CAUSES AND REMEDIES FOR NON PERFORMING- ASSETS IN INDIAN OVERSEAS BANK

E. Gopi* and Joseph Paulraj V.**

Abstract: *"Public sector banks share a disproportionate burden of the restructured accounts. An area of great concern is that at some point of time some of the restructured assets would slip to NPA. Restructured accounts have grown at a compounded annual growth rate of 47.86 per cent in public sector banks. The corresponding figures for private sector and foreign banks are 8.12 per cent and 25.48 per cent respectively.*

When an asset ceases to generate any income for a bank, whether in the form of interest or principal repayment, it is termed as non-performing asset. The non performing assets are classified as sub-standard, doubtful and loss asset. According to RBI Report, Public sector banks of Non- performing asset stood up from 3.17 per cent in FY12 to 3.84 per cent in FY13. As per the statement given by Mr.M.Narendra, Chairman and Managing Director of Indian Overseas bank. On March 2012, Indian Overseas bank's gross NPA ratio was at 2.74 per cent, but it increased to 4.20 percent in 2013 and net NPA was at 2.50 per cent, compared to 1.35 per cent in the previous year.

The study focus on "Causes and Remedies for Non-performing- Assets in Indian Overseas Bank". The research followed by Empirical research. The study will depend on the data that are collected from secondary sources. The secondary data will be collected from the Audited report, balance sheet and RBI Report. The tools that are used for this study are ROE decomposition analysis, Capital Adequacy ratio and some statistical tool etc., from this analysis will conclude the causes and remedies of the non performing asset for public sectors bank.

Key words: *"Causes and Remedies for Non-performing- Assets in Indian Overseas Bank"*

I. INTRODUCTION

The problem of non-performing assets has shaken the entire Indian banking sector. NPAs affect the smooth flow of credit. Banks raise resources not just on fresh deposits, but also by recycling the funds received from the borrowers. Thus, when a loan becomes non-performing, it affects recycling of credit and credit creation. Apart from this, NPAs

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affect profitability as well, since higher NPAs require higher provisioning, which means a large part of the profits needs to be kept aside as provision against bad loans. In India, the concept of NPA came into the reckoning after reforms in the financial sector were introduced on the recommendations of the Report of the Committee on the Financial System (Narasimham, 1991) and an appropriate accounting system was put in place.

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II. REVIEW OF LITERATURE

A study on causes and remedies for non performing assets in Indian public sector banks with special reference to agricultural development branch, state bank of Mysore

This paper concludes that the bankers can avoid sanctioning loans to the non creditworthy borrowers by adopting certain measures. They are 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. Fourthly, the banker should motivate the farmer to pay the interest properly and in a timely manner. Fifthly, the banker also has to educate the farmer regarding the effects and consequences of defaulting. By considering all the above factors the banker can reduce the nonperforming assets in a bank.[6]

Mounting NPAs in Indian Commercial Banks

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.[7]

A Study on Management of Non Performing Assets in Priority Sector reference to Indian Bank and Public Sector Banks(PSBs)

His objective are,

- To know and study about the non-performing assets in Indian Bank, Tamil Nadu.

- To find out Non Performing Assets under the Priority sector lending in Indian Bank and Compare with Public Sector Banks (PSBs)

- To make appropriate suggestions to avoid future NPAs and to manage existing NPAs in Indian Bank.

He conclude that The Priority sector advances have been analyzed in detail under three major heads, viz., Agriculture, Small Scale Industries and Other Priority Sector. Further weaker section advances, which forms part of Priority sector, have also been studied. The data related to Priority sector advances for 10 years have been collected for Indian Bank and for the Public Sector Banks as a whole. The data have been tabulated comfortably with required percentage calculation and mean calculations. Besides the loans and advances granted under priority sector, the NPA figures have also been tabulated both for Indian Bank and the Public Sector Banks as a whole. The data so provided helped to have an in-depth analysis about the participation of Indian Bank in lending activities to priority sector in comparison with that of the Public Sector Banks as a whole. The growth of Indian Bank's lending to Priority sector is more than that of the Public Sector Banks as a whole. In case of NPA management, the performance of Indian Bank is better than that of Public Sector Banks as a whole. However, Indian Bank has slippages during the period of study in controlling of NPAs in the early years of the decade. Indian Bank is still not comfortable in the area of NPA management. Therefore, the management of Indian Bank must pay special attention towards the NPA management and take appropriate steps to arrest the creation of new NPAs, besides making recoveries in the existing NPAs. Timely action is essential to ensure future growth of the Bank.

