Non-Performing Assets: A Study of Scheduled Commercial Banks in India

E. Hari Prasad★, G.V. Bhavani Prasad★★

Abstract

Banking sector is the back bone of nation's economy. In India, banking sector is playing a vital role in economic development of by providing the required finance to various sectors. One of the primary functions of banks is lend money. Banks create credit to extend financial assistance in the form of business loans, agricultural loans, vehicle (automobile) loans, housing loans, personal loans etc. This lending process results credit risk to banks and then lead to non-performing assets (NPAs). These NPAs increase the carrying cost and adversely affect the profitability of banks and finally show negative impact on banks' net worth. The present paper is aimed to study the performance of public sector in India with reference to their NPAs.

Keywords: *Public Sector Banks, Gross NPAs, Net NPAs Economic Development, Capital Adequacy*

Introduction

Prior to economic liberalization, public sector banks (PSBs) played a dominant role in Indian economy. On the recommendations of the Narasimham Committee (1991), the government of India introduced financial sector reforms. Many private and foreign players were permitted to enter into Indian financial system. With the entry of private and foreign players into the financial system, PSBs started to compete with well diversified and affluent private and foreign players to provide best and distinctive products and services according to needs of customers. In the globalized economy, scheduled commercial banks (SCBs) face challenges of high competition from players in the market and technological advancement. This requires strengthening the internal controlling system in banks as regards cost of banking operations, adapting the new techniques, introducing innovating services and products, adequate and stringent norms of bank management etc.

Banking sector mobilizies funds from the public in the form of deposits and channelize those funds to various sectors in the economy in the form of loans and advances. Money lent in the form of loans and advances embrace the largest part of asset portfolio of the bank. These assets generate interest income for the bank. In addition, banks also invest money in securities, real estate to carry out the banking operations.

On the recommendations of the Narasimham Committee, the banking sector has undergone see changes in respect of credit management and asset quality. Prior to economic liberalization 1991, asset quality was not a prime issue to banks but nowadays, the asset quality is one the major issue for banks in India. So, now, banks are very vigilant in sanctioning loans due to escalating non-performing assets (NPAs) and in current scenario NPAs are one of the major concerns for banks in India.

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Non-performing asset (NPAs)

A Non-performing asset (NPA) is defined as a credit facility in respect of which the interest and instalment of principal has remained 'past due' for a specified period of time. In simple terms, an asset is tagged as non-performing when it ceases to generate income for the bank. The portion of the NPA in the bank's asset portfolio swallows the portion of profits gained by the banks and adversely affects the value of the banking service. The quantity of NPAs in the bank's assets portfolio plays vital role in evaluating the financial soundness of the bank. Thus, NPA ratios are considered for measuring the financial performance of the selected banks in respect of NPAs.

Gross NPA to Gross Advances

Gross NPAs are the total of all loan assets that are classified as NPAs as per RBI guidelines as on Balance Sheet date. Gross NPA is advance which is considered as irrecoverable, for which bank has made provisions, and which is still held in banks' account books. 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 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 made for NPAs. Net NPA shows the actual burden of banks. Now a day in India, bank balance sheets contain a huge amount of NPAs. The process of recovery of these assets and write off of these assets are very time consuming, the provisions the banks have to make against the NPAs according to the RBI 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

Review of Literature

Numerous studies have been conducted by scholars to evaluate the non-performing assets of banking sector in India and abroad. Prasad and Veena(,2011) studied causes for NPAs and strategies to reduce this in Indian banking sector to conclude that PSBs were facing more problems of NPA than the private sector and foreign banks because of lending to priority sector. Lending for poverty elevation programmes which failed on various grounds in meeting their objectives was found to be reason for NPAs. The huge amount of loan granted under these schemes was totally unrecoverable by banks due to political manipulation, misuse of funds and non-reliability of target audience of these sections.

Ahmad &.Jegadeshwaran, (2013) examined the non performing assets of nationalized banks. It was found that level of nonperforming asset both gross and net on an average showed upward trend for all the nationalized banks while the growth rates were different. Banks was ranked on the basis of average gross NPA rank and net NPA rank. They inferred that there was significant difference between gross and net NPA among nationalized banks, this describes their efficiency in the management of NPAs.

