AN ANALYSIS OF NON-PERFORMING ASSETS IN THE INDIAN BANKING SYSTEM

DR. SOHELI GHOSE

Abstract: An asset becomes non-performing when it ceases to generate income for the bank. Earlier an asset was considered as non-performing asset (NPA) based on the concept of 'Past Due'. A 'non performing asset' (NPA) was defined as credit in respect of which interest and/ or instalment of principal has remained 'past due' for a specific period of time. An amount is considered as past due, when it remains outstanding for 30 days beyond the due date. However, with effect from March 31, 2001 the 'past due' concept has been dispensed with and the period is reckoned from the due date of payment. In this paper I have analysed the main reasons behind NPAs in India. I have also studied the Gross and Net NPA of 5 randomly selected Private Sector Banks between 2010 and 2015 (Secondary Data). It was found that the overall Gross NPA ratio of all scheduled commercial banks follows the trend like that of the public banks because of the large constituent of their gross NPAs in the total amount, with the percentage hovering around 80%.

Key Words: Commercial Banks, Doubtful Assets Non Performing Assets and Scheduled Banks

Introduction: An asset becomes non-performing when it ceases to generate income for the bank. Earlier an asset was considered as non-performing asset (NPA) based on the concept of 'Past Due'. An amount is considered as past due, when it remains outstanding for 30 days beyond the due date. With effect from March 31, 2001 the 'past due' concept has been dispensed with and the period is reckoned from the due date of payment. With a view to moving towards international best practices and to ensure greater transparency, '90 days' overdue* norms for identification of NPAs have been made applicable from the year ended March 31, 2004. With effect from March 31, 2004, an NPA shall be 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 order' for a period of more than 90 days, 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,
- In the case of direct agricultural advances

With effect from September 30, 2004 the following revised norms are applicable to all direct agricultural advances:

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons.
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

For the purpose of these guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops.

The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each state.

- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

Any amount due to the bank under any credit facility, if not paid by the due date fixed by the bank becomes overdue. An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit / drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Identification of assets as NPAs should be done on an ongoing basis: The system should ensure that identification of NPAs is done on an on-going basis and doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per prescribed norms. Banks should also make provisions for NPAs as at the end of each calendar quarter, so that the income and expenditure account for the respective quarters as well as the P&L account and balance sheet for the year end reflects the provision made for NPAs. Banks classify their assets into the following broad groups, viz.

Standard Asset: It does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset should not be an NPA.

Sub-standard Assets: With effect from March 31, 2005 an asset would be classified as sub-standard if it remained NPA for a period less than or equal to 12 months. In such cases, the current net worth of the borrowers/ guarantors or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full.

Doubtful Assets: With effect from March 31, 2005, an asset is required to be classified as doubtful, if it has remained NPA for more than 12 months. A loan classified as doubtful has all the weaknesses inherent as that classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss Assets: A loss asset is one where loss has been identified by the bank or internal or external auditors or by the Co-operation Department or by the Reserve Bank of India inspection but the amount has not been written off, wholly or partly.

Literature Review: *Meeker Larry G. and Gray Laura (1987)* performed a regression analysis comparing the NPAs statistics with examiner classifications of assets suggests that the NPAs information can be a useful aid in analyzing the asset quality of banks, particularly when the information is timely. *Paul Purnendu , Bose,Swapan and Dhalla, Rizwan S. (2011)* attempted to measure the relative efficiency of Indian PSU banks on overall financial performances. Here, Non-Performing Assets is a negative financial indicator. *Selvarajan B. and Vadivalagan G. (2012)* in their paper concluded that the fear of Non-Performing Assets permeates the psychology of bank managers in entertaining new projects for credit expansion. *Murthy, K. V. Bhanu Gupta, Lovleen.(2012)* focussed on the impact of liberalization on the non-performing assets of the four banking segments by studying the overall trends in NPAs. They used the Structure- Conduct-Performance (S-C-P) approach that shows the relationship between competition and conduct, concentration and growth in NPAS. The results show that on an average across the banking industry segments, average non-performing assets in the past 11 years have been declining at the rate of 13% p.a. compounded growth rate. Though new private sector banks and the foreign banks seem to be more efficient but their conduct does not show consistency and stability. *Kavitha. N (2012)*, emphasized on the assessment of NPAs on profitability its magnitude and impact. Credit of total advances was in the form of doubtful assets in the past and has an adverse impact on profitability of all Public Sector Banks affected at very large extent when non-performing assets work with other banking and also affect productivity and efficiency of the banking groups.

