plan in order to remove the stress over the asset. This framework also requires the formation of a Central Registry of Information on Large Credits (CRILC), which will be responsible to accumulate the data relating to the borrowers having aggregate fund based and non-fund based exposures worth Rs500 crier or more from the banks, non-banking financial companies- systemically important (NBFC-SIs) and NBFC-Factors. There are various other things that RBI has brought forward including the requirement of a proper credit risk management mechanism within the organisation.

iii) Central Registry of Information on Large Credits (CRILC)

The main intent of setting up this registry was to keep a record of the large borrowers and those which are under stress. The RBI requires all the banks, NBFC-SIs and NBFC-Factors to report all the data relating to the borrowers having an aggregate fund based and non-fund based exposure of Rs500 crore or more or of such borrowers who have been classified as SMA-0 in the books.

iv) Corporate debt restructuring norms for the NBFCs

Earlier, the NBFCs were not allowed to be part of the corporate debt restructuring mechanism under the corporate debt restructuring (CDR) cell, but with this notification, RBI has now allowed the NBFCs to restructure their assets under the CDR cell and made their restructuring regulations at par with that of the banks. This has created a lot of buzz in the NBFC sector and it is believed that RBI has made this move in tune with the soaring concerns over NPAs. Henceforth, the NBFCs will be able to restructure their stressed asset either through one on one arrangement with the borrowers or along with other lenders through the CDR cell. Through this notification, the RBI has brought an incentive for the NBFCs, whereby they can retain their “standard” assets in the books even after restructuring, only if it is able to implement the restructuring scheme within a period of 120 days from the date of receipt of application for restructuring by the NBFCs. This incentive may encourage the NBFCs to restructure the stressed assets and make an effort to make them good. However, this special incentive is available with the NBFCs only till 31 March, 2015. Apart from the above measures, the RBI earlier came out with several other such reforms, however; still it could not get the control over the rising NPAs.

Conclusion

In spite of so many measures, NPAs still remain to be a matter of concern for all. The reason for such an uncontrollable situation is the lack of practicality in policy making. The main check should be implemented at the initial stages of a transaction – strict credibility criteria and guidelines for implementation for the same should be formulated by the RBI itself, instead of relying on the board of the respective financial institution. This would ensure that the money lent goes to the right hands.

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