

INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, IT & MANAGEMENT

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IMPACT OF NON PERFORMING ASSET ON PROFITABILITY OF PUBLIC AND PRIVATE SECTOR BANKS IN INDIA

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ABSTRACT

The NPAs 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 as Indian banks are highly dependent on income from interest on funds lent. This study shows that extent of NPA is comparatively very high in public sectors banks as compared to private banks. Although various steps have been taken by government to reduce the NPAs but still a lot needs to be done to curb this problem. The NPAs level of our 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 make more provisions for faster settlement of pending cases and also it should reduce the mandatory lending to priority sector as this is the major problem creating area. So the problem of NPA needs lots of serious efforts otherwise NPAs will keep killing the profitability of banks which is not good for the growing Indian economy at all.

KEYWORDS

NPA, Indian banks.

BANKING SECTOR IN INDIA

India cannot have a healthy economy without a sound and effective banking system. The banking system should be hassle free and able to meet the new challenges posed by technology and other factors, both internal and external.

The government's regulation policy for banks has paid rich dividends with the nationalization of 14 major private banks in 1969. Banking today has become convenient and instant, with the account holder not having to wait for hours at the bank counter for getting a draft or for withdrawing money from his account. In the past three decades, India's banking system has earned several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to metropolises or cities in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main aspects of India's growth story.

The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management. Asset quality was not prime concern in Indian banking sector till 1991, but was mainly focused on performance objectives such as opening wide networks/branches, development of rural areas, priority sector lending, higher employment generation, etc. While the primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., but in recent times the banks have become very cautious in extending loans. The reason being mounting nonperforming assets (NPAs) and nowadays these are one of the major concerns for banks in India

NPA

A Non-Performing Asset (NPA) is defined as a credit facility in respect of which the interest and/or installment of principal has remained „past due“ for a specified period of time.

In India, the definition of NPAs has changed over time. According to the Narasimham Committee Report (1991), those assets (advances, bills discounted, overdrafts, cash credit etc.) for which the interest and/or installment of principal remains due for a period of four quarters (180 days) should be considered as NPAs.

With an aim of moving towards the international best practices and ensuring greater transparency, a standard criterion of "90 days" overdue norm was fixed for identification of NPA from the FY ending March, 2004 in the Indian financial system. Thus, as per present convention, a non-performing asset refers to a loan or an advance where:

- # Interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a term loan
- # The account remains „out of order“ for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC)
- # The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted
- # Interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes
- # Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts

WHY ASSET BECOME NPA?

A several factors is responsible for increasing size of NPAs in PSBs. The Indian banking industry has one of the highest percents of NPAs compared to international levels. A few prominent reasons for assets becoming NPAs are as under

- # Lack of proper monitoring and follow-up measures
- # Lack of sincere corporate culture Inadequate legal provisions on foreclosure and bankruptcy
- # Change in economic policies/environment.
- # Non transparent accounting policy and poor auditing practices
- # Lack of coordination between banks/FIs
- # Directed lending to certain sectors
- # Failure on part of the promoters to bring in their portion of equity from their own sources or public issue due to market turning unfavorable
- # Criteria for classification of assets

FOUR CATEGORIES, ON THE BASIS OF AGE OF OVERDUE

STANDARD ASSETS

Standard asset is one which does not disclose any problem and which does not carry more than normal risk attached to business. Thus, in general, all the current loans, agricultural and non-agricultural loans which have not become NPA may be treated as standard asset

SUB-STANDARD ASSETS

A Non-performing asset may be classified as sub-standard on the basis of the following criteria. (a) An asset which has remained overdue for a period not exceeding 3 years in respect of both agricultural and non-agricultural loans should be treated as substandard. (b) In case of all types of term loans, where installments are overdue for a period not exceeding 3 years, the entire outstanding in term loan should be treated as sub-standard. (c) An asset, where the terms and conditions of the loans regarding payment of interest and repayment of principal have been renegotiated or rescheduled, after commencement of production, should be classified as sub-standard and should remain so in such category for at least one year of satisfactory performance under the renegotiated or rescheduled terms. In other words, the classification of an asset should not be upgraded merely as a result of rescheduling unless there is satisfactory compliance of the above condition.

