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AN ANALYSIS OF NON PERFORMING ASSETS IN CHALLENGING PHASE OF INDIAN BANKING INDUSTRY

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ABSTRACT

Non Performing Assets (NPA) has become a big challenge for banking industry. Growth of Indian banking industry was highest among all industries but increasing NPA is one of the big hurdles in growth. NPAs reflect the working performance and efficiency of banks. A high level of NPAs suggests high probability of a large number of credit defaults that adversely affect the profitability and net-worth of banks and also erodes the value of the asset. The NPA growth involves the necessity of provisions, which reduces the overall profits and shareholders' value. The issue of Non Performing Assets has been discussed at length for financial system all over the world. Existence of Non Performing Assets in the banks not only affects the banks performance, but also the whole economy. NPA reflects the state of health of the industry and trade in country. NPA directly affect the profitability and cost of fund of banks. Increasing of NPA reduces the profit of banks, RBI continuously trying to reduce the losses of banks by giving by amending the norms of credit analysis of customers, giving standards/norms i.e. Basel I/II/III . The paper attempts to give basics of NPA and analyze aggregate changes in NPA of different banks' groups. The paper has also put the important views and analysis based suggestions of some valuable researches done in this area.

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INTRODUCTION

After liberalization all banks have got liberty as for as loans and advances are concern. India is developing country and banks and financial institutions contribute much in the growth of the country. Incomes of individuals are increasing very fast in India and saving always grows faster than income. Capital formation and flow of funds boost the banking and financial institutions. A period of last 10 years the growth of banking industry were average approximately 27 percent. The primary function of banks is totally depend on savings and incomes of individuals. To lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., earlier banks were not very much particular about customer's profiles in recent times the banks have become very much cautious and standardized the norms in extending loans. Loans and advances have grown very faster rate and mounting non-performing assets (NPAs) as well. In general term, NPA is defined as a loan asset, which has ceased to generate any income for a bank whether in the form of interest or principal repayment. It not only adversely affects the profitability of banks by provisioning in the profit and loss account, but NPA carrying cost is also increased which results in excess & avoidable management efforts to manage it. Apart from this, a high level of NPA also puts strain on a bank's net worth because banks are under pressure to maintain a desired level of Capital Adequacy according to Basil norms and in the absence of comfortable profit level, banks eventually look towards their internal financial strength to fulfil the norms thereby slowly eroding the net worth.

Indian Banking has seen many changes in the last decade like imposition of prudential standards, greater competition among banks, entry of new private banks, etc. One might say merge the weak banks to form bigger ones. Cut the flab from the huge workforce. As evidence indicate that large numbers of bank employees may be retrenched or given a golden handshake due to high level of NPA availability in the Banks account - a huge percentage of these NPA come from willful defaulters who get bank loans through the political pressure. They squander public money and someone else pays for it with their jobs.

As far as recovery of debts is concern it is reflected through the formula calculated as the doubtful and substandard loans are divided by Net advances expressed as percentage of net advances. This formula is calculated on national level and is applicable at district level as well.
After the implementation of LPG policy in the banks, RBI has also taken necessary step to solve the problem of high level of NPA in the banks mainly RBI has done regulatory changes in the credit management. One of the major change is that as per **the prudential norms suggested by the Reserve Bank of India (RBI), a bank cannot book interest on an NPA on accrual basis.** In other words, such interests can be booked only when it has been actually received. Therefore, Assets are classified into following four categories:

1. Standard Assets
2. Sub-standard Assets
3. Doubtful Assets
4. Loss Assets

Standard Assets:

In technical sence, Standard assets are the ones in which the bank is receiving interest as well as the principal amount of the loan regularly from the customer. Here it is also very important that in this case the arrears of interest and the principal amount of loan do not exceed 90 days at the end of financial year. If asset fails to be in category of standard asset that is amount due more than 90 days then it is NPA and NPAs are further need to classify in sub categories.

Provisioning Norms:

- From the year ending 31.03.2000, the banks should make a general provision of a minimum of 0.40 percent on standard assets on global loan portfolio basis.
- The provisions on standard assets should not be reckoned for arriving at net NPAs.
- The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions - Others' in Schedule 5 of the balance sheet.

