

Non Performing Assets of Public Sector Banks in India

Manish Kapoor

*Assistant Professor, Post Graduate Deptt. Of Economics,
DAV College, Amritsar-143001 PUNJAB, INDIA.*

Abstract - The Non-Performing Assets (NPA'S) problem is one of the foremost and the most formidable problems that has shaken the entire banking industry like an Earthquake. At the Macro level, NPA'S have choked off the supply line of credit to the potential borrowers, thereby having a negative effect on capital formation and arresting the economic activity in the country. At the Micro level, the unsustainable level of NPA's has eroded the profitability of banks through reduced interest income and provisioning requirements, besides restricting the recycling of funds leading to serious asset-liability mismatches.

Keywords : Credit Appraisal , Profitability, Monetary and Fiscal Policy, Provisioning, capital Market.

I. INTRODUCTION

The three letters “NPA” strike terror in banking sector and business circle today. NPA is a short form of “Non-Performing Assets”. In banking, NPA are loans given to doubtful customers who may or may not repay the loan on time. There are two types of assets viz. performing and non-performing. Performing loans are standard loans on which both the principle and interest are secured and their return is guaranteed.

Non Performing assets means the debt which is given by the Bank is unable to recover it is called NPA .Non-Performing Asset [NPA] is a result of asset Liability mismatch, A NPA account in the books of accounts is an asset as it indicates the amount receivable from the Defaulters. It means if any bank gives loan to the customer if the interest for that loan is not paid by the customer till 90 days then that account is called as NPA account.

A loan or lease that is not meeting its stated principal and interest payments. Banks usually classify as nonperforming assets any commercial loans which are more than 90 days overdue and any consumer loans which are more than 180 days overdue. More generally, an asset which is not producing income.

II. DEFINITIONS:

An asset, including a leased asset, becomes Non-Performing when it ceases to generate income for the bank. A 'non-performing asset' (NPA) was defined as a credit facility in respect of which the interest and/or installment of principal has remained 'past due' for a specified period of time. The specified period was reduced in a phased manner as under:

w.e.f. 31.03.1993 : four quarters

w.e.f. 31.03.1994 : three quarters

w.e.f. 31.03.1995 : two quarters

w.e.f. 31.03.2001 : 180 days

w.e.f. 31.03.2004 : 90 days

days' delinquency norms are not applicable to Agriculture segment

With the effect from March 31, 2004, NPA shall be a loan or an advance where:

1. Term loan: Interest and /or installment of principal remain over due for a period of more than 90 days.
2. Cash credit/overdraft: The account remains 'out of order' for a period of more than 90 days.
3. Bills: The bill remains overdue for a period of more than 90 days from due date of payment.
4. Other Loans: Any amount to be received remains overdue for a period of more than 90 days.
5. Agricultural Accounts: In the case of agriculture advances, where repayment is based on income from crop. An account will be classified as NPA as under:
 - a) If loan has been granted for short duration crop: interest and/or installment of Principal remains overdue for two crop seasons beyond the due date.
 - b) If loan has been granted for long duration crop: Interest and/or installment of principal remains overdue for one crop seasons beyond due date.

Assets can be categorized into Four categories namely (1) Standard (2) Sub -Standard (3) Doubtful (4) Loss: the last three categories are classified as NPAs based on the period for which the asset has remained non-performing and the realisability of the dues.

(1) Standard assets: The loan accounts which are regular and do not carry more than normal risk. Within standard assets, there could be accounts which though have not become NPA but are irregular. Such accounts are called as special Mention accounts.

(2) Sub-Standard Assets: With effect from 31.3.2005, a sub- standard asset is one, which is classified as NPA for a period not exceeding 12 Months (earlier it was 18 months). In such cases, the current net worth of the borrower/ guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the bank in full. In other words, such an asset will have well defined credit weakness that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

(3) Doubtful Assets: With effect from 31 march 2005, an asset is to be classified as doubtful, if it has remained NPA or sub standard for a period exceeding 12 months (earlier it was 18 months). A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weakness make collection or liquidation in full,- on the basis of currently known facts,conditions and values- highly questionable and improbable.

(4) 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 uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recoverable value.

