Management Perspective of Non-Performing Assets :
A Challenge For Indian Banking Sector in the Post Economic Reform Era

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Abstract

A bank is an establishment, which is indulged mainly in accepting of all kinds of deposits and lending money to the needy people/sector to disburse its role or function as a banker for the upliftment of the weaker section of the society. The concept of NPA has emerged as an obstacle for the banking sector on the way of achieving their targets. Non-performing assets are one of the major concerns for banks in India. A high level of NPAs suggest high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The Indian banking sector is facing a serious problem of NPAs. To improve the efficiency and profitability, the NPAs have to be scheduled. It is highly impossible to have zero percentage of NPAs. But at least Indian banks can try competing with foreign banks to maintain the international standard in this respect. The problem of losses and lower profitability of Non-Performing Assets (NPAs) and liability mismatch in banks and financial sector: An attempt is made in this paper regarding management of NPAs, the factors contributing to NPAs, the magnitude of NPAs, reasons for high NPAs and to manage NPA in Indian banking operations. Besides this an attempt will be made to find out the ratio of NPAs belonging to Public as well as Private sector banks, management of credit risk and measures to control the menace of NPAs.

Keywords: NPA-Non-Performing Assets, PSB- Public Sector Banks, Private Sector Banks, Foreign Banks, SCB- Scheduled Commercial Banks.

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INTRODUCTION

Non-performing assets (NPAs) of banks or bad loans, as they commonly called, have been a menace for the banking sector across the world. Non-performing assets (NPAs) have also been detrimental to the performance of the Indian banks. (Sanjeev, 2007). The banking system in India comprises of commercial banks as well as cooperative banks, of which the former accounts for more than 90 per cent of banking system’s assets. Besides a few foreign and Indian private banks, the commercial banks comprise nationalized banks (majority equity holding is with the Government), the State Bank of India (SBI) (majority equity holding being with the Reserve Bank of India) and the associate banks of SBI (majority holding being with State Bank of India). The public sector banks of India have emerged strong across all key indicators as the global financial turmoil and slowing domestic economy put the banking sector on a test. The public sector banks have not only reduced the lending rates but have also managed to record higher average net profit and lower NPAs level in comparison to private sector banks. However, the only problem of the Public Sector Banks these days are the increasing level of the non performing assets. The non performing assets of the Public Sector Banks have been increasing regularly year by year. If we glance on the amount of non-performing assets we may come to know that in the year 1995 the NPAs were Rs. 38,385 crore and reached to Rs. 1,17,200 crore in 2012 in Public sector banks and comparatively in the year 2001 the NPAs were Rs. 6410 crore and reached to Rs. 18,700 crore in 2012 in Private sector banks.

NPAs are drag on profitability of banks because besides provisioning, Banks are also required to meet the cost of funding these unproductive assets. It reduces earning capacity of Assets. Return on Assets also gets affected. NPAs carry on risk weights of 100%. As NPAs do not earn any income, they adversely affect Capital Adequacy Ratio (CAR). PSBs are incurring around as high as 11% of their NPAs as operating cost for monitoring and recovering NPAs every year. Regulatory and credit rating agencies’ abroad are also not comfortable with the high level of NPAs of Indian Banks. New Branch licenses are also not given to the Banks where they have high level of NPAs.

The NPAs are considered as an important parameter to judge the performance and financial health of banks. NPAs in simple words may be defined as the borrower does not pay principal and interest for a period of 180 days. However, it is taken into consideration now that default status would be given to a borrower if dues are not paid for 90 days.
If any advance or credit facility granted by the bank to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances / credit facilities having a performing status. (Kaur and Singh, 2011)

**REVIEW OF LITERATURE:**

1- **Mohnani & Deshmukh (2013)** in their article ‘A Study of Non-Performing Assets on Selected Public and Private Sector Banks’ they have suggested that Post reform era has changed the whole structure of banking sector of India. The emerging Competition has resulted in new challenges for the Indian banks. Hence, parameters for evaluating the performance of banks have also changed. This paper provides an empirical Approach to the analysis of profitability indicators with a focal point on non-performing assets (NPAs) of public and private sector banks.

2- **Jain (2002)** in his thesis titled, “Non-performing Assets in Commercial and Development Banks in India” highlighted that the future profitability of banks would depend on their alertness, operational efficiency, customer orientation, creation of large volume of performing assets, attainment of optimum levels of productivity. Since retail customers are fast becoming more demanding in the current competitive environment, banks have to offer value-added services. Banks, which are pro-active, respond quickly to the changing needs of the customer, and give adequate attention to the changing scenario, alone can survive successfully to perform well and prosper.

