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NPAs Implication on Banking Sector & Economy

G.Pavan Krishna
MBA student PACE Institute of Technology & Sciences

ABSTRACT

A "Non-Performing Asset" (NPA) was defined as a credit facility in respect of which the interest and/ or instalment of principal has remained "past due" for a specified period of time. An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. The Non-Performing Assets strike terror in banking sector today. The dreaded NPA increases year by year continuously. Due to this risk performance of the banking sector has been decreasing and some of them have been liquidated. The three letter black snake (NPA) is going up. Now we should think seriously about the regulator norms of our financial sector. It may be guarantor norms, recovery rules and its implementation. All banking policy has a chance of improvement. All the recommendations work in certain limitation, condition and assumption. We cannot predict about the customers perception about the loan repayment. Out of majority and big defaulters are escape from the recovery and innocent guarantor some time trap in this incident or bank may lost its assets. Therefore now there are various techniques developed by the defaulters. At the time of application their intention may be doubtful. Sometime internal employee also involved in this activity. This study focused on impact of NPA on national economy and recommendation of regulatory norms.

INTRODUCTION

The business of banking essentially involves intermediation-acceptance of deposits and channeling these deposits in to lending activities. Since the deposits received from the depositors have to be repaid to them by the bank, they are known as banks 'Liabilities' and as the loan given to the borrowers are to be received back from them, they are termed as banks' 'Assets' so assets are banks loans and advances.

In the traditional banking business of lending financed by deposits from customers, Commercial Banks are faced with the risk of default by the borrower in the payment of either principal or interest. This risk in banking parlance is termed as 'Credit Risk' and accounts where payment of interest and /or repayment of principal is not forthcoming are treated as Non-Performing Assets, as per the Reserve Bank of India, an asset, including a leased asset, becomes non-Performing when it ceases to generate income for the bank. Existence of Non-Performing Asset is an integral part of banking and every bank has some Non-Performing Assets in its advance portfolio. However, the high level of NPA is a cause of worry to any financial institution.

INDIAN BANKING AND NPA REGULATIONS:

until mid eighties, management of NPAs was left to the banks and the auditors. In 1985, the first ever system of classification of assets for the Indian banking system was introduced on the recommendations of A. Ghosh Committee on Final Accounts. This system, called the 'Health Code System' (HCS) involved classification of bank advances into eight categories ranging from 1 (satisfactory) to 8 (bad and doubtful debt). In 1991, the Narasimhan Committee on the financial system felt that the classification of assets according to the HCS was not in accordance with international standards and suggested that

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for the purpose of provision, banks should classify their advances into four broad groups, viz. (i) standard assets; (ii) substandard assets; (iii) doubtful assets; (iv) loss assets. Following this, prudential norms relating to income recognition, asset classification and provisioning were introduced in 1992 in a phased manner. In 1998, the Narasimhan Committee on Banking Sector Reforms recommended a further tightening of prudential standards in order to strengthen the prevailing norms and bring them on par with evolving international best practices. With the introduction of 90-days norms for classification of NPAs in 2001, the NPA guidelines were brought as par with international standards.

The NPAs can broadly be classified into (i) Gross NPAs, (ii) Net NPAs. Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on balance sheet date. It reflects the quality of loans made by banks. (Gross NPAs Ratio = Gross NPAs/Gross Advances). Net NPAs are those type of NPAs in which the banks deduct the provisions regarding NPAs. It shows the actual burden of banks (Net NPAs = Gross NPAs-Provision/Gross Advances-Provisions).

FACTORS RESPONSIBLE FOR NPAs

The following factors confronting the borrowers are responsible for incidence of NPAs in the banks:-

(i) Diversion of funds for expansion/modernization/setting up new projects/helping promoting sister concerns.

(ii) Time/cost overrun while implementing projects.

(iii) External factors like raw-material shortage, raw-material/Input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accident etc.

(iv) Business failure like product failing to capture market, inefficient management, strike/strained labour relations, wrong technology, technical problem, product obsolescence, etc.

(v) Failure, non-payment/over dues in other countries, recession in other countries, externalization problems, adverse exchange rate, etc.

(vi) Government policies like excise, import duty changes, deregulation, pollution control orders, etc.

(vii) Wilful default, siphoning of funds, fraud, misappropriation, promoters/management disputes etc.

Besides above, factors such as deficiencies on the part of the banks viz. deficiencies in credit appraisal, monitoring and follow-up; delay in release of limits; delay in settlement of payments/subsidies by Government bodies, etc. are also attributed for the incidence of NPAs.