Samir & Kamra, (2013), analyzed the position of NPAs in selected public and private sectors banks and found that the problem of NPA was greater in the public sector banks as compared to private and foreign banks in India. Similarly, the problem of NPAs was more in non-priority sector than priority sector. Further, they observed that the SSI sector has largest share in the total NPA among banks of the priority sector. As a result, financial health of banks had been adversely affected. It also highlighted the policies pursued by the banks to tackle the NPAs and suggested a multi-pronged strategy to speed up recovery of NPAs in banking sector. Banks in India must apply the basic principles of financial management to solve the problems of mounting NPA.

Samir & Kamra, (2013) made a comparative analysis of the trends of NPAs of the Public, Private (Old and New) and foreign sector banks in India. He found that the position of NPAs was improving in India. NPAs were having a declining trend over a period of the study, but Non-Performing Assets of the public sector banks were still higher than private and foreign sector banks. Top management of private and foreign sector banks was more professional having core competent and expertise than those of the public sector banks. So, they are more competent in making plans for recovering funds from borrowers (both individuals and institutional). The public sector banks are required to lend money to weaker sections of the society, where the chances of recovery is almost negligible. That is why, though the NPAs of public sector banks have sharp declining trend, still it is higher than private and foreign sector banks.

An attempt was made by (Singh, 2016) to understand NPA, the status and trend of NPAs in Indian Scheduled commercial banks, reasons for high impact of NPAs on Scheduled commercial banks in India and recovery of NPAS through various channels. The NPA level of Indian banks is still high as compared to the foreign banks. It is not at all possible to have zero NPAs. The bank management should speed up the recovery process. The problem of recovery is not with small borrowers but with large borrowers and a strict policy should be followed for solving this problem. The government should also provide some more provisions for faster settlement of pending cases. This problem of NPA needs lots of serious efforts otherwise NPAs will have the adverse impact on the profitability of banks which is not good for the growing Indian economy at all.

Gupta & Gautam, (2017) evaluated the performance of the Punjab National Bank with reference to the problem of Non-Performing Assets (NPAs). Results of study found that level of NPAs both gross and net exhibited increasing trend and there was a negative relationship between Net profits and NPA of PNB. This was because of mismanagement and wrong choice of client. To improve the efficiency and profitability, the NPA should to be reduced further.

Research Gap

From the above literature review, it was found that no study has been conducted from the period 2001 to 2016 in context of the scenario of NPAs in commercial banks in India and there is a gap existing for the comprehensive research on quality aspects of Non-Performing Assets. Most of the studies were being done on causes, impact and management aspects of NPAs. No study was concentrated on recovery of NPAs. The present paper tries to fill this gap and aimed to study the scenario of NPA of scheduled commercial banks during the period of 2001-16 and their recovery through various channels.

Objective of the Study

Following are the main objectives of the present study:

1. Examine NPA positions of Indian Scheduled commercial banks over the period of 2000-01 to 2015-16
2. Analyze comparative percentage of both GNP and NNPA as a percentage of Advances among different categories of Banks.
3. Offer suitable preventive measure to reduce problem of NPAs.

Sources of Data

Data have been collected mainly from the secondary/

published sources. The sources of data for this paper are the bulletins of RBI and literature published by various magazines, journals, books and research papers dealing with the current banking scenario.

Methodology

This research paper is descriptive in nature based on various reports of RBI, journals, periodicals and other related publications. The main aim of the paper is to examine the performance of scheduled commercial banks with respect to their asset quality in the context of nonperformance assets (NPAs). The study covers period of 16 years from the financial year 2000-01 to 2015-16.

Limitation of the Study

The important limitations of the present paper are as follows;

- NPAs are changing with the time. The study is done in the present environment without foreseeing future developments.
- Though findings of the paper with such limitation may not be totally correct to make generalization yet contribution is valuable to form general perspective.

Details of NPAs of scheduled commercial banks during the period 2000-01 to 2015-16 are presented in the table-1 in Appendix. Data depict that, an average annual growth rate of 18.30 per cent was recorded in respect of gross advances and an average of 18.58 per cent of CAGR was recorded in respect of net advances during the study period. The gross NPAs of commercial banks had grown from at 15.07 per cent and net NPAs at 16.42 per cent for the period. Gross NPAs were raised from Rs. 963.63 lakhs to Rs. 6552.00 lakhs showing an average growth rate of 15.07 per cent per annum and net NPAs rose from Rs.324.61 lakhs to Rs.3698.00 lakhs indicating a compound growth rate of 16.42 per cent per annum during the period.

