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NON-PERFORMING ASSETS

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ABSTRACT:

The economic growth of a country is heavily reliant on the crucial function of the banking industry. A sound banking sector is essential for maintaining a healthy financial system and a productive economy. After the economic reforms in 1991, the banking industry in India underwent a significant change. The banking industry in India is properly regulated and has enough capital. No other country in the world has financial and economic conditions that are as exceptional as those in this country. According to the analysis of credit, market, and liquidity risks, it can be inferred that Indian banks are generally robust and have successfully navigated through the global economic crisis.

Banks are currently facing a significant risk in the form of nonperforming assets (NPAs), which have caused a decrease in their profits.

Keywords: NPA, Bank, economic growth

INTRODUCTION:

The modern economy relies heavily on the banking sector. The financial industry relies on it heavily as a significant financial support system that is integral to the smooth operation of an economy. The state of the economy can be assessed through the banking system. Banks primarily generate revenue by collecting interest on loans and advances, as well as receiving repayment of the principal amount. The funds obtained through interest payments and repayment of principal by borrowers are utilized to generate resources again. Yet, the accumulation of non performing assets (NPAs) hinders the smooth functioning of credit flow. This impedes the expansion of credit and has an impact on the banks' profitability. During the fiscal year 2021, Public sector banks in India reported a gross Non-Performing Assets (NPA) amounting to more than six trillion rupees. In 2019, there were 7.3 trillion rupees, but it decreased. On the other hand, private sector banks reported an increase in gross NPAs from 1.8 trillion rupees in the 2019 financial year to 2 trillion rupees in the 2021 financial year. "Bad assets" is another term used to describe non-performing assets. For instance, they comprise of loans that are not performing well and are improbable to be fully paid back by the borrower. Banks are faced with a significant obstacle due to NPAs, as they diminish banks' liquidity and profitability. The Reserve Bank of India defines NPA as any asset, whether leased or not, that fails to generate income for the bank, rendering it non-performing.

Definition by RBI on different cases of NPA

NPA is a loan or an advance where…

- Interest and/ or instalment of principal remain overdue for a period of more than **90 days** in respect of a term loan.
- The account remains '**out of orde**r' in respect of an Overdraft/Cash Credit (OD/CC).
- The bill remains overdue for a period of more than **90 days** in the case of bills purchased and discounted.
- The instalment of principal or interest thereon remains overdue for **two crop seasons for short duration crops.**
- The instalment of principal or interest thereon remains overdue for **one crop season for long duration crops**.
- The amount of liquidity facility remains outstanding for more than **90 days**, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.

In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of **90 days** from the specified due date for payment.
When the borrower stops paying interest or principal on a loan, the lender will lose money. Such a loan is known as Non-Performing Asset (NPA). Indian Banking industry is seriously affected by Non-Performing Assets**.**

Based on the period to which a loan has remained as NPA, it is classified into 3 types:

Categories of NPAs	Criteria
Substandard Assets	An asset which remains as NPAs for less than or equal to 12
Doubtful Assets	An asset which remained in the above category for 12 months.
Loss Assets	Asset where loss has been identified by the bank or the RBI,

The production of bad loans in a bank's portfolio is detrim ental to the banking sector since it impacts the balance she et's stability and size. The return on assets is also affected negatively. Provisioning for doubtful and bad loans results in a decrease in overall profitability due to a significant nu mber of profits being set aside. The escalating carrying costs of NPA accounts are an additional burden for banks, as these funds could have been utilized for profitable ventu res. Financial institutions are required to maintain a specific level of capi tal adequacy to bolster their overall value.

The issue of NPAs is not a recent occurrence in India, and the Government has implemented various measures on leg al, financial, and policy fronts to address it.. In the year 1991, the Narasimhan committee recommended many reforms to tackle NPAs. Some of them were implemented.