PUBLIC SECTOR BANKS IN INDIA

The banking system in India consists of Commercial Banks and Cooperatives Banks of which the Commercial Banks account for more than **90 percent** of the banking system's assets. Based on the ownership pattern, the Commercial Banks can be grouped into three type i.e. (i) State owned or Public Sector Banks (PSBs)- that is the State Bank of India and its subsidiaries and the nationalized banks (there are 27 PSBs functioning in the country as on 31.3.2014), (ii) Private Banks under Indian ownership, and (iii) Foreign Banks operating in India.

The PSBs dominated the banking business in the country. In 1990-91, they accounted for as much as **91 percent** of the total assets-with Private Indian Banks with **3 percent** and Foreign Banks with **6 percent**. After entry of a number of new Private Indian Banks in the mid 1990s, the Indian Banking Industry continued to dominated by the PSBs. At the end of 2000-2001, PSBs accounted for a little under 80 percent of total assets with Indian private sector with over **12 percent** and

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foreign banks with **8 percent**. Whereas at end March 2013, the PSBs accounted for about **72.7 percent** of the total assets in the Indian Banking Industry with **20.8 percent** with Private Banks and **6.5 percent** with foreign banks.

The classification of advances as per the newly introduced 'prudential norms' enabled a proper assessments of the extent level of NPAs in the Indian banking system for the first time. Asset quality in the banking system has deteriorated in the post-crisis years and among banks groups, PSBs had the highest level of stress in terms of NPAs and restructured advances.

TRENDS IN NPAs IN PUBLIC SECTOR BANKS

The Initial figure for the NPAs were quite high, As on March 31, 1992, for the PSBs together, as much as Rs.17,400 crore or **14.5 percent** of outstanding advances or **6.7 percent** of total assets comprised bad loans of varying degree.

Gross and Net NPAs of Public Sector Banks since 1992-93 to 2012-13 (Amount in Rs. billion)

(Per cent)

Year	Gross NPAs Amount	Gross NPAs as percentage of Gross Advances	Gross NPAs as percentage of Total Assets	Net NPAs Amount	Net NPAs as percentage of Net Advances	Net NPAs as percentage of Total Assets
1993	392.5	23.2	11.8	–	–	–
1994	410.4	24.8	10.8	–	–	–
1995	383.8	19.5	8.7	–	10.7	4.0
1996	416.6	18.0	8.2	–	8.9	3.6
1997	435.77	17.8	7.8	202.85	9.2	3.6
1998	456.53	16.0	7.0	212.32	8.2	3.3
1999	517.10	15.9	6.7	242.11	8.1	3.1
2000	530.33	14.0	6.0	261.87	7.4	2.9
2001	546.72	12.4	5.3	279.77	6.7	2.7
2002	564.73	11.1	4.9	279.58	5.8	2.4
2003	540.90	9.4	4.2	248.77	4.5	1.9
2004	515.37	7.8	3.5	193.35	3.1	1.3
2005	483.99	5.5	2.7	169.04	2.1	1.0
2006	413.58	3.6	2.1	145.66	1.3	0.7
2007	389.68	2.7	1.6	151.45	1.1	0.6
2008	404.52	2.2	1.3	178.36	1.0	0.6
2009	449.57	2.0	1.2	211.55	-0.9	0.6
2010	599.26	2.2	1.3	293.75	1.1	0.7
2011	746.00	2.4	1.4	360.00	1.2	0.7
2012	1124.89	3.2	1.9	593.00	1.5	1.0
2013	1644.62	3.6	2.4	900.00	2.0	1.3

Source: (i) RBI. Handbook of Statistics on the Indian Economy, 2005-06, 2013-14 http://dbie.rbi.org.in (ii) Rajiv Ranjan and Dhal, Sarat Chandra, Non Performing Loans and Terms of Credit, RBI Occasional Paper, Volume 24, No.3 Winter 2003

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PUBLIC SECTOR BANK WISE DATA ON NPAs DURING LAST 3 YEARS

Sl. No.	Bank name	2012	2013	2014
1	Allahabad bank	2059	5137	8068
2	Andhra Bank	1798	3714	5858
3	Bank of Baroda	4465	7983	11876
4	Bank of India	5894	8765	11869
5	Bank of Maharastra	1297	1138	2860
6	Barathiya Mahila Bank Ltd.	0	0	0
7	Canara Bank	4032	6260	7570
8	Central Bank of India	7273	8456	11500
9	Corporation Bank	1274	2048	4737
10	Dena Bank	957	1452	2616
11	IDBI Bank Ltd	4551	6450	9960
12	Indian Bank	1851	3565	4562
13	Indian Overseas Bank	3920	6608	9020
14	Oriental Bank of Commerce	3580	4184	5618
15	Punjab and Sindh Bank	763	1537	2554
16	Punjab National Bank	8720	13466	18880
17	Syndicate Bank	3183	2979	4611
18	UCO Bank	4086	7130	6621
19	Union Bank of India	5450	6314	9564
20	United Bank of India	2176	2964	7118
21	Vijyay Bank	1718	1533	1986
22	State Bank of Bicanar and Jaipur	1651	2119	2733
23	State Bank of Hyderabad	2007	3186	5824
24	State Bank of India	39676	51189	61605
25	State Bank of Mysore	1503	2081	2819
26	State Bank of Patiala	1888	2453	3758
27	State Bank of Travencore	1489	1750	3077
	Total	**117262**	**164462**	**227264**

