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NON-PERFORMING ASSETS IN INDIAN BANKING SYSTEM: A GRAVE EPIDEMIC

Sarvjeet Kaur[1] and Vikas Kumar[2]
[1]Research Scholar , Deptt. of Commerce , Kurukshetra University Kurukshetra .
[2]Research Scholar , Deptt. of Commerce , Kurukshetra University Kurukshetra.

ABSTRACT :

banking is an indispensable constituent of the Indian financial system. It acts as a heart of the Indian economy. But at present, the artery of this heart is totally blocked by a big and alarming figure of non-performing assets. This paper makes an attempt to study the NPAs of the Indian banking system. For this purpose NPA data belonging to 6 years (2012-13 to 2017-18) of Public sector banks, private sector banks, and foreign banks is taken from the official website of RBI. Result shows that the NPAs figure is much higher in PSBs than private and FBs and the amount of NPAs is showing an increasing trend during the study period. In sector wise comparison major part is contributed by the non-priority sector which is 80% of total NPAs than priority sector which is 20%. Various internal, as well as external factors responsible for NPAs and their impact are also discussed in the later part of the paper. The study also shows the effectiveness of recovery channels which are lok adalats, DRTs and SARFAESI act 2002 introduced by government and results shows that these channels are not effective in their purpose fulfillment. This study found that NPAs is a grave epidemic eating up the profitability of banks mainly the PSBs. There is a need to resolve this epidemic so that the performance of the banking sector could be improved.

KEYWORDS : *Indian banking system, NPAs, SARFAESI Act, 2002, Lok Adalats.*

• INTRODUCTION:

Indian banking system: financial system is rightly termed as backbone of an economy. If any economy dreams to grow then the first condition is that its financial system must be strong enough. It creates a sound link between surplus unit and deficit unit which is called as transfer process. Banking is an indispensable constituent of financial system. Banks acts as a mediator as they collect small savings of the people which were scattered in the form of deposits and make them available in the form of loans to the needy section of the society. Demand for money mainly arises from the sectors like agriculture, small industries, trading concerns and general public for consumption purpose. Indian banking system consists of commercial banks, regional rural banks and cooperative banks. Commercial banks are further classified in to public sector banks, private sector banks (Indian private banks and foreign private banks). All these banks working together termed as life blood of Indian financial system. Indian banking is governed and controlled by RBI which is apex and central bank of our country. It was formulated in 1935 under the RBI act 1934. It is called reserve bank as it keeps reserve of all the commercial banks. RBI is the banker of the banks. It puts a check on money supply and credit creation in the economy with the help of monetary policy.

Conceptual framework of NPA: the major obstacle in the way of Indian banks is the rising trend of non-performing assets. Non-performing assets are like bad cholesterol. As bad cholesterol block the artery of heart and create hindrance in blood circulation, so the NPAs are blocking the nerve of Indian banking system and are bottleneck in smooth circulation of finance.

Definition of NPAs: Assets become non-performing when it ceases to generate income for the bank. NPAs is defined by RBI as a credit facility in respect of which the interest and installment of principal has remain past due for a specified period of time. The specified period is reduced in a phased manner.

Year ending march 31	Specified period
1993	Four quarter
1994	Three quarter
1995	Two quarter
2004	One quarter

With effect from March 31, 2004 a NPA shall be a loan or any credit facility where:

Loan or credit facility	Amount overdue for more than 90 days
Term loan	Interest or installment of principal
Overdraft/ cash credit	Amount remain out of order
Bill purchased and discounted	Bills remain overdue

Interest/ installment remain overdue for two harvest season but not exceeding two and half year in agricultural advance and any amount overdue on any other account.

Here out of order means the outstanding balance remain continuously in excess of the sanctioned limit and overdue means if amount is not paid within the date fixed by banks.

Classification of non-performing assets and their provisioning requirement:

Sub-standard	doubtful	Loss assets
Would be one which have remained NPAs for a period less than or equal to 12 months. And carries more than normal risk.	Would be one if it has remained in the sub-standard category for the period of 12 months.	Would be one where loss has been identified by bank itself or by the external auditor and the amount has not yet fully written off.