Table-2 in Appendix, presents annual percentage increase in gross and net non-performing assets of scheduled commercial banks during the period of 2001-16. Both GNPAs and NNPAs were recorded very high in 200-01 showing GNPAs and NNPAs 11.40 and 6.20 percent respectively. The trend was slowly decreased up to 2010-11recording 2.50 and 1.10 per cent respectively. Then after, 2011-12 onwards these were increasing and reached to 7.60 per cent and 4.60 per cent respectively by end of the financial year 2015-16. The same was presented in the following graph which shows how the NPA curve has been moving up in the recent years (Figure 1) in Appendix.

Data in the table-3 and figure-2 in Appendix . furnish details of bank group wise gross non-performing assets during the period from 2000-011 to 2015-16. Gross NPAs in respect of Public Sector Banks (PSBs) were 12.40 per cent in 2000-01 and reduced to 2.00 per cent 2008-09, there after increased and reached to 9.83 per cent in 2015-16. In the case of private sector banks gross NPAs were 8.4 per cent in 2000-01 and dropped to 1.80 per cent by the end of March 2013-14. It was increased to 2.8 per cent in 2015-16. GNPAs in respect of foreign banks decreased from 6.8 per cent in 2000-01 to 1.8 per cent in 2007-08 and thereafter increased and reached to 4.20 per cent by the end of 2015-16.

H01 – There is no significant variation among the bank groups in respect of GNPA as percentage of Gross advances.

Table 4: ANOVA

Source of Variation	SS	df	MS	F	P-value	F - critic
Columns	31.30666	2	15.65333	7.241034	0.002716715	3.315829501
Error	64.8526	30	2.161753			
Total	347.4521	47				

To test the null hypothesis analysis of variance

(ANOVA) is conducted. According to the ANOVA, calculated F value is greater than critical F value and it is significant at 5 per cent level. So, it is inferred that there is significant variations among the bank groups in respect of gross NPAs and rejected the null hypothesis.

H02–There is no significant variation among the bank groups in NNPAs as percentage of net advances.

Table 6: ANOVA

Source of Variation	SS	df	MS	F	P-value	F critic
Columns	21.038 87917	2	10.5 1944	8.3234 8559	0.001 332	3.315 83
Error	37.914 7875	30	1.26 3826			
Total	134.61 73667	47				

According to the ANOVA the F value is significant at 5 per cent level of significance. So, it is inferred that there is significant variations among the bank groups in respect of net NPAs and rejected the null hypothesis.

H03: There is no significant variation in GNPAs NNPAs over the period of 2000-2016

Table 7: ANOVA GNPAs and NNPAs

F-Test Two-Sample for Variances		
Mean	GNPA	NNPA
	4.63	2.232667
Variance	6.970643	2.180864
Observations	15	15
df	14	14
F	3.196276	
P(F<=f) one-tail	0.018737	
F Critical one-tail	2.483726	

Further, it is also tested to examine the variation in GNPAs and NNPAs of banks over the study period. As above table 7, calculated F Value is greater than critical F value is significant at 5 percent level and So, the null hypothesis is rejected. it can conclusively stated that there is significant variations in GNPAS and NNPAs of Banks over time.

Stressed Assets

NPAs alone do not explain the asset quality of advances provided by banks. Some of the advances are given further choice to repay loans by offering easier conditions and norms such as reducing the rate of interest or extending time period of repayment. Some of the advances are known as written of assets. These written off assets are compensated through other methods. Then, a new classification of assets is made in the form of stressed assets that comprise of restructured loans and written off assets besides NPAs.

Stressed assets = NPAs + Restructured loans + Written off assets.

According to the information published by Indianeconomy.net, the ratio of stressed assets to gross advances of the Indian banking system is increasing from 2013 onwards. It has risen from around 6 per cent at the end of March 2011 to 11.1 per cent by March 2015 and to 11.5 per cent at the end of March 2016. Public Sector Banks have the highest stressed asset ratio 14.5 per cent of total advances as of March 2016, compared to 4.6 per cent in the case of private sector banks.

Impact of NPAs on Banks' Credit

Banks' share in the flow of credit, which was around 50 percent in 2015-16 declined sharply to 38 percent in 2016-17. However, the aggregate flow of resources to the commercial sector was not affected owing to a sharp increase in private placements of debt by non-financial entities and net issuance of commercial papers (CPs); the aggregate share of these two in total credit flow to the commercial sector increased to 24.3 percent in 2016-17 (www.bloombergquint.com/global-economics/2017/financial-stability).

