

A Study on the Problem of NPAs in Banks**Dr. Ankeshwar Prakash, Associate Professor of Commerce, DAV College Saddhaura****Abstract**

Ever since the process of economic reforms began in India, it is the banking sector which has been the major flag bearer of all economic reforms undertaken during this period. During all these years this sector has delivered under diverse expectations. But after 2008 when US subprime crisis took place and the world economy showed symptoms of slowdown, the problem of NPAs has started increasing globally, India being no exception to it. The problem has so much increased that banking sector has started feeling its pressure. This paper is an attempt to look into the main causes of increasing NPAs and suggest measures to overcome this problem.

Introduction

Banking sector can be termed as the back bone of financial sector of a country. It is the banks which provide financial resources for various sectors like agriculture, infrastructure, iron and steel, automobiles, pharmaceuticals, healthcare, real estate and consumer goods etc. of an economy. In fact, banks act as catalyst of growth by providing financial assistance to agriculture and industry. In emerging economies, banks not only perform duties of financial intermediation but also carry the additional responsibility of achieving the government's social agenda. Because of this close relationship between banking and economic development, the growth of the overall economy is intrinsically correlated to the health of the banking industry. During the time period from 2002 to 2008 when economy was growing at a faster rate, credit growth in the Indian banking sector was in excess of 22%. It was in 2008 when the world started moving backwards due to economic slowdown and demand for credit grew slower and banks also started showing lesser interest in extending credit to the needy. This proved counter-productive for overall economic development of the nation. This also resulted in increase in stressed assets (SAs) in India which almost doubled from 5.7% in FY08 to 10.2% in FY13, further glooming the scenario of banking industry as NPAs affect the smooth flow of credit. In India due to the social banking motto, the problem of bad loans did not receive priority from policy makers initially. However, with the reform of the financial sector and the adoption of international banking practices the issue of NPAs received due focus. Thus, 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.

What is NPA?

Non-performing asset means an asset or account of borrower, which has been classified by bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the direction or guidelines relating to assets classification issued by RBI. An amount due under any credit facility is treated as “past due” when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement system, recovery climate, up gradation of technology in the banking system etc, it was decided to dispense with “past due” concept, with effect from March 31, 2001. Accordingly as from that date, a Non performing asset shall be an advance where

- i Interest and/or instalment of principal remain overdue for a period of more than 180 days in respect of a term loan,
- ii The account remains ‘out of order’ for a period of more than 180 days, in respect of an overdraft/cash credit (OD/CC). Out of Order means an account in which the outstanding balance remains continuously in excess of sanctioned limit/drawing power.
- iii The bill remains overdue for a period of more than 180 days in case of bill purchased or discounted. Any credit facility is said to be overdue if it is not paid on due date fixed by the bank.
- iv. Interest and/or principal remain overdue for two harvest seasons but for a period not exceeding two and half years in case of an advance granted for agricultural purpose.

Objective of the Study

The main objective of the study is to assess main causes of occurring NPAs and suggesting remedial measures to overcome this problem.

Growth of Bank Credit

In India bank credit has been the significant contributor to the investment. Banks have played a pivotal role in economic development of India, especially after nationalisation of banks. They have been the major resource in implementing the social agenda of successive governments ever since independence. The following table shows decadal growth of bank credit after independence:

Table 1

Growth of Bank Credit in India

Year (as on 31 st March)	Bank Credit (in Billion Rs.)
1951	5.00
1961	13.00
1971	47.00
1981	254.00
1991	1164.00
2001	5114.00
2011	39420.00
2014	67352.00

Source: RBI monthly bulletin October 2014 (Speech delivered by R. Gandhi, Deputy Governor RBI on 26/8/2014 in Credit Summit India 2014)

The above table shows the important role played by Indian banking sector in the overall development of the nation. It is very much clear that right from the days of independence of India, banking sector has remained forward in delivering credit to the markets. During all these years the capital market has remained far behind when it comes to providing investment funding to the markets.

As the process of LPG gained momentum, the banks also started providing liberal credit to the industry. As a result the problem of NPAs started rising. According to RBI Annual Report 2013-14 (pp 83-84) about 47% of the aggregate credit outstanding by the banks was to industrial sector, which alone accounted for over 58% of gross NPAs of the banking sector. Gross advances to six industries-infrastructure, metal & products, textiles, chemical & chemical products, engineering industries and mining & quarrying constituted 30% of total advances and 36% of gross NPAs.

