A STUDY OF NON PERFORMING ASSETS (NPA) MANAGEMENT IN INDIAN BANKING

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ABSTRACT
A well-built Indian banking sector is significant for a prosperous economy. Management of NPA is a burning issue now a day in banking sector. 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 most important operation of the banking business is recovery of lending money. For that purpose The Narasimham Committee on Financial Sector Reforms has recommended that the policy on income recognition by banks should be in conformity with the international best practices which require Classification of assets in two categories as below - Performing Assets (PA) – The asset which provides positive return annually. Non-performing Assets (NPA)- The asset which don’t perform means don’t bring any Return called NPA. The concept of Non-performing Assets (NPA) was introduced for the first time in the Narasimham Committee report was tabled in Parliament on December 17th 1991. Management of NPA is burning issue now a day in banking sector.

Keywords: NPA (Non performing Assets); PA (Performing Assets); Gross NPA; Net NPA

INTRODUCTION
NPA is a loan asset which stops to generate the income for the bank whether in the form of interest or principal repayment. The basic factor to determine whether an account is NPA or not, is the record of recovery and not the availability of security. With effect from March 31, 2004, a non-performing asset (NPA) shall be a declared as a loan or an advance where;

• Installment of principal or interest remain overdue for a period exceeding 90 days in respect of a Term Loan,
• The account remains 'out of order' for a period of more than 90 days, relating to Cash Credit or Bank Overdraft
• The bill remains unsettled for a period of more than 90 days in respect of purchased or discounted bills.
• 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 91 days.

The net non-performing assets (NPAs) of banks had gone up 51% in FY13 to RS.92825/- crores. According to a recent CRISIL report, the gross NPAs of banks are slated to increase from 3.3% in March 2013 to 4% by March 2014. The banking sector's asset quality woes further worsened in the last one year, with gross non-performing asset (GNPA) ratio inching to 4.45 per cent as on March 15 this year, as compared to 4.1 per cent in March 2014, according to the latest data released by the Reserve Bank of India (RBI).

**Types of NPA**

NPAs are classified into three categories based on the period for which the asset has remained non-performing and the realizibility of Dues.

1. **Sub Standard Assets** - In this category the account holder has not paid the installment from last 90 days and up to 1 year. Bank has made a 10% provision of funds for this category to meet the losses generated from NPA from their profit.

2. **Doubtful Assets** - A doubtful asset which has been remained NPA for a period exceeding 12 months.

3. **Loss Assets** - All the Assets which cannot be recovered are called as loss assets, after this the assets are delivered to recovery agent for the purpose of sale.

**Gross and Net NPA**

Gross NPA is advance which is consider is irrecoverable, for whom the bank has made provisions, and which is still held in bank’s book of accounts. In other words, Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI Guidelines as on Balance Sheet date. Gross NPA reflects the quality of the loans made by banks. It consists of all the nonstandard assets like as sub-standard, doubtful, and loss assets.

Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden of banks.Net NPA is obtained by deducting items like interest due but not recovered, part payment received and other income kept in suspense account from gross NPA. GNPA is often referred as an indicator reflecting the quality of asset, where a higher GNPA indicates deterioration in asset quality and vice versa.

The gross NPA and Net NPA are always expressed as a percentage of advances. The percentage of gross NPA to advance include interest suspense account where the bank is following and are deducted from gross NPA to arrive at net NPA.

\[
\text{Gross NPAs Ratio} = \frac{\text{Gross NPAs}}{\text{Gross Advances}}
\]

\[
\text{Net NPAs} = \frac{\text{Gross NPAs} – \text{Provisions}}{\text{Gross Advances} – \text{Provisions}}
\]

**LITERATURE REVIEW**

This section provides an overview of existing literature with regards to NPA Management in Indian Banking. This literature review helps me to better understanding of NPA Management.

Sharma R. (2002) in “Non-Performing Assets” stated that the burden being immense, the reduction of NPAs of the Banking sector should be treated as a national priority to make the Banking system stronger, more resilient and geared to meet the challenges of globalization. The thrust of the policies of the Government, RBI and the Banks should be on how best to tackle existing NPAs, recovery of arrears, minimizing incidence of fresh NPAs, improving asset quality and preventing deterioration of assets.
S.N. Bidani (2002) Non-performing Assets are the smoking gun threatening the very stability of Indian banks. NPAs wreck a bank’s profitability both through a loss of interest income and write-off of the principal loan amount itself. This is definitive book which tackles the subject of managing bank NPAs in it’s entirely, starring right from the stage of their identification till the recovery of dues in such accounts.

Dr. Kumar M.K., Reddy C.M. and Muktha K.C. (2004) in their article “Causes of NPAs and Remedial Measures” observed that the Bank’s bottom line improvement largely depends on reduction in NPA and preventing NPAs would also help to improve the profitability of Banks. However good the credit dispensation process may be total elimination of NPAs is not possible in banking business owing to externalities but their incidence can be minimized.

