MOUNTING NPAS IN INDIAN COMMERCIAL BANKS

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ABSTRACT

The problem of non-performing assets has shaken the entire Indian banking sector. The main reason of high percentage of NPAs is the target-oriented approach, which deteriorates the qualitative aspect of lending. NPAs put detrimental impact on the profitability, capital adequacy ratio and credibility of banks. The paper highlights the most significant factors contributing towards the problem of non performing assets from the point of view of top bankers from public sector banks in India, some foreign banks and the measures required for management of NPAs like reformulation of banks' credit appraisal techniques, establishment of monitoring department.

As the build-up of NPAs has been a major factor in the erosion of profitability of public sector banks in India, the Narasimham Committee (II) underscored the need to reduce the average level of NPAs of all banks from 15 to 3 percent by 2002. The definition of weak banks given by this committee has internalized the concept of NPAs. The Working Group on Restructuring Weak Public Sector Banks supplemented the above definition by a combination of seven parameters covering solvency, earning capacity and profitability.

The problem of non-performing asset (NPAs) in the Indian banking system is one of the foremost and the most formidable problems that have shaken the entire banking industry. NPA is a double-edged weapon. On the one side bank cannot recognize interest on NPAs accounts and on the other, it is a drain of the banks' profitability due to high funding cost. Higher NPAs ratio shakes the confidence of investors, depositors, lenders etc. It also causes poor recycling of funds, which in turn will have deleterious effect on the deployment of credit. The non-recovery of loans effects not only further availability of credit but also financial soundness of the credit of oragnisation.

The problem of non-performing assets has shaken the entire Indian banking sector. The main reason of high percentage of NPAs is the target-oriented approach, which deteriorates the qualitative aspect of lending. The other reasons are willful defaults, ineffective supervision of loan accounts and lack of technical and managerial expertise on the part of borrowers. NPAs put detrimental impact on the profitability, capital adequacy ratio and credibility of banks. The paper highlights the most significant factors contributing towards the problem of non performing assets from the point of view of top bankers from public sector banks in India, some foreign banks and the measures required for management of NPAs like reformulation of banks' credit appraisal techniques, establishment of monitoring department.

As the build-up of NPAs has been a major factor in the erosion of profitability of public sector banks in India, the Narasimham Committee (II) underscored the need to reduce the average level of NPAs of all banks from 15 to 3 percent by 2002. The definition of weak banks given by this committee has internalized the concept of NPAs. The Working Group on Restructuring Weak Public Sector Banks supplemented the above definition by a combination of seven parameters covering solvency, earning capacity and profitability.

An asset is classified as non-performing asset (NPA) if the borrower does not pay dues in the form of principal and interest for a period of 180 days. However with effect from March 2004, default status would be given to a borrower if dues are not paid for 90 days. If any advances or credit facility granted by bank to a borrower becomes non- performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances / credit facilities having performing status.

Classification of Bank Assets

Reserve Bank of India (RBI) has issued guidelines on provisioning requirement with respect to bank advances. In terms of these guidelines, bank advances are mainly classified into:

Standard Assets: Such an asset is not a non- performing asset. In other words, it carries not more than normal risk attached to the business.

Sub-standard Assets: It is classified as non- performing asset for a period not exceeding 18 months.

Doubtful Assets: Asset that has remained NPA for a period exceeding 18 months is a doubtful asset.

Loss Assets: Here loss is identified by the banks concerned or by internal auditors or by external auditors or by Reserve Bank India (RBI) inspection.

In terms of RBI guidelines, as and when an asset becomes a NPA, such advances would be first classified as a sub-standard one for a period that should not exceed 18 months and subsequently as doubtful assets.

It should be noted that the above classification is only for the purpose of computing the amount of provision that should be made with respect to bank advances and certainly not for the purpose of presentation of advances in the banks' balance sheet.