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained *non-performing* and the *reasonability* of the dues:

1) Sub-standard Assets
2) Doubtful Assets
3) Loss Assets

Sub-standard 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 month. The following features are exhibited by substandard assets: the current net worth of the borrowers / guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full; and the asset has 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

A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, 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. With effect from March 31, 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months.

Provisioning Norms:

- 100 percent of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis.
- In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 20 percent to 50 percent of the secured portion depending upon the period for which the asset has remained doubtful.

Additional provisioning consequent upon the change in the definition of doubtful assets effective from March 31, 2003 has to be made in phases as under:

i). As on31.03.2003, 50 percent of the additional provisioning requirement on the assets which became doubtful on account of new norm of 18 months for transition from sub-standard asset to doubtful category.

ii). As on 31.03.2002, balance of the provisions not made during the previous year, in addition to the provisions needed, as on 31.03.2002.

- Banks are permitted to phase the additional provisioning consequent upon the reduction in the transition period from substandard to doubtful asset from 18 to 12 months over a four year period commencing from the year ending March 31, 2005, with a minimum of 20 % each year.

Loss Assets

A loss asset is one which 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. Also, these assets would have been identified as „loss assets" by the bank or internal or external auditors or RBI inspection but the amount would not have been written off wholly.

Provisioning Norms:

The entire asset should be written off. If the assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

Types of NPA

1. Gross NPA 2. Net NPA

Gross NPA

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. It can be calculated with the help of following ratio:

Gross NPAs Ratio = Gross NPAs / Gross Advances

Net NPA

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. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high. It can be calculated by following:

Net NPAs = Gross NPAs – Provisions / Gross Advances - Provisions

The following are some probable reasons for an assets (Loans and Advances) becoming Non Performing Assets:

1) Funds borrowed for a particular purpose but not use 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, delaying settlement of payments\ subsidiaries by government bodies etc.,

REVIEW OF LITERATURE

A Profile of Banks 2008-09 (Reserve Bank of India)

The Report consist the performance and progress of all banks at individual level and industry as whole. The data from 04-05 to 08-09 has been taken for analysis. Performance of bank has been analyze by considering following ratio: Business per employee, Profit per employee, Capital and Reserves & surplus, Deposits Investments, Advances Interest income, Other income, Interest expended, operating expenses, Cost of Funds (CoF), Return on advances adjusted to (CoF), Wages as % to total expenses, Return on Assets, CRAR , Net NPA ratio. The report also comments on service quality and customer satisfaction.

Management of Non-Performing Assets in Indian Public Sector Banks with special reference to Jharkhand (2007) Santanu Das

It had taken a state specific research in the banking sector. Researcher rightly points to the fact that Expansion of credit is a must for a country like India. But as mentioned above, high credit growth may lead to high NPAs. Policymakers, therefore, face the dilemma as to how to minimize such risks that arise from dilution in credit quality, while still allowing bank lending to contribute to higher growth and efficiency."Challenges of NPA to PSBs in India." (2008) *Sachin Nanda*

The research has been found that the Public Sector Banks are facing today problem of Non Performing Assets . If the proper management of the NPAs is not undertaken it would hamper the business of the banks. The NPAs would destroy the current profit, interest income due to large provisions of the NPAs, and would affect the smooth functioning of the recycling of the funds.

"*Would its Past Reflect its Future Performance: Indian Banks?" (2008)Gurcharan S. Pritam Singh and Dr. Susila Munisamy*

This paper investigates the technical efficiency and productivity of the Indian banking sector over the period spanning 2002 to 2006 using data envelopment analysis (DEA). The empirical findings indicate a wide diversity of efficiency and productivity exists among Indian banks. Productivity growth has been found close to eight percent over a period of five year. This is because of use of technology. The foreign banking group is found to be more productive as compared with nationalized and private banking groups. The research suggested that Indian banks should improve their performance in all respect and use technology.

Impact of new Private Sector banks on State Bank of India (Special reference to Madhya Pradesh (2007) Dhade Aruna.

The study examines the parameters which new generation Private Sector banks have influences on state bank of India. Emphasis has been placed on exploring and identifying the issues of competition for banking professionals in general and State Bank of India in particular. The research analysed the financial data with the help of Ratio Analysis. Deposits, Advances, Investment, Income, Expenses, total assets, NPA, Profitability have been considered as variable.