When a Sub Standard account is classified as Doubtful or Loss without waiting for 12 months: If the realizable value of tangible security in a sub Standard account which was secured falls below 10% of the outstanding, it should be classified loss asset without waiting for 12 months and if the realizable value of security is 10% or above but below 50% of the outstanding, it should be classified as doubtful irrespective of the period for which it has remained NPA.

Objectives of the study : The objectives of my study are as following:

- v To know which is better in terms of NPAs from both the banks SBP and OBC banks.
- v To understand what is Non Performing Assets and what are the underlying reasons for the emergence of the NPAs.
- v To understand the impacts of NPAs on the operations of the Banks.
- v To know what steps are being taken by the Indian banking sector to reduce the PAs?
- v To evaluate the comparative ratios of the SBP &OBC banks.
- v To know why NPAs are the great challenge to Banks. To understand the meaning & nature of NPAs.
- v To study the general reasons for assets become NPAs.
- v What are the methods adopted by the RBI to look after NPA management .

III. NEED OF THE STUDY

Following Type of need arises for this study:

- v To study what kind of role NPAs are playing upon the operations of the Bank.
- v To know the variables available to control NPAs.
- v The need also has been felt to study the financial performance of SBP bank.

IV. SCOPE OF THE STUDY

The scope of the study is as given below:

- v Banks can improve their financial position or can increase their income from credits with the help of this project.
- v This project can be used for comparing the performance of the bank with others.
- v This can also be applicable to know the reasons of increase in NPAs.
- v This project also gives light upon Impact of NPAs.
- v Concept of NPAs can be made clear.
- v To present a picture of movement of NPA in The SBOP Bank.

V. LIMITATIONS OF THE STUDY

The Limitations that I felt in my study are:

- v The data collected by me was not sufficient for report studying.
- v I haven't got enough time to study my report so that becomes the cause of limitation in the study.

v Since my study is based upon Secondary data , the practical operations as related to NPAs are adopted by the banks are not learned.

v The solutions are not applicable to every bank.

Research Methodology: The present study is Empirical in nature, in which conclusions have been reached on the basis of Secondary data. The secondary data has been collected from various officially published and unofficially unpublished magazines and periodicals. Attempt has been made to arrange the collected data into statistical tables through the medium of technology.

Review of Literature : Sergio(1996) in a study of non performing loans in Italy found evidence that an increase in the riskiness of loan assets is rooted in bank's lending policy due to relatively unselective and inadequate assessment of sectoral prospects. Rajaraman and Vasishtha (2002) in an empirical study provided an evidence of significant bivariate relationship between an operating efficiency indicator and the problem of loans of psb's. Das and Ghosh (2003) empirically examined non-performing loans of india's psb's in terms of various indicators like asset size, credit growth and macro-economic condition and operating efficiency indicators.

VI. CAUSES FOR AN ACCOUNT BECOMING NPA

v Those Attributable to Borrower :

- a) Failure to bring in Required capital
- b) Too ambitious project
- c) Longer gestation period
- d) Unwanted Expenses
- e) Over trading
- f) Imbalances of inventories
- g) Lack of proper planning
- h) Dependence on single customers
- I) Lack of expertise
- j) Improper working Capital Mgmt.
- k) Mis management
- l) Diversion of Funds
- m) Poor Quality Management
- n) Heavy borrowings
- o) Poor Credit Collection
- p) Lack of Quality Control

v Causes Attributable to Banks :

- a) Wrong selection of borrower
- b) Poor Credit appraisal
- c) Unhelpful in supervision
- d) Tough stand on issues
- e) Too inflexible attitude
- f) Systems overloaded
- g) Non inspection of Units
- h) Lack of motivation
- i) Delay in sanction
- j) Lack of trained staff
- k) Lack of delegation of work
- l) Sudden credit squeeze by banks
- m) Lack of commitment to recovery
- n) Lack of technical, personnel & zeal to work.

v Other Causes :

- a) Lack of Infrastructure
- b) Fast changing technology
- c) Un helpful attitude of Government
- d) Changes in consumer preferences
- e) Increase in material cost

- f) Government policies
- g) Credit policies
- h) Taxation laws
- I) Civil commotion
- j) Political hostility
- k) Sluggish legal system
- l) Changes related to Banking amendment Act

VII. ANALYSIS OF DATA COLLECTED:

Ratio Analysis :

The relationship between two related items of financial statement is known as ratio. A ratio is just one number expressed in terms of another. The ratio is customarily expressed in three different ways. It may be expressed as a proportion between the two figures. Second it may be expressed in terms of percentage. Third, it may be expressed in terms of rates. The use of ratio has become increasingly popular during the last few years only. Originally, the bankers used the current ratio to Judge the capacity of the borrowing business enterprises to repay the loan and make regular interest payments. Today it has assumed to be important tool that anybody connected with the business turns to ratio for measuring the financial strength and earning capacity of the business.

