



Non-performing asset: An empirical study on nationalized banks in India

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Abstract

In India Non-performing assets are one of the important factors for banks. NPA gives the best health indication of the banking industry. NPAs reflect the performances of banks. NPAs are the primary indicators of credit risk. NPAs are an inevitable burden on the banking industry. However, the only problems of the Public Sector Banks these days are increasing level of the non performing assets. The non performing assets of the Public Sector Banks have been increasing regularly year by year. On the contrary, the non performing assets of private sector banks have been decreasing regularly year by year except some years. The Indian banking sector is facing a serious problem of NPA. The magnitude of NPA is comparatively higher in public sectors banks than private sector banks. To improve the efficiency and profitability of banks the NPA need to be reduced and controlled.

Keywords: gross NPA, net NPA, public sector banks, private sector banks

Introduction

Background

Non-performing Assets (NPAs) 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 Narasimham 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 helped largely to clean NPA in the Indian banking industry.

Reserve Bank of India constantly endeavors to ensure that prescriptions in this regard are close to international norms. The efficiency of a bank is not always reflected only by the size of its balance sheet but by the level of return on its assets.

After nationalization, the amount of nonperforming assets was around 15% which can be considered as one of the biggest limitations for the commercial banks.

NPAs have an adverse effect on the return on assets in several ways-

- They erode current profits through provisioning requirements.
- They result in reduced income.
- They limit recycling of funds, set in asset liability mismatch.

Definition of the problem

The Indian banking sector has been facing serious problems of raising Non- Performing Assets (NPAs). The NPAs growth has a direct impact on profitability of banks. Non- performing assets are one of the major concerns for scheduled commercial banks in India. NPAs reflect the performance of banks. A high level of NPAs suggests 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. NPAs affect the

liquidity and profitability, in addition to posing threat on quality of asset and survival of banks. The problem of NPAs is not only affecting the banks but also the whole economy.

Literature Review

There are many studies conducted on the issue of Non Performing Asset Management in Indian Banks, following is the review of few literatures about the NPA Practices and Management conducted for Banks in India.

Kaur, H. and Pasricha, J.S. (2004) highlighted the problem of non-performing assets in public sector banks. The study covered the prudential norms given by RBI and also analysed the NPA management policies of public sector banks.

Kaur and Saddy (2011) in the research paper entitled "A Comparative Study of Non-Performing Assets of Public and Private Sector Banks" an attempt is made to clarify the concept of NPA, the factors contributing to NPAs, the magnitude of NPAs, reasons for high NPAs and their impact on Indian banking operations.

Srinivas K T (2013) emphasis on identify the Non-performing assets at Commercial banks in India. This paper highlights the various general reasons which convert advances/ assets into NPA and also give suitable suggestion on findings to overcome the mentioned problem.

Research Gap

The existing literature shows that majority of the study is done in RRBs, but the present situation shows that there are maximum chances of NPAs in nationalized banks. So, the study of NPAs of nationalized banks is very important. This study will fill the gap in the literature by focusing on the analysis of NPAs of a nationalized bank in India.

NPA is a big threat to banks profitability. To address the problem the following aspects are considered.

- a. How can NPAs be prevented or how can be NPAs managed?

- b. When the assets slip to NPA category despite all preventive efforts by the banks, how can the increase in NPA be controlled?
- c. What effective measures are possible for recovery of NPAs through various channels?

Significance of the study

Indian banking sector has the nation in developing the business and service sectors. But recently the banks are facing the problem of credit risk. It is found that many general people and business people borrow from the banks but due to some genuine or other reasons are not able to repay back the amount drawn to the banks. The amount which is not given back to the banks is known as non-performing assets which hamper the business of the banks.

The main aim behind making this report is to know how a Public Sector Banks operate their business and how NPAs play its role to the operations of the bank. The present study also focuses on the existing system of Public Sector Banks to manage the problem of NPAs.

Research Methodology

1. Descriptive study: The study is descriptive as it throws light on the phenomenon of NPA's together with the RBI norms.
2. Exploratory study: This study is exploratory as it tries to investigate into the causes of NPA's and suggest remedial measures.

Lending Process

The following mechanism is in place for processing of loan proposal, disbursement & monitoring by the Banks

Pre-sanction process-loan appraisal

- Pulling of CIBIL Report
- Pre-Sanction Visit Report (PSVR) on Visit to:
 - Residence
 - Business Unit
 - Moveable / Immoveable Securities
 - Audited Balance Sheet (Min 2 Years – 3 years ideal)
 - Credit Rating
 - Calculation of Maximum Permissible Bank Finance

Post-sanction process

- Creation of Equitable/Registered Mortgage (Registration With CERSAI)
- Creation of Charge
- Hypothecation of present & future assets in Banks name
- Infusion of Margin Money by Borrower/Promoter
- Collection of Post dated cheque.
- Securities – NSC, KVP, FD, Shares, LIC etc.

