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Changing Issues Related to Declining of Non-Performing Assets in Banks

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ABSTRACT

This paper explores an empirical approach to the analysis of Non-Performance Assets (NPAs) of public, private, and foreign sector banks in India. 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. This paper aims to find the fundamental factors which impact NPAs of banks. A model consisting oftivo type's of factors, viz., macroeco - nomie factors and bank-specific parameters, is developed arid the behavior of NPAs of the three categories of banks is observed. The empirical analysis assesses how macroeconomic factors and bank-specific parameters affect NPAs of a particular category of banks. The results show that movement in NPAs over the years can be explained well by the factors considered in the model for the public and private sector banks. The other important result's derived from the analysis include the finding that banks' exposure to priority 'sector lending educes NPAs. The Impact of competitive culture of public,, private, and foreign sector banks in India with in themselves helpes in declining of NPA's from banks.

KEYWORDS: *non performaing of asset, banking sector survival, changing scenario*

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INRODUCTION

Banking sector reforms in India have progressed promptly on aspects like interest rate deregulation, reduction in statutory reserve requirements, prudential norms for interest rates, asset classification, income recognition and provisioning. But it could not match the pace with which it was expected to do. 1 he accomplishment of these norms at the execution stages without restructuring the banking sector as .such is creating havoc. This research paper deals with the problem of having non-performing assets, the reasons for mounting non-performing assets and the practices in present situation for dealing with non-performing assets. Indian banking sector is having a serious problem due to non performing. The financial reforms have helped largely to clean NPA around Rs. 52,000 crores in the year 2004. The earning capacity and profitability of the bank are highly affected due to this. 'NPA is defined as an advance for which interest or repayment of principal or both remain outstanding for a period of more than two quarters. The level of NPA acts as an indicator showing the bankers credit risks and efficiency of allocation of resource. During pre-nationalization period and after independence, the banking sector remained in private hands. Large industries who had control in the management of the banks were utilizing major portion of financial resources of the banking system and as a result low priority was accorded to priority sectors. Government of India nationalized the banks to make them both from as an instrument of economic and social change and the mandate given to the banks was to expand their networks in rural areas and to give loans to priority sectors such as small scale industries, self-employed groups, agri-culture and schemes involving women.

To a certain extent the banking sector has achieved this mandate. Lead Bank Scheme enabled the banking system to expand its network in a planned way and make available banking series to the large number of population and touch every strata of society by extending credit to their productive endeavors. This is evident from the fact that population per office of commercial bank has come down from 66,000 in the year 1969 to 11,000 in 2004, Similarly, share of advances of public sector banks to priority sector increased from 14.6% in 1969 to 44% of the net bank credit. The number of deposit accounts of the banking system in-creased from over 3 crores in 1969 to over 30 crores. Borrowed accounts increased from 2.50 lakhs to over 2.68 crores.

Meaning of NPAs

An asset is classified as Non-performing Asset (NPA) if due in the form of principal and interest are not paid by the borrower for a period of 180 days. However with effect from March 2004, default Reader & Head, School of Commerce & Management Sciences **Research Student, both from SRTM University, Nanded-431 606 (Maharashtra).

Status would be given to a borrower if dues are not paid for 90 days. If any advance or credit-facilities granted by banks 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.

Though the term NPA connotes a financial asset of a commercial bank, which has stopped earning an expected reasonable return, it is also a reflection of the productivity of the unit, firm, concern, industry and nation where that asset is idling. Viewed with this perspective, the NPA is a result of an environment that prevents it from performing up the expected levels. The definition of NIP As in Indian context is certainly more liberal with two quarters norm being applied for classification of such assets. The RBI is moving over to one-quarter norm from 2004 onwards.

Magnitude of NPAs

In India, the NPAs that are considered to be at higher levels then those in other countries have of late, attracted the attention of public. The India banking system had acquired a large quantum of NPAs which can be termed as legacy NPAs. NPAs seem to be growing in public sector banks over the years.

Causes for Non Performing Assets

A strong banking sector is important for a flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. The Indian banking system, which was operating in a closed economy, now faces the challenges of an open economy.

On one hand a protected environment ensured that banks never needed to develop sophisticated treasury operations and\ sset Liability Management skills.

On the other hand a combination of directed lending and son banking relegated profitability and competitiveness to the background. The net result was unsustainable NPAs and consequently a higher effective cost of banking services.

One of the main causes of NPAs into banking sector is the directed loans system under which commercial banks are required a prescribed percentage of their credit (40%) to priority sectors. As of today nearly 7 percent of Gross NPAs are locked up in 'hard-core' doubtful and loss assets, accumulated over the years.