1. Gross NPA Ratio:

Gross NPA Ratio is the ratio of gross NPA to gross advances of the Bank. Gross NPA is the sum of all loan assets that are classified as NPA as per RBI guidelines, The ratio is to be counted in terms of percentage and the formula for GNPA is as follows:

$$\text{GROSS NPA RATIO} = \frac{\text{GROSS NPA}}{\text{GROSS ADVANCES}} * 100$$

BANKS	AS ON MARCH 31, 2009		
	GROSS NPAs	GROSS ADVANCES	GROSS NPA RATIO
STATE BANK OF PATIALA	57390	4396081	1.31
ORIENTAL BANK OF COMMECRE	105812	6906472	1.53

Interpretation:

The above table indicates the quality of Credit portfolio of the banks. High gross NPA ratio indicates the low Credit portfolio of bank and vice-versa. We can see from the above table the OBC has higher gross NPA ratio of 1.53. Whereas the SBP showed lower ratio with 1.31 in the year 2009 as compare to OBC bank.

2. *Net NPA Ratio :*

The net NPA Percentage is the ratio of NPA to net advances in which the provision is to be deducted from the gross advances. The provision is to be made for NPA account. The formula for that is:

$$\text{NET NPA RATIO} = \frac{\text{GROSS NPA} - \text{PROVISION}}{\text{GROSS ADVANCES} - \text{PROVISIONS}} * 100$$

<p>Gross NPA – Provision = Net NPA</p> <p>Gross Advances – Provision = Net Advances</p>
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	AS ON MARCH 31, 2009		
	NET NPAs	NET ADVANCES	NET NPA RATIO
BANKS			
STATE BANK OF PATIALA	26353	435872070	0.6
ORIENTAL BANK OF COMMECRE	44243	63204285	0.7

Interpretation:

The above table indicates the quality of Non Performing Assets of the banks. High Net NPA ratio indicates the low Credit portfolio & risk of bank and vice-versa. We can see from the above table the OBC has higher Net NPA ratio of 0.7. Whereas the SBP showed lower ratio with 0.6 in the year 2009 as compare to OBC bank.

3. *Provision Ratio:*

Provisions are to be made for to keep safety against the NPA , & it directly affect on the gross profit of the Banks. The Provision Ratio is nothing but total provision held for NPA to gross NPA of the Banks. The formula for that is:

$$\text{Provision Ratio} = \frac{\text{Total Provision}}{\text{Gross NPAs}} * 100$$

(Provision= Gross NPA-net NPA)

	PROVISION RATIO(%)
STATE BANK OF PATIALA	58.34
ORIENTAL BANK OF COMMECRE	57.90

Interpretation:

This Ratio indicates the degree of safety measures adopted by the Banks. It has direct bearing on the profitability, Dividend and safety of shareholders’ fund. If the provision ratio is less, it indicates that the Banks has made under provision. The highest provision ratio is showed by Oriental Bank of Commerce with 66.40 % as compared to State Bank of Patiala with 61.60 %. The lowest provision ratio is showed state Bank of Patiala with only 10.97 %

4. Problem Asset Ratio:

It is the ratio of gross NPA to total asset of the bank. The Formula for that is:

$$\text{Problem Asset Ratio} = \frac{\text{gross NPA's}}{\text{Total Assets}} * 100$$

	AS ON MARCH 31 ,2009		
BANKS	Gross Npa’s	Total assets	Problem Asset Ratio
STATE BANK OF PATIALA	57390	69665	0.82
ORIENTAL BANK OF C. OMMECRE	105812	112539	0.94

Interpretation:

It has been direct bearing on return on assets as well as liquidity risk management of the bank. High problem asset ratio, which means high liquid. The above table indicates the quality of Credit portfolio of the banks. High Problem Asset ratio indicates the low Credit portfolio of bank and vice-versa. We can see from the above table the OBC has higher problem Asset ratio of 94.3. Whereas the SBP showed lower ratio with 82.3 in the year 2009 as compare to OBC bank. However SBOP too have high problem asset ratio. The high problem asset ratio indicates higher risk & threat to bank.

