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## AN EMPIRICAL ANALYSIS ON ASSET QUALITY OF PUBLIC SECTOR BANKS IN INDIA: NON- PERFORMING ASSETS TO ADVANCES

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### ABSTRACT

*The banking sector is the lifeline of any modern economy. It is one of the important financial pillars of the financial sector, which plays a vital role of functioning of an economy. Banks performance is reflected by its asset quality. Asset quality is one of the most critical factors in determining overall financial performance of a banks. Asset quality is related to the left-hand side of the bank balance sheet. The primary factors affecting overall asset quality is the quality of loan portfolio and credit administration process. The primary objective behind measuring assets quality is to ascertain the components of Non-performing Assets. This study analyse the asset quality of public sector banks in India.*

### KEYWORDS

asset quality, gross NPAs to gross advances, net NPAs to net advances.

### INTRODUCTION

Asset quality is an important aspect of bank management entails the evaluation of a firm asset in order to facilitate the measurement of the level and size of credit risk associated with its operation. It relates to the left-hand side of a bank balance sheet and focused on the quality of loans which provides earnings for a bank. Asset quality and loan quality are two terms with basically the same meaning while its management is considered extremely important by the banking sector. According to the Basle Committee on Banking Supervision, the core principles for effective banking supervision comprised twenty-five core principles out of which seven are designed to address the relevant issues of bank asset quality or credit risk management (Basle, 1997). This implied that asset quality is of general concern to financial supervisory authorities in every country throughout the world. The following factors which influence the Bank's asset quality are: The level, distribution, severity, and trend of problem, classified, nonaccrual, restructured, delinquent, and nonperforming assets for both on- and off-balance sheet transactions.

The adequacy of the Allowance for Loan and Lease Losses and other asset valuation reserves.

The credit risk arising from or reduced by off-balance sheet transactions, such as unfunded commitments, credit derivatives, commercial and standby letters of credit, and lines of credit.

The diversification and quality of the loan and investment portfolios.

The extent of securities underwriting activities and exposure to counter-parties in trading activities.

The existence of asset concentrations.

The adequacy of loan and investment policies, procedures, and practices

The adequacy of internal controls and management information systems.

The volume and nature of credit documentation exceptions.

### NON-PERFORMING ASSETS

Non-performing assets are one of the important phenomena that have to properly follow by the banks, to maintain the growth of the banking activity. NPA's are an inevitable burden on a banking system. Banks need to observe their standard assets regularly in order to prevent any account becoming an NPA. Now way a days a good performance of any bank depends upon the proper maintenance of the NPAs and looking them within the control level. The Reserve Bank of India has issued a parameter for a bank regarding NPA that the interest and principal remind overdue beyond 90 days i.e. the term loan, cash credit, overdraft, bill purchase or discount are all classified as NPA.

### NPA AS DEFINED BY RBI

(i) interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,

(ii) the account remains 'out of order', in respect of an Overdraft/Cash Credit (OD/CC),

(iii) the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,

(iv) the instalment of principal or interest there on remains overdue for two crop seasons for short duration crops,

(v) the instalment of principal or interest there on remains overdue for one crop season for long duration crops,

(vi) the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.

(vii) in respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

### GROSS AND NET NPAs

Before measuring the asset Quality, it is essential to study the types of NPAs which are as follows:

#### (A) Gross NPA:

Gross NPAs are the sum total of all asset which 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.

#### (B) Net NPA:

Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA is obtained by reducing the provisions from Gross NPAs and 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.

### ASSET CLASSIFICATION

Banks are required to classify nonperforming assets further into the following three categories based on the period for which the asset has remained nonperforming and the realisability of the dues:

1. Substandard Assets
2. Doubtful Assets
3. Loss Assets

#### Substandard Assets

With effect from March 31, 2005, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

#### Doubtful Assets

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

#### Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is 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.

