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Non-Performing Asset

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Abstract

A Non-performing asset is defined as a credit facility in which the interest and installment of principal due of predetermined period. This paper attempt is made to highlight the Non performing asset, classification of NPA, type of NPA, symptoms of NPA, preventive measurement for NTA.

Introduction

Non-Performing Asset means an assets or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset in accordance with the direction or guidelines relating to assets classification issued by RBI. In other words, Non-Performing Assets is credit facility in respect of which the interest and / or installment of Sprincipal has remained 'past due' for a specified period of time. In simple terms, asset is tagged as non performing asset when it ceases to generate income for the lender.

Research design

Research is descriptive in nature. Data and information collected from various sites, reports and publications.

Asset Classification

Banks are required to classify nonperforming assets further into the following three categories based on the period for which the asset has remained nonperforming and the reliability of the dues:

i. Substandard Assets
ii. Doubtful Assets
iii. Loss Assets

Substandard 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 months. In such cases, the current net worth of

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the borrower/ guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full. In other words, such an asset will have well defined credit weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

Doubtful Assets

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.

Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is 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.

Types Of Non-Performing Assets

There are two types of NPA

i. Gross NPA

ii. Net NPA

Gross NPA

Gross NPA are the sum total of all loans assets that are classified as NPA's as RBI guidelines as on Balance sheet date. Gross NPA reflects the quality of the loans made by banks. It consists of all the non standard assets like sub-standard, doubtful, loss assets. It can be calculated with the help of following ratio:-

Gross NPA's Ratio = Gross NPA's **/** Gross Advances

Net NPA

Net NPA are those type of NPA's in which the bank has deducted the provision regarding NPA's. Net NPA shows the actual burden of banks. In India, banks balance sheet contain a huge amount of NPA's and the process of recovery and write off loans is very time consuming, the provisions the banks have to make against the NPA's according to the guidelines of RBI. It can be calculated as

Net NPA's = Gross NPA-Provisions / Gross Advances-Provisions

REASONS FOR NPA's

An account becoming NPA's due to internal and external factors

Internal Factors

i. Funds borrowed for a particular purpose but not use for the said purpose.
ii. Project not completed in time.
iii. Poor recovery of receivables.
iv. Excess capacities created on non economic cost
v. Business failure.
vi. Willful defaults, siphoning of funds, fraud, disputes, management disputes, misappropriation.
vii. Wrong selection of borrowers.
viii. Non – inspection of units.

External Factors

i. Sluggish legal system i.e long legal tangles, changes that had taken place in labor laws and lack of sincere effort.
ii. Scarcity of raw material, power and other recourses.
iii. Industrial recession.
iv. Govt. policies like excise duty, import duty changes.
v. Fast changing technology.
vi. Changes related to banking amendment act.
vii. Taxation laws.

Impact Of Non –Performing Assets

The problems of NPA's in Indian banking system is one of the foremost and the most formidable problem. The non recovery of loans effects not only further availability of the banks.

Profitability

NPA's put detrimental impact on the profitability as bank stop to earn on one hand and attract higher provisioning compared to standard assets on the other hand. Bank are providing around 25% to 30% additional provision on incremental NPA's which has direct bearing on the profitability of the banks.

Credit Contraction

The increased in NPA's put pressure on the recycling of funds and reduce ability of banks for lending more and thus result in lesser interest income.

Liability Management

In the light of high NPA's banks tends to lower interest rate on deposits and likely to levy higher interest rate on advances. 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 weight 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.

Shareholder's Confidence

Normally shareholders are interested to enhance value of their investment though higher dividends and market capitalization which is possible only when the bank earned significant profit. The increased NPA level is likely to have adverse impact on the bank business as well as profitability there by the shareholders doesn't receive a market return on their capital.

Public Confidence

Creditability of banking system is also affected greatly due to higher NPA's because it shakes the confidence of general public in the soundness of the banking system. The increased incidence of NPA's not only affects the performance of the bank but also the confidence of public.