The problem India faces is not lack of strict prudential norms but

1. The legal impediments and time consuming nature of asset disposal proposal.
2. Postponemen! of problem in • order to show higher earnings.
3. Manipulation of debtors using political influence.

Causes for an Account becoming NPA		
Those attributable to borrower	**Causes attributable to banks**	**Other causes**
a) Failure to bring in required capital	a) Wrong selection of borrower	a) Lack of infrastructure
b) Too ambitious project	b) Poor credit appraisal	b) Fast- changing technology
c) Longer gestation period	c) Unhelpful in supervision	c) Unhelpful attitude of Government
d) Unwanted expenses	d) Tough stand on issues	d) Changes in consumer preferences
e) Over trading	e) Too inflexible attitude	e) Increase in material cost
f) Imbalances of inventories	f) Systems overloaded	f) government policies
g) Lack of proper planning	g) Non inspection of units	g) Credit policies
h) Dependence on single customer	h) Lack of motivation	h) Taxation laws
i) Lack of expertise	i) Delay in sanction	i) Civil commotion
j) Improper working capital Mgmt	j) Lack of trained staff	j) Political hostility
k) Mis management	k) Lack of delegation of work	k) Sluggish legal system
l) Diversion of funds	l) Sudden credit squeeze by banks	l) Changes related to Banking amendment Act
m) Poor quality management	m) Lack of commitment to recovery	
n) Heavy borrowings	n) Lack of technical, personnel & zeal	
o) Poor credit collection		
p) Lack of quality control		

Macro perspective behind NPAs

A lot of practical problems have been found in Indian banks, especially in public sector banks. For example, the government of India hand given a massive wavier of Rs. 15,000 Crs. under the Prime Ministership of Mr. V.P. Singh, for rural debt during 1989-90. This was not a unique incident in India and left a negative impression on the payer of the loan. Poverty eleviation programs like IRDP, RKEP, SUME SEPUP, JRY, PMRY etc., failed on various grounds in meeting their objective. 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. Credit allocation became 'Lon Melas', loan proposal evaluations were slack and as a result repayments were very poor.

There are several reasons for an account becoming NPA

- Internal factors
- External factors

Internal factors
1. Funds borrowed for a particular purpose but not used 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. Willful defaults, siphoning of funds, fraud, disputes, management disputes, misappropriation 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-
a. Long legal tangles
b. Changes that had taken place in labour laws
c. Lack of sincere effort.
2. Scarcity of raw material, power and other resources.
3. Industrial recession.
4. Shortage of raw material, raw materialXinputprice escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accidents.
5. Failures, nonpayment\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.,

Asset classification
The RBI has issued guidelines to banks for classification of assets into four categories.

1. Standard assets
These are loans which do not have any problem are less risk.

2. Substandard assets
These are assets which come under the category of NPA for a period of less then 12 months.

3. Doubtful assets
These are NPA exceeding 12 months.

4. Loss assets
These NPA which are identified as unreliable by internal inspector of bank or auditors or by RBI. (see Table 1)

Income recognition and provisioning
Income from NPA is not recognized on accrued basis but is booked as income only when it is actually received. RBI has also tightened the provisions norms against asset classification. It ranges from 0.25% to 100% from standard asset to loss asset respectively, (see Table 2 & 3)

Table 1:The classification of assets of scheduled commercial bank (Amount Rs. crorss)

Assets	2001	2002	2003	2004
Standard Assets	494716 (88.6)	609972 (89.6)	709260 (91.3)	837130 (92.8)
Sub Standard assets	18206 (3.3)	21382 (3.1)	20078 (2.6)	21026 (2.3)
Doubtful assets	37756 (6.8)	41201 (6.10	39731 (5.1)	36247 (4.36)
Loss assets	8001 (1.4)	8370 (1.2)	8971 (1.2)	7625 (0.8)
Total NPA	63963 (11.4)	70953 (10.4)	68780 (8.8)	902027 (100)

Table 2: Gross and net NPA of different banks, secterwise (end of March 31)(in%)

Category	Gross NPA/Gross Advance			
	2001	2002	2003	2004
Public sector bank	12.37	11.09	9.36	7.79
Private sector	8.37	9.64	8.07	5.84
Foreign bank	6.37	9.64	8.07	5.54

Table 3 ***(end of March 31)(in%)***

Category	*Net NPA/Net Advance*			
	2001	2002	2003	2004
Public sector bank	6.74	5.82	4.53	2.98
Private sector	2.27	2.49	2.32	1.32
Foreign bank	1.82	1.89	1.76	1.49

The table II and III show that the percentage of gross NPA/gross advance and net NPA/net advance are in a decreasing trend. This shows the sign of efficiency in public and private sector banks but still if compared to foreign banks, Indian private sector and public sector banks have a higher NPA.