### MACRO PERSPECTIVE BEHIND NPAs

A lot of practical problems have been found in Indian banks, especially in public sector banks. Poverty elevation programs like IRDP, RREP, SUME, SEPUP, JRY, PMRY etc., failed on various grounds in meeting their objectives. The huge amount of loan granted under these schemes were totally unrecoverable by banks due to political manipulation, misuse of funds and non-reliability of target audience of these sections. Loans given by banks are their assets and as the repayment of several of the loans were poor, the quality of these assets were steadily deteriorating. Loan proposal evaluations were slack and as a result repayment were very poor. There are several reasons for an account becoming NPA. Such as Internal factors and External factors

#### INTERNAL FACTORS

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, delay in settlement of payments/ subsidiaries by government bodies etc.,

#### EXTERNAL FACTORS

1. Sluggish legal system
2. Scarcity of raw material, power and other resources.
3. Industrial recession.
4. Shortage of raw material, raw material/input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accidents.
5. Failures, non payment/ over dues in other countries, recession in other countries, externalization problems, adverse exchange rates etc.
6. Government policies like excise duty changes, Import duty changes etc.,

### REVIEW OF LITERATURE

**Prashanth K. Reddy (2002)** had mentioned that financial sector reform in India has progressed rapidly on aspect like interest rate deregulation, reduction in reserve requirements, barriers to entry, prudential norms and risk-based supervision. It further looks into the effect of the reforms on the level of NPAs and suggest mechanisms to handle the problem by drawing on experiences from other countries.

**Bhatia (2007)** had pointed out that the NPAs are considered as an important parameter to judge the performance and financial health of banks. The level of NPAs is one of the drivers of financial stability and growth of the banking sector.

**Das S (2007)** had recommended that expansion of credit is a must for a country like India. It was found that high credit growth may lead to high NPAs. The paper also mentioned that the effective and regular follow-up of the credit sanctioned is necessary to ascertain any embezzlement or diversion of funds.

**Suresh Kumar (2014)** had viewed that NPAs have always been a big worry for the banks in India. To improve the efficiency and profitability of the banks, the NPAs have to be controlled. Required orientation towards proper handling of NPAs should be given to the bank staff by formal training. After the loan disbursement, proper follow-up strategy should also be prepared.

**Vighneswara Swamy (2015)** had suggested that better credit management practices need to be taken up for bank lending to adverse effect of NPAs.

**Chilkuri SS (2016)** had mentioned that to reduce the NPAs, bank should frequently review the outstanding advances, Wilful defaulters and take timely measures to cut down the rise in NPAs which will improve the asset quality of banks.

**Vivek Rajbahadur Singh (2016)** had observed that the Non-Performing Assets have always created a big problem for the banks in India. It is just not only problem for the banks but for the economy too. The money locked up in NPAs has a direct impact on profitability of the bank and study shows that extent of NPA is comparatively very high in public sectors banks.

### OBJECTIVES OF STUDY

1. To Study the NPAs in Public Sector Banks in India.
2. To Study the trend level of NPAs in Public Sector Banks in India.

### RESEARCH METHODOLOGY

The Secondary data were extensively used. The secondary data were collected from various published sources such as annual reports of RBI, relevant Journals and search engines.

TABLE NO 1.1: GROSS ADVANCES AND GROSS NPAs OF PSBs (Amount in Rupees Billion)

Year	Gross Advances	Gross NPAs (Amount)	Gross NPAs as Percentage of Gross Advances
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2007-2008	18190.74	404.52	2.2
2008-2009	22834.73	449.57	2.0
2009-2010	27334.58	599.26	2.2
2010-2011	30798.04	746.00	2.4
2011-2012	35503.89	1178.39	3.3
2012-2013	45601.69	1656.06	3.6
2013-2014	52159.20	2272.64	4.4
2014-2015	51667.18	2784.68	5.0

Source: dbie.rbi.org.in

The above table depicts the amount of Gross Advances, Gross NPA and the percentage of Gross NPA during the period of 2007-08 to 2014-15. The amount of advances has increased from Rs. 18190.74 Billion in 2007-08 to Rs. 51667.18 Billion in 2014-15. The amount of gross NPA has increased from Rs. 404.52 billion in 2007-08 to Rs. 2784.68 billion in 2014-15. Similarly, NPA percentage is also showing the rising trend from 2.0 in 2007 to 5.0 in 2015.

