A STUDY OF NON-PERFORMING ASSETS IN INDIAN BANKING SECTOR

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Received: July 18, 2018 Accepted: August 29, 2018

ABSTRACT *For economic development banking system should be proper and adequate. Main functions of banks are accepting deposits from public and granting loan to the public. Now a day NPA has become a major problem for banking sectors. Indian financial system comprises banking system, financial markets, financial assets and financial services provided by different institutions.NPA affects the financial performance as well as the economic growth of a country. India is ranked among the top five biggest NPA holding countries after March 2015. NPA refers to those loans which cease to generate incomes or principal amount for the banks. The funds of public get blocked in bad loans and cannot be recycled in banking operations. This paper tries to present the trends of NPA in Indian banking system in last few years, reasons for rising NPA and consequences of NPA on the working of banks (liquidity and profitability) and suggest some ideas to solve the problem of rising NPA.*

Keywords: *Nonperforming assets, liquidity, profitability, Narashima committee*

INTRODUCTION

Banks are considered the backbone of every country's economy. A country's economy can't grow without adequate banking system. Banks mobilize the deposits of public by providing loans and capital to various users and industries. Banking business carry various risk such as interest risk, credit risk, liquidity operational risk and management risk. In modern world, NPA has become a major problem for Indian banking system. Huge increase in amount of NPA spoils the financial positionof banks and economy because public sector banks cover 70% assets of financial market in India. A high level of NPA means direct burden on profitability and liquidity of banks. The concept of NPA was introduced in banking system by financial reforms 1991 (Narashima Committee). Before understanding the concept of NPA, let's try to understand the banking terminology regarding assets.

Standard Assets: Standard assets are those assets on which banks earn regular interest and payments from their borrowers. These assets carry normal risk.

Sub Standard Assets: Sub Standard assets are considered those assets which is classified as NPA for a period less than or equal to 18 months.

Doubtful Assets: Doubtful assets are those assets which are classified as an NPA for more than 18 months. A doubtful asset has all weakness of substandard asset as well as the weakness of liquidation in full.

Loss assets: Loss assets are those assets which are considered uncollectable wholly or partly. This asset does not yield return or principal amount to banks and cannot be disposed of or recycled immediately.

According to RBI, an asset becomes NPA when it ceases to generate revenue/income for the bank or a loan on which principal amount and interest remain due for a specific time or more. A NPA asset shall be a credit or loan where,

In case of **term loans**, Interest and principal amount remain unpaid for more than 90 days.

In case of **cash credit/overdraft**, Amount remains out of order for time of more than 90 days.

In the case of **bills purchased& discounted**, the bills remain unpaid for more than 90 days.

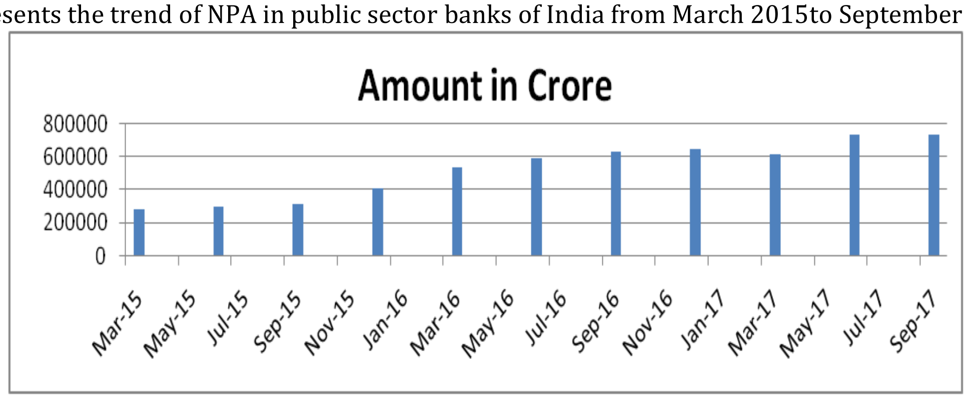
In the case of **advances to agriculture purpose,** interest / principal amount remain unpaid for more than 2 harvest seasons.

It is the primary responsibility of bank management and statutory auditors to make provision for decrement in value of loan advances. Inspecting body of Reserve bank of India assists the bank management and statutory auditors to make necessary and adequate provisions under the guidelines of RBI regarding provisions. According to prudential norms banks should make provisions for their substandard assets, doubtful assets and loss assets. On loss assets there are no chance of recovery of funds so the entire amount of loans should be written off. In the case of doubtful assets, 100% for the advances which are not realizable by the assets provided for the security. In the case of secured portion of advances, provisions may be made ranging from 20% to 50% depending upon the time period for which the advances havebeen considered as doubtful. This can be explained by the following table.

