Non-Performing Assets: Reasons And Remedies

Dr.B.Sudha, Dr.R.Alamelu mangai

Abstract: Asset quality is an important parameter to judge the financial performance of a bank. Non-Performing assets not only ceases income of banks and requires higher provisioning and deteriorates profit margin of the banks. Alarming NPA of banks are the biggest hurdles for the socioeconomic development of our country. To tackle the NPA problem Government of India has announced the recapitalization plan for the PSBs. Moody's research report stated that, "the government's Rs.2.11 lakh crore capital infusion in public sector banks would narrow the gap between the capital profiles of public and private sector banks. This capital infusion will also help public sector banks build their provisioning coverage ratios as they will be allocated much of their operating profits towards loan-loss provisioning without having to worry about the impact on their capital positions". The researchers in this article made an attempt to highlight the reasons for the NPA.

Keywords: NPA, reasons, provisioning, bank, profitability, borrower, asset quality.

---

1 INTRODUCTION

Across the globe mounting NPAs are the big challenges for the banking sector, especially for the banks in the developing nations. Since 1991, the problems of the NPA have been considering greater attention in India. The presence of NPAs in banks makes the following impacts.

1) NPA ceases to generate incomes of the banks.
2) Huge provisioning for bad loans eat away the income earned from the good loans, thus affecting the financial soundness of the banks.
3) Mounting NPAs affect the banks' reputation and profitability. The market value of the shares comes down, thus badly affecting the investors and the public would think of to contribute to bank's deposits and resources.
4) Continuous rising NPAs impair bank's profitability. It badly affects the employees' morale, because the career growth and incentives of the employees also condensed.
5) The development of the nation greatly depends on the sound financial system. If huge amount blocked in the NPAs, the bank cannot support the economic activity and it adversely affects the economy of the nation.
6) Provisioning for NPA affects the capital adequacy ratio (CAR), it falls below the standard prescribed by the RBI. To meet the shortage, the banks go for public issue for capital rising. The cost of public issue is also high which further affects the profit, at the same time in such depressed condition full subscription is not possible and the banks are forced to issue at discounts. However, the central government injects more than two lakh crores in the capital of Public Sector Banks to bail them out of crisis.

- *Dr.B.Sudha, Associate Professor, Department of Banking management, Alagappa University,Karaikudi.E-Mail:sudha.pooja.78@gmail.com*
- *Dr.R.Alamelumangai, Professor Department of Banking management, Alagappa University, Karaikudi.*

II. NON-PERFORMING ASSETS

The NPA is a loan or advances for which, interest or principle, remained overdue for a period of 90 days.

III. CLASSIFICATION OF LOAN ASSETS

A. Standard Assets

Standard assets generate continuous income and repayments as and when they fall due. So a standard asset is a performing asset. Such assets carry a normal risk and are not NPAs in the real sense. Hence, no special provisions are required for Standard Assets.

B. Sub-Standard Assets

A sub-standard asset is one, which is considered as non-Performing for a period of 12 months.

C. Doubtful Assets

All those assets which are considered as non-performing for period of more than 12 months are called as Doubtful assets.

D. Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection, but the amount has not been written off wholly. In other words, such an asset is considered uncollectable and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

IV. FACTORS CONTRIBUTE FOR THE NPA

High level of NPAs poses serious threat to the overall performance of the economy. Huge provisions for losses is required, the less is the amount of capital they can leverage. Banks are forced to practice conservative approach in sanctioning new loans, lead to credit chomp in the financial market, resulting in economic and deregulation. During the year 2016- 17 and 2017-18 the gross NPAs of all Indian Banks increased from 3.47 lakh crore to 4.31 lakh crore. Financial sector reforms, 1991 has shifted the banking sector constantly from the regulated market to the deregulated market based economy. After the introduction of liberalization and globalization, there has been a fabulous development in the Indian financial mar- ket. The banks are in the phase of transformation, Technology is the key driver, and existence of cut throat competition in the banking industry has created biggest challenge in the form of high NPAs. The NPAs are the nightmare for the Indian banking industry and government. The policy makers examined the NPAs in different dimensions and framed several prudential norms to reduce the NPA level with the help of various recommendations issued by the committees which is specially framed to address NPA problem. The variables that cause NPAs are summarized below

V. OBJECTIVE OF THE STUDY

The issues of NPA remain a bigger challenge for the banking sector. In the 1990's the government appointed the Narasimham Committee to study the reasons for NPA and to recommend the steps to reduce NPA. The Government of India in the year 1990 introduced a number of reforms to deal with the problems of NPA. In this backdrop the present paper to highlight the major reasons for the NPA.