3- **Tamal DattaChaudhuri (2005)** examined the “Resolution Strategies for Maximizing Value of Non-Performing Assets (NPAs)”. The article indicates that declining capital adequacy adversely affects shareholder value and restricts the ability of the bank/institution to access the capital market for additional equity to enhance capital adequacy. So, if a resolution strategy for recovery of dues from NPAs is not put in place quickly and efficiently, these assets would deteriorate in value over time and little value would be realized at the end except may be its scrap value.

4- **Prashanth K Reddy (2002)** in his thesis titled, “A comparative study of Non Performing Assets in India in the Global context - similarities and dissimilarities, remedial measures” highlighted that financial sector reform in India has progressed rapidly on aspects like interest rate deregulation, reduction in reserve requirements, barriers to entry, prudential norms and risk-based supervision. But progress on the structural-institutional aspects has been much slower and is a cause of concern.
5-Bidani (2002) in his book titled, “Managing Non-Performing Assets in Banks” highlighted that banks are concerned with their heavy NPA portfolio which was impairing their profitability and are taking all possible steps to contain the same. Banks have achieved a reasonable degree of success to bring down their existing NPAs but due to heavy slippage of standard accounts to NPA category the overall position continued to deteriorate.

6-Misra (2003) in his article, “Managing Non-Performing Assets: A Professional Approach”, highlighted that the profitability of the financial institutions largely depended upon the level of income generated through optimum use of the assets after paying the cost of fund for acquiring them and other administrative costs involved therein. Redefined objective of managing NPAs through profit maximization approach and risk management approach were suggested.

7-Kumar (2005) in his article, “Non-Performing Assets in Indian Banks” studied that the Indian banking sector faced a serious problem of NPAs. The extent of NPAs has comparatively higher in public sectors banks. To improve the efficiency and profitability, the NPAs have to be scheduled. Various steps have been taken by government to reduce the NPAs. It is highly impossible to have zero percentage NPAs. But at least Indian banks can try competing with foreign banks to maintain international standard.

8-Khanna(2012) in his article “Managing Non Performing Assets in Commercial Bank” has opined that a strong banking sector is important for flourishing economy. The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management. While the primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., but in recent times the banks have become very cautious in extending loans. The reason being mounting nonperforming assets (NPAs) and nowadays these are one of the major concerns for banks in India.

9- Kanika(2010) in his “Empirical study of non-performing assets management of Indian public sector banks” has explained that the Indian banking system has undergone significant transformation following financial sector reforms. It is adopting international best practices with a vision to strengthen the banking sector. The public sector banks dominate the Indian banking system with almost 82 percent market share in the total deposits and advances of the industry. Several prudential and provisioning norms have been introduced, and these are pressurizing banks to improve efficiency and trim down NPAs to improve the financial health in the banking system.
10- Shalini (2013) in her article “A study on causes and remedies for non performing assets in Indian public sector banks with special reference to agricultural development branch, state bank of Mysore” suggested that Credit management includes planning, organizing, controlling, directing and co-ordinating the credit sanctioning policies in order to decrease the non performing assets.

11- Rajamohan (2012) in his article “Analysis of NPAs of the Public Sector Banks in India” he has clearly described that Indian banking industry plays a pivotal in the socio economic development of the country. During the past few years the banks gain sufficient strength to pose good performance which is reflected in the high growth of low cost deposits, a well diversified credit portfolio across corporate, retail and small and medium enterprises improved margins and spread good other income and better quantity of asset through a consistent reduction in Non-performing assets.

12- Rajeev and Mahesh in their article “Banking sectors reforms and NPA: A study of Indian Commercial Banks” have told that the issue of non-performing assets (NPAs), are the root cause of the recent global financial crisis, has been drawing the attention of the policy makers and academicians alike. The problem of NPAs, which was ignored till recently, has been given considerable attention after liberalization of the financial sector in India. This exploratory paper examines the trends of NPAs in India from various dimensions and explains how mere recognition of the problem and self-monitoring has been able to reduce it to a great extent.

13- Khurana, Khalsa & Singh (2010) in their article “NPA Management : A Study of New Private Sector Banks In India” they have opined that a Non Performing Asset is an asset or account of borrower, which has not been serviced by the borrower, and the bank has stated the same as sub-standard, doubtful or loss asset, as per the norms and directions of the RBI. Non-Performing Assets (NPA) have emerged as an alarming threat to the Indian banking industry and their reduction has become synonymous with professional functioning and management of banks.