Table 2

GDP vs. GNPA's (in %)

Financial Year	GDP	Credit Growth	GNPAs
2001-02	4.2	-	11.4
2002-03	5.4	-	10.4
2003-04	3.9	-	8.8
2004-05	8.0	-	7.2
2005-06	7.0	30.9	5.2

2006-07	9.5	30.8	3.3
2007-08	9.6	28.1	2.5
2008-09	9.3	22.3	2.2
2009-10	6.7	17.5	2.3
2010-11	8.4	16.9	2.4
2011-12	8.4	21.5	2.5
2012-13	6.5	17.0	3.1
2013-14	4.8	15.1	3.6
2014-15	4.9	-	4.5

Source: 'Growing NPAs in banks Efficacy of credit rating agencies' A report created by ASSOCHAM in May 2014, www.pwc.in

The above table shows the growth of NPAs and its relation with GDP. The table clearly suggests that throughout this period of 14 years one can see that all the years with high GDP showed high credit growth and lower NPA rates. Years 2005-06, 2006-07 and 2007-08 have been the years when GDP was above 9% and during the same period, NPAs declined to as low as 2.2% in the year 2007-08. Thus it can be safely concluded that there is close correlation between high growth rate and high recovery of loans. But a strange thing is that from the year 2005-06 onwards credit growth in India has started declining from 30.9% in 2005-06 to almost half at 15.1% in 2013-14. Still the growth of NPA has been on higher side during this period. On 31st March, 2014 total outstanding bank credit was Rs. 57.90 trillion and on the same date total size of stressed assets was Rs. 5.91 trillion approximately 10.2% of the total credit given to customers. This shows high growth of NPAs.

Factors for Rise in NPAs

The banking sector has been facing the serious problems of the rising NPAs. But the problem of NPAs is more in public sector banks when compared to private sector banks and foreign banks. During the year ending on March 2013 and March 2014 GNPA ratio of PSBs was 3.8% and 4.7% respectively while that of Private Sector Banks was 1.9% respectively for both the years and in case of foreign banks this ratio was 3% and 3.4% respectively. The main reasons for growth of NPAs in PSB can be divided into external as well as internal factors. Some of the reasons are given below:

External Factors

Ineffective Recovery Mechanism

The Govt. has set up machinery in the form of DRTs, Lok Adalats, one time settlement plans and had implemented SARFAESI Act 2001 for the recovery of loans and advances. Due to their negligence and

ineffectiveness in their work the bank suffers the consequence of non-recovery, their by reducing their profitability and liquidity.

Wilful Defaulters

There are borrowers who intentionally show their inability to pay back loans. 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.

Agricultural NPAs

The following table presents the picture of growing NPAs in agriculture sector. It is evident from the table that from 2008-09 onwards the ratio of agricultural NPAs to agricultural loans has constantly risen, presenting a sorrow picture of this sector. There may be various reasons like less rainfall, excess rainfall resulting in flooding, spread of some diseases etc. Thus the bank has to make large amount of provisions in order to compensate those loans, hence end up with reduced profit.

Table 3
Agriculture Loans and NPAs

Year	Agricultural Loans Outstanding (Rs. Billion)	Gross NPAs (Agriculture) (Rs. Billion)	Ratio of NPAs to Agricultural Loans
2008	3081	97	3.2
2009	3744	72	1.9
2010	4636	104	2.2
2011	5072	167	3.3
2012	5802	248	4.3
2013	6428	302	4.7
2014	7792	340	4.4

Source: RBI Annual Report 2013-14

Industrial Sickness

Improper project handling, ineffective management, lack of adequate resources, lack of advance technology and inadequate govt. policies etc. 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 and increasing NPAs.

Lack of Demand

Indian entrepreneurs still doesn't show their preference for consumer research. As a result they are unable to judge the actual requirement of the consumer. Thus they end up producing products which fail to create demand and meet the desired target. As a result they have to incur losses. Another reason for lack of demand may be the weak market sentiment due to persistent depression worldwide. Take for example real estate sector where till day the sentiment is not good and large amount of bank funds have been locked in incomplete projects. The banks, in order to recover the loan amount, sell their assets, at prices much lower than the valuations which were shown at the time of sanctioning of loans. Thus the banks have to record the unrecovered part of loan as NPA.

Change in 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. Take the case of handloom sector. The fallout of withdrawal of state patronage from handloom sector is that the most of the weavers' Co-operative societies have become defunct. The rehabilitation plan worked out by the Central government to revive the handloom sector has not yet been fully implemented. So the over dues due to the handloom sectors are becoming NPAs.