DOUBTFUL ASSET

A Non-Performing Asset may be classified as doubtful on the basis of following criteria: As asset which has remained overdue for a period exceeding 3 years in respect of both agricultural and non-agricultural loans should be treated as doubtful. In case of all types of term loans, where installments are overdue for more than 3 years, the entire outstanding in term loan should be treated as doubtful. As in the case of sub-standard assets, rescheduling does not entitle a bank to upgrade the quality of advance automatically

LOSS ASSET

Loss assets are those where loss is identified by the bank/ auditor/ RBI/ NABARD inspectors but the amount has not been written off wholly or partly. In other words, an asset which is considered unrealizable and/ or of such little value that its continuance as a doubtful asset is 12 not worthwhile, should be treated as a loss asset. Such loss assets will include overdue loans in cases

- (a) where decrease or execution petitions have been time barred or documents are lost or no other legal proof is available to claim the debt,
- (b) where the members and their sureties are declared insolvent or have died leaving no tangible assets
- (c) where the members have left the area of operation of the society (refers to the borrower in whose name the respective Loan Account with SCB/ CCB) leaving no property and their sureties have also no means to pay the dues
- (d) where the loan is fictitious or when gross misutilisation is noticed
- (e) amounts which cannot be recovered in case of liquidated societies agricultural and non-agricultural loans is required to be done into

LITERATURE REVIEW

Sontakke. N. R, Tiwari.C.(2013) highlighted that NPA is catching the attention as a big problem for the Indian banks after the reform in financial sectors. NPA affects the profitability because banks can't generate income from these and it also increases the Provisions and funding costs. Poor management of NPA can badly affect the economy. They had suggested the appropriate measures to control or decrease NPAs.

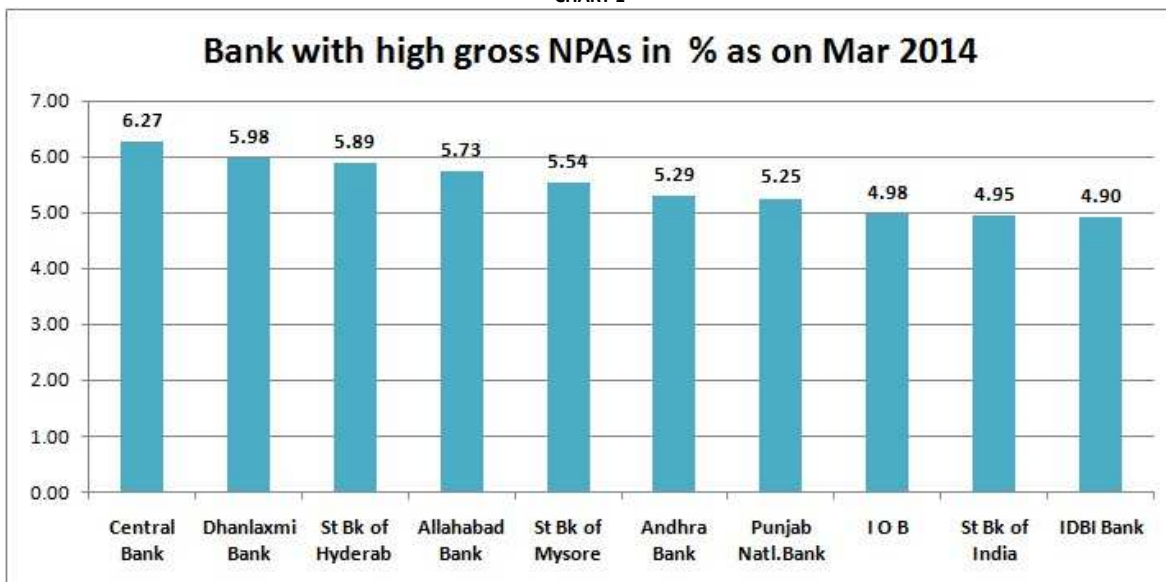
Sikdar.P, Makkad.M (2013) discussed that to control the level the NPAs proper credit and risk assessment mechanism is required and prudential and provisional norms must be minimised to reduce Non-Performing Assets. Restructuring of banking organisations, managerial efficiency improvement and for the proper valuation of credit worthiness requirement of skill up gradation is necessary. There is a need of suitable credit appraisal policy. Banks should have to follow measures to reduce the level of NPA.