III. METHODOLOGY

Need for the Study

The problem of NPAs in the Indian banking system is one of the foremost and the most formidable problems that had impact the entire banking system. On March 2012,

Indian Overseas bank's gross NPA ratio was at 2.74 per cent, but it increased to 4.20 percent in 2013 and net NPA was at 2.50 per cent, compared to 1.35 per cent in the previous year. Higher NPA ratio trembles the confidence of investors, depositors, lenders etc. The non-recovery of loans effects not only further availability of credit but also financial soundness of the banks.

Objectives of the Study

- To analysis the composition of NPAs in different sectors.
- To identify the NPAs impact towards ROE decomposition analysis.
- To establish relationship between NPAs and profitability.
- To study various ratios to determine the relationship of different factors and its impact on the NPA position of the bank.
- To predict the status of capital adequacy ratio of the bank.
- To predict the status of bank's financial health.
- To study the NPA coverage of IOB Bank in different financial years and its effect on the overall efficiency of the bank at different points of time.
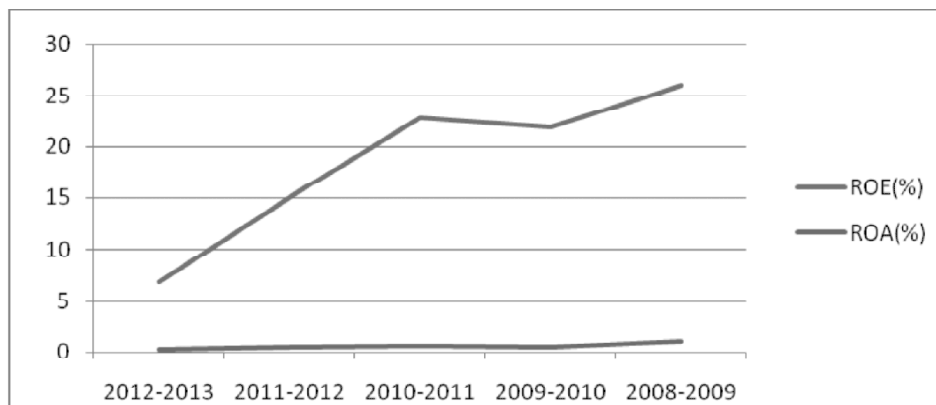
IV. DATA ANALYSIS AND INTERPRETATION

DU PONT ANALYSIS FOR THE YEAR 2009 to 2013

Year	2013	2012	2011	2010	2009
ROE(%)	6.81	14.98	22.75	21.9	26.04
ROA(%)	0.23	0.5	0.6	0.54	1.1

Interpretation

From Du-Pont chart, it is clear that bank ROA is decreasing in the year march 2013 and this is due to holding of assets. If the holding of assets is high in the bank, return

of the bank will be low. The ROE value of IOB Bank is going down. So that the shareholders' equity is falling

Altman Z Score Model

$Z = 1.2T_1 + 1.4T_2 + 3.3T_3 + 0.6T_4 + 0.999T_5$.