14- Amitabh Joshi (2003) conducted a survey on “Analysis of NPAs of IFCI Ltd”. The study found that profitability and viability of Development of Financial Institutions are directly affected by quality and performance of advances.
15- Gurumoorthy(2012) In their article Non-Performing Assets (A Study With Reference To Public Sector Banks) have analyzed that: In the liberalized economy, Banking and Financial sector get high priority. The banks in India are facing the problem of Non-Performing Assets (NPAs). The earning capacity and profitability of the banks are highly affected because of the existence of NPAs. Moreover the non-performance or non-receipt of interest and principal blocked banks money in the form of funds and is not available for further use of banking business and thus the profit margin of the banks goes down. In this connection bank must aware of the problems and recovery legislations of NPAs.

**Importance of the study:**

In spite of the overall growth in business of the public and private sector banks, particularly in advancing loan in much liberal manner, the number of defaulters is also increasing from time to time. So it seems highly important to have a study on the management of NPA in banking sector. Further the effective management of NPA both RBI and commercial banks are tried their best putting different types of mechanism. NPA is not a challenge to the lender or supplier of fund rather than it creates a problem for those firms seeks the financing help of banks for their short term as well as long term financing. So NPA creates an unhealthy atmosphere of faithlessness, which minimises the credit facilities, availed by different sectors of the society. As a result bad impact falls upon the national income in general and state income in particular. So in micro level the growth rate of various sectors of economy is slow down which encourage the unemployment problem for the society.

On the basis of the above-mentioned facts the purposed study is highly important for proper management of NPAs in banking sector in post reform era.

**Objectives:** The present article has the following specific objectives.

1- To study the trends in non performing assets of various banks.
2- To determine the ratio of gross NPA to gross advance.
3- To examine the act approved at parliament for recovering NPA.
4- To find out trends in NPA level.
5- To suggest various measurements for NPA Management.
6- To identify the reasons for an asset turning into NPA.
Research Methodology:

Till now a lot of research work has been done on different aspects of banking sector, such as-portfolio behaviour of banks, credit mobilization by banks etc. But an important area of like non-performing asset in banking sector has been neglected. Very few persons have undertaken the research study on NPA. So, it seems important for me to do a thorough research study on the management of NPA in banking sector.

The primary data was collected with a view to identifying the causes of huge NPAs. A questionnaire was prepared and direct personal interviews and discussions with various bankers were held. The target respondents were the officers working in various commercial banks (like public sector banks, private sector banks and foreign banks) in India. The officers considered in the sample were occupying various positions (like assistant manager, Zonal manager, NPA departmental manager, credit officers, etc.) in the bank.

Secondary data, which from the base for the major part of the study, was obtained from various sources such as various publications of RBI like RBI Bulletin, IBA bulletins, Annual Reports on banking trend and progress in India, and whatever was not available as published data was collected through the case studies of banks.

Period of Study: For this study the data on Scheduled Commercial banks for a period of FIVE years i.e. from 2007-08 to 2011-12 has been taken.

Mathematical and statistical tools such as percentage, trend analysis etc. have been used to complete the purpose of the study. The use of tables, charts, graphs etc., have also been made where ever they are needed and necessary for clarity of thoughts, easy understanding and to make the presentation of research more simulative.

NPA: A CONCEPTUAL STUDY

In terms of Reserve Bank of India guidelines on Non Performing Assets (NPA), an asset shall be reckoned as NPA provided an asset, including a leased asset, becomes non performing when it ceases to generate income for the bank. Therefore, a NPA is a loan or an advance where:
Management Perspective of Non-Performing Assets: A Challenge For Indian Banking Sector in the Post Economic Reform Era

a) interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan, b) the account remains ‘out of order’ in respect of an Overdraft/Cash Credit(OD/CC), c) the bills remains overdue for a period of more than 90 days in case of bills purchased and discounted, d) the instalment of interest or principal remains overdue for two crop season for short duration crops, e) the instalment of principal or interest thereon remains overdue for one crop season for long duration crops, f) the amount of liquidity facility remains outstanding for more than 90 days, in respect of securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006, g) in respect of derivative transactions, the overdue receivables representing positive mark to market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

NPA: AN ANALYTICAL STUDY

Non-Performing Assets

Gross NPA ratio at system-level increased, mainly on account of the deterioration in asset quality of public sector banks. During 2011-12, the deteriorating asset quality of the banking sector emerged as a major concern, with gross NPAs of banks registering a sharp increase. The spurt in NPAs could be attributed to the slowdown prevailing in the domestic economy as well as inadequate appraisal and monitoring of credit proposals. The deterioration in assets quality was more pronounced in the case of public sector banks. During 2011-12, the gross NPAs of public sector banks increased at a higher rate as compared with the growth rate of NPAs at a system-level. (Table 1 & Chart-1)