Veerakumar, K. (2012) The Indian banking sector has been facing serious problems of raising Non-Performing Assets (NPAs). Like a canker worm, NPAs have been eating the banking industries from within, since nationalization of banks in 1969. NPAs have choked off quantum of credit, restriction the recycling of funds and leads to asset-liability mismatches. It also affected profitability, liquidity and solvency position of the Indian banking sector. One of the major reasons for NPAs in the banking sector is the 'Direct Lending System' by the RBI under social banking motto of the Government, under which scheduled commercial banks are required to lend 40% of their total credit to priority sector. The banks who have advanced to the priority sector and reached the target suffocated on account of raising NPAs, since long. The priority sector NPAs have registered higher growth both in percentage and in absolute terms year after year.

OBJECTIVES
1. To understand the concept of PA (performing Asset) and non-performing assets (NPA).
2. To analyze the major causes of NPA and their significance on the generation of NPA.
3. To study the general reasons for assets to become Non-performing assets.
4. To make a comparative study of NPA’s of selected public sector banks and private sector banks.

RESEARCH METHODOLOGY
For the study, secondary data has been collected using annual report of “Reserve Bank of India” publication including Trend & Progress of banking in India”, statistical tables related to banks in India and report on currency and finance. Articles and papers relating to NPA published in different business journals, magazines, newspaper, periodicals were studied and data available on internet and other sources has also been used. The banks selected for the study are prominent banks among all banks in their respective sector and includes:

- Public Sector Bank -State bank of India (SBI) & Punjab National Bank (PNB), OBC, CANARA Bank &Vijaya Bank
- Private Sector Bank- HDFC Bank, ICICI Banks, Axis Bank, IndusInd Bank & Yes bank

NPA – Causes, Impact and Management
NPA is primarily influenced by the level of advances. The economic variables exercise influence on the relationship between the advances and NPA. During periods of economic growth, the advances grew at a faster rate than the growth of NPA, while in a period of economic recession; the growth rate of advances will be comparatively less than the growth rate of NPA. Any NPA Management policy has to identify the causes for the occurrence of NPAs. These causes may be attributed to either the borrower or the bank itself or may be due to factors beyond the control of both. Again these may be internal or external for either the borrower or the bank.
External causes: Natural calamities and climatic conditions, Recession, changes in Government policies changes in economic conditions, Industry related problems, Impact of liberalization on industries, Technical problems

Internal causes: Internal defaulters, Faculty projects, Most of the project reports are ground realities, proper linkages, product pricing etc. Some approach for the “heck” of starting a venture, with poor knowledge of product risks, over depended on poorly paid killed workers and technicians, Building up pressure for sanctions, Inept handling by banker’s lack of professionalism and appraisal standards, Non-observance of system, procedures and non-insistence of collaterals etc, Lack of post sanction monitoring, unchecked diversions.

There is also some other less transparent reasons why NPAs are on rise. For one, the process of Non-Performing asset disposable is riddled with legal impediments and delay. Secondly, highly connected corporate debtors have been known to political pressure to get banks to waive their dues or restructure terms in their favor. In election time political parties make populist promises-such as the offer of easy credit to the small scale and rural sectors which may not yield the expected result – which commercial banks forced to honor.

**Impact of Rising NPAs**

Rising NPAs not only affects profitability but also the liquidity, so the below point is summarized as impact of rising NPAs-

- Return on Assets- NPAs reduces earning capacity of the asset and as a result of this return on asset gets affected.
- Current profit- The current profit is reduced, as banks have to make provision for NPA.
- Cost of capital- for measuring performance towards shareholders value creation, cumulative loan loss provisions on NPAs s considered as capital. Hence, it increases cost of capital.
- Incurrence of additional cost - Banks at times have to borrow at high cost to fulfill their commitment/obligations, which increases the cost of funds.
- 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.
- Capital Adequacy Ratio- NPA”s carry risk weight of 100% (to the extent it is uncovered). Therefore they block capital for maintaining Capital adequacy. As NPA”s do not earn any income, they are adversely affecting “Capital Adequacy Ratio” of the bank.
- Public Image- The high level of non-performing assets also affects the image of the bank in the public. The credit rating of the bank also affected due to high NPA and Consequently business prospects in the country and abroad.
- Involvement of Management- Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now days, banks have special employees to deal and handle NPAs, which is additional cost to the bank.

**NPA Management**

Effective NPA Management has become very vital in view of the multifarious impact NPAs have on profitability. No income accrues from NPAs. Provisioning eats into the profit made from other operations. Effective NPA Management is a real challenge to day and the entire staff members need to be sensitized to the urgency of task on hand. Management of NPA is essential for bank’s survival and
growth. Credit risk is inherent in banking. It should be controlled through prudent risk management mechanisms, credit appraisal and follow-up.

