Non-performing Assets & Its Recovery–A Study on Indian Scheduled Commercial Banks

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Abstract: The best indicator for the health of the banking industry in a country is its level of Non-performing assets (NPAs). NPAs are one of the major concerns for banks in India. It reflects the performance of banks. Reduced NPAs generally gives the impression that banks have strengthened their credit appraisalprocesses over the years and growth in NPAs involves the necessity of provisions, which bring down the overall profitability of banks. The problemof NPAs is not only affecting the banks but also the whole economy.Narasimham committee had recommended few steps to resolve the issues relating to non-performing assets. The magnitude of NPA is comparatively higher in public sectors banks. To improve the efficiency and profitability of banks the NPA need to be reduced and controlled. This paper deals with understanding the concept of NPAs, its magnitude, major causes for an account becoming non-performing, recovery of NPAS through various channels and high impact of NPAs onScheduled commercial banks in India.

Keywords: Non-Performing Asset, Scheduled Commercial banks, NarasimhamCommittee

INTRODUCTION

Granting of credit for economic activities is the prime duty of banking. Apart from raising resources through fresh deposits, borrowings and recycling of funds received back from borrowers constitute a major part of funding credit dispensation activity. Lending is generally encouraged because it has the effect of funds being transferred from the system to productive purposes, which results into economic growth. However, lending also carries a risk called credit risk, which arises from the failure of borrower. Non-

recovery of loans along with interest forms a major hurdle in the process of credit cycle. Thus, these loan losses affect the bank's profitability on a large scale. Though complete elimination of such losses is not possible, but banks can always aim to keep the losses at a low level.

Non-performing Asset (NPA) has emerged since over a decade as an alarming threat to the banking industry in our country sending distressing signals on the sustainability and endurability of the affected banks. The positive results of the chain of measures affected under banking reforms by the Government of India and RBI in terms of the two Narasimhan Committee Reports in this contemporary period have been neutralized by the ill effects of this surging threat.

The main recommendations of the committee with respect to Asset Quality are as follows:

(i)   The ratio of non-performing assets to the total assets should be reduced.

(ii)   For evaluating the quality of assets portfolio, advanced covered by Government guarantees, which have turned sticky, be treated as Non-Performing Assets.

(iii) For banks with a high NPA portfolio, the following two alternative approaches could be adopted:

   (a)   All loan assets in the doubtful and loss categories should be identified and their realizable value determined. The assets could be transferred to an Asset Reconstruction Company (ARC) which would issue NPA Scrap Bonds.

   (b)   The banks with high ratio of Non-Performing Assets (NPA) should issue bonds backed by Government guarantee.

(iv)   The interest subsidy element in credit for the private sector should be totally eliminated. Interest rate on loans under Rs. 2 lakhs should be deregulated.

Despite various correctional steps administered to solve and end NPA problem, concrete results are eluding. It is a sweeping and all pervasive virus confronted universally on banking and financial institutions. The severity of the problem is however acutely suffered by Nationalized Banks, followed by the SBI group, and the all India Financial Institutions.

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 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. NPA is a result of an environment that prevents it from performing up to expected levels.

REVIEW OF THE LITERATURE

Dash, M.K. and Kabra, G. (2010) examined the determinants of NPA in the Indian Commercial Banks with particular emphasis on the sensitivity of NPA to macroeconomic and bank specific factors in India. The study used regression analysis and a panel data set covering 10 years (1998-99 to 2008-09). The authors

explained that both bank specific and macroeconomic factors has impacted the loan portfolio of commercial banks in India. Based on analysis, the study concluded that the commercial banks that are aggressive and chargerelatively higher interest rates incurred greater NPAs.

Prasad and Veena, D. (2011) in their study examined the trends and issues relating to the NPA in Indian Banking Sector. Inference based on analysis indicated that the impact of increased recovery on NPA, decline in fresh slippage, sharp increase in gross loans, setting up of ARC, etc helped to present better NPA ratio's. The authors pointed out that PSBs problems are mainly due to excessive manpower, excessive NPA while private sector banksconsolidated themselves through the adoption of latest technology and systems. The study recommended revitalizing the PSBs and incorporating the best practices in operations, technology and management to improve financial performance.

Poongavanam, S. (2011) examined various literatures on issues, causes and remedial solution to manage NPA in Indian banking sector. The article explained the significant changes in Indian banking during the liberalization period and indicated the need to further enhance measures to manage the NPA. The author concluded the study stating the need to provide more importance to NPA management and proper remedial solutions.

Patidar and Kataria (2012) criticized Priority sector lending as one of the major reasons for accumulation of non-performing assets during pre-reform period.