Standard assets	Sub-standard assets	Doubtful	Loss assets
Agriculture and SME loans 0.25% Commercial real estate 1.0% Residential housing sector (comm.) 0.75% All other loans 0.40%	For secured loans 15% For unsecured loans 25%	Secured 25% Unsecured 40% Up to 1 year 25% 3 years 40% more Than 3 year 100%	100% of amount

Gross and net NPAs: gross NPA is the total number of NPAs. It consists of overdue interest payment and principal installment. Net NPAs is the difference between total (gross) NPA and provision created on NPAs. E.g gross NPA is 200 cr. Provision is 20 crore, at the end bank collect only 120 crore, then net NPA will be 200-120= 80 and 80-20=60 crore.

LITERATURE REVIEW

Mohnani and Deshmukh (2013) found that the NPA ratio of PNB was less as compared to SBI and in private sector banks, HDFC performed far better than ICICI.

Jayakoddi and Rangarajan (2016) examined gross and net NPAs of public and private sector banks and concluded that private sector banks performed well in controlling the NPAs in comparison to public sector banks. Bank of Baroda and HDFC applied good policy measures to curb their NPAs.

Shanmugasundram (2013) discussed the causes of NPAs and found that major causes were legal impediments, manipulation by debtors and postponement of the problem in order to show higher earnings. In sector-wise comparison, it was observed that the major part was contributed by large industries.

Pandey et al. (2013) made a cross country comparison on NPAs and found that the quality of bank assets was improving across counties and NPA as a percentage of totals was declining for all countries.

Niranjan and Meenakshi (2007) in their study do Indian banks understate their bad loans? Observed that all banks were engaged in earning management and weaker banks significantly understate their bad loans.

Above studies reveal that NPA problem is more serious in public sector banks and the major part is contributed by non-priority sector.

OBJECTIVES OF THE STUDY:

- To analyze the gross and net NPAs in Public sector banks, private sector banks and foreign banks
- To make a sector wise comparison of NPAs
- To analyze the efficiency of recovery channels

Sample and Data: the present study consist of PSBs, private sector banks and foreign banks and their NPAs are analyzed by taking last 6 years data (2012-13 to 2017-18) data is collected from the official website of RBI (operation and performance of SCBs) data is shown in the form of tables and graph to make it easy to analyze.

Analysis of data: This study is descriptive in nature and the data is analyzed through percentage and put in the form of table and graphs to make it understandable.

Table 1:- Trend in Gross Non-Performing Assets:

Year	Public Sector Banks		Private Sector Banks		Foreign Banks	
	Amount	% of gross adv.	amount	% of gross adv.	Amount	% of gross adv.
2012-13	1645	3.6	204	1.8	60	0.5
2013-14	2273	4.4	242	1.8	88	0.7
2014-15	2785	5.0	337	2.1	141	0.9
2015-16	5400	9.3	562	2.8	158	4.2
2016-17	6847	11.7	932	4.1	136	4.0
2017-18	8956	14.6	1293	4.7	138	3.8