Reasons for Increasing NPAs

One of the reasons for rising of NPAs is economic slowdown. It is believed that interest rates are going up with the economic slowdown and for which the corporate find it difficult to repay loans. Reasons other than interest rates also influence NPAs in banking sector.

External Reasons

1.Slowdown of global economy leads to lower the foreign trade (contributes 40 per cent of GDP) particularly in case of exports of some products like textiles, leather, gems, engineering products etc. This adversely affects the corporate in the country and finding it difficult in repayment of loans.

2.Delay in sanctioning permits to environmental projects like, mines, power sectors causes variation in prices of inputs which increases cost, impact the performance and affects adversely the paying capacity of companies.

3.In India banks are highly regulated. Banks are required to provide 40 percent of total advances to priority sectors that include agricultural, MSMEs. This priority sector lending (PSL) has significantly contributed to the NPAs. Out of the total lending to PSL, incremental NPAs were more in respect to MSMEs followed by agriculture and education loans constitute 20 per cent of its NPAs.

Internal Reasons

1. An unsystematic advance by public sector banks is the main reason for inferior assets quality of banks.

2.Lack of rigorous loan appraisal system in PSBs while sanctioning loans to infrastructure projects i.e. high gestation period and lack of proper monitoring system for which corporate suffer to repay loans causing rise in NPAs.

3. Poor recovery mechanism of banks such as " wait and watch method" of banks in recovering loans in most of the time leads to weakening the asset quality of banks.

Impact of NPAs

The asset quality and return on assets reveal the performance of the bank. The NPAs reduce the interest income to banks and attract provisions from current profits (Zafar, Adeel and Khalid, 2013) thus reducing capacity to invest. Since asset quality has significant effect on banks operation, RBI has included asset quality as one of the important parameter in CAMEL rating approach to evaluate the performance of banks.

A. Profitability

NPAs block the money of banks in terms of bad asset. This blockage of money increases the opportunity cost and decreases the profitability. NPAs adversely affect the return on investment (ROI) and not only distress current year profits but also future profits which lead to loss of long-term profitable avenues.

B. Liquidity

As money gets blocked, the profit of the bank reduces. And also there is lack of cash in hand leading to borrowing money from other sources in the short period for which the bank needs to incurr additional cost. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.

C. Additional Management Cost

NPAs increase indirect cost of time and efforts of management. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now a days banks are appointing special employees to deal and handle NPAs, which is additional cost to the bank.

D. Value of the Bank/Credit Loss

NPAs adversely affect the value of bank in terms of market credit. They will lose their goodwill, brand image and credit which have negative impact on depositors who deposit their money in banks.

Prevention of NPAs

Various steps have been taken by the government and RBI to recover and reduce NPAs. The following are the some steps that can prevent NPAs in banks.

1. Conventional:

Banks should be more conventional at the time of sanctioning advances to such sectors that have traditionally responsible for NPAs. For instance, infrastructure sector which NPAs raise mostly because of long gestation period of the projects.

2. Improving processes:

Banks should go for thorough verification of financial statements and credit history of the companies while granting the loans. Banks should rely more on the information supplied by the noted credit agencies.

3. Relying less on restructuring the loans:

For restructuring loan, instead of waiting to turn it to a loss asset, banks may officially start the process to recover such a loan. This will avert restructuring a loan and several issues associated with it.

4. Digitalization of Banking Transactions

The NPA in non-corporate sector (priority sector) is less than that of the corporate sector. Hence, more and more people and firms should be brought under the banking system by adopting new technologies and electronic means. Innovative methods of banks will play a crucial role in decreasing NPAs. Process of digitalization of banking transaction will highly be helpful in improving the asset quality of banks. As said by the new M.D. of SBI, Mr. Viswanathan proposed ideas such as a single demat account for all investments and credit cards for school students (above class 8th) to make them aware with the banking system.

Conclusion

This research finds NPA to be the problem for banking system as a whole. Three hypotheses tested shows that there are significant differences in NPA among types of Banks and over the period the paper covered for study. Since Banking system is the backbone of the financial system of the nation, the potentiality of the nation's economy is directly depending on the performance of banking system. The problem of NPAs arises because of inappropriate credit appraisal that weakens the banking system in the country. NPAs are obstacle to the success of the bank and negatively affect the bank's performance. So, it is essential to bank to maintain the NPAs as less as possible by adopting the appropriate credit appraisal system. Banks have to take preventive measures rather than curative measures. To manage NPAs banks have consider the following points.