Pandey and Kaur (2012) observed that the willful default is non-payment of dues despite having adequate cash flow and net worth, Signs of siphoning of funds by the borrower, falsification of records, disposal of securities without bank's approval, fraudulent practices etc., point out a default situation.

Siraj and Pillai (2012) opined that the SARFAESI Act provided the much needed momentum for NPA management in banks.

Siraj, K.K. and Pillai, P.S. (2012) examined the performance of NPA in Indian banking during post-millennium period. To achieve its stated objectives, the authors utilized bank-group wise performance statistics during post-millennium period up to the period ended 31st December 2011. Using various statistical tools such as AAG rate, correlation and regression study, the study recognized that NPA remains a major threat and the incremental component explained through additions to NPA poses a great question mark on the efficiency of credit risk management practices of banks in India.

Tracey, M. (2011) examined the impact of NPA on Loan Growth using an econometric case study of Jamaica and Trinidad and Tobago. To undertake the study, the author utilized banking statistics from Bank of Jamaica, the Central Bank of Trinidad and Tobago. The study estimated the threshold range for the Loan-NPL relationship using regression analysis for two Caribbeancountries. The results of the study suggested a threshold range for NPA as determining differential loan behavior of banks. An implication of the study is the inference drawn which highlight that bank lending behavior could restrain economic activity, especially in periods of stress when NPA is high.

Thiagarajan, S. and Ramachandran, A. (2011) analyzed the credit risk component of the Indian Banking sector using financial data for the period 2001-2010. In specific terms, the authors examined the use of certain key credit risk ratios to measure the credit risk. Inference based on ratio analysis highlighted a gradual decrease in the ratio of NPA to total loans for both public and private sector banks from 2001 to

2008 and gradual increase from 2009 to 2010. Their findings are consistent with the findings that although a similarity exists in movement of selected ratios, the sector wise comparison showed significant differences among different bank groups.

Research gap

The distinctive parts of writing identified with Non-Performing Assets of researchers throughout the years have been gathered and utilized for this review, yet there is a gigantic time gap existing for the complete research on quality parts of Non-Performing Assets. The majority of the examination and studies are being done on causes, effect and administration parts of NPAs.

Problem identification

Non-performing assets of banks are one of the biggest hurdles in the way of socio-economic development of India. The level of NPAs of the banking system in India is still too high. It affects the financial standing of the banks so that it is a heavy burden to the banks. A vigorous effort has to be made by the banks to strengthen their internal control and risk management systems and to setup early warning signals for timely detection and action.

Objectives of the study:

1. To examine the status of NPA of scheduled commercial bank in India.

2. To explore the causes for increasing NPAs.

3. To examine the impact of NPA.

4. To study the recovery of NPA through various statutory bodies.

Limitations of the study:

1. The basis for identifying non-performing assets is taken from the Reserve Bank of India circulars.

2. Reasons for NPAs and Management of NPAs are changing with the time. The study is done in the present environment without foreseeing future developments.

Scope of the study:

1. The study could recommend measures for the banks to stay away from future NPAs and to decrease existing NPAs.

2. The study will choose proper strategies suited to deal with the NPAs and build up a period bound activity plan to capture the development of NPAs.

Research Design

The current study is descriptive in nature. The paper discusses the conceptual framework of NPA and it also highlights the trends, causes and impact of NPA on scheduled commercial banks during the period of 10 years i.e. from 2006-07 to 2015-16. Several reputed research journals, articles, magazines including RBI website has been referred during the study.

Non-Performing Assets in Indian Scheduled Commercial Banks

Table 1
Gross Advances (GADV) and Gross NPAs (GNPA) (Amount in Rupees Million)

Years		Public Sector Banks	Private Sector Banks	Foreign Banks	SCB
	GNPA	388484	91016	22414	501914
2006-07	GADV	14644950	4182410	1246770	20074130
	%	5.28	2.18	1.80	2.50
	GNPA	397605	124380	26384	548369
2007-08	GADV	18190740	5236990	1606580	25034310
	%	4.55	2.38	1.64	2.19
	GNPA	449574	168898	64371	682843
2008-09	GADV	22834734	5751668	1660116	30246518
	%	4.19	2.94	3.88	2.26
	GNPA	594344	173409	71336	839089
2009-10	GADV	25193309	5795349	1632130	32620788
	%	5.06	2.99	4.37	2.57
	GNPA	746639	182386	50687	979712
2010-11	GADV	30798042	7232054	1929719	39959815
	%	5.40	2.52	2.63	2.45
	GNPA	1172620	187678	62966	1423264
2011-12	GADV	35503892	8716413	2267773	46488078
	%	7.36	2.15	2.78	3.06
	GNPA	1644615	210705	79649	1934969
2012-13	GADV	45601686	11512463	2604049	59718198
	%	7.66	1.83	3.06	3.24
	GNPA	2272639	245424	115556	2633619
2013-14	GADV	52159197	13602528	2995755	68757480
	%	9.05	1.80	3.86	3.83
	GNPA	2784680	341062	107610	3233352
2014-15	GADV	56167175	16073394	3366090	75606659
	%	9.53	2.12	3.20	4.28
	GNPA	5399564	561857	158052	6119473
2015-16	GADV	58183484	19726588	3763373	81673445
	%	17.08	2.85	4.20	7.49