Recommendation by the Narasimhan committee

- The Debt Recovery Tribunals (DRTs) – 1993
- Credit Information Bureau – 2000
- SARFAESI Act – 2002
- ARC (Asset Reconstruction Companies)
- Corporate Debt Restructuring – 2005
- Compromise Settlement
- 5:25 rule – 2014
- Joint Lenders Forum – 2014
- Mission Indradhanush – 2015
- Strategic debt restructuring (SDR) – 2015
- Asset Quality Review – 2015
- Sustainable structuring of stressed assets (S4A) – 2016
- Insolvency and Bankruptcy code Act-2016
- Public ARC vs. Private ARC – 2017
- Bad Banks – 2017

Literature review

The issue of NPAs has caused lenders and policy maker's great concern. Numerous research studies have be en carried out to understand the factors that contribute to the rise in NPA s, the tactics that must be used to address the problem at an early stage, and the changes t hat have been made to reduce the accumulation of NPAs.

Thomas and Vyas (2016) in a recent study on the loan recovery strategy of Indian banks suggest two measures, preventive and corrective. The paper also discusses several corrective measures – legal, regulatory, and non-legal that are to be taken to recover the non-performing loans.

Singh (2016) in another recent study on NPAs and recovery status find that the problem is more severe for the public sector banks compared to the private sector banks. The academic review points to the need to have strict lending policies for the speedy recovery of loans.

Mehar (2017) in the post-demonetization period looks into the impact of the government's notebandi decision on the NPA of Indian Banks. The researcher finds both positives and negatives of the event on the banking industry.

Sengupta and Vardhan (2017) have compared the two banking crisis episodes post-liberalization- one that took place in the late 1990s and the other that commenced after the 2008 global financial crisis that raised the issue of NPAs. The authors are of the view that strong governance, proactive banking regulations, and a strong legal framework for the resolution of NPAs would assist in solving the problem of NPAs. On the other hand, regulatory forbearance would adversely affect the banking crisis.

Mittal and Suneja (2017) have analyzed the level of NPAs in the banking sector in India and the causes that have led to the rise in NPAs. They have proposed that though the government has taken a number of steps to reduce the problem of NPAs, bankers should also be proactive in adopting well-structured policies to manage NPAs. The loan should be sanctioned after considering the return on investment of a proposed project and the creditworthiness of the customers.

Mishra and Pawaskar (2017) have recommended that banks should have a good credit appraisal system so as to avoid NPAs. They point out that the problem of NPAs can be solved if there is a proper legal structure to support the banks in the recovery of debt.

Kumar (2018), in her study, has found that NPAs have a serious negative impact on the profitability and liquidity of the banking sector. According to her if the issue of NPAs is managed efficiently, then many microeconomic issues such as poverty, unemployment, and imbalances of the balance of payments can be reduced, the money market can be strengthened, and thus, the image of the Indian banking system can be improved in the international market.

Veena and Pathi (2018) analyzed that the post-merger performance of NPAs is more and increased compared to the pre-merger performance of gross and net NPAs. They examined that every year the NPAs have been increasing leading to an adverse effect on the 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 whether 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 the 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 banks need to invest in technology like big data analytics to analyze credit worthiness of customers before sanctioning 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 ceased to generate income for the bank, which in turn, lowers the profitability and ability of the bank to generate further credits. The decline in the bank's profitability is causing adverse economic shock as well as putting consumer deposits at risk.

Hawaldar, I.T., Spulkar, C., Lokesh, A., Birau, R., Robegen, C. (2020) in their study analyzing non-performing assets in agriculture loans. A case study in India concluded that there is no significant difference in pre and post-sanction of agriculture loans and management of non-performing assets by banks. The wilful default by borrowers and more NPAs in banks are due to debt waiver policies announced by political parties.

Jethwani, B., Dave, D., Ali, T., Phansalker, S., and Ahhirao, S. (2020) in their study Indian agriculture GDP and NPA: A regression model found that the repayment of farm loans adversely affects factors like rural population, low export value of crop and low crop production for the year. It should be understood that the farm loan waivers cannot solve the problem.

Selvam, P. and Premnath S., (2020) in their study titled "Impact of coronavirus on NPA and GDP of Indian Economy" finds that the NPAs increased during theperiod and suggested that government should resolve pending cases quickly and stop mandatory landings which is the real problem segment.