Findings of research are, there is no significant impact on Return on assets, profit margin ratio, and Interest margin ratio.

Deposit and Advance have also not been affected. "Comparative analysis of private and Public Sector's NPA" (2007) Soni Jigar j.

The research pointed out that there is a huge difference in the public and Private Sector bank's NPA and their handling of the same. He also concluded that Public Sector bank's average NPA is lesser than the average NPA of Private Sector banks. Profitability and Productivity in Indian

Banks: A Comparative Study: (2007) Mittal Manish and Dhade Aruna

This paper compares various categories of banks on their productivity and profitability. While there is no remarkable difference in the spread ratio, there is a significant difference in Burden ratio among the Public Sector and Private Sector & Foreign banks. The key to profitability for the Public Sector banks is increased productivity. Those Public Sector banks that have been able to increase the productivity found themselves at par with the Private Sector banks.

Report on Trend and Progress of Banking in India 2007-08

The Report consists of detail of banking industry, performance of grouped and individual banks in all respect. Mainly it highlighted Policy Developments in Commercial Banking, Operations and Performance of Commercial Banks in all aspect like, deposit advances, profitability, NPA, Assets quality, liquidity management, Earning, Capital Adequacy, Service quality etc.The report is also concentrated on Developments in Co-operative Banking, Micro Finance Retail Banking, Performance of Non-Banking Financial Institutions on their Financial Stability and Perspectives.

A comparative study of performance of Public Sector banks and Private Sector banks (with special reference to Indore district): (2006)Jhawar Ashok

The researcher used primary and secondary data to compare the performance of Public and Private banks working in Indore district. Aggregate data of public and Private Sector banks group has been used for analysis. A Questionnaire has been administrated to assess the customer satisfaction. Deposits, Advances and Profitability of banks have been used for quantitative analysis and functions of banks, Branch mechanism, Employees related information, customer satisfaction etc. used for qualitative analysis. It has been found that the growth of Private Sector banks was much faster than Public Sector banks in respect of deposits while the growth of advances of Public Sector banks was better than Private Sector banks during sample period. It has also been observed that growth of profit of Public Sector banks was much better than that of Private Sector banks. The Private Sector banks were using technology and able to provide better services to their customers in sampled period.

Banking Sector Developments in India 1980-2005: What the Annual Accounts Speak? (2006) Ramashastri A.S. and Achamma Samuel

This paper is an attempt to study the trends in important banking indicators form the 25-years period from 1980 to 2005. Analyzing the data from balance sheets of banks, the paper draws some important conclusions for the banking sector as a whole as well as for different bank groups. Across the bank groups, there has been a significant reduction in the non-performing assets (NPAs). The share of non-interest income in the total income has been increasing across the different bank groups. This is a welcome trend as it may reduce the risks arising out of the sole dependency on interest as the source of income. Wages as a percentage of operating expenses of Public Sector banks is more than 60 percent. This situations possibly calls for more appropriate and pragmatic human resource policies and proper manpower planning for the future of these banks.

Banks in the Private Sector both foreign and domestic, however, have reduced their wage components in the operating expenses and are spending more for other business boosting measures like image building, software development etc. “Would its Past Reflect its Future Performance: Indian Banks? *A Comparative Study of Domestic and Foreign Bank Performance in Thailand (2006).*

OBJECTIVE OF THE STUDY

To analyze and compare Non –Performing Assets of different banks’ groups and their efficiency in terms of managing NPA in challenging phase. The research is based on secondary data obtained from RBI, IBA and some researches have already been done in the same fields. Data has been taken for the period 2005-2013. The period is considered for the research because of RBI issued new guideline for management and administrates the NPA. Ratios, growth, graphs and charts have been used for analysis purpose.