Period for which advances has been considered doubtful	Provisions requirement
Up to one year	20%
One to three years	30%
More than 3 years	50%

And as on 31 March 2001, 50% additional provisioning is required on the assets which became doubtful on account of new norms of 18 months for transition from substandard asset to doubtful category. For substandard assets, a provision of 10 percent should be made without giving any concession for DICGC/ECGC guarantee cover and a general provision of 0.25 percent should be maintained on global loan portfolio. Kumar S. (2018) explained in their research paper the trend of NPA from year 2010 to 2017 and methods to reduce the NPA of banking system. She described that banks had made efforts to reduce NPA through introducing legal channel such as LokAdalats, Debt Recovery tribunals and appeals to SARFAESI.Tiwari A. and Garg Vipul (2018) explained the trend of NPA, impacts of NPA on Indian banking system. They explained that due to mismanagement of banks, NPA increase rapidly and banking companies should take strong actions to control the NPA. The authors described that lack of professional's competencies, wrong selection of projects and insufficient management are the main causes of increasing NPA in banking sector.Avaniojha and Jha Chandra (2017) described in their research paper the working mechanism of State Bank of India, impact of NPA on working on working procedure of State Bank of India. They explained the various indicators related to growth like market share of State Bank of India, capital adequacy Ratio, total deposits, Gross advances, Gross NPA etc.Mittal Raj kumar and Suneja (2017) had attempted to examine the level of NPA and causes responsible to increase NPA. They suggested some factors like revision of existing credit appraisal and monitoring system by RBI, review of all loan accounts at fixed interval, proper training to bank employees & staff to overcome the weakness of credit appraisal and credit monitoring etc. to reduce the NPA. They used secondary data to compare the performance of public and private banks. They explained in their research paper that NPA has become major problem for public sector banks and these public sector banks should effectively control NPA.Ayub Ahmed and Vishwanathpanwar (2016) explained the comparison the between public and private sector banks in their research article. They suggested that for improvement in performance of banks, banks should control their increasing NPA by appreciating the prompt payers of loans, giving special incentives to customers who repay the amount of loans and banks should take all necessary steps to verify the loan holder's documents.

The Gross NPA refers to the amount of NPA and its provisions to the total advances given by banks whereas net NPA means the amount of NPA on advances after deducting the provisions made for NPA. NPA of public sector banks in India are increasing rapidly. After the scam of Vijay Malaya's banks loan, NPA of Indian public banks increased very fast. He borrowed an amount of 9000 crore from public sector banks in which State Bank of India was on the top in providing him loans. This scam directly hit the liquidity and profitability of banks. Indian banks Gross NPA stood on 8.40 lakhs crore on 30 September 2017which was an increase of approx. 1.31% from the last quarter June 2017 whereas NPA of public sector banks stood on 7.33 lakhs crore in September 2017.State bank of India have the largest amount of NPA in their assets. Also in some private banks NPA have grown from pastquarter by 1.09 lakhs crore. In SBI an increase of 24086 crore in bad loans was noted whereas after Nirav Modi scam Punjab National Bank has reported maximum increment of 29100 crore in gross NPA to 86620 crore in March 2018. India's NPA are recorded on fifth position in world after March 2015.The NPA of public sector banks are sharply increasing. The following graph represents the trend of NPA in public sector banks of India from March 2015to September 2017.



Not only the public sector banks but some private sector banks are recorded a growth in their bad loans. Among private sector banks Gross NPA of ICICI and axis banks has risen to 17.4% and 37% from the last quarter in march 2017.Baks have to spend a large amount of funds to make provisions for NPA. The following table shows the movement of NPA in Indian banking system in financial year 2016 and 2017.

Type of Bank	Gross NPA (in crore)		Net NPA (in crore)	
	As on 31 March 2016	As on 31 March 2017	As on 31 March 2016	As on 31 March 2017
SBI and its Associates	1219686	1778106	688944	969322
Nationalized Banks	417978	5069217	2515679	2861565
Private Sector Banks	561874	932092	266774	477802
Small Finance Banks	637	2205	457	1147
Foreign Banks	158052	136291	27619	21369

Objectives of Study:

- To review the trend of NPA prevailing in Indian banking sector.
- To know the causes and consequences of NPA on Indian banking system.

RESEARCH METHODOLOGY

The present study is descriptive in nature. Secondary data has been used to show the trend of NPA borrowed from various journals, research papers, newspapers, books and RBI site.

CAUSES OF NON-PERFORMING ASSETS

Lack of proper credit appraisal system: In Indian banks there is lack of proper credit appraisal system to ensure the returns on loans and this becomes a reason for NPA because there is no proper investigation of borrowers before granting them loans for a time period.