Graph 1

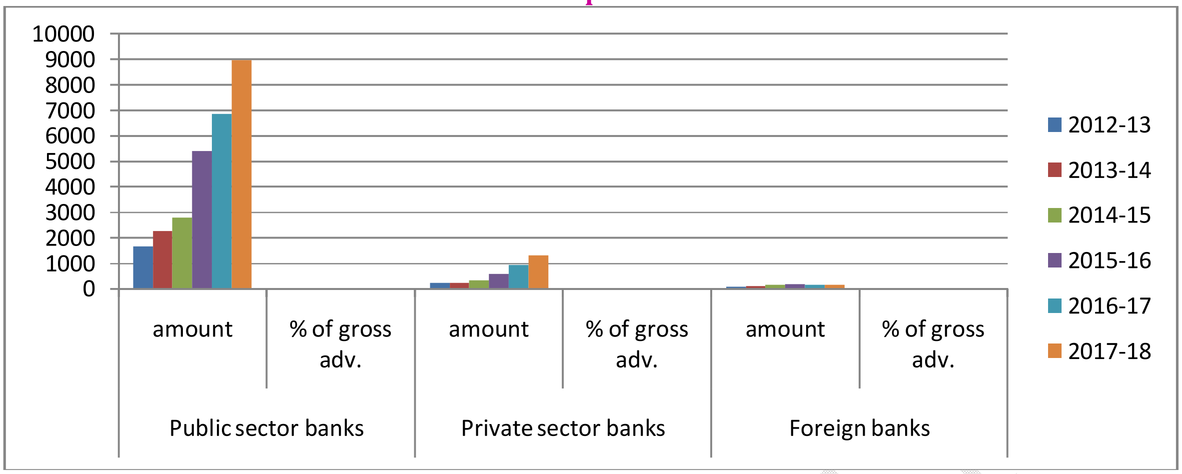

Table 1 shows the trend of gross NPA for 6 years. It is clear that amount as well as % of NPAs is showing an increasing trend. In PSBs it reached from 1645 in 2012-13 to 8956 in 2017-18. Private sector bank NPA rises from 204 to 1293 in 2017-18. Along with an absolute amount, percentage of gross advances was also rising. Amount of FBs also rises during the study period. It was 60 billion in 2012-13 and goes up to 138 in 2017-18. It is evident that the problem of NPA is more severe in public sector banks and its least in foreign banks.

Table 2 Trend in Net Non-Performing Assets

Year	Public Sector Banks		Private Sector Banks		Foreign Banks	
	Amount	% of gross adv.	amount	% of gross adv.	amount	% of gross adv.
2012-13	900	2.0	79.25	3.1	26.6	1.0
2013-14	1306	2.6	115.65	3.9	31.6	1.1
2014-15	1599	2.9	107.61	3.2	17.62	0.5
2015-16	3204	5.7	267	1.4	28	0.8
2016-17	3831	6.9	478	2.2	21	0.6
2017-18	4545	8.0	642	2.4	15	0.4

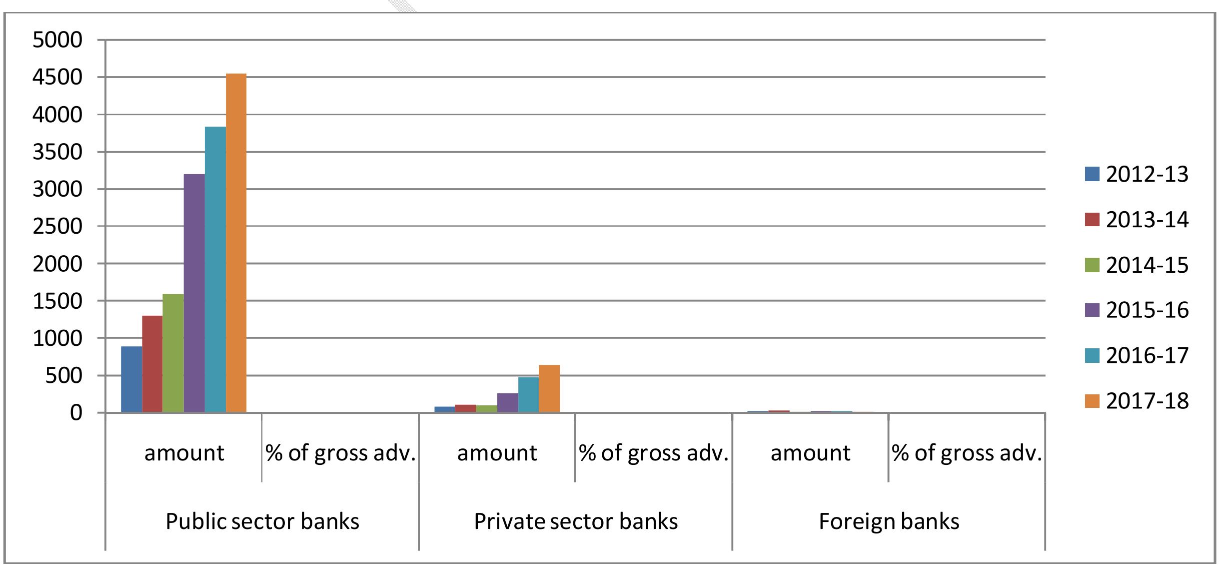

Table 2 shows net NPA and it is also clear that net NPAs are also increasing. It reached from 900to 4545 in PSBs, 79 to 642 in private sector banks but foreign banks are showing a declining trend. It decreased from 26.6 billion In 2012-13 to 15 billion in 2017-18.