Srinivas.K.T.(2013) stressed upon the fact that while sanctioning loans banks have to see whether the borrower is trust worthy or not and they have to avoid borrowers of non-trustworthy position. They have to make sure that loan amount must be utilised as per the purpose of the loans. Loans should not be provided to the previous loans defaulters as per their goodwill. Education for the consequences and effect is required for the borrower; banks can reduce their NPAs after considering all these points. NPA must be considering as actual National Priority.

Samir, Kamra.D (2013) focussed on the financial institutions that are adversely effected by Non-Performing assets in both term psychologically and financially. Credit management skills are required to reduce the level of nonperforming assets. There is a necessity to master the experience for the proper monitoring of exposure levels, for the industries in trouble timely action is required, Skill and expertise of management of NPA, settlement after negotiations, settlement after compromises, legal remedies, these measures are valuable to reduce the level of Non-performing assets. After so many experiments nothing can reduce the level of NPA.

Mehta. L, Malhotra. M (2014) evaluated that NPA is a main threat for the Banks in India. Non-performing assets must be managed properly for the healthy environment of Indian banks.in their research paper they discussed the positive impact of priority sector lending's on NPAs. Recession was considered as a one of the reason for the continuous increase in the NPAs.

CHART 1



Source-www.rbi.org

UNDERLYING REASON FOR NPA IN INDIA

An internal study conducted by RBI shows that in the order of prominence the following factor contribute to NPAs.

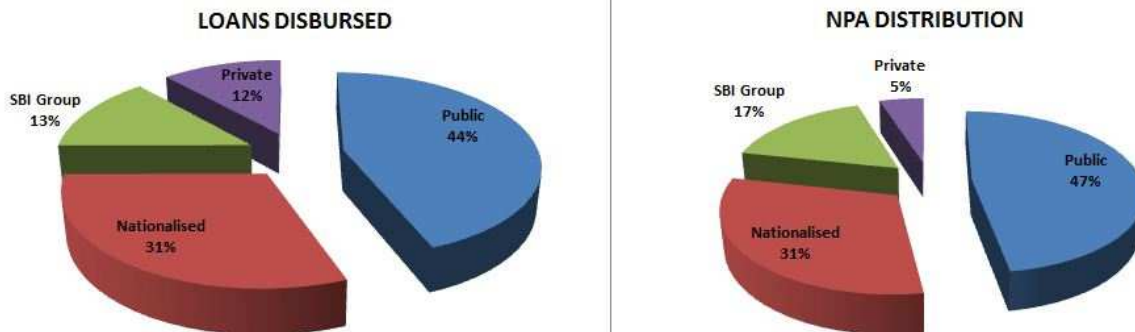
INTERNAL FACTORS

- a. Defective lending process - There are three cardinal principles of bank lending that have been followed by the commercial banks since long. i. Principle of safety ii. Principle of liquidity iii. Principle of profitability.
- b. Inappropriate technology - Due to inappropriate technology and management information system, market driven decisions on real time basis can't be taken. Proper MIS and financial accounting system is not implemented in the banks, which leads to poor credit collection, thus NPAs. All the branches of the bank should be computerized.
- c. Improper swot analysis - The improper strength, weakness, opportunity and threat analysis is another reason for rise in NPAs. While providing unsecured advances the banks depend more on the honesty, integrity, and financial soundness and credit worthiness of the borrower.
- d. Poor credit appraisal system - Poor credit appraisal is another factor for the rise in NPAs. Due to poor credit appraisal the bank give advances to those who are not able to repay it back. They should use good credit appraisal to decrease the NPAs.
- e. Managerial deficiencies -The banker should always select the borrower very carefully and should take tangible assets as security to safe guard its interests. When accepting securities banks should consider the: 1. Marketability 2. Acceptability 3. Safety 4. Transferability The banker should follow the principle of diversification of risk based on the famous maxim do not keep all the eggs in one basket, it means that the banker should not grant advances to a few big farms only or to concentrate them in few industries or in a few cities. If a new big customer meets misfortune or certain traders or industries affected adversely, the overall position of the bank will not be affected
- f. Absence of regular industrial visit - The irregularities in spot visit also increases the NPAs. Absence of regularly visit of bank officials to the customer point decreases the collection of interest and principals on the loan. The NPAs due to wilful defaulters can be collected by regular visits.
- g. Faulty credit management - like defective credit in recovery mechanism, lack of professionalism in the work force.

