REVIEW OF RESEARCH

A STUDY OF NON PERFORMING ASSETS IN BANKS OF HYDERABAD KARNATAKA REGION

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ABSTRACT:

Banking sector reforms in India has progressed promptly on aspects like interest rate deregulation, reduction in statutory reserve requirements, prudential norms for interest rates, asset classification, income recognition and provisioning. But it could not match the pace with which it was expected to. The accomplishment of these norms at the execution stages without restructuring the banking sector as such is creating havoc, this research paper deals with the problem of having non-performing assets, the reasons for mounting of non-performing assets and the practices present in other countries for dealing with non-performing assets.

KEYWORDS: *interest rates, asset classification , banking sector.*

INTRODUCTION:

To a certain extent the banking sector has achieved this mandate. Lead Bank Scheme enabled the banking system to expand its network in a planned way and make available banking series to the large number of population and touch every strata of society by extending credit to their productive Endeavour's. This is evident from the fact that population per office of commercial bank has come down from 66,000 in the year 1969 to 11,000 in 2004. Similarly, share of advances of public sector banks to priority sector increased from 14.6% in 1969 to 44% of the net bank credit. The number of deposit accounts of the banking system increased from over 3 crores in 1969 to over 30 crores. Borrowed accounts increased from 2.50 lakhs to over 2.68 crores.

The accumulation of huge non-performing assets in banks has assumed great importance. The depth of the problem of bad debts was first realized only in early 1990s. The magnitude of NPAs in banks and financial institutions is over Rs.1, 50,000 crores. While gross NPA reflects the quality of the loans made by banks, net NPA shows the actual burden of banks. Now it is increasingly evident that the major defaulters are the big borrowers coming from the non-priority sector. The banks and financial institutions have to take the initiative to reduce NPAs in a time bound strategic approach. Public sector banks figure prominently in the debate not only because they dominate the banking industries, but also since they have much larger NPAs compared with the private sector banks. This raises a concern in the industry and academia because it is generally felt that NPAs reduce the profitability of banks, weaken its financial health and erode its solvency. For the recovery of NPAs a broad framework has evolved for the management of NPAs under which several options are provided for debt recovery and restructuring. Banks and FIs have the freedom to design and implement their own policies for recovery and write-off incorporating compromise and negotiated settlements.

TYPES OF BANKS:

PUBLIC SECTOR BANKS:

Public sector banks are the ones in which the government has a major holding. Public Sector Banks dominate 75% of deposits and 71% of advances in the banking industry. Public Sector Banks control commercial banking India, these can be further classified into:

1) Nationalized banks
2) State Bank of India and its associates
3) Regional Rural Banks

PRIVATE SECTOR BANKS:

Private sector banks came into existence to supplement the performance of public sector banks and serve the needs of the economy better. As the public sector banks were merely in the hands of the government, banks had no incentive to make profits and improve their financial capability. The main difference between public and private sector banks is only that public sector banks follow the RBI interest rules strictly but private banks can make some changes in them but only after the approval from the RBI. Private sector banks are the banks which are controlled by the private lenders with the approval from the RBI. Their interest rates are slightly costly as compared to public sector banks.

Non-Performing Asset or NPA, It is called such as while it is an "Asset", it does not bring substantial income to its Owner or is just dormant. Call it a white elephant if you wish. Basically, it is having something that should work but does not. It is supposed to make Non- Performing Assets work. The RBI has issued guidelines to banks for classification of assets into four categories.

A. Standard (Assets):

These are loans which do not have any problem are less risk.

B .Substandard (Assets):

These are assets which come under the category of NPA for a period of less than 12 months.

C. Doubtful (Assets):

These are NPA exceeding 12 months.

D. Loss (Assets):

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.