Table 3 Trend in all Scheduled Commercial Banks

Year	Gross		Net	
	Amount	% of gross adv.	Amount	% of gross adv.
2012-13	1972	3.2	986	1.7
2013-14	2630	3.8	1426	2.1
2014-15	3229	4.3	1758	2.4
2015-16	6119	7.5	3498	4.4
2016-17	7918	9.3	4331	5.3
2017-18	7265	11.2	5207	6.0

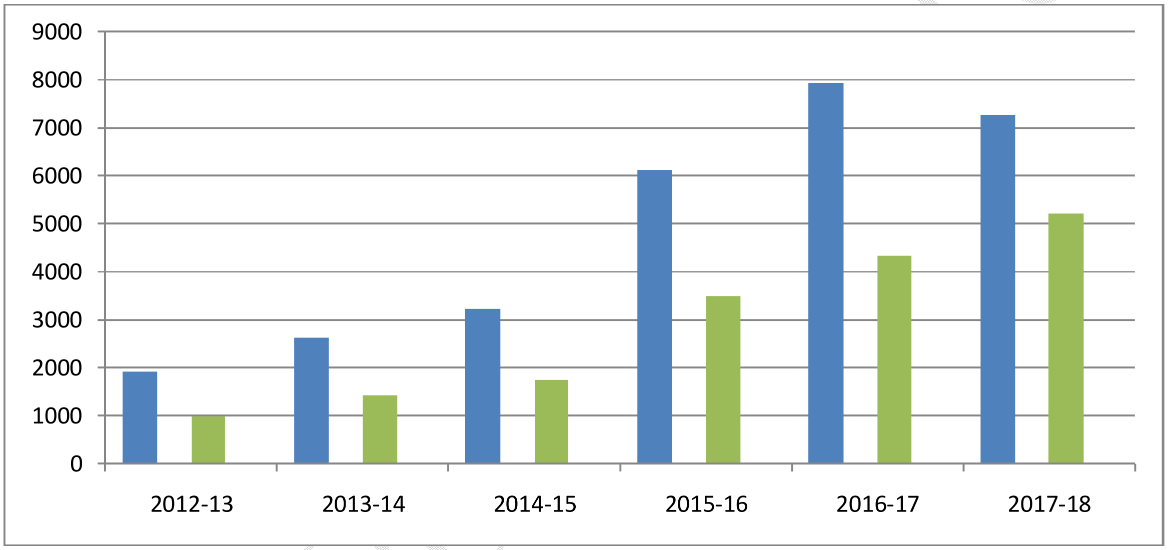

Table 3 depicts the trend of NPAs in all scheduled commercial banks. Here gross NPAs are indicated by a blue bar and NNPAs are indicated by green bar. It is evident from the table that NPAs in SCBs are increasing during study period. Gross NPAS increased from 1972 billion in 2012-13 to 7265 billion in 2017-18 and NNPA increased from 986 billion to 5207.

Table 4 Sector wise NPAs of SCBs

Year	Priority Sector Non-Performing Loans					
	Public Sector Banks		Private Sector Banks		Foreign Banks	
	Amount	%	Amount	%	amount	%
2015-16	1281	25.5	101	21	23	14.3
2016-17	1543	24.1	133	18	24	17.8
2017-18	1875	22.2	184	18	12	8.6

Table 5 NPAs of Non-Priority Sector

Year	Non-Priority Sector Npas					
	Public Sector Banks		Private Sector Banks		Foreign Banks	
	Amount	%	Amount	%	Amount	%
2015-16	3740	74.5	382	79	135	85.7
2016-17	4868	75.9	605	82	112	82.2
2017-18	6580	77.8	840	82	126	91.4

Table 4 shows that priority sector NPAs are much higher in PSBs. But the %age of gross advance is declining from 25.5% to 22.2% in 2017-18. The Priority sector NPAs of PVBs also increasing but the % is decreasing. On the contrary NPAs of FBs is decreasing. It is least in FBs and highest in PSBs.

Table 5 shows the NPAs of non-priority sector. It is evident that non-priority sector NPAs are approximately three times higher than priority sector. It is 74.5% in 2015-16 and goes up to 77.8% in 2017-18 in the case of PSBs. In case of PVBs and FBs more than 80% NPAs are contributed by non-priority sector.

Causes of Non-Performing Assets

from the analysis of tables and graphs showing gross and net NPAs as well as sector wise NPA, it becomes clear that this epidemic named NPA is more severe in public sector banks than private and foreign banks. The cause behind this alarming figure of NPAs can be segregated in internal and external factors.