TOP 5 LEADING SECTORS IN NPA's

NUMBER	SECTOR	PERCENTAGE %
1	Agriculture	4.7
2	Construction	4.0
3	Cement	2.7
4	Infrastructure	1.5
5	Iron & Steel	1.0

Source:- Financial Stability report June 2013

Symptoms of NPA:

There are four symptoms by which one can recognize a Performing Asset turning in to Non Performing Asset.

1) Financial

2) Operational and Physical

3) Attitudinal Changes

4) Other

Financial

* Non-payment of the very first installment in case of term loan.
* Bouncing of cheques due to insufficient balance in the accounts.
* Irregularity in installment.
* Irregularity of operations in the accounts.
* Unpaid overdue bills
* Declining Current Ratio.
* Payment which does not cover the interest and principal amount of that installment.
* While monitoring the accounts it is found that partial amount is diverted to sister concern or parent company.

Operational and Physical

* If information is received that the borrower has either initiated the process of winding up or are not doing the business.
* Overdue receivables.
* Stock statement not submitted on time.
* External non-controllable factor like natural calamities in the city where borrower conduct his business.
* Nonpayment of wages.

Attitudinal Changes

* Use for personal comfort, stocks and shares by borrower.
* Avoidance of contact with bank.
* Problem between partners.

Others

* Changes in Government policies.
* Death of borrower.
* Competition in the market.

Preventive Measurement for NPA

1) Early Recognition of the Problem:

Invariably, by the time banks start their efforts to get involved in a revival process, it too late to retrieve the situation- both in terms of rehabilitation of the project and recovery of bank s dues.

2) Identifying Borrowers with genuine intent:

Identifying borrowers with genuine intent from those who are non- serious with no commitment or stake in revival is a challenge confronting bankers. Here the role of frontline officials at the branch level is paramount as they are the ones who have intelligent inputs with regard to promoters sincerity, and capability to achieve turnaround.

3) Timeliness & Adequacy of response:

Longer the delay in response, grater the injury to the account and the asset. Time is a crucial element in any restructuring or rehabilitation activity. The response decided on the basis of techno-economic study and promoter s commitment, has to be adequate in terms of extend of additional funding and relaxations etc. Under the restructuring exercise. The package of assistance may be flexible and bank may look at the exit option.

4) Focus on Cash flows:

While financing, at the time of restructuring the banks may not be guided by the conventional fund flow analysis only, which could yield a potentially misleading picture. Appraisal for fresh credit requirements may be done by analyzing funds flow in conjunction with the Cash Flow rather than only on the basis of Funds Flow.

5) Management Effectiveness:

The general perception among borrower is that it is lack of finance that leads to sickness and NPAs. But this may not be the case all the time. Management effectiveness in tackling adverse business conditions is a very important aspect that affects a borrowing unit s fortunes. A bank may commit additional finance to angling unit only after basic viability of the enterprise also in the context of quality of management is examined and confirmed.

6) Multiple Financing:

During the exercise for assessment of viability and restructuring, a Pragmatic and unified approach by all the lending banks / FIs as also sharing of all relevant information on the borrower would go a long way toward overall success of rehabilitation exercise, given the probability of success/failure.

Conclussion

The Non Performing Assets is one of the biggest problems that the banks are facing today. The NPA's destroy the current profit, interest income and smooth functioning of the banks. Banks also redistribute the loss to other borrowers by charging higher interest rate, lower deposit rate and higher landing rates. If the proper management of NPA's is not undertaken it would hamper the business of banks. Banks identify the NPA's symptoms and taking preventive actions regarding the NPA's. RBI also ensures that NPA's reduces as far as possible. Right steps, timely and concerted actions and a revival of the Indian economy will put a lead on NPA’s. Prevention however has to become a priority than mere cure.

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