REASONS FOR GROWING NPAs IN THE CURRENT PERSPECTIVE

The rising NPAs in recent period can attributed to the affects of the global recession coupled with internal factors like the slowdown in the domestic economy which had adversely affected the performance of corporate as well as small and medium enterprises leading to a negative impact on credit quality. The asset quality of PSBs aggravated in comparison to private sector banks as big ticket corporate loans form a larger share of the credit portfolio for PSBs. Data available with the Finance Ministry showed that thirty companies together owed Rs.2,27,264 crore as on September 30, 2014 to Public Sector Banks.

Another reason for sudden rise in gross NPAs of PSBs was reported to be on account of a shift to a system based recognition of NPAs from a manual one. Prior to this the computation for most banks was worked out manually at branch level and was therefore subject to discretion of managers.

The RBI in its Financial Stability Report, December 2013 has indentified five sectors - Infrastructure, Iron and Steel, Textiles, Aviation, and Mining - as the stressed sectors. PSBs have high exposures to the 'industry' sector in general and to such 'stressed' sectors in particular. Increase in NPAs of banks is mainly accounted for by switchover to system-based identification of NPAs by PSBs, slowdown of economic growth, and aggressive lending by banks in the past, especially during good times. As PSBs dominate the Indian Banking Sector and increase in the NPAs of PSBs is matter of concerns, steps are being taken to improve the situation.

IMPLICATIONS OF NPAs

For Economy:
Developing of sound and healthy financial institutions, especially banks, is an essential condition for maintaining over all stability of the financial system of the country. The high level of NPAs in banks and financial institutions has been a matter of grave concern to the public as bank credit is the catalyst to the economic growth of the country and any bottleneck in the smooth flow of credit, one cause for which is the mounting NPAs, is bound to create adverse repercussions on the economy. When the loans taken are not repaid, much of the funds go out of financial system and the cycle of lending- repaying-borrowing is broken. The banks have also to repay their depositors and others from whom the money had been borrowed. If the borrowers donot pay, the banks have to borrow additional funds to repay the depositors and creditors. This leads to a situation where banks are reluctant to lend fresh funds to new projects or the on-going projects thus choking the system. Once the credit to various sectors of the economy slows down, the economy is badly hurt. There is slow down in GDP growth and industrial output and fall in the profit margins of the corporates which resultantly cause depression in the market.

For Banking:
The most important business implication of the NPAs is that it leads to credit risk management assuming priority over other aspects of bank's functioning. The bank's whole machinery would thus be pre-occupied 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 reduction in interest income, high level of provisioning (as banks are required to keep aside a portion of their operating profit as provisions, as NPAs increases 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 ability to meet 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 affects on the sustainability and growth of the banking system, and if not managed properly could lead to bank failure.

INITIATIVES TAKEN BY THE GOVERNMENT

Some recent initiatives taken by the government to address the rising NPAs include:-

- Appointment of nodal officers in banks for recovery at their head offices/zonal offices/for each Debts Recovery Tribunal (DRT).

- Thrust on recovery of loss assets by banks and designating asset reconstruction companies (ARC) resolution agents of banks.

- Directing the state-level bankers' committees to be proactive in resolving issues with the state governments.

- Sanction of fresh loans on the basis of information sharing amongst banks.

Conducting sector / activity-wise analysis of NPAs.

- Close watch on NPAs by picking up early warning signals and ensuring timely corrective steps by banks including early detection of sign of distress, amendments in recovery laws, and strengthening of credit appraisal and post credit monitoring.

CONCLUSION

A strong banking sector is important for a flourishing economy. The failure of the banking system may have an adverse impact on other sectors thus, there is need to ensure that the banking system recognizes financial distress early, takes prompt steps to resolve it, and ensure fair recovery for lenders and investors so that banking sector start functioning without stress. Indian Banks' performance stressed & low due to NPA. Reasons of the current bad loan pile of Public sector banks are, lapses in the due diligence process (at the time of granting loans), easy approach towards defaulters, competition among banks. RBI should implement more measures & guidelines to PSB.

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