VI. REASONS FOR NPA

The following are the reasons for the mounting NPAs in banks during the recent past:

- Diversion of funds by borrowers.
- No strong legal actions against defaulters
- Political interferences in the lending process.
- Lack of follow-up supervision
- Loans to economically weaker section contributes for more NPA
- Credit guarantee schemes and waiving of collateral secu- rity increase NPA level
- Government Schemes such as debt waiver, debt restruc- turing increase NPAs.

VII. REASONS AND REMEDIES FOR NPA

A. Diversion of funds by borrowers:

Diversion of funds is one of the main reasons for the mushrooming of bad loans in our country. Anil Sinha, the then director of the Central Bureau of Investigation, stressed monitoring of end use of money by banks is Essential, especially in case of large value advances to detect the diversion of funds. According to Reserve Bank of India (RBI), diversion of funds refers to using the borrowed funds for the purposes other than the purpose for which the loan was sanctioned; deploying short term working capital funds for the long term uses not in compliance with the terms of sanction; and routing of funds to subsidiaries or other corporate by whatever modalities; diversion of funds through any bank other.

B. No strong legal actions against defaulters

NPA largely occurring from the inadequate legal system, the Indian legal works for the borrowers' interest and the legal procedures are highly time consuming. The government announced The Banking Regulation (Amend- ment) Ordinance, 2017 in May 2017, which includes the provisions in the Banking Regulation Act, 1949, to handle the stressed asset cases. The RBI and the government realized that the there should be strong legal actions against the willful de- faulters and the law and home ministries opined that the diversion of funds is considered as a breach of trust and hence it is a punishable offense. On January 28, the RBI set up the working group to recommend appropriate measures, including criminal action and penalties, against the default borrowers who have intentionally diverted the borrowed funds. The working group submitted their report in May and suggested that the diversion of funds is a punishable offense under the code. There are different rules for all the corporate entities. For example, Anil Ambani, Reliance Defense requested the IDBI to convert their loan into long-term credit, the request was taken into consideration, but the same approach for the Vijay Mallya and other willful defaulters cases are not advisable.

C. Political interferences in the lending process

In India Political interference in banking activities cannot be fully removed. Being a democratic country, the finance ministry interferes in the selection of a chairman, direc- tors and managing directors of the bank. The government forces banks to provide financial assistance to certain sectors and individuals for the interests of the country. This can be removed by giving autonomy to the boards of the banks. The RBI is also under the political interference today. In 2007-08, the bank's support investment in infrastruc- ture, Power, steel, textile and telecom sectors which con- tribute to 61% of the stressed assets. The RBI, working with the banks and government to deal with the problem of stressed assets properly. The bank should be permitted to choose the sector they wish to offer financial assistance. For example, foreign banks concentrate on export credit rather than agriculture. Similarly, private sector banks prefer to lend housing credit in urban areas. It is time the Indian banking sector is permitted to grow its balance sheets, and perform business the only way that it ought to be done, namely, with respect to the bottom lines.

D.Lack of follow-up supervision

The absence of regular follow-up by the bank officials to the borrowers' site increases the default. NPA has not occurred overnight and therefore, will require a regular institutional visit. The technical team must be formed for the field visit. Physical verification of progress achieved by the assisted unit helps to monitor the end use of funds and regular recovery of loans

E.Loans to economically weaker section contributes for more NPA

As most of the government development schemes for the economically weaker section such as the Swachh Bharat Abhiyan, the Pradhan Mantri Jan Dhan Yojana, the Pradhan Mantri Gram Sadak Yojana etc.. are routed through Public Sector Banks (PSBs), the PSBs are with huge NPAs when compared to Private Sector Banks and Foreign banks. It is estimated that about85% of the NPAs are from public sector banks loans and advances. For example, NPAs in the State Bank of India is worth Rs 2.23 lakh crore.