External Factors

Intentional Defaulters: this can be symbolized as a robust cause of NPAs at present. One prominent is recent case of PNB scam. Because of the mal intention of some evil minded people, NPAs of public sector banks are showing alarming figures. These types of people should be recognized well on time and there must be some robust measure to curb such type of mal activities and get back money extended to them as loans.

Natural Calamities: the largest part of the Indian population depends on agriculture. Due to the lack of irrigation facilities, farmers mainly depend on rainfall. If there is insufficient rainfall in a year farmers get unable to produce an adequate level of crop output. They face difficulty in repaying loan interest and principal amount. Secondly, due to insufficient agricultural produce, MSME sector also does not get timely and cost-effective raw material resulted in a lack of production.

Changed Phase Of Business Cycle: at the time of boom in the economy every sphere of activity shows that a positive trend. New and new enterprises entered the market demanding financial assistance from banks. Due to high competition banks also follow a liberal loan policy and extend a huge amount of loans without carefully inspecting the future prospect of projects. When the phase of the business cycle changed depression arrives. Now a large quantity of enterprise starts suffering huge losses and there become a question mark on their existence itself. They have to face lots of problems regarding the payments of interest and principal amount as well.

Industrial Sickness: inappropriate planning before project implementation, poor management, changing technology and poor demand forecasting resulted in industrial sickness. These sick industries do not pay their obligations.

Ineffective Recovery Channels: - recovery channels established by the government are proved to be ineffective in achieving their objectives. A number of recovery tribunals are set up but due to their carelessness, the bank suffers the consequences of no recovery.

Developmental Schemes Of The Government: one of the main causes of high figure of NPAs in PSBs is that they are obligated to be a medium of various government development schemes introduced from time to time. PSBs are directed to provide loans under such schemes which later on turn in to bad loans. Recently RBI has raised the red flag on the spike in NPAs under the government scheme to support micro-enterprises in the county- the Pradhan Mantri Mudra Yojana. The central bank has flagged that bad loans under PMMY have risen to 11000 crores.

Internal or Bank Specific Factors:

Defective Lending Process: banks should extend the credit to those borrowers where it is certain that borrower is in a position to pay back the principal along with interest. On the contrary bad loans happen when loans are extended without appropriate inspection and checking credit history of borrowers. If credit appraisal system is poor there will be a strong probability that funds could go in wrong hands.

Lack of Regular Follow Up of Loans: if banks do not have a close watch on post disbursement allocation of loan then loan amount can be diverted to other activities.

Effects of NPAs: banking is based on three fundamental the principles, which are the principle of safety, principle of profitability and principle of liquidity. If the first principle gets ignored it will have grave consequences for rest of the two principles.

Effect on Profitability and Liquidity: banking is a business and like all other business it survives on the profitability. A bank can be profitable when it is able to get interested on loans and its assets are performing. Due to high NPAs banks, neither gets interested nor principal installment. It jeopardizes bank's profitability. Along with profitability, liquidity also gets hamper. In the situation of reduced liquidity banks will not be able to discharge its obligations on time (say payment of demand deposits).

Unavailability of Funds for Productive and Genuine Purpose: when a huge amount of funds get blocked in bad loans then banks are left with less liquidity. It creates an impediment in the extension of funds to productive purpose resulted in a lack of finance for a genuine purpose.

Increased Cost of Finance: to cover up the loss of these bad loans banks charges a higher rate of interest from genuine borrowers also. This creates a problem for banks.

Reduced Economic Growth: banks play a vital role in economic development but due to blockage of funds in bad loans, the banking sector gets stigmatized and feel shy in extending loans to productive projects resulted in less capital formation and reduced economic growth.

Recovery Channels of NPAs:

Lok Adalats: it is a mechanism to settle the matters related to the recovery of dues of the amount above 5 lakh. It has no judicial powers. Bank and borrower with mutual agreement arrive at a settlement and that is placed before court. Now the court will pass a decree as per the terms of a settlement.

Debt Recovery Tribunals: the government of India constituted 33 DRTs and 5 DRAT (debt recovery appellate tribunal) across the country to help the institutions recover their bad loans. DRT enforces provisions of the RDDBFI act and SARFAESI act 2002 to recover bad dues.