NON PERFORMING ASSETS AS A MAJOR ISSUE AND CHALLENGE FOR BANKING INDUSTRY:

Non-performing Assets are threatening the stability and demolishing bank‘s profitability through a loss of interest income, write-off of the principal loan amount itself. RBI issued guidelines in 1993 based on recommendations of the Narashiman Committee that mandated identification and reduction of NPAs be treated as a national priority' because the level of NPA act as an indicator showing the bankers credit risks and efficiency of allocation of resource. The financial reforms in Indian bank industry have helped largely to clean NPA which was around Rs 152,000 crores in the year 2017. The earning capacity and profitability of the bank are highly affected due to this NPA.

In the March 2018 quarter, the gross non-performing assets (NPAs) of Indian banks surged past Rs 10 trillion. This surprised many observers, if not the bankers, as the true extent of bad debt was not evident before the Reserve Bank of India (RBI) arm-twisted lenders to disclose whatever was hidden under the carpet. There are many economic reasons for this NPA pile-up, but the numbers ballooned after the central bank's February 12 circular. The circular said if a loan is not serviced for 90 days, it is in default and recovery proceedings can be started against it.

Not surprisingly, the gross NPA of all listed banks jumped to Rs 10.25 trillion in the March quarter, from Rs 8.86 trillion in the December 2017 quarter.

PRIVATE SECTOR PEERS BANKS' GNPA RATIO STOOD AT A MUCH LOWER LEVEL OF 4.7 PERCENT AS AGAINST 4.1 PERCENT IN FY17

System-wide gross non-performing assets of banks rose to 11.2 percent or at Rs 10.39 trillion in FY18 from 9.3 percent a year ago, and the share of public sector banks stood at Rs 8.95 trillion, or at 14.6 percent, according to the Reserve Bank data released Friday.

In FY17, system-wide gross NPAs stood at 9.3 percent and that of state-run lenders stood at 11.7 per cent.

"During FY18, the GNPA ratio reached 14.6 percent for state-run banks due to restructured advances slipping into NPAs and better NPA recognition," RBI said in its report on 'Trends & Progress of Banking in 2017-18'

In terms of the net NPA ratio, state-run banks saw significant deterioration at 8 percent in FY18 from 6.9 percent year-ago.

Private sector peers banks' GNPA ratio stood at a much lower level of 4.7 percent as against 4.1 percent in FY17.

"Resolute efforts on the part of private sector banks to clean up their balance sheets through higher write-offs and better recoveries also contributed to their lower GNPA ratios," the report said.

Asset quality of foreign banks improved marginally to 3.8 percent in FY18 from 4 percent in FY17.

In FY18, the share of doubtful advances in total gross NPAs increased sizeably to Rs 5.11 trillion or 6.7 per cent of the system, driven up by state-run banks whose ratio stood at 9 percent.

In fiscal 2018, share of sub-standard and loss assets in GNPAs of private banks declined to 1.1 percent and 0.2 percent, respectively due to aggressive write-offs.

During the year under review, the fresh slippages rose for state-run lenders on account of restructured advances slipping into NPAs and a decline in standard advances.

In the previous fiscal, the GNPA ratio of public sector banks arising from larger borrower accounts (exposure of Rs 5 crore and above) increased to 23.1 per cent from 18.1 per cent in the FY17.

But this saw an improvement in FY18. "During the first half of FY18, NPAs in large borrower accounts of state-run banks and private sector banks declined to 21.6 percent and 7 percent, respectively," the report said.

The gems & jewellery sector saw a significant increase in GNPAs during FY18 with unearthing of frauds at PNB, which bore the brunt of the Rs 14,000 crore scam by Nirva Modi and his uncle Mehul Choksi.

"Frauds have emerged as the most serious concern in the management of operational risks, with 90 percent of them located in the credit portfolio of banks," the report said.

A large value frauds involving Rs 50 crore and above constituted about 80 percent of all the frauds during 2017-18.

Nearly 93 percent of the frauds worth Rs 10 lakh or more occurred in state-run lenders while private banks accounted for just 6 percent.

"We will continue to monitor asset quality as well as resolution of stressed assets with a focus on implementation of the new resolution framework," the RBI said in the report.