Source: dbie.rbi.org.in

The above table shows the Gross Advances and Gross NPA of Public, Private, Foreign and in total for all the Scheduled Commercial Banks (SCBs) for 10 years i.e., from 2006-07 to 2015-16. The GNPAs of Scheduled Commercial Banks has increased from Rs. 501914 billion (2006-07) to Rs. 6119473 billion

(2015-16), whereas the Gross Advances for the same period has increased from Rs. 20074130 billion to Rs. 81673445 billion. The Gross NPA ratio has increased from 2.50% (2006-07) to 7.49% (2015-16). The GNPAs are more in Public Sector Banks – 88.24% for the year 2015-16.

Table 2
Net Advances (NADV) and Net NPAs
(NNPA) (Amount in Rupees Million)

		Public Sector Banks	*Private Sector Banks*	*Foreign Banks*	*SCB*
	NNPA	153250	39688	9147	202085
2006-07	NADV	14582020	4168232	1243057	19993309
	%	1.05	0.95	0.74	1.01
	NNPA	175909	53803	12543	242255
2007-08	NADV	18110663	5190297	1599392	24900352
	%	0.97	1.04	0.78	0.97
	NNPA	211554	74120	29967	315641
2008-09	NADV	22743117	5678464	1617590	30039171
	%	0.93	1.31	1.85	1.05
	NNPA	293753	63726	29772	387251
2009-10	NADV	25021884	5699051	1593047	32313982
	%	1.17	1.12	1.87	1.20
	NNPA	360636	44318	12847	417801
2010-11	NADV	30538483	7181207	1924337	39644027
	%	1.18	0.62	0.67	1.05
	NNPA	592052	44012	14122	650186
2011-12	NADV	35158176	8676607	2247788	46082571
	%	1.68	0.51	0.63	1.41
	NNPA	899509	59944	26626	986079
2012-13	NADV	45171056	11457716	2593570	59222342
	%	1.99	0.52	1.03	1.67
	NNPA	1303938	88615	31657	1424210
2013-14	NADV	51604694	13529915	2956425	68091034
	%	2.53	0.65	1.07	2.09
	NNPA	1600003	141283	17627	1758913
2014-15	NADV	55483419	15973771	3344642	74801832
	%	2.88	0.88	0.53	2.35
	NNPA	3203758	266774	27669	3498201
2015-16	NADV	56644644	19546546	3715665	79906855
	%	5.66	1.36	0.74	4.38

Source: dbie.rbi.org.in

The above table shows the Net Advances and Net NPA of Public, Private, Foreign and in total for all the Scheduled Commercial Banks (SCBs) for 10 years i.e., from 2006-07 to 2015-16. The Net NPAs of Scheduled Commercial Banks has increased from Rs. 202085 billion (2006-07) to Rs. 3498201 billion (2015-16), whereas the Net Advances for the same period has increased from Rs. 19993309 billion to Rs. 79906855 billion. The Net NPA ratio has increased from 1.01% (2006-07) to 4.38% (2015-16). The NNPAs are more in Public Sector Banks – 91.58% for the year 2015-16.

Causes for Non-Performing Assets

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.

There are several reasons for an account becoming NPA.

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. Willful 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. Lethargic legal system: Long legal tangles, Changes that had taken place in labour laws and Lack of sincere effort.

2. Industrial recession.

3. Shortage of raw material, raw material\input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accidents.

4. Failures, non-payment\ over dues in other countries, recession in other countries, externalization problems, adverse exchange rates etc.

5. Government policies like excise duty changes, Import duty changes etc.

Following are some of the impacts of NPAs:

1. Depositors do not get rightful returns and many times may lose uninsured deposits. Banks may begin charging higher interest rates on some products to compensate Non-performing loan losses

2. Bank shareholders are adversely affected

3. Bad loans imply redirecting of funds from good projects to bad ones. Hence, the economy suffers due to loss of good projects and failure of bad investments

4. When bank do not get loan repayment or interest payments, liquidity problems may ensue.

Result of NPAs on an organization

1. Decrease profitability.

2. Reduce capital assets and lending limits.

3. Increase loan loss reserves.

Table 3
Showing NPAs recovered by Various Statutory Bodies
(Amount in Billion)