Wrong choice of projects by borrowers: Many borrowers can't analysis the pros and cons of a project and funds got blocked in these projects. These projects can't give adequate return & profits to investors and these projects funds become loan that could not recover by banks.

Inflexible attitude of banks employees: One of the main reasons for increase in NPA is inefficient skills of banks employees and inadequate knowledge of banking system. Employees of banks can't tackle the strategy of some fraudulent borrowers and the funds borrowed by these people unrecoverable loan for banking system.

Lack of quality control: In India there is no strict rules against the banks frauds. People with some knowledge of laws and rules can escape from the legislative actions. They present false documentations regarding their property and security at the time of borrowing and become successful in taking loans from banks.

Political interference: In India, different political parties interfere in operations of banks regarding their lendingtransactions. As the government change, the policies regarding credit also change which creates problem for banking sector. Many times government gives concessions to different parties to repay their loans and allow them to use loans without payment of loans in different circumstances. Ultimately this becomes NPA in banking system and a burden on this sector.

Recession in market: Some time a long recession also give rise to bad loans. In recession many industries suffer losses; production reduces and cannot generate incomes and do not timely pay the loan granted from banks. This becomes an obstacle to repay the loans of banks.

CONSEQUENCES OF NPA

NPA affects the functions of banks in many ways.

NPA means funds got blocked and are not available for further lending means the amount of bad loans can't utilize to lend and in other banking activities. So it decreases the liquidity available in the banking system.

To handle the NPA all banks have to make a provisions for Non-performing assets which is ultimately a charge on the bank's profit and reduce profitability of banking sector.

Higher level of NPA spoils the reputation of the banks and it reduces the chances for future growth of particular growth.

Different stakeholders get disappointed and upset as they receive a lesser returns on their investment and they do not invest their funds in banking sector whereas banking sector is essential for the growth and development of economy.

Expenses of banks also increase because of establishment of different accounts for maintaining records of non-performing assets

Higher level of NPA indicates mis-management in banks which are not able to recover the amount due from different parties.

Increase in NPA is an ultimate burden on the society because due to NPA, demand for cash increases as a result of non-satisfaction of people in banking industry.

Suggestions to address rising NPAs

NPA has become a major problem for banking system especially for public sector banks. For economic development it is necessary to reduce or control the NPA. Here are some suggestions to solve the problems of banking sector.

Recapitalize, reforms and then privatization: By introducing the procedure of recapitalization and various reforms, the market value of banks can be enhance and privatization should be done to recover huge losses occurred by bad loans.

Government reforms: Not only privatization, other governmental reforms must be undertaken in public sector banks. For example recommendations of Nayak committee which clearly mentioned that power of selection of banks chairpersons should be according to ministry of finance in banks.

Role and objectives of banks should be clear: It is important to clarify the main objectives of banks and banks should strictly follow the procedure for loans according to their main objective. All terms and conditions related to objectives should be clearly mentioned to achieve the objectives.

Professional Qualifications: Adequate training should be given to enhance the knowledge, customer handing skills and educate the employees about the weakness of credit appraisal system of banking system. Attractive incentives should be given to attract better talent in this sector.

Proper investigation and timely inspections of all credits: Employees of banks should properly investigate the financial position of customer before granting term loans and ensure the adequate security for granting loan to recover loan in case of failure of payments. Regular checking of loans and their payment status also ensure the better recovery of loans.

Revision of Existing Credit appraisal system by RBI: Reserve bank of India should revise the credit appraisal norms regarding term loan to minimize the risk of bad debts. RBI should introduce new guidelines regarding norms of granting loan, time rate of interest, security and maturity of their loans.

CONCLUSION

NPA has adverse effect on credit system of banking sector. It affects the profitability, liquidity and reputation of banking sector. Huge funds are getting blocked in NPA and become a hindrance for growth and development of banking sector. An increasing rate of NPA can be noted in public sector banks so these banks should review their credit policies timely. In last few years the amount of NPA has increased rapidly and ultimately the burden of NPA have been suffered by the public. RBI should introduce some reforms to strengthen the credit appraisal system whereas banks should take efficient steps to control the NPA. Proper analysis of the position of borrower and after lending timely analysis should be done by Banks to reduce NPA problem. Strict actions should be taken by banks to recover NPA. Government should make efforts to help the banks in displaying the name of defaulters publicly. Government should also make efforts to bring back the defaulters in the country and to seize their property in order to repay the loans. Adequate credit appraisal, requirement based credit and proper planning for recovery of loans are some controlling steps that should be implemented on banking sector to reduce the NPA.

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