Bad Loans in Good Banks: Recent Experiences in India

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Introduction

One of the strong pillars of the Indian economic system is a banking structure with stability, solidarity and diversity with which it could withstand many challenging circumstances including the worldwide recession of 2008. In spite of these virtues it is now facing a widespread criticism that it is vitiated by alarmingly a large percentage of non-performing assets (NPAs) to total advances. The gravity of the situation could be gauged by the fact that this intimidating problem is assuming political importance which does not augur well for the very future of the Indian banking industry. The opposition parties, particularly the NDA group, had derived pleasure by making a public statement that the UPA government itself has become an NPA! What causes surprise is the disturbing fact that the central government, especially the Union Ministry of Finance is taking its own children viz., public sector banks (PSBs) for not being able to tackle the problem of NPAs. Therefore, it is worthwhile to examine some of the recent events and experiences which go to show that public money in this country is like orphans suffering from both under nutrition and malnutrition. This article is intended in the main to examine trends, causes and consequences of bad loans clearly reflecting on the qualitative aspect of assets with the PSBs accounting for the largest chunk of business in the country.

In the past sixty two years or so Indian banking scenario has dramatically changed. The Banking Regulation of Act of 1949 and the subsequent amendments paved the way for stabilization of the whole banking system albeit, its inability to give birth to mass banking even after the commencement of economic planning in 1951. Apart from the State Bank of India, as many as 20 commercial banks came under the control of the government in two tranches on July 1969 and again on April 1980. In a sense nationalization of major commercial banks was also a step towards evolving good and strong banks which could acquire social purpose and the requisite capacity to sub serve national priorities and objectives in the interest of the poorer sections of the society. Notwithstanding the criticisms against the nationalized banks on the grounds of operational efficiency, these banks no doubt played a useful role in monetizing a vast part of rural India and also in mobilizing the savings of the common people (Thingalaya, 1987). Mass banking which took shape after 1969 was a major transformation in the banking industry which cannot ignore socially disadvantaged sections of the people in India. By sponsoring regional rural banks (RRBs) the nationalized banks contributed to the process of empowerment of the sections of the rural community deprived of banking facilities for a long time even after independence.

In the era of banking sector reforms, no doubt many PSBs had to face all together different situations which they did not imagine in the pre-reform era that they have been able to encounter successfully many challenges in the era of reforms is now an established fact. The creditable achievements of PSBs are now on record. Thrust given on priority sector ending, export credit, universal banking and core banking mechanism through technology leverage are but some of the significant accomplishments of PSBs. The entry of foreign banks and the birth of private sector banks with abundant use of modern technology have in no way reduced the significance of role PSBs in the overall development process of the Indian economy. As Raghavan (2010) observed, the growth achieved on account of the spread of banking culture through the length and breadth of the country during the last forty years of nationalization and also 63 years since independence was quite unparalleled in the international banking scenario.

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Another area where the PSBs have been able to put up a fairly satisfactory performance in recent years is financial inclusion. According to CRISIL, financial inclusion has gained momentum in India with a significant rise in new savings accounts, increase in agricultural credit accounts and expansion of bank branches in deeper geographies. India's overall CRISIL Incluix score rose by 2.7 in FY-12 the highest annual increase since 2009. The Union Minister for Finance P. Chidambaram boldly declared that the growth of the banking sector during the decade 2003-2013 was commendable. The increase in the number of bank branches in this decade as well as expansion in the banking services including ATM facility and student's education loans were also indicative of positive changes. Needless to say in all these creditable matters, the PSBs surpassed other banks (IIBF Vision, 2014).

Bad Loans: Growth and Impact

The expansion due to policies of the PSBs was, however, not without negative picture. One of the perplexing problems of these banks is a sharp rise in the magnitude of bad loans in recent years which could be also construed as NPAs with some amount of conceptual difficulty. This problem came to the forefront in Bancon-13 held in Mumbai on November 15-16, 2013. Though the theme of the conference was The Banks of the Future, K C Chakrabarthy preferred to talk on future of banks which would depend on the efficacy of measures tackling the problem of growing and threatening NPAs. In his own words, "In a bank dominated economy such as India, the asset quality of the banking system has important implications for the stability of the overall financial system. The general perception about a bank's health is greatly determined by the level of NPAs held in its books. It is, therefore, not surprising that the current spurt in NPAs in banks has attracted a lot of attention". The impact of the problem of NPAs is discussed at length as in a bank dominated economy it produces ripples touching various facets of banking. There is a reason to suggest that it is not the future of banks which is at stake. It is rather the future of the market economics itself (Upadhyay, 2013). Good PSBs that successfully met the challenge of worldwide recession of 2008-09 are now not able to digest the bad food of NPAs in the domestic system.