Net NPAs increased significantly

In sync with the acceleration in growth of gross NPAs as well as a lower provisioning coverage, net NPAs registered higher growth. Net NPA ratio was increasing year to year. (Table-1)
<table>
<thead>
<tr>
<th>Items</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross NPA's</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing balance</td>
<td>404</td>
<td>130</td>
<td>29</td>
<td>563</td>
<td></td>
</tr>
<tr>
<td>Opening balance</td>
<td>401</td>
<td>125</td>
<td>28</td>
<td>554</td>
<td></td>
</tr>
<tr>
<td>Addition during the year</td>
<td>313</td>
<td>127</td>
<td>84</td>
<td>524</td>
<td></td>
</tr>
<tr>
<td>Recovered during the year</td>
<td>263</td>
<td>81</td>
<td>29</td>
<td>373</td>
<td></td>
</tr>
<tr>
<td>Written off during the year</td>
<td>-</td>
<td>-</td>
<td>15</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>Closing balance</td>
<td>452</td>
<td>171</td>
<td>67</td>
<td>690</td>
<td>599</td>
</tr>
</tbody>
</table>

Table 1: Trends in Non Performing Assets (Bank Group wise) (Amount in billions)
## Notes:

1. #: Calculated taking gross NPAs from annual accounts of respective banks and gross advances from off-site returns.
2. *: Calculated taking net NPAs from annual accounts of respective banks and net advances from off-site return
3. -: Nil/negligible.

Source: Report on Trend and Progress of Banking in India of respective years.
<table>
<thead>
<tr>
<th>Recovery Channels</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of cases referred</td>
<td>Amount involved</td>
<td>Amount recovered*</td>
<td>Col. 4 (as a % of Col. 3)</td>
<td>No. of cases referred</td>
</tr>
<tr>
<td>Lok Adalats</td>
<td>1,86,535</td>
<td>2,142</td>
<td>176</td>
<td>8.2</td>
<td>5,48,308</td>
</tr>
<tr>
<td>DRTs</td>
<td>3,728</td>
<td>5,819</td>
<td>3,020</td>
<td>0</td>
<td>51.9</td>
</tr>
<tr>
<td>SARFAESI Act</td>
<td>83,942#</td>
<td>7,263</td>
<td>4,429</td>
<td>0</td>
<td>61.0</td>
</tr>
<tr>
<td>Total</td>
<td>2,742,05</td>
<td>15,224</td>
<td>7,625</td>
<td>199.6</td>
<td>6,12072</td>
</tr>
</tbody>
</table>
Notes: 1. *: Refers to amount recovered during the given year, which could be with reference to cases referred during the given year as well as during the earlier years.
2. #: Number of notices issued.


In 2007-08, the amount recovered through these various channel was 50% of the amount involved and it was 37% in 2008-09, 24% in 2009-10, 31% in 2010-11, 23% in 2011-12. So the amount recover is declining up to the year 2009-10 and increasing in 2010-11. Again it is decreasing in 2011-12 as compared to the previous year.

During 2011-12, total amount of NPAs recovered through the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act), Debt Recovery Tribunals (DRTs) and Lok Adalats registered a decline compared with the previous year. Of the total amount recovered through these channels, recoveries under the SARFAESI Act constituted almost 50 percent. Banks approach the DRTs in case they fail to recover total amount of their bad loans through the SARFAESI Act. At present, there are 33 DRTs (Table-2). Banks have to strictly affect recoveries and to take resource to the Securitisation and Reconstruction of Financial assets and Enforcement of security Interest Act. The Act provides banks greater powers to expedite the process of recovery and for initiating action against defaulters.

As regards internal factors to NPAs, the onus rest with the banks themselves. This calls for organizational restructuring, improvement in managerial efficiency, skill up gradation for proper assessment of creditworthiness of the borrowers and a change in the attitude of the banks towards legal action which was traditionally viewed as a measure of the last resort, credit appraisal skills need to be refashioned in guise of severe competition among the banks. Banks have to facilitate faster technology up gradation, improve customer relationship and will have to devote greater attention to risk management systems.
Improving the productivity of manpower, imbibing profit consciousness among bank personnel and ensuring effective utilisation of bank resources will go a long way in increasing the earning capacity of banks and reducing the levels of NPAs.

**Conclusion:**

The present trend in NPA is increasing year to year. Gross NPA to gross advances ratio is also increasing in PSBs. But in case of Private sector and foreign banks it is declining. And if we take the overall NPA to advances ratio, it is increasing. Various steps like DRT and SARFAESI Act have been approved by the central government to reduce the level of NPAs. This has led to decline the NPAs of the Indian banking sector. But a lot more needs to be done. The NPAs level of our banks is still high as compared to the international standards. It is highly impossible to have zero percentage NPAs. But at least Indian banks can try competing with foreign banks to maintain international standard. The Indian banks should take care to ensure that they give loans to creditworthy customers as prevention is always better than cure.
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