Management of NPA

The table II & III show that during initial sage the percentage of NPA was higher. This was due to slow ineffective recovery of bank credit, lacuna in credit recovery system, inadequate legal provision etc. Various steps have been taken by the government to recover and reduce NPAs. Some of them are:

1. One time settlement/compromise scheme
2. Lok adalats
3. Debt Recovery Tribunals
4. Securitization and reconstruction of financial assets and enforcement of security Interest Act 2002
5. Corporate Reconstruction companies.
6. Credit information on defaulters and role of credit information bureaus

Difficulties with the non-performing assets

1. Owners do not receive a market return on their capital. In the worst case, if the bank fails, owners lose their assets. In modem times, this may affect a ' broad pool of shareholders.
2. Depositors do not receive a market return on savings. In the worst case if the bank fails, depositors lose their assets or uninsured balance. Banks also redistribute losses to other borrowers by charging higher interest rates. Lower deposit rates and higher lending rates repress savings and financial markets, which hampers economic growth.
3. Non performing loans epitomize bad investment. They misallocate credit from good projects, which do not receive funding, to failed projects. Bad investment ends up in misallocation of capital and, by extension, labour and natural resources. The economy performs below its production potential.
4. Non performing loans may spill over the banking system and contract the money stock, which may lead to economic contraction. This spillover effect can channellise through illiquidity or bank insolvency; (a) when many borrowers fail to pay interest, banks may experience liquidity shortages. These shortages can jam payments across the country, (b) illiquidity constraints bank in paying depositors e.g. cashing their pay-checks. Banking panic follows. A run on banks by depositors as part of the national money stock become inoperative. The money stock contracts and economic contraction follows (c) undercapitalized banks exceed the banks capital base.

Lending by banks has been highly politicized. It is common knowledge that loans are given to various industrial houses not on commercial considerations and viability of project but on political considerations; some politician would ask the bank to extend the loan to a particular corporate and the bank would oblige. In normal circumstances banks, before extending any loan, would make a thorough study of the actual need of the party concerned, the prospects of the of the business in which it is engaged, its track record, the quality of management and so on. Since this is not looked into, many of the loans become NPAs.

The loans for the weaker sections of the society and the waiving of the loans to farmers are another dimension of the politicization of bank lending.

Non-performing assets of banks on the decline

Non-performing assets on banks on the decline *(In rupee crore)*
Group-wise movements in non-performing assets 2003-04

Position	Scheduled Commercial Banks	Public Sector banks	Old private sector banks	Now private sector banks	Foreign Banks
Gross NPAs as at end March 2003	68,698	54,090	4,291	7,492	2,826
Gross NPAs as at end March 2004	64,486	51,538	4,392	5,963	2,894
Gross NPAs as at end March 2003	32,657	24,867	2,547	4,335	907
Gross NPAs as at end March 2004	24,617	18,860	2,140	2,717	900

1. The asset quality of scheduled commercial banks (SCBs) has shown a remarkable improvement in 2003-04, according to the RBI report on Trends and Progress of Banking in India' released on Monday.
2. The central bank has noted that the gross non-performing assets (NPAs) of SCBs have declined in absolute terms for a second year in succession, despite the switchover to the 90-day delinquency norm, effective March 2004.
3. Gross NPAs of scheduled commercial banks declined by 5.6 per cent in 2003-04, against a decline of 3 per cent in 2002-03. Due to significant -provisioning, the net NPAs declined substantially by 24.7 per cent during 2003-04 against a decline of 8 per cent in 2002-03, the report said.
4. The decline in NPAs is evident across bank groups. During 2003-04, reductions outpaced additions in the NPAs account. For SCBs, the decline in NPAs was accompanied by the decline in doubtful and loss assets by 8.8 per cent and 15 per cen respectively, the central bank has observed.

5. The ratio of net NPAs to net advances of SCBs declined from 4.4 per cent in 2002-03 to 219 per cent in 2003-04. All bank groups witnessed a decline in the ratio of net NPAs to net advances in 2003-04.
6. Among bank groups, the old private sector banks had the highest net NPAs ratio at 3.8 per cent, followed by public sector banks, new private banks and foreign banks. During 2003-04, the share of NPAs in the priority sector to total NPAs of public sector banks increased marginally. However, there was a decline in the share of NPAs of agriculture sector and small-scale industries but an increase in the share of other priority sectors.
7. The share of NPAs on account of public sector undertakings declined while the share of NPA of non-priority sectors increased during 2003-04.
8. For private sector banks, the share of NPAs on account of agriculture sector was lower when compared with 2002-03. However, there was an increase in the shares of NPAs on account of small-scale industries and other priority sector as well as their overall NPAs for the priority sector.
9. The share of non-priority sector NPAs in total NPAs of private sector banks was lower than that in 2002-03.
10. According to the report, the gross non-performing assets ratio of public sector banks has declined to 7.8 per cent in 2003-04 from 23 per cent in 1992-93.
11. As on June 30, 2004, 27 public sector banks had issued 61,263 notices involving an outstanding amount of Rs. 19,744 crore and had recovered an amount of Rs. 1,748 crore, under the Securitisarion and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002.
12. The number of cases and value of assets restructured under CDR mechanism as on June 30, 2004 stood at 94 and Rs. 64,017 crore respectively.