Apart from BANCON-13, the most authentic document deserving our attention in this connection is The Report on Trends and Progress in Banking in India 2012-13 published by Reserve Bank of India (RBI). The troubled assets of banks reflecting on the qualitative aspects of their lending operations are very much discussed in this report. The report tells us that the NPA ratio in the priority sector was "consistently higher than the ratio in the non-priority sector (but) the deterioration in asset quality in 2012-13 was primarily on account of the non-priority sector."

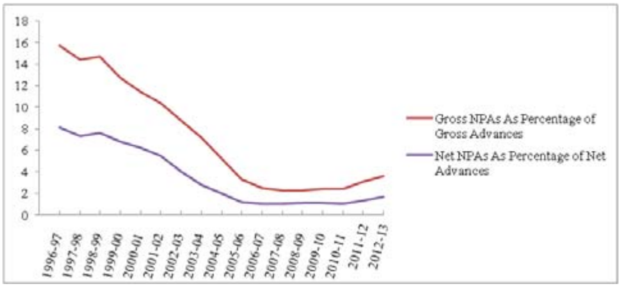
According to the RBI guidelines, an asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. This is termed as Gross NPA. Net NPA is derived by deducting balance in interest suspense account, amount of provisions held in respect of NPAs and amount of claim received and not appropriated. While discussing the impact of bad loans in good PSBs in India this distinction has a significance of its own.

In 1993 the Reserve Bank of India (RBI) issued directives on Income Recognition based on Narashimam Committee Report (1) on banking sector reforms, according to which banks had to classify their credit portfolio into two parts, first being Standard or Performing Assets and second was Non-Performing Asset. Prior to 2001 the classification of NPA was done using the concept of 'past due'. An amount was considered as past due if it remained outstanding for period of 30 days past the due date. If a loan was past due for more than 4 quarters then such asset was to be considered as NPA, when the concept was introduced in 1993.

However in the year 1994 and 1995 it was reduced to 3 quarters and 2 quarters respectively. With the intention of moving towards global best practices and to ensure better transparency '90 days' overdue norms for identification of NPA was introduced in the year 2004. According to this NPA classification and provisioning guidelines laid down by RBI in the Master Circular on Prudential norms on Income Recognition, Asset Classification and Provisioning (IRAC), the banks are required to segregate the advances as standard assets, sub-standard assets, doubtful assets and loss assets. When the Indian banks had the luxury of treating loan overdue's extending upto one year, the problem of overdues could be camouflaged. Now when international norms are to be scrupulously regarded, the real picture naturally comes to the forefront. To put it differently, good PSBs in India have to admit the adverse impact of bad loans without, not being able to conceal realities.

The Chart 1 given below depicts the Gross NPA and Net NPA of Scheduled Commercials Banks in India for a period of fifteen years following banking sector reforms. Chart 1 show that from 1996-97 to 2006-07 there were decreasing trends in the gross NPA as well as net NPA. Thereafter until 2010-11 both were more or less stable. Since 2010-11 both registered a sharp rise causing concern to the highest monetary authority (RBI) in the country.

Chart 1
Gross NPAs and Net NPAs in Scheduled Commercial Banks of India



Source: Department of Banking Supervision, RBI.

Evidently, the magnitude of gross NPAs far exceeded that of net NPAs in all the years included in Table 1. However, it needs to be emphasized here that both in 2011-12 and 2012-13, the NPAs as a percentages of total advances of Scheduled Commercial Banks (SCBs) was increasing significantly. This means that the banks need to keep higher provisioning under the Basel III norms and therefore need higher economic capital, posing an additional burden to PSBs. Precisely in this context, the words of caution given by Thingalaya (2000) that drastic reduction in the NPAs is very crucial for improving the health of the banks in India becomes all the more relevant. The RBI in the afore mentioned report for 2012-13 gave the same warning in the different way by saying that the banking system's loan quality, primarily in the industrial and infrastructure sectors, has deteriorated significantly during the year and there was an increase in total stressed assets.