- Adopting appropriate Credit assessment and monitoring system
- Timely sanction and disbursement of loans to avoid the time and the cost overruns.
- Special team of bank should examine the financial statements and credit worthiness of the company to sanction the loans.
- Identifying reasons for rotating of each account of a branch into NPA is the most significant factor for advancement of the asset quality as that would help begin suitable steps to raise the accounts.
- Modernizing the recovery machinery of the bank and updating the NPAs time to time.
- Priority should be given to small and marginal borrowers having less credit risk and consequent higher profitability.

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Appendix

Table 1: Gross and Net NPAs of Commercial Banks (Rs. in Lakhs)

S.No.	Year	Gross Advances	Gross NPAs	Net Advances	Net NPAs
1	2000-01	5586.79	693.63	5263.28	324.61
2	2001-02	6809.58	708.61	6458.59	355.54
3	2002-03	7780.43	687.17	7404.73	296.92
4	2003-04	9020.26	348.12	8626.43	243.96
5	2004-05	11526.82	593.73	11156.63	217.54
6	2005-06	15513.78	510.97	15168.11	185.43
7	2006-07	20125.1	504.86	19812.37	201.01
8	2007-08	25078.85	563.09	24769.36	247.3
9	2008-09	30382.54	683.28	29999.24	315.64
10	2009-10	35449.65	846.98	34790.92	387.23
11	2010-11	40120.79	979.00	42987.04	417.00
12	2011-12	46655.44	1370.96	50735.59	652.00
13	2012-13	59882.79	1931.94	58797.03	986.00
14	2013-14	68757.48	2641.95	67352.32	1426.57
15	2014-15	75606.65	3229.16	72391.26	1760.93
16	2015-16	82260.00	6552.00	80384.00	3698.00
CAGR (%)		18.30	15.07	18.58	16.42

Source: Reports on Trends and Progress of Banking in India-Various of issues of RBI from 2000-16.

Table 2: Non-Performing Assets of SCBs as % of respective advances

S.No.	Year	PSBs	Pvt. Banks	Foreign Banks	All SCBs
1	2000-01	12.40	8.40	6.80	11.40
2	2001-02	11.10	9.60	5.40	10.40
3	2002-03	9.40	8.10	5.30	8.80
4	2003-04	7.80	5.90	4.60	7.20
5	2004-05	5.50	4.40	2.80	5.20
6	2005-06	3.60	2.50	1.90	3.30
7	2006-07	2.70	2.20	1.80	2.50
8	2007-08	2.20	2.50	1.80	2.30
9	2008-09	2.00	2.90	3.80	2.30
10	2009-10	2.20	2.70	4.30	2.40
11	2010-11	2.40	2.50	2.50	2.50
12	2011-12	3.30	2.10	2.80	3.10
13	2012-13	3.60	1.80	3.10	3.20
14	2013-14	4.40	1.80	3.90	3.80
15	2014-15	5.00	2.10	3.20	4.30
16	2015-16	9.83	2.80	4.20	7.60
Mean		5.46	3.89	3.64	5.02
SD		3.49	2.61	1.43	3.07
CV		63.92	67.10	39.29	61.16

Source: Reports on Trends and Progress of Banking in India-Various of issues of RBI from 2001-16.

Table 3: Bank Group Wise GNPA to Gross Advances (% of respective advances)

S.No.	Year	PSBs	Pvt. Banks	Foreign Banks	All SCBs
1	2000-01	12.40	8.40	6.80	11.40
2	2001-02	11.10	9.60	5.40	10.40
3	2002-03	9.40	8.10	5.30	8.80
4	2003-04	7.80	5.90	4.60	7.20
5	2004-05	5.50	4.40	2.80	5.20
6	2005-06	3.60	2.50	1.90	3.30
7	2006-07	2.70	2.20	1.80	2.50
8	2007-08	2.20	2.50	1.80	2.30
9	2008-09	2.00	2.90	3.80	2.30
10	2009-10	2.20	2.70	4.30	2.40
11	2010-11	2.40	2.50	2.50	2.50
12	2011-12	3.30	2.10	2.80	3.10
13	2012-13	3.60	1.80	3.10	3.20
14	2013-14	4.40	1.80	3.90	3.80
15	2014-15	5.00	2.10	3.20	4.30
16	2015-16	9.83	2.80	4.20	7.60
Mean		5.46	3.89	3.64	5.02
SD		3.49	2.61	1.43	3.07
CV		63.92	67.10	39.29	61.16

Source: Reports on Trends and Progress of Banking in India-Various of issues of RBI from 2001-16.

