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NON-PERFORMING ASSETS: - CLASSIFICATION, CAUSES AND ITS REASON FOR GROWING NON-PERFORMING ASSESTS (NPA)

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Public sector banks are very important in developing countries like India. Government financing for agriculture, industry, and commerce is impossible without the assistance of bank loans. The money deposited in public banks is completely safe. The reform process led to the adoption of prudential norms for income recognition, asset classification and provisioning, and capital adequacy, all of which are in line with international best practices in response to the impact of a highly regulated banking environment on asset quality, productivity, and bank performance. Reform measures aimed primarily to improve asset quality and lower non-performing assets. With this context in mind, this research looks at how public sector banks in India deal with their nonperforming assets. To do this, we employ a combination of secondary and primary sources of information. To back up the conclusions drawn from secondary data analysis, primary research on the prevalence, impact, and management of NPA in public sector banks is conducted.

Keywords: - Non Performing Assets (NPA), Assets, Bank, Management, Loan.

I. INTRODUCTION

NON-PERFORMING ASSETS

A company's assets are its most valuable resources and property. It is the most fundamental need for every company and a crucial factor in the company's overall operational and financial success. Having assets means nothing if they aren't being used to their maximum potential, which is why businesses carry them. The result might be financial gain, enhanced productivity, or increased profitability for the company. Assets have a role in every objective. Therefore, the operation and upkeep of the assets are crucial to the success of the company. Every business has a department dedicated to asset management, whose job it is to maximize the returns on the company's holdings. In addition, the company ensures that the liability of the business is operating at peak efficiency. Asset and Liability Management (ALM) is the umbrella term for this coordinated process. Assessing how well the assets and liabilities are performing is the primary goal of this operation. This feature ensures that the business's financial processes run as smoothly as possible. The assets of a bank may be broken down into two categories: loans and investments. Financial institutions like banks offer loans to customers and investments in things like government securities and business endeavours. All of these things are considered banking system assets. The system's success is predicated largely on the quality of its asset management. This means it has to be controlled effectively.

The assets of a bank may be split into two groups. There are two types of assets, the performing and the non-performing. The standard asset, or performing asset, is the opposite of the three types of non-performing assets. The following diagram illustrates the asset structure of the bank in detail.

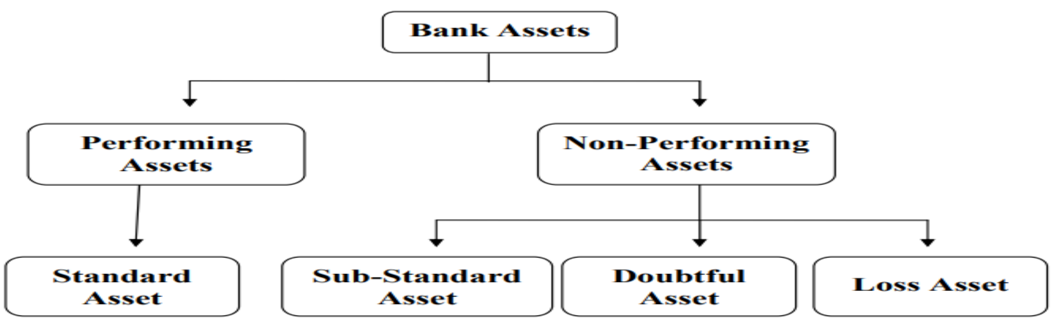

Figure 1. Classification of Bank Assets

The assets of a bank that generate profits on a consistent basis are called performing assets. This signifies that the loans and advances underlying these assets are currently making principle and interest payments to the bank. The term "Standard Asset" may be used interchangeably.

Bank assets that do not raise red flags when it comes time to pay back loans and advances are considered "standard assets." Loans and advances are being recouped on a regular basis. The loan's principle and interest are paid back to the bank on a regular basis. In addition to making timely payments of principle and interest, the borrower also agrees to never go into default for a period of more than ninety days. A loan may be considered a non-performing asset if repayment takes more than 90 days.

If an investment does not produce the anticipated profits, it is considered a non-performing asset. For more than 90 days, it has failed to provide any kind of revenue for the bank, such as interest, fees, commission, etc.

There are three ways to classify this idea, according to the Reserve Bank of India. Here is a list of them.

i. Sub-Standard Assets

ii. Doubtful Assets

iii. Loss Assets

Assets that have been past due for more than three months but less than twelve months in both principle and interest are considered sub-standard under RBI rules.