The monetary authority also said it will look into implementation of Ind-As, corporate governance in banks and a revised framework for securitisation.

The central bank also intends to issue revised prudential regulations including guidelines on exposure/investment norms, risk management framework and select elements of Basel III capital framework, it said.

NEED OF THE STUDY:

The non-performing assets that are not able to generate income for the bank are the great threat for the banking institution. Rather than generating profit for the bank, NPA drains off the income earned by the other performing asset by the way of paying interest to the real owner of the resources. It affects the overall profitability of the bank adversely by affecting the return on equity and return on asset.

There are certain ways through which it affects the financial institutions are as follows:

Thus, the need of the study of the NPA is must necessary due to these reasons. These reasons are the crucial for any bank at present. One has to realize these matters and has to take corrective action against NPA reasons, as for as possible one has to convert all the NPA accounts into PA accounts. As far as the importance of the study is concern, without the study, one can't identify the whole gamut of the NPA. To know, how the account is becoming NPA is must necessary. After identifying the reason behind the particular NPA account, one can go for a step ahead. That means for the step of how to convert into PA and how to prevent other account from becoming NPA. As for as possible, one has to eradicate the reasons of NPAs. Thus, it is highly importance to study NPA.

OBJECTIVES OF THE STUDY:

The objective of the project was to find how this Non-Performing Assets generate and what its impact on the profitability of the bank and how it can be reduced. The study is addressed to the following objectives:

- To determine the factors affecting NPA.
- To find out the effectiveness of recovery mechanism adopted by banks for NPA.
- To establish relationship between NPAs and profitability of private banks

COLLECTION OF DATA:

The relevant data was collected from both primary and secondary sources. Research population for the study comprised of private banks operating in Hyderabad Karnataka region. 06 banks responded in the concerned area are 1) Axis Bank, 2) HDFC Bank, 3) ICICI Bank, 4)IndusInd Bank, 5) ING Vysya Bank, 6) Karnataka Bank,.

The secondary sources comprised of various audited reports and publications of the Reserve Bank of India. Detailed information were collected mainly from the various volumes of the "Statistical Tables Relating to Banks in India" covering the period from 2010 - 2019 which were published by the Statistical Department of Reserve Bank of India, Mumbai from the website www.rbi.org.in.

FACTOR ANALYSIS:

Factorial profile of recovery mechanism adopted for NPA by banks

No. of rounds	No. of factors	Communalities (Above)	Iterations	KMO (Above)	Items Deleted	Items Remained	V.E %	Factor Loading (Above)
1	3	.60	4	.45	1	8	80.36	.55
2	3	.65	5	.34	-	7	80.81	.70

Descriptive Statistics of Factors affecting NPAs:

Factors	Mean	Standard Deviation	Factor Loading	Communality	Variance Explained (%)	Cronbach's Alpha
F1 Recession and management failure					28.79	.721
Recession in economy	3.15	.987	.940	.891		
Management Failure	3.00	1.780	.837	.710		
F2 Execution Problems					28.39	.709
Improper Credit Appraisal	2.92	1.115	.850	.762		
Difficulty in executing Repayment procedure	3.46	.967	.827	.713		
Cost of effective legal measures	2.46	1.391	.730	.694		
F3 Default by customers					23.62	.753
Willful Default	2.77	1.235	.914	.927		
Absence of Security	2.15	1.281	.854	.960		

Interpretation:

Factors affecting NPAs were subjected to data purification, which resulted into three factors, with KMO value = 0.34, variance explained = 80.81%, communalities above .65 and Cronbach's Alpha above .70. The factors extracted were "Recession and management failure", "Execution Problems" and "Default by customers".