Objectives:

1. To study the concept of non-performing assets in the banking structure of Indian economy
2. To analyse the impact of NPAs on the sample of companies of study for the relevant time period

Research Methodology and Data Collection: It is a *Descriptive Research*. Secondary Data about NPAs & its composition and advances of different banks is taken from Reserve Bank of India website and the annual reports of the sample banks. The data has been analysed using graphs, charts and simple ratios. A sample of 5 Private Sector Banks have been selected at random and the analysis has been done for the period of 5 years i.e. from 2010 to 2015. The banks are HDFC, ICICI, Axis, Kotak Mahindra and Indusind.

Analysis:

Reasons for an Account becoming NPA: The RBI has summarized the finer factors contributing to higher level of NPAs in the Indian banking sector as:

- Diversion of funds, which is for expansion, diversification, modernization, undertaking new projects and for helping associate concerns. This is also coupled with recessionary trends and failures to tap funds in capital and debt markets.
- Business failures which are due to inefficient management system, strained labour relations, inappropriate technology/ technical problems, product obsolescence etc.
- Recession, which is due to input/ power shortage, price variation, accidents, etc. The externalization problems in other countries also lead to growth of NPAs in Indian banking sector.
- Time/ cost overrun during project implementation stage.
- Governmental policies such as changes in excise duties, etc.
- Wilful defaults, which are because of siphoning-off funds, fraud/ misappropriation, promoters/ directors disputes etc.
- Deficiency on the part of banks, which is, delays in release of limits and payments/ subsidies by the Government of India.

Types of NPA:

Gross NPA: Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on Balance Sheet date. Gross NPA reflects the quality of the loans made by banks. It consists of all the nonstandard assets like as sub-standard, doubtful, and loss assets. It can be calculated with the help of following ratio:

Gross NPAs Ratio = Gross NPAs /Gross Advances

Net NPA: Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden of banks. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high. It can be calculated by following:

Net NPAs = (Gross NPAs – Provisions)/(Gross Advances – Provisions)

Analysis of Private Sector Banks and Inferences:

HDFC BANK:

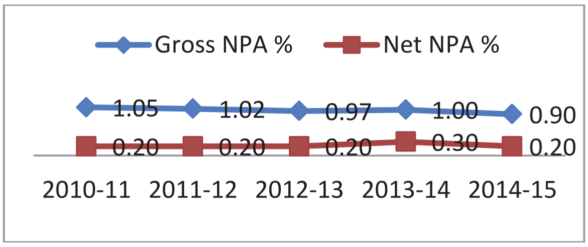

Chart 1: Gross and Net NPA of HDFC Bank

Inferences:

- The Gross NPA has risen from Rs. 1694.34 crores in FY11 to Rs. 3438.38 crores in FY16 which is an increase of 102.93% and 1744.04 crores in rupee terms. The Net NPA has risen from Rs. 296.41 crores in FY11 to Rs. 896.28 crores in FY16 which is a rise of 202.37% and 599.87 crores in rupee terms.
- The Gross NPA ratio or percentage has fallen from 1.05% to 0.90% which is a 66.67% fall in the ratio. The NPA ratio has remained the same almost throughout the 5-year phase taken into consideration for study.
- There is a decent performance, maintaining the Net NPA ratio while seeing a fall in Gross NPA ratio which is indicative of advancing better quality of loans to the borrowers and good management.