EXTERNAL FACTORS

- a. Ineffective recovery - The Govt. has set up numbers of recovery tribunals, which works for recovery of loans and advances. Due to their negligence and ineffectiveness in their work the bank suffers the consequence of non-recover, thereby reducing their profitability and liquidity.
- b. Wilful defaults - There are borrowers who are able to pay back loans but are intentionally withdrawing it. These groups of people should be identified and proper measures should be taken in order to get back the money extended to them as advances and loans.
- c. Natural calamities - This is the major factor, which is creating alarming rise in NPAs of the PSBs. Every now and then India is hit by major natural calamities thus making the borrowers unable to pay back their loans. Thus the bank has to make large amount of provisions in order to compensate those loans, hence end up the fiscal with a reduced profit.
- d. Industrial sickness - Improper project handling, ineffective management, lack of adequate resources, lack of advance technology, day to day changing govt. Policies give birth to industrial sickness. Hence the banks that finance those industries ultimately end up with a low recovery of their loans reducing their profit and liquidity.
- e. Lack of demand - Entrepreneurs in India could not foresee their product demand and starts production which ultimately piles up their product thus making them unable to pay back the money they borrow to operate these activities. The banks recover the amount by selling of their assets, which covers a minimum label. Thus the banks record the non-recovered part as NPAs and has to make provision for it.
- f. Change on govt. Policies - With every new govt. banking sector gets new policies for its operation. Thus it has to cope with the changing principles and policies for the regulation of the rising of NPAs.

FIG. 1 & 2



IMPACT OF NPA

LIQUIDITY

Money is getting blocked lead to lack of enough cash in hand which lead to borrowing money for short period of time from outside which lead to additional cost to the bank. Difficulty in operating the functions of bank is another cause of NPA. Due to lack of money Routine payments and dues are not paid on time

CREDIT LOSS

In case of bank is facing problem of NPA then it adversely affects the value of bank in terms of market credit. It will lose its goodwill and brand image because as we have discussed earlier that bank is not able to pay its dues on time and its negative impact is that people start withdrawing their money from bank which then cause liquidity problem and also decrease in credibility.

INVOLVEMENT OF MANAGEMENT

Time and efforts of management is another indirect cost which bank has to bear due to NPA otherwise time and efforts of management in handling and managing NPA would have been diverted to some fruitful activities, which would give good returns. Now a day's banks have special employees to deal and handle NPAs, which is additional cost to the bank.

PROFITABILITY

NPA means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the profitability of bank decreases not only by the amount of NPA but NPA lead to opportunity cost also as that much of profit can be invested in some return earning project/asset. So NPA not only affect current profits but also future stream of profits, which may lead to loss of some long-term beneficial opportunity. Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.

