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NON-PERFORMING ASSETS IN INDIAN BANKING SECTOR – A REVIEW OF LITERATURE STUDY

Dr. A.C. Pramila
Assistant Professor of Commerce
Maharaja's College
University of Mysore
Mysuru, Karnataka.

Abstract

Banking sector plays a vital role in the economic development of a country. A healthy financial system and an efficient economy is dependent on a sound banking sector. The Indian banking sector has gone through a significant transformation after the economic reforms in 1991. This transformation and the big size have exposed banking sector to various kinds of risks such as credit, operational, market and liquidity risks. Non-performing assets (NPAs) is one of the major risks being faced by the banks today as it has lowered the profits of the banks. Unfortunately, the Coronavirus pandemic which hit the country in 2020 has adversely affected the banking sector. This paper is aimed at the review of literature on non-performing assets in Indian banking sector.

Keywords: Banks, Non-Performing Assets, Public sector banks and Private sector banks.

Introduction

The banking sector plays a critical role in the economic development of a country. The COVID-19 which hit the country in the early 2020 has badly affected the growth of various sectors. One such adversely affected sector is the banking sector. The Indian banking sector which is already reeling under mounting NPAs is adversely affected by this pandemic. RBI governor has said that the economic impact of the pandemic may result in higher NPAs and capital erosion of banks. The economic fallout of pandemic is expected to push up NPAs of the banking sector. It is estimated that the ratio of Gross NPAs may raise to 15.2% by March 2021 under the baseline scenario. On March 27, 2020, the RBI launched the COVID-19 regulatory package to rescue the economy where in it reduced the CRR to 100bps and repo rate by 75bps along with a three month loan moratorium followed by other systematic rate cuts and regulatory easing. The efficacy of these measures for the upliftment of the economy are bound to exert much stress over the banking sector.

Objectives

The objective of the study is to present the review of literature on non-performing assets in banks in terms of the impact of non-performing assets on profitability of banks, comparative study of non-performing assets in public sector banks and private sector banks, industrial sector and agricultural sector and measures taken to combat non-performing assets in banks.

Research methodology

The study is based on secondary data. The data required for the study is collected from the published research papers in national and international journals.

Literature Review

A number of studies have been done on NPAs in Indian banking sector by academicians and researchers. The literature reviewed in this part is obtained from the research studies and articles of researchers published in various journals.

Rathore and et al. (2016) finds that because of mis-management in bank there is a positive relation between total advances, net profits and NPAs of bank which is not good. They found that the positive relation between NPA and profits are due to wrong choice of clients. There is an adverse effect on the liquidity of bank as the banks are unable to give loans to new customers due to lack of funds. They suggested the banks to do proper pre sanction evaluation and forced disbursement control to reduce in NPAs.

Vivek Rajbahadur Singh (2016) analysed that the number of NPA cases referred to SARFAESI Act has increased during the period 2008 to 14. He has interpreted that this increase is due to the efficiency of the Act in recovering the NPAs of commercial banks. According to him this Act has emerged as a blessing is in disguise for the commercial banks as they are using this Act largely in recovering their NPAs in order to increase their profitability.

Veena and Pathi (2018) analysed that the post-merger performance of NPAs is more and increasing compared to pre-merger performance of gross and net NPAs. They examined that every year the NPAs has been increasing leading to adverse effect on profitability of the bank and suggested that the government should make provisions for faster settlement of pending cases to solve the problem of NPAs.

Nithia Mary Aisac et al. (2018) used regression models and paired sample testing to analyse that there is a significant relationship between NPAs and Gross Domestic Product (GDP). The outcome of the test was that there is a significant relationship between NPAs and GDP of India.

Jayanta Chakraborti has drawn the following inferences from his study - the problem of NPAs is much more acute in public sector banks, the NPA situation in public sector banks has worsened after 2008, 90% of the stressed banks are government banks and private sector banks have performed better than public sector banks. He has suggested that the banks need to invest in technology like big data analytics to analyse credit worthiness of customers before sanctioning the loans.

Bhawna Mittal (2019) identified the effect of increasing NPA in India and stated that the NPA has increased in the last decade. It means that a large proportion of bank assets has been ceased to generate income for the bank, which in turn, lowers the profitability and ability of bank to generate further credits. The decline in banks profitability is causing adverse economic shock as well as putting consumers deposits at risk.