ICICI BANK:

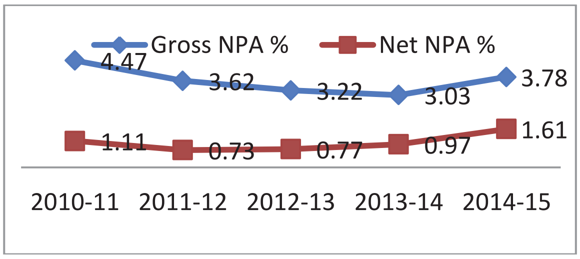

Chart 2: Gross and Net NPA of ICICI Bank

Inferences:

- The Gross NPA has risen from Rs. 10034.26 crores in FY11 to Rs. 15094.69 crores in FY16 which is an increase of 50.43% and 5060.43 crores in rupee terms. The Net NPA has risen from Rs. 2407.36 crores in FY11 to Rs. 6255.53 crores in FY16 which is a rise of 159.85% and 3848.17 crores in rupee terms.
- The Gross NPA ratio or percentage has fallen from 4.47% to 3.78% which is a 15.47% fall in the ratio. The Net NPA ratio has risen from 1.11% to 1.61%, a rise of 45.05%.
- The Gross NPA ratio has come down which is indicative of advancing better quality of loans. However both the NPA ratios have remained high which is a sign of poor health of the bank and huge amount of bad quality loans in books.

AXIS BANK:

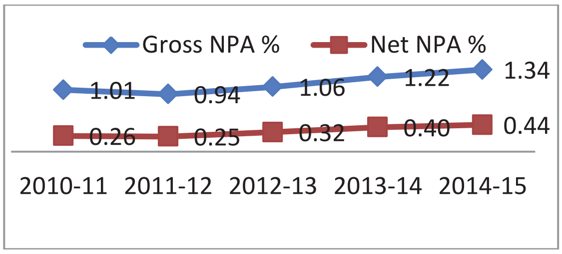

Chart 3: Gross and Net NPA of Axis Bank

Inferences:

- The Gross NPA has risen from Rs. 159.94 crores in FY11 to Rs. 4110.19 crores in FY16 which is a huge increase of 2469.83% and 3950.25 crores in rupee terms. The Net NPA has risen from Rs. 41.04 crores in FY11 to Rs. 1316.71 crores in FY16 which is a rise of 3108.36% and 1275.67 crores in rupee terms.
- The Gross NPA ratio or percentage has risen from 1.01% to 1.34% which is a 32.67% rise in the ratio. The Net NPA ratio has risen from 0.26% to 0.44%, a rise of 69.23%.
- Axis Bank has advanced bad quality of loans over the given period of time. However, it has maintained low NPA ratios comparatively and consequently good health of the bank. Gradual increase in Gross NPA ratio is worrisome.

KOTAK MAHINDRA BANK:

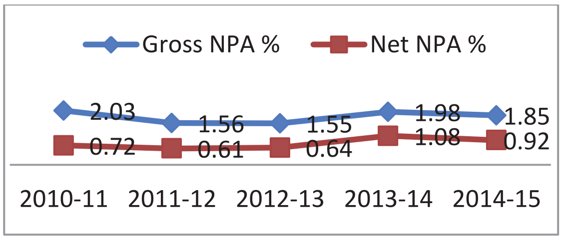

Chart 4: Gross and Net NPA of Kotak Mahindra Bank

Inferences:

- The Gross NPA has risen from Rs. 603.49 crores in FY11 to Rs. 1237.23 crores in FY16 which is a huge increase of 105.01% and 633.74 crores in rupee terms. The Net NPA has risen from Rs. 211.16 crores in FY11 to Rs. 609.08 crores in FY16 which is a rise of 188.44% and 397.92 crores in rupee terms.
- The Gross NPA ratio or percentage has fallen from 2.03% to 1.85% which is an 8.87% fall in the ratio. The Net NPA ratio has risen from 0.72% to 0.92%, a rise of 27.78%.
- There is a very small fall in the Gross NPA ratio, while the NPA ratio has risen marginally. The performance, has been fluctuating and thus a

definite conclusion about its quality of advances is difficult.