VIII. 5. CAPITAL ADEQUACY RATIO:

Capital Adequacy Ratio can be defined as ratio of the capital of the Bank, to its assets, which are weighted/adjusted according to risk attached to them i.e.

$$\text{Capital Adequacy Ratio} = \frac{\text{capital}}{\text{risk Weighted assets}} * 100$$

Bank	Problem Asset Ratio
STATE BANK OF PATIALA	0.60
ORIENTAL BANK OF COMMECRE	0.99

Interpretation:

Each Bank needs to create the capital Reserve to compensate the Non-Performing Assets. Here, OBC Bank has shown Better capital adequacy ratio with 0.99% as compare to SBOP with 0.60%.So, we can say that OBC has much power than SBOP to compensate for NPAs.

Major Findings:

In my research I have find following things:

- v OBC Bank shows high NPAs Ratio as compare to SBOP Bank.
- v High NPAs Ratio shows low credit portfolio of OBC Bank.
- v In analysis SBOP shows low risk profile as compare to OBC in terms of NPAs.
- v Study also indicates that major NPA increases because of govt. recommended priority sectors.
- v SBOP has better provisioning as compare to OBC however OBC have better capital adequacy ratio than SBOP.

IX. RECOMMENDATIONS / SUGGESTIONS

In my study I have found some limitations. For that I can suggest both the Banks following suggestions or areas of improvement:-

- v Both the Banks should give stress upon credit appraisal.
- v The credit should be backed up by securitization.
- v Banks should create effectiveness in Management.
- v Credit officer should focus upon cash flow.

- v Timely check out should be adopted.
- v Both Banks should make good provisioning policy.
- v Banks should try their best to recover NPAs.
- v The problem should be identified very early so that companies can try their best to stop an asset or A/C becoming NPA.
- v Banks should evaluate the SWOT analysis of the borrowing companies i.e. how they would face the environmental threats and opportunities with the use of their strength and weakness, and what will be their possible future growth in concerned to financial and operational performance.
- v Each bank should have its own independent credit rating agency which should evaluate the financial capacity of the borrower before than credit facility.
- v The credit rating agency should regularly evaluate the financial condition of the clients.

X. CONCLUSION

A report is not said to be completed unless and until the conclusion is given to the report. A conclusion reveals the explanations about what the report has covered and what is the essence of the study. What my project report covers is concluded below. The problem statement on which I focused my study is “NPAs the big challenge before the Banks”. The Indian banking sector is the important service sector that helps the people of the India to achieve the socio economic objective. The Indian banking sector has helped the business and service sector to develop by providing them credit facilities and other finance related facilities. The Indian banking sector is developing with good appreciate as compared to the global benchmark banks. The Indian banking system is classified into scheduled and non scheduled banks. The Banks play very important role in developing the nation in terms of providing good financial services. The SBOP Bank has also shown good performance in the last few years. The only problem that the Bank is facing today is the problem of nonperforming assets. The non performing assets means those assets which are classified as bad assets which are not possibly be returned back to the banks by the borrowers. If the proper management of the NPAs is not undertaken it would hamper the business of the banks.

The NPAs would destroy the current profit, interest income due to large provisions of the NPAs, and would affect the smooth functioning of the recycling of the funds. If we analyze the past years data, we may come to know that the NPAs have increased very drastically. The RBI has also been trying to take number of measures but the ratio of NPAs is not decreasing of the banks. The bank must have to find out the measures to reduce the evolving problem of the NPAs. If the concept of NPAs is taken very lightly it would be dangerous for the Bank. The reduction of the NPAs would help the bank to boost up their profits, smooth recycling of funds in the nation. This would help the nation to develop more banking branches and developing the economy by providing the better financial services to the nation.

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