Increase in the total assets under stress has now become alarming for both the Central Government and the RBI. In March 2011 the gross NPAs amounted to Rs. 941.21 billion. It exceeded Rs. 1.83 trillion by March 2013. Within a short period of period of six months i.e. September 2013 it shot up to Rs. 2.32 trillion, registering an increase of as much as 26.77 percent. The problem of bad loans is a burning and bubbling issue for a PSB of established reputation, namely the State Bank of India. It becomes clear from Table 2 that of the various PSBs adversely affected by mounting NPAs the State Bank of India now has to deal with this problem to satisfy the Government of India as on March 31st, 2013 it had gross NPAs touching the figure of Rs. 5,118.94 billion. Almost all PSBs exhibited dismal picture causing concern to RBI. The private sector banks (Table 2) were having safe position in respect of both absolute amount and percentage of gross NPAs to gross advances. The ICICI Bank, next only to SBI in terms of business turnover, had gross NPAs of just Rs. 960 billion.

Table 1
Gross NPAs in Scheduled Commercial Banks as on March 31st, 2013

Rank	Banks	Gross NPAs (Rs. in Crore)	Gross Advances (Rs. in Crore)	Gross NPAs to Gross Advances Ratio (%)
1	UCO Bank	71301	1315691	5.42
2	Dhanlaxmi Bank Ltd.	3803	78963	4.82
3	Central Bank of India	84562	1762337	4.80
4	State Bank of India	511894	10785571	4.75
5	State Bank of Mysore	20806	459805	4.53
6	Punjab National Bank	134658	3152440	4.27
7	United Bank of India	29638	697081	4.25
8	Indian Overseas Bank	66080	1643665	4.02
9	Allahabad Bank	51370	1309363	3.92
10	Lakshmi Vilas Bank Ltd.	4599	118923	3.87
11	Andhra Bank	37145	1001378	3.71
12	State Bank of Bikaner & Jaipur	21195	584737	3.62
13	State Bank of Hyderabad	31860	920231	3.46

Rank		NPAs	Advances	Ratio (%)
24	Punjab & Sind Bank	15369	518434	2.96
25	Canara Bank	62602	2439358	2.57
26	State Bank of Travancore	17499	683885	2.56
27	Karnataka Bank Ltd.	6389	254165	2.51
28	Bank of Baroda	79826	3328113	2.40
29	Catholic Syrian Bank Ltd.	2109	89760	2.35
30	Dena Bank	14525	664569	2.19
31	Vijaya Bank	15329	705135	2.17
32	Syndicate Bank	29785	1494227	1.99
33	Corporation Bank	20482	1193540	1.72
34	Jammu & Kashmir Bank Ltd.	6438	398537	1.62
35	Kotak Mahindra Bank Ltd.	7581	489186	1.55
36	Bank of Maharashtra	11376	763972	1.49
37	South Indian Bank Ltd.	4339	320140	1.36
38	Tamilnad Mercantile Bank Ltd.	2145	163661	1.31
39	Axis Bank Ltd.	23714	1989007	1.19
40	City Union Bank Ltd.	1731	153429	1.13
41	IndusInd Bank Ltd.	4578	446416	1.03
42	Karur Vysya Bank Ltd.	2859	297059	0.96
43	HDFC Bank Ltd.	20481	2413061	0.85
44	Ratnakar Bank Ltd.	259	63952	0.40
45	ING Vysya Bank Ltd.	1214	318916	0.38
46	Yes Bank Ltd	943	470869	0.20

Source: Department of Banking Supervision, RBI

In august 2013 there was a closed door meeting between bank chiefs and senior RBI officials in which the issue of bad loans figured very much. The erstwhile CMD of SBI stoutly defended the banks arguing that they alone could not be blamed for the baffling spike in bad loans which had reduced their profits by hurting their balance sheets. Sharply reacting to the criticisms of RBI and government officials, Chaudhari is reported to have told them that "if government and RBI continue to blame banks for rising NPAs, we would be forced to insert impossible conditions which would make it difficult for borrowers to avail the credit facility" (Nandi, 2013).