Assets that are deemed questionable because they have been past due for payment for more than 12 months yet cannot be recovered owing to their poor quality. Even after a year to three years of non-recovery, it is still considered a dubious asset by the bank.

Assets that have been deemed unrecoverable by the relevant bank, statutory auditors, or RBI inspector are considered loss assets. If bank overdoes get unpaid for more than three years, the assets representing them might be written off as a loss.

II. CLASSIFICATION OF ASSETS AS NON-PERFORMING

Non-performing assets include the following components, under the Reserve Bank of India's definition:

i. When an account stops earning interest or dividends for the bank.

ii. After 90 days, a term loan account is considered seriously delinquent.

iii. An overdraft or cash credit at a bank that has been past due for more than 90 consecutive days.

iv. Bill is 90 days past due after being bought and/or reduced.

v. There has been no payment on the securitization charge for the last 90 days.

vi. Ninety days have passed with no payment on the derivative deal.

vii. Amounts owed on principle or interest for agricultural loans are now overdue

viii. In the event of short-term agricultural loans, c) two growing seasons. In the event of long-term agricultural loans, d. for a single harvest cycle.

Therefore, on the basis of these criteria, the following factors determine how non-performing assets are categorized.

i. Nature of the account (Term Loan)

ii. Running account (Cash Credit or Overdraft account)

iii. Bill Account (Bill Purchased or Discounted)

Nature of Account (Term Loan): If a term loan's principle and interest amount are 90 days past due from the day the loan was sanctioned, they are considered non-performing assets. In addition, the due date of an account must be taken into consideration for it to be classified as a non-performing asset by a bank. Loan repayment dates are established at the time of first approval. Interest and instalment payments, with or without a moratorium, are due on this day. After the moratorium ends, the payments may be spread out over a longer time frame, such as every month, every quarter, every half year, or every year.

Running Account (Cash Credit (CC) / Overdraft (OD)): NPA status is applied to cash credit or overdraft accounts that have been operational for two consecutive quarters as of the balance sheet date. It is important to first determine if an account is irregular before treating it as such. An account is considered irregular if it meets the criteria below: If (i) the outstanding amount is consistently higher than the available drawing power, or (ii) no credits have been made in the preceding ninety days as of the balance sheet date, the account will be closed. No matter how close the outstanding amount in the account is to the maximum sanctioned/drawing capacity, if interest was debited over the same 90-day period, the credit would not be enough to pay it. An account that has been out of order for more than 90 days is considered irregular. Cash credits and overdrafts are considered non-performing assets if they remain inoperable for more than 90 days.

NPA tendencies are seen to reflect the dynamic nature of the regulatory environment. Up until the middle of the 1980s, banks and auditors in India were responsible for managing nonperforming assets. In 1985, the first-ever system of categorization of assets for the Indian banking sector was created in response to the necessity for fine tuning regulatory frameworks to cope with the evolving risk-profile of banking. Advances were placed into one of eight categories, with ratings ranging from 1 (Satisfactory) to 8 (Bad and Doubtful Debts) under this system, which was known as the "Health Code" system. Regulatory guidance underwent major shifts throughout this evolutionary period. The NPA's categorization criteria were being strengthened over time to make them consistent with global norms. Guidelines on the "restructuring of advances" were also established by the RBI in the early 1990s. Standard assets that had their interest and principal renegotiated or rescheduled after production had begun were required to be designated as non-standard under the criteria. Prior to the start of production, the instructions were revised to make it more clear how asset categorization would be applied to restructured accounts.

III. CAUSES FOR NPAS IN BANKS

(a) Primitive Information Systems - The growth of banks' assets and the complexity of credit management have outpaced the development of their corresponding information systems. Timely identification of problem accounts was delayed and banks' credit risk management capacities were impaired due to a lack of detailed data on slippages, early signs of deterioration in asset quality, segment-wise trends, and similar factors. In the years leading up to the crisis, banks missed the reversal in asset quality trends. Better credit management would not have been possible without the comprehensive database housing detailed information.