F. Credit guarantee schemes and waiving of collateral security increase NPA level

The Credit Guarantee Fund Scheme was launched by the Government of India (GoI) to provide collateral-free credit to the micro, small and medium enterprise sector. Under the scheme both the new and the existing enter- prizes are eligible to avail credit. The Ministry of Micro, Small and Medium Enterprises, Small Industries Devel- opment Bank of India (SIDBI) and the Government of India, established a Trust named Credit Guarantee Fund Trust for the Micro and Small Enterprises (CGTMSE) to launch the Credit Guarantee Fund Scheme for Micro and Small Enterprises. The scheme was previously introduced on August 30, 2000. Up to May 31, 2016, the Government of India and SIDBI jointly contribute the corpus of CGTMSE in the ratio of 4:1 respectively and has contributed Rs. 2477.78 crore as the corpus fund of the Trust. By the end of 11th Plan as announced in the Package for MSEs, the corpus was to be raised to Rs.2500 crore. According to the RBI report, the total outstanding exposure of the banking sector to MSME industrial companies was at 4.86 trillion in March 2016. The banks often see a build-up of bad loans in this segment. For example, State Bank of India, India's largest lender had an Small and Medium Enterprises loan book worth 1.89 trillion as on 31 March, where non-performing assets (NPAs) worth 17,032 crore were reported. About 9% of the SME loan are measured as bad. The NPAs of SBI is at 6.5% of the total loan portfolio. 1) Government Schemes such as debt waiver, debt re- structuring increase NPAs.: The monetary policy committee (MPC) of the RBI highlighted that the implementation of farm loan waivers across thestates could hurt the finances of states and makes them toss good money after bad, and stoke inflation. Three major states Uttar Pradesh, Punjab and Maharashtra so far have announced the large scale farm debt waivers. The cumulative farm debt waiver announced by the three states amounted to Rs77,000 crore or 0.5% of India's 2016-17 GDP. Loan waiver scheme destroys credit culture. In other words, waivers stimulate moral hazard," then RBI Governor Urjit Patel announced two days after Uttar Pradesh declared a Rs 36,000 crore loan waiver scheme

VIII. CONCLUSION

Indian banks need to handle the bad loans with meticu- lous care, maintaining adequate capital to absorb losses arising out of bad loans is vital for survival. RBI has introduced Asset Quality Review to figure out the NPA scenario of Commercial Banks in India. Under asset quality review the banks were directed to clean up their NPAs in six quarters between December 2015 and March 2017. The problem of NPAs has been given high priority in both public and private sector banks in India. The alarming NPAs are a wake-up call for the government and the banks. The loans and advances immediately after disbursement is treated as standard assets, which means good loans, unfortunately over a period of time it comes into the category bad and doubtful. Early warning signals and regular follow-up is essential to mitigate the NPAs in banks.

ACKNOWLEDGMENT

This paper is based on the Major research project en- titled "Asset Quality Management of Indian Banks – An Empirical Evaluation" funded by the Indian Council of Social Science and Research (ICSSR) under Grant No 02/200/2016-17/RP, The authors are grateful to the ICSSR for sponsoring this article.

REFERENCES

[1] Sudha.B Alamelumangai.R 'NPA crisis in IDBI Bank – An analysis', IRJMST, Vol - 8, Issue- 11 , Page(s) : 337 - 345

[2] www.rbi.org

[3] Sudha.B Alamelumangai.R , 'Recovery Of Npas Through Debt Recovery Channels In Indian Banks - An Analysis', Restaurant Business

[4] T.R.Gurumoorthy, B.Sudha, 'Non-Performing Assets (A Study with reference to Public Sector Banks), March 2019, Indian Journal of Applied Research Volume : II(Issue