INDUSIND BANK:

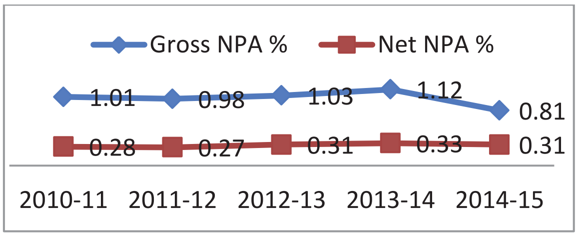

Chart 5: Gross and Net NPA of Indusind Bank

Inferences:

- The Gross NPA has risen from Rs. 265.86 crores in FY11 to Rs. 562.92 crores in FY16 which is a huge increase of 111.74% and 297.06 crores in rupee terms. The Net NPA has risen from Rs. 72.82 crores in FY11 to Rs. 210.48 crores in FY16 which is a rise of 189.04% and 137.66 crores in rupee terms.
- The Gross NPA ratio or percentage has fallen from 1.01% to 0.81% which is a 19.80% fall in the ratio. The NPA ratio has risen from 0.28% to 0.31%, a rise of 10.71%.
- The Gross NPA ratio has seen a drastic fall in FY15 in comparison to FY14, and records better performance with respect to the first 4 years of the phase taken into account where the concerned ratio has remained mostly constant. The Net NPA has also remained almost constant with a marginal rise.

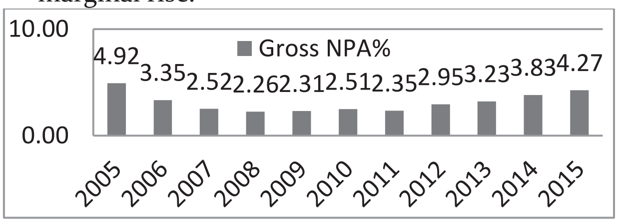

Chart 6: Gross NPA % for all Scheduled Commercial Banks in India (Source: https://www.rbi.org.in/)

Inferences:

- The above looks like a U-shaped graph which shows Gross NPA % to be consistently falling from FY05 to FY09 after which it has shown a rising trend up to FY15. The ratio has increased from 2.35% in FY11 to 4.27% which is a rise of about 81.70%.
- One of the prime reasons for poor performance of banks post 2009 in the area of asset management and deterioration of the same is the economy sluggishness which impacted the medium and large scale enterprises adversely who constituted a major portion of the borrowing from the banks. Also, huge advances were made to alleged government-favoured parties during same period.

Overall Findings and Conclusion: The private banks have mostly succeeded in keeping their NPAs low as their advances are towards strong and robust projects of the private sector which promise good returns and thus prove to be healthy investments. The priority sector includes vulnerable sectors like infrastructure, textiles, aviation, iron and steel, and mining. These sectors are famous for stalled growth and poor development. As of now, the priority sector constituent of the Gross NPAs have come down considerably however the amount in rupee terms have gone increasing from year to year and there is still an urgent need to control further. The steep rise in Gross NPA ratio post 2009 can be attributed to the advances made by the government to favoured parties allegedly which have resulted in wilful defaults.

References:

1. Larry G. Meeker and Laura Gray (1987), 'A note on non-performing loans as an indicator of asset quality', *Journal of Banking & Finance*, 11(1), pp. 161-168.
2. Purnendu Paul, Swapan K. Bose & Rizwan Dhalla (2011), 'Efficiency Measurement of Indian Public Sector Banks: Non-Performing Assets As Negative Output', *Asia Pacific Journal of Finance and Banking Research*, 5(5), p. 38.
3. Selvarajan, B.; Vadivalagan, G. (2012), 'Cost of Non Performing Assets in Indian Bank', *European Journal of Economics, Finance & Administrative Sciences*, 51, p. 27.
4. K. V. Bhanu Murthy and Lovleen Gupta (2012), 'Conduct of commercial banking in India: a study of non-performing assets', *Finance India*, 26(3), pp. 781-802.
5. N. Kavitha (2012), 'The Impact of Non-performing Assets on the Profitability of Indian Scheduled Commercial Banks: An empirical Evidence', *IJRCM*, 3 (1), pp. 27-30.
6. Ananthu V, The Value Decend of Indian Rupee; Business Sciences International Research Journal ISSN 2321 – 3191 Vol 2 Issue 1 (2014), Pg 442-450
7. RBI, RBI Guidelines Circulars on Income Recognition and Asset Classification
8. RBI, Statistical Tables Relating to Banks of India 2014-15
9. RBI, Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances 2015.

***

Dr. Soheli Ghose/Assistant Professor/Dept. of Commerce/St. Xavier's College/Kolkata/