Causes and Consequences of NPAs in Banks

One of the reasons for the accumulation of large portfolio of NPAs with banks is that the lending is not linked to productive investment and the recovery of credit is not linked to product scale. The borrowers are mainly farmers and small scale industries owner whose financial condition are generally weak. The volume of bank credit tacked in sick industries is the evidence of this malady. Sometimes it is found that an advice is given by BIFR or the directions are given by the various courts to the banks' that they should provide loans to sick industries. This type of practice is aggravating NPAs situation. Another reason for high NPAs is the faulty lending policy and making lending compulsory to priority sector by banks. There are many other causes which are also responsible for accumulation of NPAs. Many of these causes are related to faulty credit management like defective credit recovery mechanism, lack of professionalism in the work force, time lag between sanctions and disbursement of loan, unscientific repayment schedule, misutilization of loans by user, untimely communication to the borrowers regarding their due date, lack of sponge legal mechanism, politics at local levels and waive-off policy of loan by government (in year 1991 and 2008) etc have also been contributing to mounting NPAs in SCBs in India. The table 1 shows the Classification of Loan Assets of All Commercial Banks as on 31st March:

Table 1: Classification of Loan Assets of All CB's as on 31st March (Rs. in Crore)

Year	Total Advance	Total NPA	% of NPA to Advance	Standard Assets	Sub-std Assets	Doubtful Assets	Loss Assets
2001	558679	63963 (100)	11.44	494716	18206 (28.50)	37756 (59.00)	8001 (12.50)
2002	680925	70953 (100)	10.42	609972	21382 (30.13)	41201 (58.06)	8370 (11.81)
2003	778040	68780 (100)	8.84	709260	20078 (29.20)	39731 (57.80)	8971 (13.00)
2004	902027	64898 (100)	0.72	837130	21026 (32.40)	36247 (55.90)	7625 (11.70)
2005	1124926	58023 (100)	5.16	1066903	14073 (23.70)	36955 (63.80)	6996 (12.50)
2006	1473527	51242 (100)	3.48	1422285	14737 (28.50)	29940 (58.00)	6565 (13.50)
2007	1893513	50296 (100)	2.66	1843220	19883 (39.55)	24505 (48.71)	5905 (11.74)
2008	2331678	55842 (100)	2.39	2275836	26113 (46.08)	24386 (43.03)	5343 (9.43)
2009	2793133	68220 (100)	2.44	2724912	35920 (52.67)	26736 (39.19)	5564 (8.14)
2010	3271361	81813 (100)	2.50	3189548	41294 (50.47)	32668 (39.93)	7850 (9.60)
2011	4011435	94084 (100)	2.30	3917351	39878 (42.39)	44767 (47.58)	9440 (10.03)

Source: Economics intelligence service center for monitoring Indian Economy money and banking 2000-11.

Note: Figure in bracket is representing in percentage to total NPA's.

The table 1 depicts that total advances of commercial banks have increased 7.2 times from 2001 to 2011. It also depicts that percentage of NPAs to advances has declined from 11.44 % to 2.3 % in the same period. In case of doubtful assets, these were found maximum in year 2005 (63.80%). Loss assts were maximum in 2006 (13.50%). But later on it showed increase. Increasing of loss assets or NPA's is not good indicator for the development of a country or an economy.

Table 2: Classification of loan Assets According Bank Group wise (Rs.in Crore)

Standard Assets				
Year	PSBs	Pvt. Sector Banks	Foreign Banks	ALL SCB's
2001	387360 (78.30)	65071 (13.15)	42285 (8.55)	494716 (100)
2002	452862 (74.24)	109272 (17.91)	47838 (7.84)	609972 (100)
2003	523724 (73.84)	134248 (18.92)	51288 (7.23)	709260 (100)
2004	610435 (72.91)	167076 (19.95)	59619 (7.12)	837130 (100)
2005	830029 (75.90)	188789 (17.26)	74705 (6.83)	1093523 (100)
2006	1092607 (72.86)	309918 (20.66)	96907 (6.46)	1499431 (100)
2007	1335175 (72.44)	382628 (20.76)	125415 (6.80)	1843218 (100)

2008	1656585 (72.79)	459369 (20.18)	159882 (7.03)	2275836 (100)
2009	2059725 (75.59)	502768 (18.45)	162420 (5.96)	2724912 (100)
2010	2462030 (77.19)	567207 (17.78)	160311 (5.03)	3189548 (100)
2011	3008757 (76.81)	714338 (18.23)	194257 (4.96)	3917351 (100)

Source: Economics intelligence service center for monitoring Indian Economy money and banking 2000-11.