Internal Factors**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

I Principles of safety:-

By safety it means that the borrower should be in a position to repay both principal amount and interest of the sanctioned loan. The repayment of loan depends upon the borrowers':

a. Capacity to pay

b. Willingness to pay

Capacity to pay depends upon:

1. Tangible assets

2. Success in business

Willingness to pay depends on:

1. Character
2. Honesty
3. Reputation of borrower

Sometimes these principles are not properly followed and loans given without fulfilment of above requirements become NPA later on.

Inappropriate Technology

Due to inappropriate technology and management information system, market driven decisions on real time basis cannot be taken. Proper MIS and financial accounting system is not implemented in the banks, which leads to poor credit collection and thus NPAs. Though a lot of the branches of the bank have been computerized, yet poor connectivity is still a great hindrance in smooth functioning of banks.

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 borrowers and less on other important factors like borrowers' own capital investment, credit information of the borrowers from other bankers, market and credit rating agencies. This also later becomes a major cause of rising NPAs.

Analysis of the Balance Sheet

True picture of business can only be revealed through proper analysis of Profit/Loss A/c and balance sheet of the borrower firm. But how much of this analysis is done and by whom goes a long way in deciding the fate of a loan product.

Purpose of the Loan

When bankers give loan, he should analyze the purpose of the loan. To ensure safety and liquidity, banks should grant loan for productive purposes only. Sometimes the loans are given for some purpose and are ultimately used by the borrower for some other purpose.

Poor Credit Appraisal System

Poor credit appraisal is another factor for the rise in NPAs. Due to poor credit appraisal the bank gives advances to those who are not able to repay it back.

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.

Absence of Regular Industrial Visits

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.

Suggestions

On the basis of above discussion, following are some of the suggestions for reducing rate of NPAs:

1. The foremost is having a solid credit appraisal system. For this purpose the banks should take the help of credit rating agencies. The credit rating agencies should also develop credit data base of customers which can help in calculating credit scores of the customers. Such methods will help banks in knowing creditworthiness of borrowers. As a result the banks can assess the financial health of customers in a better way and thus chances of default will lessen.
2. The bankers should take utmost care in ensuring that the enterprise or business for which a loan is sought is a sound one and the borrower is capable of carrying it out successfully. He should be a person of integrity and good character. The KYC norms should be strictly followed.
3. The bankers should also 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 firms only or to concentrate them in few industries or in a few cities. If a few big customers meet misfortune or certain trades or industries are adversely affected, the overall position of the bank will not be affected. If a large amount of funds are required by some particular industry, the banks can make a kind of consortium of banks and thus diversify their risk.
4. The banks should also try to use more and more technology. There should be a proper MIS in banks so that crucial information reaches the top management in quick times so that they can take appropriate decisions in case of defaulting customers.
5. The banks should also try and develop an early warning system about shaky customers so that banks can take early decisions in case of rising chances of default of a particular customer, particular industry or particular sector. This can help in reducing chances of NPAs.

6. There should be a system which allows bankers to go for industrial visits regularly and the industries being forced to submit their balance sheet regularly to banks. Banks should take services of financial analysts to assess the financial position of customers.
7. There should be proper lending rules in the banks and these must be strictly followed. Defaulting employees should also be punished.
8. In case of agricultural loans, the banks should also motivate farmers to go for crop insurance schemes so that in case crop being spoiled due to bad weather or other reasons, the loss of banks can be shared by insurance companies also.
9. There should be stricter punishments for wilful defaulters so that people start fearing before defaulting wilfully. Vijay Mallya case is a great example in this regard.
10. Bank should also analyze the profitability, viability, long term acceptability of the project while financing. For this purpose help of experts should also be taken.
11. There should be a system of information sharing between various banks so that defaulter of one bank cannot defraud other banks.
12. The process of granting credit to customers having defaulted once should also be stricter. The same principle should also be followed in case granting finance to sick industrial units.
13. Accountability should also be fixed in case of defaults as the banks are granting loans out of hard earned money of depositors belonging to various classes. Common people keep faith in banks particularly in PSBs due to government backing.

Conclusion

At the end it can be said that the problem of NPAs is increasing day by day and it needs to be curbed at the earliest. When a loan becomes NPA, it adversely affects the process of recycling of credit and thus the whole process of credit creation is stopped. Apart from this, NPAs affect profitability as well, since higher NPAs require higher provisioning also. Therefore, the problem of NPAs is not the concern of the lenders alone but is, indeed, a concern for policy makers as well who are involved in putting economic growth on the fast track. For this purpose, the banks and the government should work in tandem to safeguard the interest of depositors because both these have to work as the custodian of public money. Strict rules and stricter compliance of rules should be the topmost priority.

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