Table 5: Bank Group Wise NNPA to Net Advances (% of net advance)

S.No.	Year	PSBs	Pvt. Banks	Foreign Banks	All SCBs
1	2000-01	6.70	5.44	1.80	6.20
2	2001-02	5.80	5.73	1.90	5.50
3	2002-03	4.50	4.95	1.70	4.00
4	2003-04	3.10	2.80	1.50	2.80
5	2004-05	2.10	2.70	0.80	2.00
6	2005-06	1.30	1.70	0.80	1.20
7	2006-07	1.10	1.00	0.70	1.00
8	2007-08	1.00	0.70	0.80	1.00
9	2008-09	0.90	0.90	1.80	1.10
10	2009-10	1.10	0.82	1.80	1.10
11	2010-11	1.20	0.53	0.60	1.10
12	2011-12	1.50	0.60	0.60	1.30
13	2012-13	2.00	0.50	1.00	1.70
14	2013-14	2.60	0.70	1.10	2.10
15	2014-15	2.90	0.90	0.50	2.40
16	2015-16	6.21	1.59	0.67	4.60
Mean		2.75	1.97	1.13	2.44
SD		1.68	1.77	0.51	1.66
CV		61.22	90.08	44.80	67.93

Source: Reports on Trends and Progress of Banking in India-Various of issues of RBI from 2001-16.

Figure 1: Gross and Net NPAs of SCBs (in percentage)

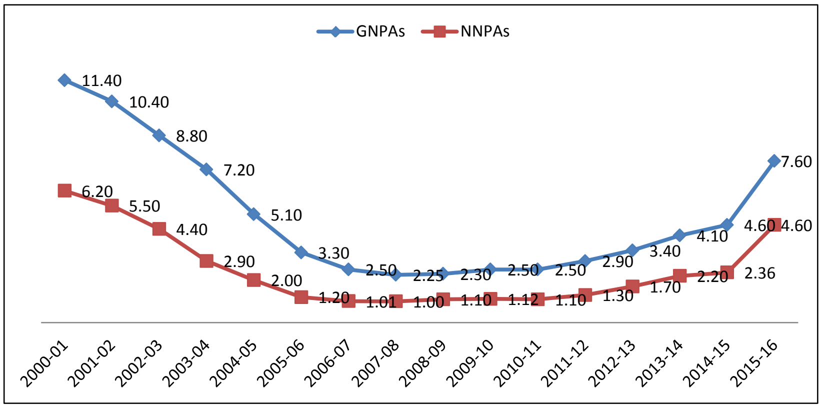

Figure 2: Bank Group Wise GNPAs

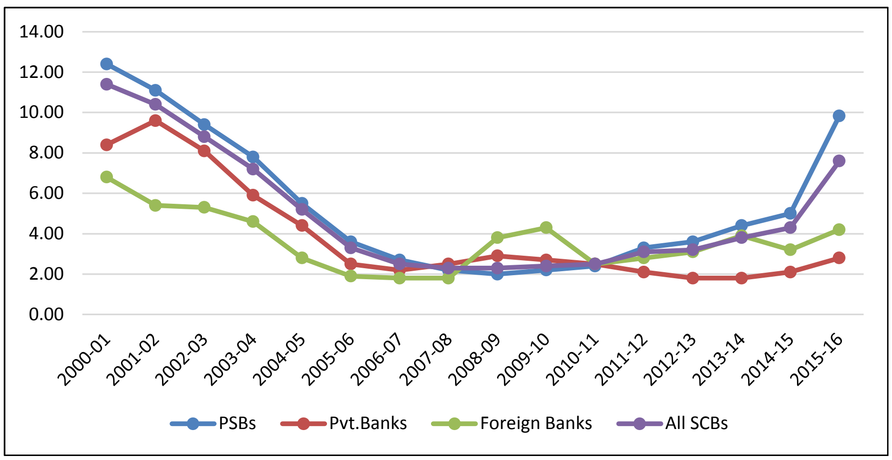

Figure 3: Bank Group Wise NNPAs