Resolution of Non-Performing Assets

At present, local banks are saddled with the management of non-or sub-performing loans (NPLs), real estate properties and other fixed assets (NPAs) for which they do not have the management time nor the resources for a proper resolution process.

As a result, they are reluctant to make new loans to industrial or commercial enterprises as both the NPLs and NPAs have put a strain on their resources. The unavailability of new loans has therefore hindered economic growth and development.

ADB intends to assist local banks resolve their problems with NPLs/ NPAs by facilitating the financing of special purpose vehicles and other mechanisms designed to acquire and service such assets. This will enable the local banking system to focus on its core operations and provide financing to productive sectors of the economy.

In addition, ADB will assist distressed companies in their restructuring and rehabilitation efforts.

The economic fundamentals of a country will also significantly improve as the NPLs/NPAs are transformed into productive uses by organizations or professionals with the expertise and the systems to manage such distressed assets.

Turning-down or declining Non-Performing-Assets in Indian context

In is now well know that the banks and financial institutions in India face the problem of amplification of non-performing assets (NPAs) and the issue is becoming more and more unmanageable. In order to bring the situation under control, various steps have been taken. Among all other steps most important one was the introduction of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 by Parliament, which was an important step towards elimination or reduction of NPAs.

One of the most important and major roles played by banking sector is that of lending business. It is generally encouraged because it has the effect of funds being transferred from the system to productive purposes, which also results into economic growth. As there are pros and cons of everything, the same is with lending business that carries credit risk, which arises from the failure of borrower to fulfill contractual obligations either during the course of a transaction or on a future obligation.

The origin of the problem of burgeoning NPAs lies in the quality of managing credit risk by the banks concerned. Imperative thing that we lack is having adequate preventive measures in place viz, fixing pre-sanctioning appraisal responsibility and having an effective post-disbursement supervision. Banks concerned should continuously monitor loans to identify accounts that have potential to become non-performing. The global norm of gross NPAs of the banking sector is about 5% whereas in India it is much higher than this. Hence, there is a long way to go before we can say that the NPAs of our banks are under control.

It is to be noted that quite often, genuine borrowers 'face the difficulties in raising funds from banks due to mounting NPAs. Either the bank is reluctant in providing the requisite funds to the genuine borrowers or if the funds are provided, they come at a very high cost to compensate the lender losses caused due to high level of NPAs. Therefore, quite often corporates prefer to raise funds through commercial papers (CPs) where the interest rate on working capital charged by banks is higher.

With the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, banks can issue notices to the defaulters to pay up the dues and the borrowers will have to clear their dues within 60 days. Once the borrower receives a notice from the concerned bank and the financial institution, the secured assets mentioned in the notice cannot be sold or transferred without the consent of the lenders.

The main purpose of this notice is to inform the borrower that either the sum due to the bank or financial institution be paid by the borrower or else the former will take action by way of taking over the possession of assets. Besides assets, banks can also take over the management of the company. Thus the bankers under the aforementioned Act will have the much-needed authority to either sell .the assets of the defaulting companies or change their management.

But the protection under the said Act only provides a partial solution. What banks should ensure is that they should move with speed and charged with momentum in disposing off the assets. This is because as uncertainty increases with the passage of time, there is all possibility that the recoverable value of asset also reduces and it cannot fetch good price. If faced with such a situation than the very purpose of getting protection under the Securitisation Act, 2002 would be defeated and the hope of seeing a growing banking sector can easily vanish.

However with the introduction of Securitisation Act, 2002 banks can now issue notices to their defaulters to repay their dues or else make defaulters face hard and tough actions under the aforementioned Act. This enables banks to get rid of sticky loans thereby improving their bottom-lines. The formulation of Asset Reconstruction companies under this Act has also helped in disposal of debt-ridden assets in a very smooth manner. The most effective way of removing NPAs from the books of the weak banks would be to move these out to a separate agency which will buy the loans and make its own efforts for their recovery. The ARC'S operations will be profit-oriented and its aim will be to recover from the acquired assets (NPAs) more than the price paid for it. These companies will be registered with the RBI with a minimum capital base of two crores.

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