To manage NPA effectively, both proactive and curative measures are required. Proactive measures implies efficient loan appraisal and its management, while curative measures focus on realizing NPA accounts using minimum possible efforts. At the pre-disbursement stage, appraisal techniques of bank need to be sharpened. All technical, economic, commercial, organizational and financial aspects of the project need to be assessed realistically.

NPA Management measures can be broadly classified into

1. Non-legal measures, and
2. Legal measures.

The various measures under this two head are detailed below:

**Non – Legal Measures**

- Preparation of ‘know-your client’ profile.
- Follow up of Potential NPA
- Review of NPA account
- Allotment of NPA account to staff
- Appointment of professional Recovery Agents
- Circulation of list of defaulters
- Recovery through Recovery Branches.
- Up gradation of NPA
- Identification of watch-list/special category accounts
- Credit Rating System
- Recovery of written-off cases

**Legal Measures**

- Recovery through Judicial process (Filing of suit)
- Execution of decreed cases
- Debt Recovery Tribunals (DRT) - DRT are empowered to attach the property of defaulter’s dependents before the delivery of judgment. Disobedience of Tribunal’s order attracts penalties.
- Securitization and Reconstruction of Financial assets and Enforceability of security interest Act 2002 (SARFAESI)
- Asset Reconstruction Companies –ARC specialize in recovery and liquidation of assets, Banks which wish to clean their NPAs to an ARC at a discounted value, after which it is the ARC responsibility to recover the outstanding dues from the borrowers directly.
- Other legal measures
Comparison of GNPA and NNPA Ratio

Table 1. Selected Public Sector Bank (Mar-15)

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Name</th>
<th>Gross NPA %</th>
<th>Net NPA %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>SBI</td>
<td>4.25</td>
<td>2.12</td>
</tr>
<tr>
<td>2</td>
<td>PNB</td>
<td>6.55</td>
<td>4.06</td>
</tr>
<tr>
<td>3</td>
<td>OBC</td>
<td>5.18</td>
<td>3.34</td>
</tr>
<tr>
<td>4</td>
<td>CANARA BANK</td>
<td>3.89</td>
<td>2.65</td>
</tr>
<tr>
<td>5</td>
<td>VIJAYA BANK</td>
<td>2.78</td>
<td>1.92</td>
</tr>
</tbody>
</table>

Table 2. Selected Private Sector Bank (Mar-15)

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Name</th>
<th>Gross NPA %</th>
<th>Net NPA %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>HDFC BANK</td>
<td>0.9</td>
<td>0.2</td>
</tr>
<tr>
<td>2</td>
<td>ICICI BANK</td>
<td>3.78</td>
<td>1.61</td>
</tr>
<tr>
<td>3</td>
<td>AXIS BANK</td>
<td>1.34</td>
<td>0.44</td>
</tr>
<tr>
<td>4</td>
<td>INDUSIND BANK</td>
<td>0.81</td>
<td>0.31</td>
</tr>
<tr>
<td>5</td>
<td>YES BANK</td>
<td>0.41</td>
<td>0.12</td>
</tr>
</tbody>
</table>

According to Table-1 & Table-2 it can be analyzed by comparing the few public and private sector bank of Gross NPA & Net NPA %, Public Sector banks have highest NPA, while private banks dominate with least NPA.

In between above selected public sectors bank, PNB having highest NPA both in terms of Gross & Net NPA %.

In between private sector Bank, ICICI bank having highest NPA both in terms of Gross & Net NPA %.

Table 3. Gross NPA % of selected Public Sector Bank

<table>
<thead>
<tr>
<th>Year</th>
<th>SBI</th>
<th>PNB</th>
<th>OBC</th>
<th>VIJAYA BANK</th>
<th>CANARA BANK</th>
<th>AVG.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>3.28</td>
<td>1.79</td>
<td>3.99</td>
<td>2.41</td>
<td>2.49</td>
<td>2.79</td>
</tr>
<tr>
<td>2012</td>
<td>4.44</td>
<td>2.93</td>
<td>4.33</td>
<td>2.68</td>
<td>2.67</td>
<td>3.41</td>
</tr>
<tr>
<td>2013</td>
<td>4.75</td>
<td>4.27</td>
<td>4.74</td>
<td>2.85</td>
<td>2.92</td>
<td>3.91</td>
</tr>
<tr>
<td>2014</td>
<td>4.95</td>
<td>5.25</td>
<td>5.43</td>
<td>2.92</td>
<td>3.35</td>
<td>4.38</td>
</tr>
<tr>
<td>2015</td>
<td>4.25</td>
<td>6.55</td>
<td>5.18</td>
<td>2.78</td>
<td>3.89</td>
<td>4.53</td>
</tr>
<tr>
<td>AVG.</td>
<td>4.33</td>
<td>4.16</td>
<td>4.73</td>
<td>2.73</td>
<td>3.06</td>
<td></td>
</tr>
</tbody>
</table>

