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IMPACT OF NON-PERFORMING ASSETS (NPAS) ON INDIAN BANKING SECTOR

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ABSTRACT

Banks are the backbone of financial systems and play an important role in economic development of the countries. Banks are the highest financial intermediaries in our economy and therefore they always deserve careful study. However, of late in general the bank's position has become precarious. This is mainly due to the high volume of Non-Performing Assets accumulated over the years. Non-performing assets are those assets which are not able to service the account by timely paying the interest charged as well as the installments agreed upon to the bank and the assets condition is such that these do not cover the outstanding balances in the account. This has a serious impact on the bank's profitability as well as the capital of the financing bank gets eroded. So far as the public sector banks are concerned the government has to fund those banks in order to keep those banks functioning. The Government as well as the Reserve Bank of India has now been equipped to take stringent actions against those defaulting borrowers and the steps are on. It is not an easy task as the securities charged to the banks do not have buyers because of the prevailing marketing conditions. The banks are expected to improve their pre sanction scrutiny of the credit proposal and should strengthen the post disbursement supervision and follow up to ensure that there is no addition to the NPAs.

Key words: Non –Performing Assets, prudent provisioning norms, wilful defaulters, capital erosion,

Introduction

Banks are the backbone of financial systems and play an important role in economic development of the countries. Banks are the highest financial intermediaries in our economy and therefore they always deserve careful study. Major changes took place in the functioning of banks in India due to the economic reforms in India which was started in early nineties. It is a fact that reforms have changed the depth and width of financial system in India. The nature of the Indian banks is quickly changing due to financial deregulation, financial innovations, financial inclusion, advancement in technology, customer's demands etc.

India embarked on a strategy of economic reforms in the wake of a serious balance-of-payments crisis in 1991; a central board of the reforms was reform in the financial sector and, with banks being the mainstay of financial intermediation, the banking sector. The objective of the banking sector reforms was to promote a diversified, efficient and competitive financial system

The Basel Committee on Banking Supervision is a forum for international cooperation on banking supervisory matters. Created by the G10 in 1974, it issued the Basel Accords on credit risk and capital adequacy in 1988 and 2004. Its name is derived from the fact that the Committee's secretariat is based at the Bank for International Settlements (BIS) in Basel, Switzerland and meetings are held there. India is a member of this organization.

Concept of NPA

Prior to 1991 the Indian banking sector was adopting a practice identifying borrowal accounts which are doubtful of recovery keeping in mind only the value of the available realizable security which was either charged to the bank are held by the borrowers. In respect of such accounts which are thus identified as doubtful of recovery the banks used to make adhoc provisions from out of their profits and continue to follow up the recovery. However, there was no disclosure of this vital information in the Annual Reports of the Banks. They were used satisfy about the adequacy of the provision for doubtful loans and advances to the statutory auditors and the auditors used to certify accordingly in their report. Thus there was no fully transparency disclosure about the bank's quality of assets held and the financial soundness of the banks.

It was for the first time when the Reserve Bank of India accepted the Basel Committee Norms regarding classification of assets and prudent norms for provisioning the true picture of the banks came to lime light. Basically the classification of the assets on the basis of the realizable value of the assets in different categories and according to the degree of risks in realization the assets were supposed to be classified. According to the RBI guidelines initially the assets were classified as under. These directions were in the first place were made applicable to the Public Sector Banks as well as scheduled commercial banks.

It will be appropriate to record here as to what the Committee on Banking Sector Reforms (Narasimham Committee II, 1998) stated about NPAs.

"NPAs constitute a real economic cost to the nation in that they reflect the application of scarce capital and credit funds to unproductive uses. The moneys locked up in NPAs are not available for productive use and to the extent that banks seek to make provisions for NPAs or write them off, it is a charge on their profits. To be able to do so, banks have to charge their productive and diligent customers a higher rate of interest. It thus becomes a tax on efficiency. It is the customer who uses credit efficiently that subsidizes the inefficiency represented by NPAs. This also raises the transaction costs in the system thus denying the diligent credit customers the benefit of lower rates, which would help them to be more efficient and competitive. NPAs, in short, are not just a problem for banks. They are bad for the economy".[1]

Performing and non – performing assets:[2]

The importance of Performing and Non-Performing Assets is increasing day by day from the formation of Shri M. Narsimham Committee or Banking Sector reform in 1991. We can say that it is the second land mark in banking sector in India

[१]Committee on Banking Sector Reforms (Narasimham Committee II, 1998)

[२] NABARD◦s Circular No. ११२/DOS- २२/ २००९ dated २३rd July २००९.

after nationalization of banks. After nationalization of banks, it has been given much attention on the lending policy of nationalized banks but not much attention was given on the aspects of recovery of the advances of the nationalized banks by Reserve bank of India.

In April, 1992, it was decided to implement the Narshimham Committee's recommendations on financial sector reforms in a phased manner over a three year period commencing from the accounting year 1992-93. Income Recognition Assets Classification (IRAC) and provisioning norms were introduced in our country with a view to reflecting a true picture of financials of Banks on the basis of their booking the income on actual basis than on accrual basis and also to classify assets according to the level of risks attached to them.

The Reserve Bank has issued directives from 31-03-1993 and presented a new concept of "Income Recognition". This is done on the recommendations of ShriM.Narsimham Committee.

According to this classification, it is stated as to classify their credit facilities into two parts:

(1) Performing Assets.

(2) Non – Performing Assets.

According to this classification, it is stated as to

(i) When the income must be said to recognize.

(ii) What provision for doubtful debts should be made, and

(iii) Full provision should be made for loss assets.