T_1 = Working Capital / Total Assets. Measures liquid assets in relation to the size of the company, T_2 = Retained Earnings / Total Assets. Measures profitability that reflects the company's age and earning power, T_3 = Earnings before Interest and Taxes / Total Assets. Measures operating efficiency apart from tax and leveraging factors. It recognizes operating earnings as being important to long-term viability, T_4 = Market Value of Equity / Book Value of Total Liabilities. Adds market dimension that can show up security price fluctuation as a possible red flag, T_5 = Sales/ Total Assets. Standard measure for total asset turnover (varies greatly from industry to industry).

| Year	2013	2012	2011	2010	2009
Z	0.18	0.258	0.276	0.24	0.188

Interpretation: Zones of Discrimination:

- Z>2.99 "Safe" Zone
- 1.8<Z<2.99 "Grey Zone"
- Z<1.80 "Distress" Zone

Chart no 5.2 Altman Z Mode

Altman Z-score of 0.18 is in distress zone. Indian overseas bank has a Z-score of 0.18, indicating it is in Distress Zones. This implies bankruptcy possibility in the next two years.
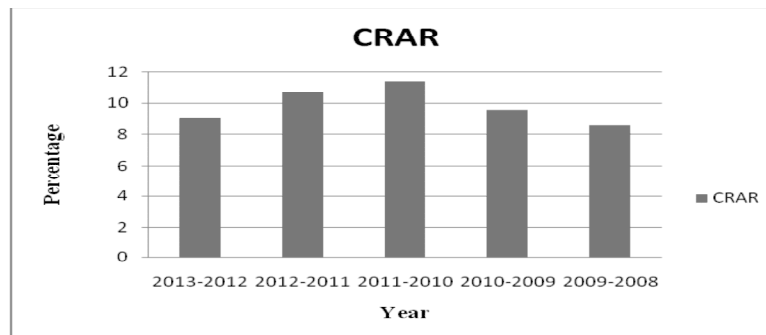
Capital Adequacy Ratios
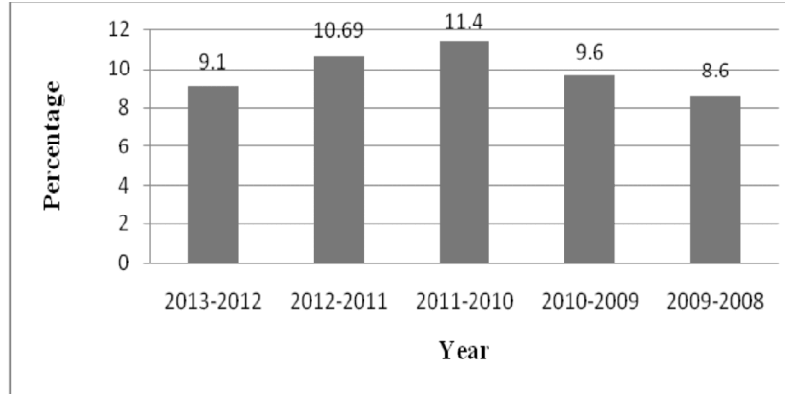
Interpretation: The capital adequacy ratio is important for them to maintain as per the banking regulations. Each bank needs to create the capital Reserve to compensate the Non Performing Assets. The above chart shows that the IOB bank maintains the minimum level Capital Adequacy ratio. The minimum level of capital adequacy ratio was 8% as per the Basel 1 committee.

Table 4.4
Sector wise NPA

Year	2012-2013	2011-2012	2010-2011	2009-2010
Agriculture & allied activities (%)	3.34	2.94	2.78	1.33
Industry (Micro & small, Medium and Large) (%)	5.68	3.23	3.45	5.99
Services (%)	3.89	2.40	1.94	4.20
Personal Loans(%)	1.67	1.38	2.01	3.37

Interpretation: The above graph indicates that the percentage of NPA is high in Industries. It is quite high when compared to previous year. The percentage of NPA is also high in service and Agriculture sector.

Chart no 4.5 Capital Adequacy Ratio

Interpretation: The capital adequacy ratio is important for them to maintain as per the banking regulations. Each bank needs to create the capital Reserve to compensate the Non Performing Assets. The above chart shows that the IOB bank maintain the minimum level Capital Adequacy ratio. The minimum level of capital adequacy ratio was 8% as per the Basel 1 committee.

4.6 Two sample t test(Testing Differences between means with Dependent Samples)

Objective: The depositor's amount wants to test at a 5% significance level, the average of gross NPA. Weight (default amount) is more than 2051cr.