Year		Lok Adalats	DRTs	Sarfaesi Act
	No. of cases referred	186,535	3728	83,942
2007-08	Amount involved	21.42	58.19	72.63
	Amount recovered	1.76	30.2	44.29
	Amount recovered (%)	8.2	51.9	61
	No. of cases referred	548,308	2004	61,760
2008-09	Amount involved	40.23	41.3	120.67
	Amount recovered	0.96	33.48	39.82
	Amount recovered (%)	2.4	81.1	33
	No. of cases referred	778,833	6019	78,366
2009-10	Amount involved	72.35	97.97	142.49
	Amount recovered	1.12	31.33	42.69
	Amount recovered (%)	1.55	32	30
	No. of cases referred	616,018	12872	1,18,642
2010-11	Amount involved	52.54	140.92	306.04
	Amount recovered	1.51	39.3	115.61
	Amount recovered (%)	2.87	27.89	37.78
	No. of cases referred	476,073	13,365	1,40,991
2011-12	Amount involved	17	241	353
	Amount recovered	2	41	101
	Amount recovered (%)	11.8	17	28.6
	No. of cases referred	840,691	13,408	190,537

(*contd...Table 3*)

Year		Lok Adalats	DRTs	Sarfaesi Act
2012-13	Amount involved	66	310	681
	Amount recovered	4	44	185
	Amount recovered (%)	6.1	14.2	27.2
	No. of cases referred	1,636,957	28,258	194,707
2013-14	Amount involved	232	553	953
	Amount recovered	14	53	253
	Amount recovered (%)	6	9.6	26.6
	No. of cases referred	2,958,313	22,004	175,355
2014-15	Amount involved	310	604	1,568
	Amount recovered	10	42	256
	Amount recovered (%)	3.2	7	16.3
	No. of cases referred	4,456,634	24,537	173,582
2015-16	Amount involved	720	693	801
	Amount recovered	32	64	132
	Amount recovered (%)	4.4	9.2	17

Source: dbie.rbi.org.in

The above table shows the percentage of recovery for Lok Adalats was 8.2% and 4.4% for the year 2007-08 and 2015-16 respectively. The highest percentage of recovery for Lok Adalats was in the year 2011-12 (11.8%). The percentage of recovery for DRT was 51.9% and 9.2% for the year 2007-08 and 2015-16 respectively. The highest percentage of recovery for DRT was in the year 2008-09 (81.1%). The percentage of recovery for SARFAESI ACT was 61% and 17% for the year 2007-08 and 2015-16 respectively. The highest percentage of recovery for SARFAESI ACT was in the year 2007-08 (61%). Undoubtedly SARFAESI ACT plays a major role in recovering the non-performing assets.

Suggestions and Recommendation

The soft measures taken by the RBI are not sufficient to reduce the NPA's in the banking sector. The following suggestion will enable the banks to reduce their NPA's if implemented by the government ofIndia. The analysis reveals that though there is phenomenal development in various banking sectors yet the public sector in particular is still lagging behind major thrust areas such as asset quality, and profitability etc. Some suggestions for improvement in the performance of public sector banks and private sector are given below:

1. Asset quality reflects the soundness offinancial institutions. Public sector banks should disburse their funds in quality assets to reduceNPA level. As the risk profile of banks' lending is more diversifying, it is essential on the part of banks to pay adequate attention to quality of lending so that credit expansion could be onsustainable basis building upon higher profitability while ensuring financial stability.

2. Suitable amendments to the existing laws must be made to enable the bankers to initiate legal proceedings against the willful defaulters e.g. Indian penal code, criminal procedure code, civil

procedure code, Indian evidence act, Hindu laws, constitution of India etc., be amended with a view to impose heavy penalty and/or punishment on defaulters.

3. A list of big defaulters should be prepared separately and the banks must give due publicity to them in the print and the electronic media along with their photographs, and the same can be sent to all police stations.

4. A healthy Banker-Borrower relationship should be developed. Many instances have been reported about forceful recovery by the banks, which is against corporate ethics. Debt recovery will be much easier in a congenial environment.

CONCLUSION

Finally, it can be concluded that the bankers can avoid sanctioning loans to the non-creditworthy borrowers by adopting certain measures. They need to do careful appraisal of the project which involves checking the economic viability of the project. A banker must consider the return on investment on a proposed project. If the calculated return is sufficiently higher than the credit amount he can sanction the loan. Secondly, he can constantly monitor the borrower in order to ensure that the amount sanctioned is utilized properly for the purpose to which it has been sanctioned. This involves the post sanction inspection by the banker. Thirdly, the banker should get both the formal and informal reports about the goodwill of the customer. If he had already proven as a defaulter, then there is no question of sanctioning loan to him.

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