SARFAESI Act 2002: its full form is securitization and reconstruction of financial assets and enforcement of security interest Act, 2002. It is proved as a very effective tool for debt recovery and it can be used in the case where NPAs are backed by securities charged to the banks by way of hypothecation or mortgage.

Corporate Debt Restructuring: restructuring the company's outstanding obligation by decreasing the interest rate paid by banks and increasing the time in which the company has to pay the obligation back.

Table 6:- Recovery of NPAs through various channels

Year	Lok adalats		DRTs		SARFAESI ACT	
	Amt. involved	Amt. received	Amt. involved	Amt. received	Amt. involved	Amt. received
2015-16	720	32	693	64	801	132
2016-17	361	23	1008	103	1414	259
2017-18	457	18	1333	72	1067	265

Percentage of total amount received:

Year	Lok adalats	DRTs	SARFAESI act
2015-16	4.4	9.2	16.5
2016-17	6.3	10.2	18.3
2017-18	4.0	5.4	24.8

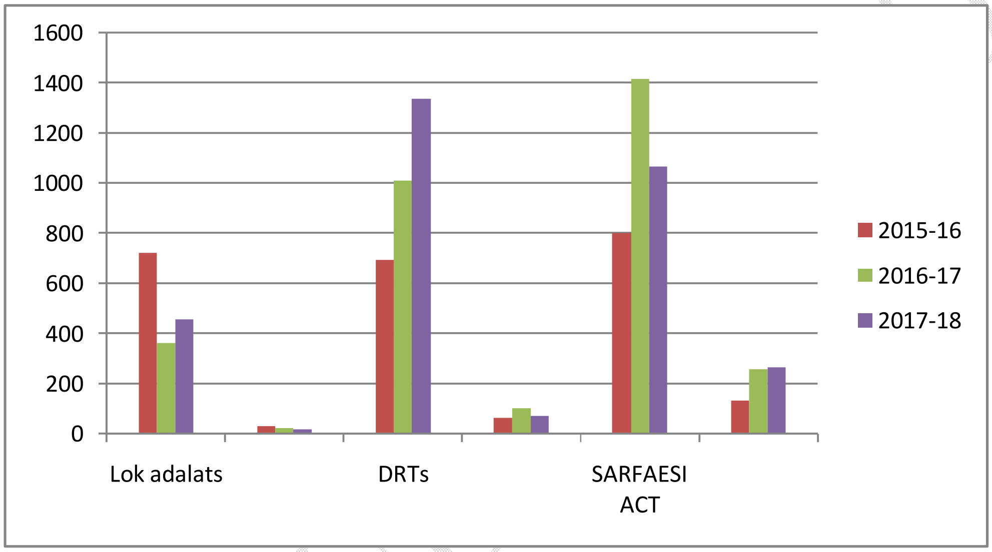

Table 6 shows that the recovery channels set up by the government are ineffective in recovering NPAs as the amount received is much lesser than amount involved. Lok adalats recovered only 4.4% in 2016, 6.3 in 2017 and 4.0% in 2018. This is a nominal figure. DRTs recover 9.2% in 2016, 10.2% in 2017 and 5.4% in 2018. Only through SARFAESI act some higher amount is recovered. It is 16.5% in 2016, 18.3% in 2017 and 24.8% in 2018. These lower recoveries put a question mark on their effectiveness and carelessness.

FINDINGS AND CONCLUSION:

study makes it clear that NPAs are much higher in public sector banks than private and foreign banks. The amount in an absolute figure is rising but the % of gross advances is declining. In sector wise comparison it comes to the knowledge that a major part of NPAs is contributed by the non-priority sector. It is nearly 80% in all types of banks. The recovery channels set up by the government is least efficient in recovering the amount. In conclusion it can be said that NPA is a virus which is killing the profitability and growth of the Indian banking sector. This three letter word now becomes the major cause of irritation for Indian banks. Funds which could be used for the growth of the economy if they were in circulation are now totally blocked in the form of bad loans. There are various reasons behind NPAs like the faulty selection of borrowers, diversion of funds, political influence, mismanagement of banks, natural calamities and global recession as well. Prevention is always better than cure so banks must do diligently inspection before providing loan and follow-up of loan is also needed.

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