Selvarajan and Vadivalagan (2013) analysed the priority sector advances under three heads viz, agriculture, small-scale industries and other priority sector. The data related to priority sector advances for 10 years i.e., from 2001 to 2010 have been collected for Indian bank and the public sector banks as a whole. According to them the growth of Indian bank lending to priority sector is more than that of public sector banks. In case of NPA management, the performance of Indian bank is better than public sector banks. However, Indian bank has slippages during the study period in controlling of NPAs. Therefore, the management of Indian bank must pay special attention towards NPA management and take appropriate steps to arrest the creation of new NPAs.

Tejashwini and Ramani (2019) examined the performance of two banks i.e., Bank of Baroda and HDFC for the three years (2017 to 19). The study finds that in spite of increasing trend noticed in both sectors of bank, private sector bank performs better than public sector banks. Advances, deposits and income generation capacity of HDFC are higher than Bank of Baroda. Profitability position, liquidity position and capability of increasing the level of provision against bad loans are noticed to be better in HDFC compared to Bank of Baroda in the study period. They concluded that amongst all the banking sectors, private sector is playing a major role in increasing its attractive lending policies and easy procedures to avail loans. This will help them increase the level of advances and deposits.

Ambuj Tiwari and Vipul Garg (2018) mentioned that higher NPAs ratio quakes the confidence of investors, depositors, lenders etc. It also causes poor recycling of funds which in turn will have harmful effect on the deployment of credit. The increasing NPAs will shoot up the price of loans interest rates. This will directly impact the investors who wish to take loans for setting up infrastructure, industrial projects etc. It leads to scarcity of funds in the Indian markets.

Abhishek Kumar Singh and Nayan Aggarwal, et al. (2019) observed that there is a direct impact on the bank's performance due to the risk of NPAs and NPA have a negative effect and influence on the performance of both public and private banks. They concluded that during 2018-19 there has been a major improvement in the asset quality of scheduled commercial banks as gross NPA ratio has declined from 11.5% to 9.3% as on March 2019. They found that the biggest reason behind the increasing NPAs of the public sector banks is the political interference in the functioning of public sector banks.

Krishna Murari (2014) analysed how effectively public and private sector banks managed their NPAs. According to him public sector banks have witnessed a continuous increasing trend in gross and net NPAs in comparison to private sector banks and there is statistically significant difference in the mean of gross and net NPA of public and private category of Indian banks. However, there is no significant difference in gross and net NPA ratio of both public and private sector banks which indicates that public and private sector banks are trying hard to reduce their NPA ratios consistently due to the regulatory and supervisory pressure. He suggested that besides preventive and corrective measures, the role of technology in managing and warning the officials in advance is crucial in NPA management.

Rashmi Kumari et al. (2017) examined the impact of NPAs on the financial performance of public and private sector banks covering a period of 2013 to 17. The data is analysed using regression model approach. The study found a significant and positive impact of gross and net NPAs on financial performance of public sector banks. Whereas gross and net NPAs have no significant impact on the financial performance of private sector banks.

Bamoriya et al. (2013) studied the impact of selected vital financial heads on NPA of scheduled commercial banks. The data is analysed using multiple regression technique. They found that there is a significant impact between total assets and total deposits on NPAs. However total advance and net interest income have no impact on NPAs.

Patidar and Kataria (2012) used multiple regression model and ratio analysis to study the impact of priority sector lending on the total NPAs of banks. The study reveals that there is significant impact of priority sector lending on total NPAs of public sector banks. Whereas there is no significant impact of priority sector lending on total NPAs of private sector banks.

Chethan Dudhe (2017) analysed the impact of NPAs on the profitability of banks. The study finds that public sector banks are more prone to NPA problems which will adversely affect their profitability. The suggestions to control the NPAs are to have a proper credit management which includes activities such as preparation of credit planning, proper credit appraisal, post sanction follow up and need based credit.

Vivek Rajbahadur Singh (2016) finds that NPA level of Indian banks is higher compared to foreign banks. The problem of recovery is not with small borrowers but with large borrowers. The government should make provisions for faster settlement of pending cases and it should reduce the mandatory lending to priority sector.

Kumar Thammanaveni (2017) analysed the recovery of NPAs of commercial banks through various channels viz., SARFAESI Act, Lok Adalat and DRT. The study finds that the number of cases referred to SARFAESI Act and DRT and the amount of NPAs recovered has increased largely during the study period 2010-16. This is due to efficiency of these recovery channels. But Lok Adalat is proved to be inefficient in recovery of NPAs and hence the commercial banks are resorting to other means of recovery.

Shriharsha Reddy (2015) investigated the impact of ownership on NPAs. According to him the nature of ownership has a significant impact on NPA levels. New private banks have the lowest NPA levels followed by old private banks and public sector banks. He also investigated that the impact of priority sector lending on NPA levels is negative and significant indicating that NPA problem in India is more due to lending to non-priority sector and sensitive sectors such as personal loan and real estate loans.