Table 4. Net NPA % of selected Public Sector Bank

<table>
<thead>
<tr>
<th>Year</th>
<th>SBI</th>
<th>PNB</th>
<th>OBC</th>
<th>VIJAYA BANK</th>
<th>CANARA BANK</th>
<th>AVG.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>1.63</td>
<td>0.65</td>
<td>2.82</td>
<td>1.55</td>
<td>1.98</td>
<td>1.73</td>
</tr>
<tr>
<td>2012</td>
<td>1.82</td>
<td>1.52</td>
<td>3.11</td>
<td>1.77</td>
<td>2.03</td>
<td>2.05</td>
</tr>
<tr>
<td>2013</td>
<td>2.1</td>
<td>2.35</td>
<td>3.29</td>
<td>1.88</td>
<td>2.31</td>
<td>2.39</td>
</tr>
<tr>
<td>2014</td>
<td>2.57</td>
<td>2.85</td>
<td>3.68</td>
<td>1.89</td>
<td>2.42</td>
<td>2.68</td>
</tr>
<tr>
<td>2015</td>
<td>2.12</td>
<td>4.06</td>
<td>3.34</td>
<td>1.92</td>
<td>2.65</td>
<td>2.82</td>
</tr>
<tr>
<td>AVG.</td>
<td>2.05</td>
<td>2.29</td>
<td>3.25</td>
<td>1.80</td>
<td>2.28</td>
<td></td>
</tr>
</tbody>
</table>

From the above table-3 & Table-4, it can clearly observed that highest average Gross NPA & highest Net NPA found in OBC 4.73 % & 3.25 % and lowest ratio found in vijayabank. In all the selected public sector banks during the period of study from 2011 to 2015 it is found that GNPA ratio shows increasing year by year till 2014 but in 2015, SBI, OBC &Vijaya bank decreases GNPA ratio compare to last year, but on yearly average basis it shows increasing trend both in case of GNPA & NNPA %.
From the above table-5 & Table-6, it can clearly observed that highest average Gross NPA & highest Net NPA found in ICICI Bank 4.73 % & 3.25 % respectively and lowest ratio found in Yes bank. In all the selected private sector banks during the period of study from 2011 to 2015 it is found that NNPA ratio shows increasing year by year .

Rising NPAs is making public sector banks unfit for private Provident Fund deposits. Surging Non-Performing Assets (NPAs) have rendered public sector banks such as State of India (SBI), Punjab National Bank (PNB) and Canara Bank unfit to take deposits from non-government Provident Funds (PF). As per the current rules governing investments by PFs, non-government Provident Funds (PF) are barred from being deposited in a commercial bank in case the NPAs of that bank exceed 2% of net advances. The Indian Banks’ Association (IBA) has requested the Union Finance Ministry to relax the norms pertaining to deposits by non-government provident funds and gratuity funds in scheduled commercial banks.

Conditions banks are required to meet for taking PFs deposits:

- Continuous profitability for immediately preceding three years
- Maintain minimum capital adequacy of 9%
- Have net NPAs of not more than 2% of net advances

Maintain minimum net worth of not less than Rs-200 crores.

**Current Scenario of NPA**

The banking sector’s asset quality woes further worsened in the last one year, with gross non-performing asset (GNPA) ratio inching to 4.45 per cent as on March 15 this year, as compared to 4.1 per cent in March 2014, according to the latest data released by the Reserve Bank of India (RBI). Stressed assets ratio, which is GNPA plus restructured standard advances for the system, stood at 10.9 per cent, as at the end of March, 2015 as compared to 10 per cent in March, 2014 and 10.7 per cent in September 2014.

GNPAs for public sector banks as on March 2015 stood at 5.17 per cent, while the stressed assets ratio stood at 13.2 per cent, which is nearly 230 bps more than that for the system.
According to the latest data released by Mundra, (Deputy Governor of RBI) the capital adequacy ratio of the banking system has been steadily declining and at the end of March 2015, it stood at 12.70 per cent as against 13.01 per cent in March 2014.

CONCLUSION

The Indian banking sector has undergone significant transformations during post-liberalization period. Though, the measures taken showed significant improvement in the NPA management, the banking sector still holds sizeable NPA in their balance sheet. The recession pressures have put significant stress on the quality of the loan portfolio. The public sector banks hold more than 75% of total advances in Indian banking sector. Therefore, any deterioration in asset quality of public sector banks has significant impact on the performance of Indian banking sector.

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.

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.

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