Saha, M., and Zaman, A. (2021) in their study titled Management of NPAs in banks with special reference to UBI found that with the decrease in NPA level, profitability of banks increased.

The objective of the study

- To Know the level of Non-Performing Assets of private and public sector banks
- To identify the reasons and impact of Non-Performing Assets on profitability.
- To offer recommendations to the regulators and policymakers

Research design

The proposed work heavily relies on this crucial research a rea as it serves as its fundamental basis. The accuracy and strength of the results rely
on the framework that is established. The present investiga tion is comprised of the subsequent design elements Sample: the individual private sector banks, the nationalized banks, and SBI and its associates have been considered.

Data period: the analysis is based on data for the period 2011-2022.Nature of the data and source: The investigation is based on secondary data, which is collected from the RBI website.

A variable of interest: gross NPAs.Research methods: in this article, the statistical tool that the researchers have used is the geometric mean for arriving at the mean growth rate and then the growth of individual banks has been compared with the average growth rate.

Analysis and Findings

The details of the analysis are presented in the sub-section below.

Reasons: -

Diversification of funds to unrelated business/fraud. Lapses due to diligence. Business losses due to changes in business/regulatory environment. Lack of morale, particularly after government schemes that had written off loans. The global, regional, or national financial crisis results in the erosion of margins and profits of companies, therefore, stressing their balance sheet which finally results in non-servicing of interest and loan payments. (For example, the 2008 global financial crisis). The general slowdown of the entire economy for example after 2011 there was a slowdown in the Indian economy which resulted in the faster growth of NPAs.

The slowdown in a specific industrial segment, therefore, companies in that area bear the heat and some may become NPAs. Unplanned expansion of corporate houses during the boom period and loans taken at low rates later being serviced at high rates, therefore, resulting in NPAs.

Due to maladministration by the corporates, for example, wilful defaulters. Due to misgovernance and policy paralysis which hampers the timeline and speed of projects, therefore, loans become NPAs. For example, the Infrastructure Sector Severe competition in any particular market segment. For example, the Telecom sector in India. Delay in land acquisition due to social, political, cultural, and environmental reasons. A bad lending practice is a non-transparent way of giving loans. Natural reasons such as floods, droughts, disease outbreaks, earthquakes, tsunamis, etc. Cheap imports due to dumping lead to a business loss for domestic companies. For example, the Steel sector in India.

Impacts: -

Lenders suffer a lowering in profit margins.

Stress in the banking sector causes less money available to fund other projects, therefore, negative impact on the larger national economy. Higher interest rates by the banks to maintain the profit margin. Redirecting funds from the good projects to the bad ones. As investments got stuck, it may result in unemployment.

In the case of public sector banks, the bad health of banks means a bad return for a shareholder which means that the government of India gets less money as a dividend. Therefore, it may impact the easy deployment of money for social and infrastructure development and result in social and political costs.

Investors do not get rightful returns.

Balance sheet syndrome of Indian characteristics that both the banks and the corporate sector have stressed balance sheets and causes the halting of the investment-led development process.

NPA-related cases add more pressure to already pending cases with the judiciary.

The Rise and Fall of Bad Loans

Gross non-performing assets (NPAs) of the banking sector dropped below 6 percent as of March 2022 — the lowest since 2016 — and net NPAs fell to 1.7 percent during the same period, indicating that the sector has remained largely unscathed from the ill effects of the Covid-19 pandemic so far, M Rajeshwar Rao, deputy governor of the Reserve Bank of India (RBI), said on Tuesday.

At the same time, it would be important to assess if the improvement in the asset quality is broad-based or only because of regulatory forbearance, he said. "The preliminary assessment of the health of the banking sector is encouraging," Rao said.

"The asset quality of banks has improved, and the gross NPAs and net NPAs of the banks have improved from the pre-pandemic levels. The fresh slippages have broadly been brought under control. Banks have also enhanced their provisions including provisions for restructured accounts," he added.