Namita Rajput et al. (2013) analysed that there is an inverse relationship among profitability and NPA. As a result, the banks can have an increasing trend of profitability only by the effective declining trend of NPAs. This would help to improve the asset quality of banks so that provisioning requirement would automatically come down leading to profits and which in turn leads to increase in the overall performance of the banks.

Namita Rajput and Anil Kumar Goyal (2019) analysed the stability of the banking sector for the period 2015 to 18 using the five dimensions of banking stability map. The dimensions are soundness, asset quality, profitability, liquidity and efficiency. According to them, the soundness which is measured by capital adequacy ratio and a leverage ratio has improved due to the implementation of capital conservation buffer. The asset quality measured by different ratios has deteriorated. Profitability which is the third measure of stability in banking system has declined due to increase in NPAs and fall in return on assets. The fourth parameter i.e., liquidating is quite satisfactory except the minor change in 2016 due to demonetization. The last pillar of checking the financial stability is efficiency which is satisfactory but needs improvement to perform better.

Agarwala and Agarwala (2019) found that the growth rate of NPAs is low in private sector banks as compared to nationalist banks as well as state bank of India and its associates. According to them the nationalised banks and associated banks of state bank of India have failed to handle the issue of poor loans effectively due to which the growth in such loans has been phenomenally high.

Senthil Arasu, Sridevi et al. (2019) identified that the asset quality in banks, especially the public sector banks is constantly deteriorating causing intolerable stress to banking sector, regulators and the Indian economy. According to them, during their study. 2014 to 18, the gross and net NPAs of both public and private sector banks have increased. They found that there is a significant positive relationship between gross NPA and net NPA of public and private sector banks and also negatively significant relationship between NPA and return on assets (ROA). The impact of gross NPA significantly influences the ROA negatively and also net NPA positively influences the ROA of both public and private sector banks. The study recommended to the regulators and respective bank officials to take necessary steps to reduce NPA and improve the recovery mechanism.

Sunil Kapadia and Venu Madhav (2019) narrated some important factors leading to rise in NPA level of scheduled commercial banks. The factors are relaxed and loose credit management and monitoring, rerouting of funds for modernization, diversification and expansion time and cost overrun during the project implementation stage, the unforeseen and abrupt crashing of capital markets there by inability to raise funds, failure to identify and acknowledge early warning signals shown by standard assets. They have suggested that the problem of NPA can be addressed at the budding stage of credit consideration itself with a risk management mechanism and appropriate credit appraisal and the prudential norms laid down by the RBI must equip the banking system to reduce if not completely to keep away from the problem of NPAs.

Ahita Paul (2018) examined the factors leading to the increased occurrence of NPAs are external such as decrease in global competitive commodity prices leading to slower exports. Some are more intrinsic to the Indian banking sector. According to him loans currently classified as in NPAs originated in the mid 2000 at a time when the economy was booming and business outlook was very positive. Large corporations were granted loans for projects based on extrapolation of their recent growth and performance. But as economic growth stagnated in 2008 due to global recession, the repayment capability of these corporations decreased. This led to the India's twin balance sheet problem, where both the banking sector and the corporate sector have come under financial stress. The banks at this time took to the practice of ever greening where fresh loans were given to some promoters to enable them to pay off their interest. This effectively pushed the recognition of these loans as non-performing to a later date, but did not address the root causes of their unprofitability.

Iqbal T. Havaldar et al. analyse the management of NPAs in agriculture credit by different types of banks. The analysis revealed that there are no differences in pre and post sanction process of agriculture credit and NPAs management in different types of banks. The NPAs in banks were due to wrong debt waiver policies of the political parties and wilful default of borrowers. They concluded that in a globalised economy, NPAs in agricultural loans can significantly influence India's sustainable development.

Findings

1. NPAs has increased in the last one decade.
2. Management of NPAs in private sector banks is better than public sector banks.
3. NPAs affect the profitability of banks curtailing its lending activities. This in turn will affect the development projects.
4. NPAs in certain cases are due wrong debt waiver policies of the government.
5. NPA problem in India is more due to lending to non-priority sector and sensitive sectors such as personal loan and real estate loans.

Conclusion

Today banking sector is one of the biggest service sectors in India. The rising NPAs could severely affect the bank's profitability and lending capacity. With increased defaults, banks will need to be re-capitalized i.e., more money will have to be invested in them to keep them going. Besides recapitalization a prudent credit risk management can help banks to reduce NPAs and enable growth in the banking sector. It is the need of the hour for the management of banks to avoid the creation of new NPAs.

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