TABLE 1: GROSS AND NET NPA OF PUBLIC SECTOR BANKS

Year	SBI				PSB				Bank of Baroda			
	GNPA	%GNPA	NNPA	%NNPA	GNPA	%GNPA	NNPA	%NNPA	GNPA	%GNPA	NNPA	% NNPA
2009	36346	3.01	9,532	1.76	2965.33	1.55	1552.59	1.09	1842.92	1.2	602.32	0.34
2010	19535	3.09	10,870	1.72	3356.24	1.68	1678.52	1.12	2400.69	1.25	652.26	0.38
2011	25,326	3.28	12,346	1.63	4,379.39	1.79	2,038.63	1.23	3,152.50	1.36	790.88	0.35
2012	39,676	4.44	15,818	1.82	8,719.62	2.93	4,454.23	1.52	4,464.75	1.53	1,543.64	0.54
2013	51,189	4.75	21,956	2.1	13,465.79	4.27	7,236.50	2.35	7,982.58	2.4	4,192.02	1.28
Avg.	30,263	3.6	14,108	1.8	6577.27	2.44	3392.09	1.46	3,968.69	1.548	1,556.22	0.578

TABLE 2: GROSS AND NET NPA OF PRIVATE SECTOR BANKS

Year	ICICI				HDFC				AXIS			
	GNPA	%GNPA	NNPA	%NNPA	GNPA	%GNPA	NNPA	%NNPA	GNPA	%GNPA	NNPA	%NNPA
2009	96,49	3.96	45,53	2.09	1988	1.12	627	0.63	897	1.15	327	0.4
2010	94,80	4.36	38,41	2.12	1,816	1.09	392	0.31	1318	0.98	419	0.4
2011	10,034	4.47	2,407	1.11	1,694	1.05	296	0.2	159	1.01	41	0.26
2012	9,475	3.62	1,860	0.73	1,999	1.02	352	0.2	1,806	0.94	472	0.25
2013	9,607	3.22	2,230	0.77	2,334	0.97	468	0.2	2,393	1.06	704	0.32
Avg.	44,083	3.92	18,089	1.36	1,966	1.05	372.56	0.3	1,315	1.02	392.7	0.32

TABLE 3: GROSS AND NET NPA OF PUBLIC AND PRIVATE SECTOR BANKS

Year	Public Sector Banks				Private Sector Banks			
	GNPA	%GNPA	NNPA	%NNPA	GNPA	%GNPA	NNPA	%NNPA
2009	21154.25	5.76	11,707	3	2885	6.23	954	3.12
2010	25,292	6	13,201	3	3,134	6	811	3

Source: statistical table from trends and report on banking

CONCLUSION

The NPAs 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 as Indian banks are highly dependent on income from interest on funds lent. This study shows that extent of NPA is comparatively very high in public sectors banks as compared to private banks. Although various steps have been taken by government to reduce the NPAs but still a lot needs to be done to curb this problem. The NPAs level of our 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 make more provisions for faster settlement of pending cases and also it should reduce the mandatory lending to priority sector as this is the major problem creating area. So the problem of NPA needs lots of serious efforts otherwise NPAs will keep killing the profitability of banks which is not good for the growing Indian economy at all.

SUGGESTIONS TO REDUCE NPA

As non-performing assets can prove a threat to the creditability of commercial banks, various methods were identified to reduce them. These methods are stated as follows:

1. To do away with this specific requirement of filing a suit with court towards recovery of NPAs, Government of India enacted the Securitization and Reconstruction of Financial Assets & Enforcement of Securities Interest (SARFAESI) Act or popularly referred to as Securitization Act in the year 2002.
2. Adequate capital requirement is also an important component so the Basel Committee recommended that the capital adequacy ratios should be proposed towards ensuring that the commercial banks maintain adequate buffers in the form of capital as cover for advances granted under various categories. The idea is that a bank's own funds should also be employed towards loan granting activity, instead of solely depending on public deposits.
3. Banks should find out the original reasons or purposes of the loan required by the borrowers.
4. Proper identification of the guarantee should be checked by the bank including security of his or her wealth.
5. Based on the recent trends, banks should emphasize more on priority sectors for reducing the quantum of NPAs.
6. Banks should ensure the credibility of the borrower.
7. Bank officials should frequently visit the unit and assess the physical conditions of the assets, receivables and stock therein.
8. While advancing loans, the three principles of bank lending viz, Principle of safety, principle of liquidity and principle of profitability must be adhered to.
9. Bank should critically examine and analyse the reasons behind time overrun.
10. The banks should ensure that the assets are fully insured

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