Note: Figure in bracket is representing in percentage to total NPA's.

The table 2 shows that total no. of standard assets of commercial banks has increased eight times from 2001 to 2011. It also depicts that percentage of PSB's has decreased from 78.30% to 76.81% in the same period. In case of Pvt. Sector banks it has increased from 13.15% in 2001 to 18.23% in 2011. In case of foreign banks, it has decreased from 8.55% in 2001 to 4.96% in 2011.

Table 3: Bank Groups' Wise NPAs (Rs in crore)

Year	Total Advances	Total NPA of all CB's	Advances	NPA's	Advances	NPA's	Advances	NPA's
	All CB's	All CB's	PSB's	PSB's	Pvt. Banks	Pvt. Banks	Foreign Banks	Foreign Banks
2001	558679	63963	442134 (100)	54774 (12.38)	71149 (100)	6078 (8.54)	45396 (100)	3111 (6.85)
2002	680925	70953	509369 (100)	56507 (11.09)	120938 (100)	11666 (9.64)	50618 (100)	2780 (5.49)

2003	778040	68780	577813 (100)	54.89 (9.36)	146046 (100)	11798 (8.07)	54181 (100)	2893 (5.33)
2004	902027	64898	661975 (100)	51541 (7.78)	177420 (100)	10344 (5.83)	62632 (100)	3013 (4.81)
2005	1124926	58023	817248 (100)	46817 (5.44)	230632 (100)	8851 (4.57)	77046 (100)	2355 (4.81)
2006	1473527	51242	1070872 (100)	41378 (3.71)	303793 (100)	7774 (2.45)	98862 (100)	2090 (2.07)
2007	1893513	50293	1373777 (100)	38602 (2.81)	391870 (100)	9239 (2.36)	127867 (100)	2452 (1.92)
2008	2331678	55842	1696333 (100)	39749 (2.34)	472345 (100)	12976 (2.75)	163000 (100)	3118 (1.91)
2009	2793133	68220	2103763 (100)	44039 (2.09)	519655 (100)	16888 (3.25)	169714 (100)	7294 (4.30)
2010	3271361	81813	2519331 (100)	57301 (2.27)	584591 (100)	17384 (2.97)	167439 (100)	7128 (4.26)
2011	4011435	94084	3079804 (100)	71047 (2.30)	732310 (100)	17972 (2.45)	199321 (100)	5065 (2.54)

Source: - Economic intelligence Service, country for monitoring Indian Economy, money and banking 2000 to 2011.

Note: PSB's:- Public Sector Banks, Pvt.: Private and Figure in brocket is percentage to advance.

The table 3 reveals that NPAs of public sector banks shows declining trend since 2001 to 2011. It has declined from 12.38% in 2001 to 2.30 % of total advances in public sector banks in 2011. This shows that public sector banks are taking corrective measures to improve their profitability. In case of private sector banks NPAs were maximum in the year 2002 (9.64%). Then it decline 2.45 % in year 2011. In case of foreign banks, NPAs were maximum in year 2001 (6.85%) which declined to 1.91 % in 2008. The table also shows that NPAs are declining in case of all banks. If we compare among the NPAs bank groups' wise then it is found that the NPAs have been maximum in case of public sector banks in whole period under study.

Table 4: Position of NPAs and CRAR of all SCB's

Year	Gross NPA Ratio to Gross Advances	Net NPA Ratio To Net Advances	Capital Adequacy Ratio
2001	11.44	6.2	11.40
2002	10.42	5.5	12.00
2003	8.84	4.0	12.70
2004	0.72	2.8	12.90
2005	5.16	2.0	12.80
2006	3.48	1.2	12.32
2007	2.66	1.0	12.28
2008	2.39	1.1	13.01
2009	2.44	1.1	13.20
2010	2.50	1.1	13.60
2011	2.25	0.97	14.17

Source: Center for Monet ring of Indian Economy 2000 to 2011.

The table 4 shows that ratio of gross non-performing assets to gross advances is continuously decreasing from 11.44% in 2001 to 2.25% in 2011. It shows that ratio of net non-performing assets to net advances is also continuously decreasing which was 6.2% in 2001 and declined to 0.97% in 2011. The table also shows that capital adequacy ratio is increased from 11.40% to 14.17% in above said period. It shows that capital adequacy ratio is increasing.