Bank Groups	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Public Sector Bank	48405	42105	38968	40452	45156	57301	74,664	117,262	164462
Private Sector Bank	8546	7720	9255	12997	16863	17384	18242	18768	21069
Foreign Bank	2183	1919	2263	2872	6807	7128	5069	6297	7977
TOTAL	59134	51744	50486	56321	68826	81813	97,975	142,327	193508

Net NPA Rs. in Crors

Bank Groups	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Public Sector Bank	16903	14384	15325	17836	21033	4425	36055	59162	89950
Private Sector Bank	4094	3141	4028	5647	7395	2166	4432	4401	5994
Foreign Bank	648	806	927	1254	2973	757	1283	1411	2661
TOTAL	21645	18331	20280	24737	31401	7348	41770	64974	98605

ADVANCES Rs. in Crors

Bank Groups	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Public Sector Bank	856062	1106347	1440146	1797401	2260155	2519331	5292006	6039620	6967961
Private Sector Bank	220542	309578	414751	518402	568764	584591	1398217	1693128	1989804
Foreign Bank	75318	97556	126339	161959	165415	167439	493036	588179	621562
TOTAL	1151922	1513481	1981236	2477762	2994334	3271361	7183259	8320927	9579327

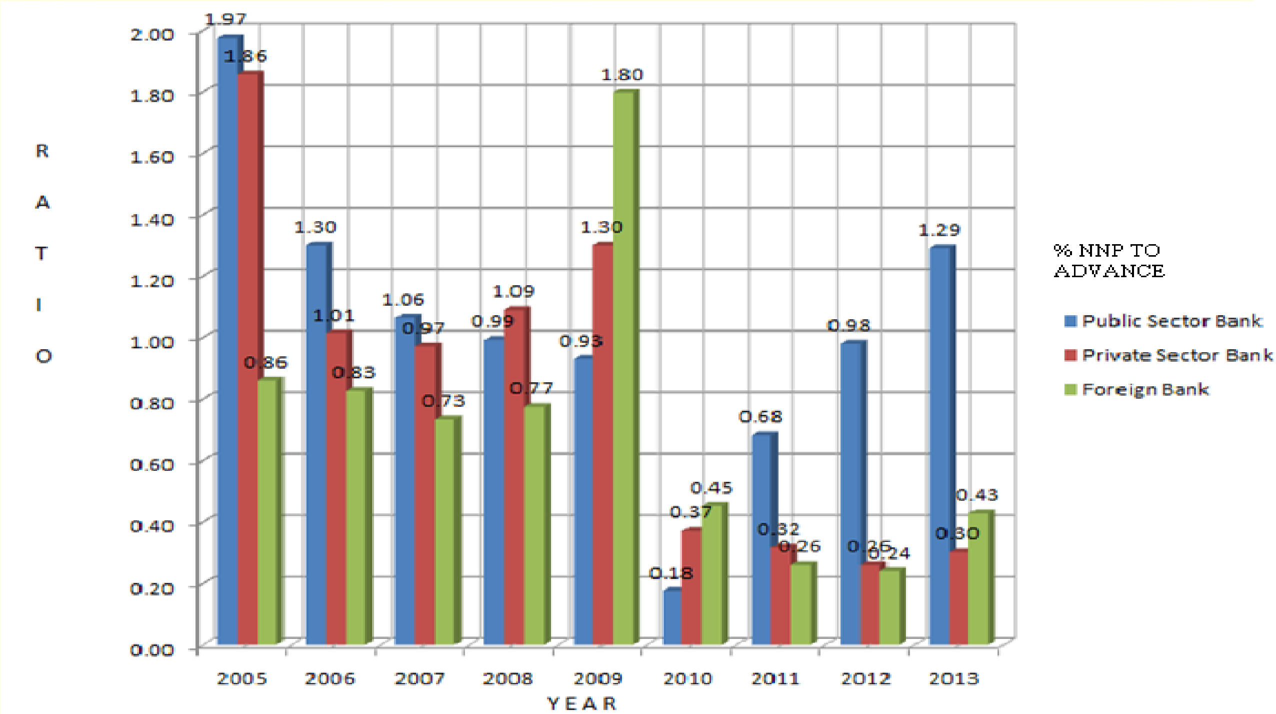
Percentage of Gross NPA to Advance

Bank Groups	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Public Sector Bank	5.65	3.81	2.71	2.25	2	2.27	1.41	1.94	2.36
Private Sector Bank	3.87	2.49	2.23	2.51	2.96	2.97	1.3	1.11	1.06
Foreign Bank	2.9	1.97	1.79	1.77	4.12	4.26	1.03	1.07	1.28
TOTAL	5.13	3.42	2.55	2.27	2.3	2.5	1.36	1.71	2.02