Step 1: Formulation of hypothesis $H_0: \mu_1 - \mu_2 = 2051$ Null hypothesis: average gross NPA is only 2051 cr. $H_1: \mu_1 - \mu_2 > 2051$ Alternative hypothesis: Average of gross NPA exceeds 2051 cr $\alpha = 0.05$ level of significance.

Before		*After*	
Year	Deposits	Year	Advances
2013	202135.3480	2013	160364.1171
2012	178434.1764	2012	140724.4443
2011	145228.7511	2011	111832.9775
2010	110794.7110	2010	78999.1593
2009	100115.8896	2009	74885.2726

Step 2: choose the appropriate distribution and the find the critical value

Deposits	Advances	Loss	Loss squared
202135	160364.1171	41771.23	1744835731
178434	140724.4443	37709.73	1422023895
145229	111832.9775	33395.77	1115277694
110795	78999.1593	31795.55	1010957108
100116	74885.2726	25230.62	636584034.2
	Total	169902.9	5929678462

Step 4: Conclusion: Reject Null hypothesis (H_0). Average gross NPA exceeds 2051 cr.

V. SUGGESTION

- The percentage of doubtful assets is less, when it's compared to the percentage of sub standard assets. But there is no much difference. Therefore the bank needs to take necessary steps to reduce the percentage of doubtful assets and sub standard assets which make the loss assets to 0%.

- The percentage of total provision ratio is high. It affects the profit of the bank. So, the bank must reduce the Gross NPA value.

- The ROE value of IOB Bank is going down. Therefore the shareholders' wealth maximization also reduces. The main reason is high NPA value. The bank should take remedy steps to reduce NPA and increases the profit due to they can control

the current market value of share and increase the shareholders wealth maximization.

- CBIL maintains a database of borrowers that banks and financial institutions may easily access. The RBI also plays its part by circulating lists of wilful defaulters of banks and financial institutions and of borrowers facing lawsuits for recovery, to caution the industry against issuing fresh loans to concerned companies, their promoters or directors.

- Indian overseas bank has a Z-score of 0.18, indicating it is in Distress Zone. Because the bank revenue level is low. So the bank must improve revenue level.

- As per law, every bank must maintain a capital adequacy ratio which is the ratio of total capital to risk weighted assets, of 9% or 10% or higher. As NPAs go up, so do the aggregated risk weighted assets, forcing the bank to allocate further capital in order to maintain the ratio. Today commercial banks in India are struggling to meet CAR norms. The IOB bank maintains the minimum level Capital Adequacy ratio because the problem asset ratio is high.

  The financial health of banks improved due to prescribed prudential norms. Almost all banks improved their Capital adequacy and Asset quality (measured by the net NPAs as a percentage of net advances) during the period of the study.

- The major causes are less transparent reason is because NPAs are on rise from average NPA from one sample tests. For one the process of (Non- performing) assets disposal is riddled with legal impediments and delay.

- Secondly, highly connected corporate debtors have been known to use political pressure to get banks to waive their dues or restructure terms in their favour. During election time, political parties make populist promises – such as the offer of easy credit to the small scale and rural sectors which may not yield the expected results, which commercial banks are forced to honor.

- The restructured loan portfolios of banks are likely to expand, as several infrastructure projects, mostly in the power sector, are nearing their date of commencement of commercial operations without issues like land acquisition etc. Due the bank can reduce the Gross Nonperforming assets in future.

CONCLUSION

Given the new environment, Indian overseas banks can't remain unaffected by the changes round and challenges before them. Therefore Indian overseas banks need to restructure themselves. The following practices need to be adopted on urgent basis;

Greater professionalism, Greater emphasis on diversification and sources non interest income, Consultancy services, Equipping themselves to operate in the deregulated environment, Necessary changes in the legal stipulations, Cost management, Bench marking of service standards to improve productivity and Proficiency, A self-regulatory organization to monitor the activities of banking.

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