Table 5: Gross Profit/Loss Percentage of Total Assets in SCBs Bank Groups' Wise (Profitability of Bank Group)

Year	Scheduled Commercial Bank	Public Sector Banks	Private Sector Banks	Foreign Banks
2001	1.53	1.34	1.74	3.05
2002	1.94	1.88	0.66	3.10
2003	2.39	2.31	1.00	3.20
2004	2.66	2.67	0.95	3.68
2005	2.17	2.18	0.83	2.98
2006	1.95	1.88	1.71	3.34
2007	1.91	1.75	1.84	3.51
2008	1.93	1.67	2.05	3.84
2009	2.33	2.47	-	4.95
2010	2.17	1.87	2.68	3.70
2011	2.26	2.06	2.58	3.52

Source: Report on Trend and Progress in India 2000-2011.

The table 5 shows that gross profit/Loss percentage which was 1.53, 1.34, 1.74 and 3.05 of total assets in case of Scheduled Commercial Banks, Public Sector Banks, Private Sector Banks and Foreign Banks respectively in the year 2001 which has marginally increased in the year 2011 to 2.26, 2.06, 2.58 and 3.52 respectively.

Table 6: Net Profit/Loss Percentage of Total Assets in Scheduled Commercial Bank (Profitability of Bank Group)

Year	Scheduled Commercial Bank	Public Sector Banks	Private Sector Banks	Foreign Banks
2001	0.49	0.42	0.70	0.93
2002	0.75	0.72	0.66	1.32
2003	1.01	0.96	1.00	1.56
2004	1.13	1.12	0.95	1.65
2005	0.89	0.87	0.83	1.29
2006	0.88	0.82	0.87	1.54
2007	0.90	0.83	0.87	1.67
2008	0.99	0.88	1.01	1.82
2009	1.13	1.13	-	1.98
2010	1.05	0.97	1.28	1.26
2011	1.10	0.96	1.43	1.74

Source: Report on Trend and Progress in India 2000-2011.

Table 6 shows that Net profit/loss percentage of total asset which was 0.49, 0.42, 0.70 and 0.93 in respect of Scheduled Commercial Banks, Public Sector Banks, Private Sector Banks and Foreign Banks respectively in the year 2001 has increased to 1.10, 0.96, 1.43 and 1.74 respectively in 2011. It shows good management on the part of banks and sound position of recovery of debts.

The problem of non-performing asset (NPAs) in the Indian banking system is one of the foremost and the most formidable problems that have shaken the entire banking industry. NPA is a double-edged weapon. On the one side bank cannot recognize interest on NPAs accounts and on the other, it is a drain of the banks' profitability due to high funding cost. Higher NPAs ratio shakes the confidence of investors, depositors, lenders etc. It also causes poor recycling of funds, which in turn will have deleterious effect on the deployment of credit. The non-recovery of loans effects not only further availability of credit but also financial soundness of the credit of oragnisation.

There are a number of factors responsible for weak performance in respect of debt recovery and consequently banks' accounts turning into NPAs. NPAs occur due to the factors attributed to the borrowers, lenders and also due to external environment. Borrowers may divert their funds for expansion, modernization, diversification etc. (RBI, 1999). The borrowers' low priority to technology upgradation, inadequate attention to research and development, inefficient management etc. also lead to accounts in becoming non-performing. Loans may turn bad due to faulty policies of lenders also. Credit appraisal policies followed by the banks are old and ineffective. Sometimes delays in sanction/ disbursement also make the project unviable. Banks need to have effective credit monitoring policy for follow up, but unfortunately banks are not able to follow up the loan accounts efficiently which leads to loans being difficult to recover. Legal system is also ineffective. It takes a number of years to recover the amount.

It is evident from this research paper that the problem of NPAs in India has not yet reached in the critical stage that has reached in most countries. Industry related loan accounts which are near about 42% of total loans, and 20% of the industry-related loan assets can be considered as problematic. However, the burden of NPAs does have a serious impact on the long-term viability of the Indian financial sector and the absence of efficient resolution mechanisms will affect the growth of credit to the banking industry.

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