(b) Higher NPAs not only from the GDP slowdown - Bank asset quality is profoundly affected by the state of the economy as a whole. The recent drop in asset quality has roughly coincided with the slowdown in the country's growth rate, lending credence to the oft-cited thesis that bank asset quality is cyclical and tied to the broader economic picture. The patterns in the growth rate of gross nonperforming assets and in the slippages of Indian banks suggest that the. seeds of current deterioration in asset quality had been sowed far before the slowdown in economic development in 2006-08. As a result, the recent downturn in the country's macroeconomic performance is not a sufficient explanation for the present drop in asset quality. The present asset quality of the banking system is the result of a number of causes and causal interactions, including but not limited to the slowdown in GDP growth rate.

(c) Lax credit management - Inadequate credit management during the "good years" before the crisis ultimately led to asset impairment, as shown by the study. Banks with faster credit expansion between 2004 and 2008 also had faster nonperforming loan expansion between 2008 and 2013. The banks with the greatest CAGRs of both credit and nonperforming assets (NPAs) between 2004 and 2009 also had the highest CAGRs of NPAs between 2008 and 2013. Therefore, problems with credit evaluation emerged throughout the years leading up to the crisis, credit monitoring was ignored, and recovery efforts progressed slowly.

IV. REASONS FOR GROWING NON-PERFORMING ASSETS:

The rising amount of non-performing assets is a challenge for the banking industry worldwide. After Greece (36.40%), Italy (16.40%), Portugal (15.50%), and Ireland (11.90%), India ranks fifth globally in terms of non-performing assets, at 11.20%. India has nonperforming loans of more than 10,000,000,000,000. There are 8.95 trillion rupees in nonperforming loans at public sector banks and 1.26 trillion rupees at private sector institutions. The fast pace of growth is a source of worry for the government and the banking industry. The rapid increase in NPAs is a mystery that is now being probed. The following causes have been linked to the accelerated expansion of non-performing assets.

1. Factors related to the Borrower

2. Factors related to the Banks

3. Other factors

Factors related to the Borrower:

The major cause for the increase in nonperforming assets is variables associated with the borrower. Borrowers often run into problems while trying to settle their debt by paying off both the main and the accrued interest. The following are a few of the explanations behind this.

i. The businesspeople borrow the money from the banks to launch the company and cover initial operating expenses. However, they may be unable to repay the principal and interest on the loan after taking it out. Moreover, occasionally they are unable to pay the loan amount owing to their own inherent reluctance. The amount of bad debts rises as a result.

ii. Borrower business failure also contributes significantly to the rising NPAs. There might be various causes for this to occur. Some examples include inadequate leadership, poor internal controls, outdated technology, employee dissatisfaction, etc.

iii. Another factor contributing to rising non-performing assets is insufficient return on investment from high-stakes ventures. Borrowers sometimes exaggerate expected profits from investments and set unrealistically high payback targets when they apply for loans. The project does not really provide the predicted profit. As a consequence, nonperforming loans (NPAs) continue to rise since borrowers are unable to repay their principal.

iv. Another major factor contributing to loan default is unhealthy market competition (iv). The businessman may also be unable to repay the loan if the cost of the project rises as a result of inflationary tendencies.

v. Borrowers no longer need to worry because of the complex and time-consuming legal process and government oversight. This causes them to feel reluctance while making loan payments. Therefore, it contributes to the growth of banks' nonperforming assets.

vi. Increasing non-performing assets are a result of a number of factors, including business cycles such economic depression and recessionary patterns. Because of this, companies are unable to make enough money. Borrowers' inability to repay their debts is a direct result of this shortfall.

vii. In the case of farmers as borrowers, grounds for non-payment of loans include crop failure, seasonal changes, floods, farmer suicide due to on-going losses in the sale of agricultural commodities, etc. This is adding to the banks' non-performing assets as well.

viii. A major challenge for company management in our nation has been the adoption of new government regulations like demonetization and the Goods and Services Tax (GST) system. The result is a rise in nonperforming loans throughout the nation as company owners default on their bank loans.