The Banks are required to classify their advances (Assets) into four broad categories:

(1) Standard Assets

(2) Sub-standard Assets

(3) Doubtful Assets, and

(4) Loss Assets

A standard asset is one (i) which does not disclose any problems and (ii) which does not carry more than normal risk attached to the business. Such an asset is Performing

Asset and not NPA. Sub-standard, doubtful and loss Assets are individually and collectively known as Non – Performing Assets (NPA).

On classifying the assets as stated above the banks are directed to make provisions out of their profits as per the directions of the Reserve Bank of India. And therefore, the term Gross NPA and Net NPA has been introduced since then. Gross NPAs refer to the funds blocked in the NPA accounts while Net NPA is the figure of Gross NPAs less the provisions made against it. Now even on the standard assets the banks are expected to make some provision as in course of time the account may turn into NPA.

Impact of NPAs on the banks/and Credit Societies:

The NPAs have blasting impact on the return on assets in the following ways:-

1. The capital adequate ratio is disturbed and cost of capital will go up.
2. The Economic Value Addition (EVA) by banks gets upset.
3. The current profits of banks are eroded.
4. The interest income of banks reduced due to non-receipt basis.
5. Banks profitability is affected adversely because of the provision of doubtful debts and consequent write off as bad debts.
6. Return on Investment (ROI) is reduced.
7. The assets and liability mismatch will widen.
8. It limits recycling of the funds.

With this background information let us try to understand the present position of the Indian banking industry vis-à-vis its position relating to NPAs.

One of the major challenges for the Indian banking system is to address the NPA issue which has also affected the profitability of banks besides coming in the way of future bank lending as banks have been cautious while lending especially for long term purposes.

Around 14% of the bad loans in public sector banks (PSBs) are due to wilful defaulters. The total gross non-performing assets (NPAs) of 21 PSBs stood at Rs 7.33 lakh crore as on September 30, 2017. Of this, Rs 1.01 lakh crore of loans were termed as those in wilful default.

The term wilful defaults refer to the deliberate action of default in the repayment of the bank's borrowed money which is mainly because of diversion of funds for other than non-intended purposes

Current scenario on NPA front

As of June 2017, public sector banks are more stressed than their private sector counterparts with the former figuring among the top 20 banks with the highest gross non-performing asset (GNPA) ratios, according to CARE Ratings' analysis of the first quarter results of 38 banks.

IDBI Bank (with gross NPA ratio of 24.11 per cent of gross advances) and Indian Overseas Bank (23.6 per cent) have NPA ratios of over 20 per cent. Among PSBs, Indian Bank has the lowest GNPA ratio of 7.21 per cent, the credit rating agency said.

Eight PSBs banks — IDBI Bank, Indian Overseas Bank, UCO Bank, Bank of Maharashtra, Central Bank of India, Dena Bank, United Bank of India, and Corporation Bank — had a GNPA ratio of over 15 per cent as of June 2017.

YES Bank is the only bank in the sample of 38 banks with a Gross NPA ratio of less than One (1).

Of the 9,025 cases of wilful defaults in PSU banks, lenders have filed cases against 8,423 for recovery of Rs 95,384 crore of NPAs. They have also filed 1,968 police complaints in cases of loan amounts totalling Rs. 31,807 crore. In 6,937 accounts, representing an outstanding of Rs 87,458 crore, banks have also initiated proceedings to attach and sell assets under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act.

The magnitude of this amount is so severe that the bank's very existence has come in danger. These are mainly corporate accounts involving huge loans which were sanctioned by the Director Boards of the respective banks. There is a room to believe that the diversion of funds by these defaulting borrowers was in connivance with the political leaders and the top brass of the bank.

This heavy dose of loss assets has resulted in the erosion of the capital of many banks and being the public sector banks the government of India has to pump in huge funds for the survival of the banks. The Govt. of India is seriously pursuing the commercial banks to take stringent actions against those defaulting borrowers where large funds are involved and the Central Finance Ministry is monitoring this issue. The central government has also strengthened the banks by providing adequate powers to them to bail these borrowers for recovery. Reserve Bank of India has been equipped with adequate powers to deal with these banks and their NPA accounts.

The banks in turn have also geared up their recovery effects and it is also being monitored by the top officials of the respective banks. However, it is for sure that the outstanding balances in the books and the available securities charged to the banks do not match. There is a mismatch. Disposal of the securities is also a problem as there are no buyers, as such outstanding balances remain uncovered.

The central government has recently (31st Dec. 2017) pumped in six stressed public sector banks as under to strengthen their capital base. These banks and the funds pumped in are as under

Bank of India Rs.2257 Crores, Central Bank of India Rs.323 crores, Dena Bank Rs.243 crores, IDBI Bank Rs.2729 crores, Bank of Maharashtra Rs.650 crores, United Commercial bank Rs.1375/- crores. These banks have been directed to put in vigorous efforts for the recovery of the bad loans.

From the recent press reports it is gathered that in order to improve their earnings banks are now trying to mop up funds by enhancing the services charges to its customers for the various services that the bank renders. The move is certainly being opposed by the customers.

Conclusion:

The banks are required to be very selective and the quality of the assets should be thoroughly examined before the funds are disbursement. Even the post disbursement supervision and follow up mechanism should be strengthened so as to ensure that there are no fresh additions to the NPAs of the bank. The supervision over the assets financed should be such that any incipient sickness in the account is timely noticed and corrective actions are taken up urgently to bring back the account in the standard assets. Only these measures will enable the banks to arrest the further deterioration in its working.

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