REASONS FOR AN ACCOUNT BECOMING NPA:

1. Internal factors
2. External factors

Internal factors:

- Funds borrowed for a particular purpose but not use for the said purpose.
- Project not completed in time.
- Poor recovery of receivables.
- Excess capacities created on non-economic costs.
- In-ability of the corporate to raise capital through the issue of equity or other debt
- Instrument from capital markets.
- Business failures.
- Diversion of funds for expansion\modernization\setting up new projects\ helping or
- Promoting sister concerns.
- Willful defaults, siphoning of funds, fraud, disputes, management disputes, misappropriation
- etc.
- Deficiencies on the part of the banks viz. in credit appraisal, monitoring and follow-ups,
- delaying settlement of payments\ subsidiaries by government bodies etc.,

External factors:

1) Sluggish legal system:
- ❖ Long legal tangles
- ❖ Changes that had taken place in labor laws
- ❖ Lack of sincere effort.

2) Scarcity of raw material, power and other resources.
3) Industrial recession.
4) Shortage of raw material, raw material\input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accidents.

IMPACT OF NPAS ON BANK PERFORMANCE:

The efficiency of a bank is not reflected only by the size of its balance sheet but also the level of return on its assets. The NPAs do not generate interest income for banks but at the same time banks are required to provide provisions for NPAs from their current profits.

- ❖ The NPAs have deleterious impact on the return on assets in the following ways.
  - ✓ The interest income of banks will fall and it is to be accounted only on receipt basis.
  - ✓ Banks profitability is affected adversely because of the providing of doubtful debts and
- ❖ Consequent to writing it off as bad debts.
  - ✓ Return on investments (ROI) is reduced.
  - ✓ The capital adequacy ratio is disturbed as NPAs are entering into its calculation.
  - ✓ The cost of capital will go up.
  - ✓ The assets and liability mismatch will widen.
  - ✓ The economic value addition (EVA) by banks gets upset because EVA is equal to the net
- ❖ operating profit minus cost of capital and
  - ✓ It limits recycling of the funds.

It is due to above factors the public sector banks are faced with bulging NPAs which results in lower income and higher provisioning for doubtful debts and it will make a dent in their profit margin. In this context of crippling effect on banks operation the slew asset quality is placed as one of the most important parameters in the measurement of banks performance under the Camel's supervisory rating system of RBI:

Profitability:

NPA means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the prodigality of bank decreases not only by the mount of NPA but NPA lead to opportunity cost also as that much of profit invested in some return earning project/asset. So NPA doesn't affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity. Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.

Liquidity:

Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for shortest period of time which lead to additional cost to the company. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.

Involvement of Management:

Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now day s banks have special employees to deal and handle NPAs, which is additional cost to the bank.

Credit Loss:

Bank is facing problem of NPA then it adversely affect the value of bank in terms of market credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting their money in the banks.

Early Symptoms: By which one can recognize a performing asset turning in to non-performing asset Four categories of early symptoms:-

1) Financial:

- Non-payment of the very first installment in case of term loan.
- Bouncing of cheque due to insufficient balance in the accounts.
- Irregularity in installment.
- Irregularity of operations in the accounts.
- Unpaid overdue bills.
- Declining Current Ratio.
- Payment which does not cover the interest and principal amount of that installment.
- While monitoring the accounts it is found that partial amount is diverted to sister concern
- or parent company.

2) Operational and Physical:

If information is received that the borrower has either initiated the process of winding up or are not doing the business.

- Overdue receivables.
- Stock statement not submitted on time.
- External non-controllable factor like natural calamities in the city where borrower
- conduct his business.
- Frequent changes in plan.
- Nonpayment of wages.

3) Attitudinal Changes:

- Use for personal comfort, stocks and shares by borrower.
- Avoidance of contact with bank.
- Problem between partners.

4) Others:

- Changes in Government policies.
- Death of borrower.
- Competition in the market

MEASURES TO CONTROL NPAs:

It is proved beyond doubt that NPAs in bank ought to be kept at the lowest level. Two pronged approaches viz., (i) Preventive management and (ii) Curative management would be necessary for controlling NPAs.