Factors related to the Banks:

Indian banks are partly to blame for the rise of bad loans in the nation. Due to laws and requirements, banks make mistakes, fuelling the rapid expansion of non-performing assets. In this setting, several factors contribute. Here are a few of the most salient.

i. Lenders often make poor decisions on whom borrowers to provide credit to. This choice might be deliberate or happen subconsciously. Vijay Mallya and NiraavModi are two of the strongest instances of this in our nation. They've stolen from their victims to the tune of 9 and 11 thousand billion rupees. Such fraud is a major source of anxiety since it contributes to the growth of non-performing assets.

ii. The corruption and partiality of bank officials is also a major contributor to the escalation of bad loans in the nation. They lend money to friends, family, and acquaintances without asking about their ability to pay it back. The borrowers' inability to repay the loaned sum is a major contributor to the expansion of nonperforming assets.

iii. A major contributor to the increase in non-performing assets in the nation is the fact that banks do not conduct frequent appraisals before approving loans for borrowers to pay back in installments. There has been a rise in nonperforming assets because some banks are not taking the necessary steps to recoup the money they loaned out.

iv. Banks must adhere to established procedures for approving loan applications. The Reserve Bank of India (RBI) issues and periodically revises these regulations. The loan amount must be approved in accordance with their policies. In addition, the loan amount and the borrower's ability will determine the payback plan. Sadly, some banks are not adhering to these standards, which are resulting in a growing trend of nonperforming loans.

v. Unhealthy levels of interbank coordination and cooperation among bankers are also significant here. The borrower has taken out loans from several banks and financial organizations, and is now in a position where he or she cannot pay them back. This explains why NPAs have been increasing in India.

Other Factors:

Borrower and bank variables aren't the only ones to blame for the rise in non-performing assets in the nation; the political, governmental, legal, and technical environment of the country, etc., all play a role. Here are some of the key considerations that are crucial.

i. Bank employees are uncertain about their roles since the government is constantly changing its policies on the financial sector. In the demonetization era, for instance, 72 changes were implemented. Bank staff sanctioned inappropriate loans due to their lack of familiarity with the new regulation, making recovery much more difficult.

ii. Public sector banks are obligated by government policy to provide loans to the designated priority sector at a reduced interest rate. ii. The bankers will suffer a direct loss due to this subsidy. The financial institutions are likewise having a hard time recovering. As a result, the rise of non-performing assets in public sector banks may also be traced back to this government strategy.

iii. Many borrowers are consciously choosing to stop repaying their loans since there is no effective legal process for doing so. Non-performing asset recovery follows standard legal procedures. Due to RBI regulations, it is not uniformly applied across all bank locations. As a result, borrowers are willingly defaulting on their loans since they are relying on this flawed system. In the end, it contributes to a rise in NPAs.

iv. Moreover, recovery technology is rapidly evolving. iv. There is not enough time for recovery authorities to learn how to use the new equipment. Therefore, technological shifts are to blame for the bad loan epidemic.

v. Finally, we may say that political interference in the banking sector in our nation has made it more difficult to recoup the loan amount, leading to a rise in non-performing assets.

The government of India and the Reserve Bank of India (RBI) have granted the banks the recovery mechanism in order to limit the rising non-performing assets and recover it from the borrowers. A discussion of this mechanism follows.

(d) Sub-optimal credit management in PSBs - PSBs had much more severe credit management issues over a longer period of time. Since not all types of banks were hit equally hard by the recession, the large gap in asset quality between PSBs and new private sector and foreign banks is evidence that the economy is not the only cause of the recent decline in bank assets.

V. CONCLUSION

According to the data, NPA increased more rapidly in the priority sector. Lending to "high priority" industries was also blamed by banks for nonperforming loans. Because it is tied to a larger social goal, progress in priority sectors is inevitable. There has to be greater leeway for bankers to choose their own financing schemes. The quality of the project and the creditworthiness of the borrower should be taken into account when making judgments about any project, priority or non-priority sector.

The analysis shows that the primary causes of nonperforming assets are the borrower's intentional default and the borrower's decision to diversify their portfolio. The absence of oversight and follow-up just makes matters worse. Adding people to the loan department and giving them additional opportunities to learn and grow can help alleviate this issue. This will allow for consistent monitoring, increasing confidence that the project will be carried out as intended. Bankers may then use this information to identify potentially nonperforming assets and take corrective action to save the project or begin the recovery process. Banks, as part of their first credit rating process, should place their clients into several risk groups based on factors like management quality, SWOT analysis, etc. Any deviation in actual performance from expected performance should be communicated through periodic reviews of the project's progress. Bankers may use the results of such an analysis to see whether the project has entered a higher risk category. Banks will be able to take preventative action to keep the asset from becoming nonperforming if they have this information.

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