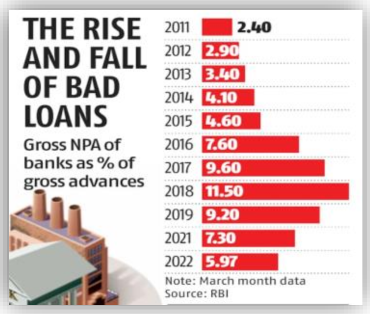
Asset quality of Indian banks started deteriorating in the early part of the last decade and peaked in March 2018 with gross NPA hitting 11.5 percent of gross advances. Since then, the asset quality of banks has been improving.

In the last year also, there has been an improvement. Gross NPAs of scheduled commercial banks were at 7.3 percent in March 2021 and 6.9 percent in September 2021.While exuding confidence about the improvement in the banking system's asset quality, Rao also cautioned that the industry has to exhibit prudence and ascertain whether the current levels of asset quality being exhibited are on account of improvement in fundamentals of business, deleveraging and efficiency gains or on account of support extended by authorities through various measures.

"We expect banks and other financial institutions to proactively undertake stress testing of their loan books subjecting them to various levels of stress, including extreme scenarios to estimate the loss absorption limits wherever available at their disposal and take measures to augment the same wherever necessary," Rao said.

"While we have attempted to combat the impact of the pandemic on the financial system, the task is only half done. We have to ensure that the financial system escapes unscathed as we exit from the pandemic-driven regulatory forbearance," he said. Not only has there been an improvement in the asset quality of the banking system, but banks have also shored up their capital base to deal with any untoward situation that may arise going forward. They are also well-placed to support the economy with a rise in credit demand.

"Today, most of the banks have comfortable capital positions, which would position them well to support economic recovery. These data points do give us a degree of comfort at this juncture. However, we may also have to wait a bit longer to see how the impacts completely play out," Rao said. Loan growth of banks has picked up in the last few months, growing at over 12 percent now. According to the latest RBI data, commercial banks' credit growth was 12.1 percent year on year till May 20, as compared to 6 percent a year ago.



Conclusion

The overall findings point to a worrisome situation for the banking sector. An analysis of the growth rate at the NPA level shows that the problem is evident not only with small-sized banks but also with big names in the banking space. The government of India and RBI has taken a number of initiatives to reduce the level of bad loans NPAs, but they are still very high compared to international standards. To reduce them, banks must develop an efficient management system and the staff involved in sanctioning the advances should be trained in the proper documentation. Banks should conduct proper inspection and credit appraisal before approving a project and then carry out regular monitoring to ensure that the amount must be utilized for the purpose for which it has been given. The most important business implication of the NPAs is that it leads to credit risk management assuming priority over other aspects of the bank's functioning. The bank's whole machinery would thus be preoccupied with recovery procedures rather than concentrating on expanding business. A bank with a high level of NPAs would be forced to incur carrying costs on non-income-yielding assets. Other consequences would be a reduction in interest income, a high level of provisioning (as banks are required to keep aside a portion of their operating profit as provisions, as NPAs increase banks have to increase the amount kept aside as provisions which will reduce their net profits) stress on profitability and capital adequacy, gradual decline in the ability to meet the steady increase in cost, increased pressure on Net Interest Margin (NIM) thereby reducing competitiveness, steady erosion of capital resources and increased difficulty in augmenting capital resources. NPAs generate a vicious cycle of effects on the sustainability and growth of the banking system, and if not managed properly could lead to bank failure. The need of the hour to tackle NPAs is some urgent remedial measures. This should include Technology and data analytics to identify the early warning signals. Mechanism to identify the hidden NPAs development of internal skills for credit assessment. Forensic audits to understand the intent of the borrower. Gross nonperforming assets (GNPAs) of scheduled commercial banks (SCBs) fell to a six-year low of 5.9 percent in March 2022 and could fall further to 5.3 percent by March 2023, according to the Financial Stability Report of the Reserve Bank of India (RBI).

"Under the assumption of no further regulatory reliefs as well as without taking the potential impact of stressed asset purchases by National Assets Reconstruction Company Limited into account, stress tests indicate that the GNPA ratio of all SCBs may improve from 5.9 percent in March 2022 to 5.3 percent by March 2023 under the baseline scenario driven by higher expected bank credit growth and declining trend in the stock of GNPAs, among other factors," the report for June 2022 said.

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