Percentage of NPA to Advance

Gross NPA **Rs in Crors**

Bank Groups	2005	2006	2007	2008	2009	2010	2011	2012	2013
Public Sector Bank	1.97	1.3	1.06	0.99	0.93	0.18	0.68	0.98	1.29
Private Sector Bank	1.86	1.01	0.97	1.09	1.3	0.37	0.32	0.26	0.3
Foreign Bank	0.86	0.83	0.73	0.77	1.8	0.45	0.26	0.24	0.43
TOTAL	1.879	1.211	1.024	0.998	1.049	0.225	0.581	0.781	1.029



ANALYSIS AND INTERPRETATION

The measure of non-performing assets helps to assess the efficiency in allocation of resources made by banks to productive sectors. Absolute growth of gross NPA of banking industry has been recorded 16.39% with average of 3.28%. Public Sector banks managed their NPA efficiently in2004-05 to 2008-09. Negative growth has been seen in the analysis period. Higher growth has been in Private Sector banks and foreign banks.

Net NPA analysis has also been showing the same performance of different groups. Foreign banks group's Net NPA is 71.76% with highest average growth, 16.13% of Private Sector and with 4.89% Public Sector banks. The trend of improvement in the assets quality of banks continued during the period.

The reasons are that the Indian banks could recover a higher amount of NPA during the period. Among the various channels of recovery available to banks for dealing with bad loans, the

SAFAESI Act and Debt Recovery tribunals (DRTs) have been most effective in term of amount recovered (report on trend and progress of banks 08-09).

During last three to four year (2010- 2013) NPAs of PSB including SBI group Gross and Net non-performing assets (NPAs) have increased sharply(200%). In the first quarter of the current financial year as a rapidly slowing economy is resulting in a quantum leap in bad loans. State Bank of India (SBI), the country's largest lender, topped the list of banks with the highest gross NPAs (in percentage terms) during the quarter among BSE-Bankex constituents. The gross NPA to advances for SBI, which has seen a steady increase in bad loans, surged to 5.56% in April-June, the highest since the quarter ending March 2011. Gross NPAs have increased 81 basis points (0.81%) for SBI during the quarter, data with the Centre for Monitoring Indian Economy (CMIE) showed. During the above period (2009-2013) the private sector banks group efficiently reduced the Gross and Net NPA and reduced to 30 basis point (0.30%) from 130 basis point (1.3%) and foreign bank's group reduced to 43 basis point (0.43%) from 180 basis point (1.8%).The trend of improvement in the assets quality of Banks continued during the period.

The bank profiles (published by RBI) of different banks have been analyzed between year 2008 to 2012, the banking sector has written off between 10 to 12 ten per cent of the Outstanding gross non-performing loans which helped in limiting the growth of gross non-performing loans. The extent of write off was lower in 2010-11 as compared with the previous year; however, in comparison with 2008 and 2009, the ratio was on the higher side. This indicated that during the last two years, writing off of NPAs was an important factor in maintaining the asset quality.

The reasons are that the Indian Banks could recover a higher amount of NPA during the period. Among the various channels of recovery available to Banks for dealing with bad loans, the SAFAESI Act and Debt Recovery tribunals (DRTs) have been most effective in term of amount recovered (report on trend and progress of Banks 08-09).

CONCLUSION AND SUGGESTIONS

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 has already been applied. The bank should follow suggestions and instruction given by the act. To recover the NPA Debt recovery tribunal should be given more independency. Foreign Banks should also take help of debt recovery tribunal for fast recovery of NPA. Credit recovery process should be reviewed and be strengthened. Especially the big defaulters should not be escaped and their names should be published in local and national dailies and also on web sites. Efforts should be made to ensure that they could not even take fresh loans from other Banks. The composition of NPAs of Public Sector banks interestingly reveals that NPAs connected to non-priority sector has increased, whereas, NPAs relating to priority sector advance exhibited a decline. This goes to explode the commonly held myth that the problem of NPAs is caused mainly due to the credit allocations made to priority sectors. Considering the facts it is required to give the attention on non priority sectors loans and advances and review the procedure valuation of assets/security against which the loans and advances are given. NPA writing off is not the solution. Banks are required to make NPA productive. There are many government policies which are interrupting the recovery and relaxing the outstanding the separate accounting treatment is to be given then only actual efficiency of banks (especially public sector banks) could be measured.

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