1. Preventive Management:

a) Credit Assessment and Risk Management Mechanism:

A lasting solution to the problem of NPAs can be achieved only with proper credit assessment and risk management mechanism. The documentation of credit policy and credit audit immediately after the sanction is necessary to upgrade the quality of credit appraisal in banks. In a situation of liquidity overhang the enthusiasm of the banking system is to increase lending with compromise on asset quality, raising concern about adverse selection and potential danger of addition to the NPAs stock. It is necessary that the banking system is equipped with prudential norms to minimize if not completely avoid the problem of credit risk.

b) Organizational Restructuring:

With regard to internal factors leading to NPAs the onus for containing the same rest with the bank themselves. These will necessities organizational restructuring improvement in the managerial efficiency, skill up gradation for proper assessment of credit worthiness and a change in the attitude of the banks towards legal action, which is traditionally viewed as a measure of the last resort.

c) Reduce Dependence on Interest:

The Indian banks are largely depending upon lending and investments. The banks in the developed countries do not depend upon this income whereas 86 percent of income of Indian banks is accounted from interest and the rest of the income is fee based. The banker can earn sufficient net margin by investing in safer securities though not at high rate of interest. It facilitates for limiting of high level of NPAs gradually. It is possible that average yield on loans and advances net default provisions and services costs do not exceed the average yield on safety securities because of the absence of risk and service cost.

d) Potential and Borderline NPA's under Check:

The potential and borderline accounts require quick diagnosis and remedial measures so that they do not step into NPAs categories. The auditors of the banking companies must monitor all outstanding accounts in respect of accounts enjoying credit limits beyond cut – off points, so that new sub-standard assets can be kept under check.

2. Curative Management:

The curative measures are designed to maximize recoveries so that banks funds locked up in NPAs are released for recycling. The Central government and RBI have taken steps for arresting incidence of fresh NPAs and creating legal and regulatory environment to facilitate the recovery of existing NPAs of banks. They are: Debt Recovery Tribunals (DRT): In order to expedite speedy disposal of high value claims of banks Debt Recovery Tribunals were setup. The Central Government has amended the recovery of debts due to banks and financial institutions Act in January 2000 for enhancing the effectiveness of DRTs. The provisions for placement of more than one recovery officer, power to attach dependents property before judgment, penal provision for disobedience of Tribunals order and appointment of receiver with powers of realization, management, protection and preservation of property are expected to provide necessary teeth to the DRTs and speed up the recovery of NPAs in times to come.

a) Lok Adalats:

The Lok adalats institutions help banks to settle disputes involving accounts in doubtful and loss categories. These are proved to be an effective institution for settlement of dues in respect of smaller loans. The Lok adalats and Debt Recovery Tribunals have been empowered to organize Lok adalats to decide for NPAs of Rs. 10 lakhs and above.

b) Asset Reconstruction Company (ARC):

The Narasimhan Committee on financial system (1991) has recommended for setting up of Asset Reconstruction Funds (ARF). The following concerns were expressed by the committee.

- It was felt that centralized all India fund will severely handicap in its recovery efforts by lack of widespread geographical reach which individual bank posses and.
- Given the large fiscal deficits, there will be a problem of financing the ARF.

Subsequently, the Narasimhan committee on banking sector reforms has recommended for transfer of sticky assets of banks to the ARC. Thereafter the Varma committee on restructuring weak public sector banks has also viewed the separation of NPAs and its transfer thereafter to the ARF is an important element in a comprehensive restructuring strategy for weak banks. In recognition of the same ARC Bill was passed to regulate Securitization and Reconstruction of financial assets and enforcement of security interest.

The ICICI BANK has promoted the country's first Asset Reconstruction Company. The company is specialized in recovery and liquidation of assets. The NPAs can be assigned to ARC by banks at a discounted price. The objective of ARC is floating of bonds and making necessary steps for recovery of NPAs from the borrowers directly. This enables a onetime clearing of balance sheet of banks by sticky loans.

c) Corporate Debt Restructuring (CDR):

The corporate debt restructuring is one of the methods suggested for the reduction of NPAs. Its objective is to ensure a timely and transparent mechanism for restructure of corporate debts of viable corporate entities affected by the contributing factors outside the purview of BIFR, DRT and other legal proceedings for the benefit of concerned. The CDR has three tier structure viz., a. CDR standing forum b. CDR empowered group and c. CDR cell.