Problem in Non-Priority Sectors

The general belief that lending to priority sectors by PSBs is the main culprit causing NPAs is now disproved. Data published by RBI shows that lending to non-priority sectors is the major cause to worry. In the above mentioned report for 2012-13 the RBI disclosed that deterioration in asset quality in 2012-13 was primarily on account of the non-priority sector. Data in Table 3 shows the composition of gross NPAs of PSBs for the period of 2003-2013. The non-priority sectors which accounted for 50.71 percent of NPAs in 2003 accounted for 57 percent in 2013 for PSBs in general.

Table 2

Composition of NPAs of Public Sector Banks - 2003 and 2013

Nationalised Banks	Priority Sector		Non-Priority Sector		Public Sector		Total
	Amount (Rs. in billion)	Per cent Share	Amount (Rs. in billion)	Per cent share	Amount (Rs. in billion)	Per cent share	Amount (Rs. in billion)
2003	168.86	47.10	184.02	51.33	5.61	1.56	358.49
2013	404.86	42.21	553.59	57.71	0.78	0.08	959.22
SBI and its Associates							
2003	80.53	47.49	83.79	49.41	5.26	3.10	169.58
2013	264.42	44.09	334.94	55.85	0.31	0.05	599.67
Public Sector Banks							
2003	249.39	47.23	267.81	50.71	10.87	2.06	528.07
2013	669.28	42.93	888.53	57.00	1.08	0.07	1,558.90

Source: Trend and Progress of Banking in India 2012-13

The number of wilful defaulters in the non-priority sectors is causing very to erring banks, the Central Government and the RBI. It is said that RBI Governor Raghuram Rajan singled out willful defaulters on his first day in office in September 2013. The prevalence of so called wilful defaults is symptomatic of a loose credit culture that plagues the Indian economy, keeping underperforming companies in business, crowding out other borrowers and leaving tax payers on the hook to recapitalize the PSBs (Pandey, 2013). P Chidambaram came down heavily on banks for showing what he called "laxity to willful defaulters". In his seventy eighth foundation day lecture of Indian Overseas Bank in New Delhi he said that banks must pay attention to the portfolio of NPAs, identify wilful defaulters, take stern actions to recover loans from them even while helping others who are genuinely caught in business down turn to recover so that they can pay the loans in course of time (Anon, 2013). Does Chidambaram really mean what he says when he is quite aware of the fast approaching Lok Sabha polls? After all the willful defaulters too have the power to vote and also the power to influence votes of others!

One of the major stumbling blocks for co-operatives and commercial banks is the politically motivated announcements of the loan waiver schemes both by the Center and State Governments. Such announcements and possibilities of loan waiver particularly for mobilizing votes have more often than not created environments for accumulation of over dues, eventually leading to NPAs. The Sixth Five Year Plan (1980-1985) document had lamented that the mounting overdues were clogging the process of credit recycling in the co-operative sector. It also sounded a warning: "While the sheer volume of overdues in some states make it impractical solutions for recover these in one installment and demands some practical solutions for recovery over a phased period, the tendency which has developed in some states to write off the debts can only be viewed with extreme concern. It sets an undesirable precedent and will hamper recovery efforts in future" (Joshi, 1997). But subsequent governments at the central and state levels did not take heed of the warning given by the Planning Commission while announcing loan waiver schemes mainly as populist measures. The inevitable consequence was the emergence of environments conducive to the massive accumulation of over dues and NPAs.

The Union Finance Ministry has asked all PSBs to reduce their bad loans or NPAs to just one percent of their total advances by March 31st, 2014. The PSBs have been advised to adopt a multi-pronged strategy for loan recovery. The chief components of which are constitution of board level committee for monitoring recovery, review of NPA accounts of Rs. 1 crore and above by the board, the top 300 accounts by the management of the boards and formulation of guidelines for NPA management as part of an early warning system. In addition banks have been also advised panel measures against willfull defaulters which, among others include not granting them additional loan facilities (Sinha, 2013).

In his Interim Budget for 2014-15 Chidambaram has this to say: "Banks are under strain owing to rising non-performing assets. Bankers have assured me that as the economy turns they will be able to contain the NPAs, recover more loans and build healthier balance sheets". It only means that unless the health of the Indian economy improves bankers cannot build healthier balance sheets. We don't know how long we have to wait for the improvement in the economy of the country for getting a solution to a problem perplexing the PSBs.

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