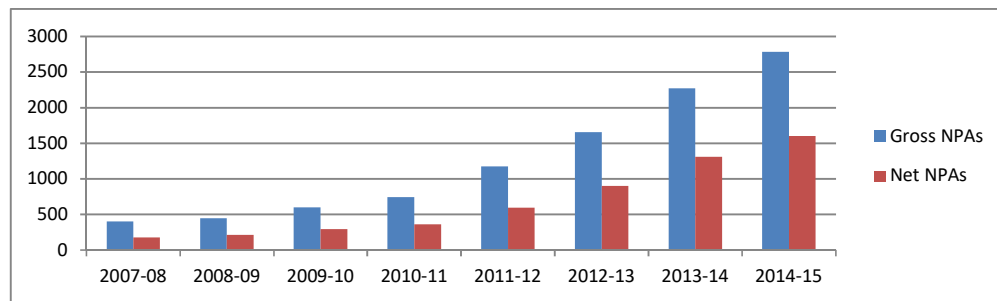
TABLE NO. 1.2: NET ADVANCES AND NET NPAs OF PSBs (Amount in Rupees Billion)

Year	Net Advances	Net NPAs (Amount)	Net NPAs as Percentage of Net Advances
2007-2008	17974.01	178.326	1.0
2008-2009	22592.12	211.05	0.9
2009-2010	27013.00	293.75	1.1
2010-2011	33056.32	360.00	1.2
2011-2012	38773.08	593.91	1.5
2012-2013	44728.45	900.37	2.0
2013-2014	51011.37	1306.35	2.6
2014-2015	54762.50	1602.08	2.9

Source: dbie.rbi.org.in

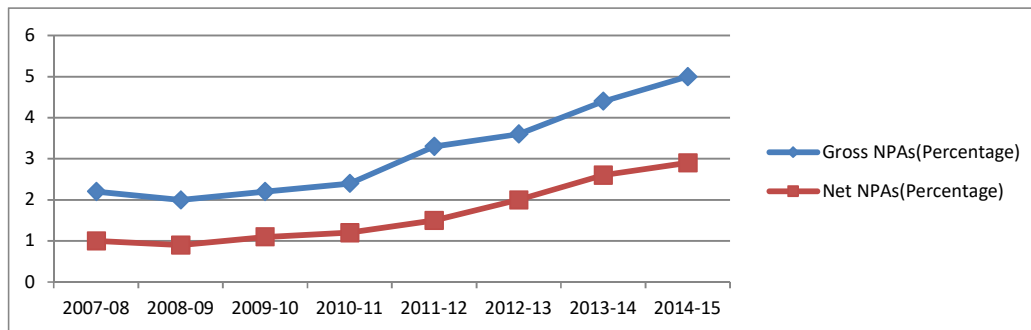
The above table depicts the amount of Net Advances, Net NPA and the percentage of Net NPA during the period of 2007-08 to 2014-15. The amount of advances has increased from Rs. 17974.01 Billion in 2007-08 to Rs. 54762.50 Billion in 2014-15. Further the amount of Net NPA has increased from 178.326 billion in 2007-08 to Rs. 1602.08 billion in 2014-15. Similarly, Net NPA percentage is also showing the rising trend from 1.0 in 2007 to 2.9 in 2015.

FIGURE 1: PUBLIC SECTOR BANKS (GROSS AND NET NPAs)



The above figure shows the trend of Gross NPA and Net NPA in billion for the period of 8 years starting from 2007-08 to 2014-15. The X-axis represent the years whereas Y-axis represent the amount of NPA. We can observe here that the Gross NPA and Net amount of PA has been showing an upward trend beginning from 2007-08 to 2014-15.

FIGURE 2: GROSS AND NET NPAs PERCENTAGE



The above figure portrays the trend of Gross NPA and Net NPA in percentage for the period of 8 years starting from 2007-08 to 2014-15. The X-axis represent the years whereas Y-axis represent the percentage of NPA. We can observe here that the Gross and Net percentage of NPA has been showing an upward trend beginning from 2007-08 to 2014-15.

**CONCLUSION**

Asset quality is one of the important parameter which indicates operational efficiency of the banks; therefore, there is a need of managing assets quality in a bank become mandatory in all commercial banks. Asset quality is highly depending on priority sector lending which are resulting more nonperforming assets. In order to reduce NPA and improve the asset quality banks should develop efficient credit management system and also revamping the corporate debt restructuring (CDR) mechanism, creating a special resolution mechanism for the infrastructure sector, setting up a National Asset Management Company, liberalising norms to raise capitalisation of asset reconstruction companies, and improving the effectiveness of the insolvency regime. Hence, it is concluded that managing or maintaining asset quality in commercial banks are very essential to produce better result of the banks.

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