The Mechanism of the CDR: It is a voluntary system based on debtors and creditors agreement. It will not apply to accounts involving one financial institution or one bank instead it covers multiple banking accounts, syndication, consortium accounts with outstanding exposure of Rs. 20 crores and above by banks and institutions.

The CDR system is applicable to standard and sub – standard accounts with potential cases of NPAs getting a priority. In addition to the steps taken by the RBI and Government of India for arresting the incidence of new NPAs and creating legal and regulatory environment to facilitate for the recovery of existing NPAs of banks, the following measures were initiated for reduction of NPAs. Circulation of Information of Defaulters: The RBI has put in place a system for periodical circulation of details of willful defaulters of banks and financial institutions. The RBI also publishes a list of borrowers (with outstanding aggregate rupees one crore and above) against whom banks and financial institutions in recovery of funds have filed suits as on 31^{st} March every year. It will serve as a caution list while considering a request for new or additional credit limits from defaulting borrowing units and also from the directors, proprietors and partners of these entities.

d) Recovery Action against Large NPAs:

The RBI has directed the PSBs to examine all cases of willful default of Rs. One crore and above and file criminal cases against willful defaulters. The board of directors are requested to review NPAs accounts of one crore and above with special reference to fix staff accountability in individually.

e) Credit Information Bureau:

The institutionalization of information sharing arrangement is now possible through the newly formed Credit Information Bureau of India Limited (CIBIL) It was set up in January 2001, by SBI, HDFC, and two foreign technology partners. This will prevent those who take advantage of lack of system of information sharing amongst leading institutions to borrow large amount against same assets and property, which has in no measures contributed to the incremental of NPAs of banks.

SUGGESTIONS TO CONTROL NPAs:

The Bank should adopt the following general strategies to control NPAs. The suggestions are as follows:

- Projects with old technology should not be considered for finance
- Large exposure on big corporate or single project should be avoided.
- Operating staffs' credit skills should be up graduation.
- There is need to shift banks approach from collateral security to viability of the project
- and intrinsic strength of promoters.

- Timely sanction and or release of loans by the bank is to avoid time and cost overruns.
- Bank should prevent diversion of funds by the promoters.
- Operating staff should scrutinize the level of inventories/receivables at the time of
- assessment of working capital.
- The Credit section should carefully watch the warning signals viz. non-payment of
- quarterly interest, dishonor of check etc.
- Effective inspection system should be implemented.
- Identifying reasons for turning of each account of a branch into NPA is the most
- important factor for upgrading the asset quality, as that would help initiate suitable steps
- to upgrade the accounts.
- The bank must focus on recovery from those borrows who have the capacity to repay but
- are not repaying initiation of coercive action a few such borrows may help.
- The recovery machinery of the bank has to be stream lined; targets should be fixed for
- field officers / supervisors not only for recovery in general but also in terms of upgrading
- number of existing NPAs.
- In the bank there should be a proper manpower planning.
- Bank should try to establish the branches in competitive market, so it will increase their
- profit.
- Bank has required increasing the cash and bank balances byreducing the unnecessary expenses for future plan

CONCLUSION:

Growing NPAs is one of the biggest problems that the private Indian banks are facing today. If proper management of the NPAs is not undertaken it would hamper the efficiency of the banks. If the concept of NPAs is taken very lightly it would be dangerous for the banking sector. The NPAs destroy the current profit and interest income and affect the smooth functioning of the recycling of the funds. Banks also redistribute losses to other borrowers by charging higher interest rates. Lower deposit rates and higher lending rates repress savings and financial markets, which in turn hampers the economic growth of the country. Thus, it is highly essential for the banks to focus their attention on growth of NPAs and take appropriate measures to regulate their
growth.

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