Impact of NPA upon banks

A strong banking sector is important for flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. Non-performing assets are one of the major concerns for banks in India. The only problem that hampers the possible financial performance of the public sector banks is the increasing results of the Non-performing Assets. The

Non-performing Assets impacts drastically to the working of the banks. The efficiency of a bank is not always reflected only by the size of its balance sheet but by the level of return on its assets. NPAs do not generate interest income for the banks, but the same time banks are required to make provisions for such NPAs from their current profits.

1. They erode current profits through provisioning requirements.
2. They result in reduced interest income.
3. They require higher provisioning requirements affecting profits and accretion to capital. They limit recycling of funds, set in assets-liability mismatches, etc.
4. Adverse impact on Capital Adequacy Ratio.
5. ROE and ROA goes down because NPAs do not earn.
6. Bank's rating gets affected.
7. Bank's cost of raising funds goes up.
8. RBI's approval required for declaration of dividend if Net NPA ratio is above 3%.
9. Bad effect on Goodwill.
10. Bad effect on equity value.

Recovery Management

Meaning of recovery management

Recovery Management is the process of planning, testing, and implementing the recovery procedures and standards required to restore service in the event of a component failure; either by returning the component to normal operation, or taking alternative actions to restore service. Recovery Management is the acknowledgement that failures will occur regardless of how well the system is designed. The intent is to anticipate and minimize the impact of these failures through the implementation of predefined, pretested, documented recovery plans and procedures.

The primary objective of recovery Management is to ensure that service level requirements are achieved. This is accomplished by having recovery procedures in place that will restore service to a failing component as quickly as possible.

Methods of NPA management

Conventional Methods

- Follow up-Telephone/Letters
- Up gradation of accounts
- Cash Recovery through repayment by borrower/guarantor
- Adjustment of Liquid Securities-FDR/RD/Savings /NSC/KVP-Cash Recovery
- Filing of Suit
- Sale of enforceable securities through SARFAESI Act 2002
- Rescheduling and restructuring of accounts
- Compromise/One Time Settlement
- Sale to Asset reconstruction Company (ARC)
- Write off

Other Methods

- Adjustment of Insurance Claim(Vehicle, Fire, Stock, Theft, Housing, Life, etc)
- Liquidation of Company/Declaration of Bankruptcy
- BIFR-Declaration of Sick Industries by Hearing before Board-Sale

Findings and Conclusion

Findings

1. The high gross NPA ratio of UCO Bank for the two consecutive financial years 2014-15 and 2015-16 indicates the low credit portfolio of the bank.
2. The rise in NPAs has been attributed to the effects of global recession coupled with internal factors such as slowdown in the domestic economy.
3. The asset quality of UCO bank has deteriorated as big ticket corporate loans form a larger share of the credit portfolio of the bank.
4. The five sectors — infrastructure, steel, textiles, aviation, and mining — where public sector banks in general have large exposure, have contributed to the big rise in NPAs. In a few cases corruption and undue influence which affected lending decisions. Some companies were involved in fraud as well which surged the levels of bad loans.

Recommendations

Recommendations for Improvement of Recovery Performance & NPA Management:

1. As the growth rate and volume in Retail is very low, it triggers very high percentage NPA, hence Bank should continue to give corporate credit to highly rated companies even if the actual rate of return is less, in order to reduce % of GNPA.
2. Banks should started focusing on retail loans, avoiding exposure to big corporate and consortium lending. Larger contributions from small ticket retail, MSME and SME loans and limiting unsecured and large ticket exposure would help in containing NPAs.
3. Banks should give stress upon credit appraisal.
4. The credit should be backed up by securitization.
5. Banks should create effectiveness in Management.
6. Credit officer should focus upon cash flow.
7. Timely check out should be adopted.
8. Banks should make good provisioning policy.
9. Banks should try their best to recover NPAs.
10. The problem should be identified very early so that companies can try their best to stop an asset or A/C becoming NPA.

Limitations of the study

1. The study on management of non-performing assets is limited to the UCO Bank.
2. The time span of the study is confined to only two years due to paucity of time and availability of first hand information.
3. Reasons for NPAs and Management of NPAs are changing with time. The study is done in the present environment without foreseeing future developments.

Future scope of the study

The study has the following scope in the future:

1. The study could suggest measures for the banks to avoid future NPAs.
2. The study may help the government in creating & implementing new strategies to control NPAs.

3. The study will help to select appropriate techniques suited to manage the NPAs and develop a time bound action plan to arrest the growth of NPAs.

Conclusion

Banking industry has undergone a major change after the first phase of economic liberalization. Further, after adoption of BASEL system the concept of NPAs has come into the Indian Banking Sector. Hence NPA management is the most important aspect of banking sector, especially considering the huge rise in NPAs dues to slowdown in Real Estate & Manufacturing/Mining sectors in particular as well as drought/lack of irrigation creating huge financial burden on the farmers on the run up to the economic crisis 2008.

Thereafter, banks are very cautious in extending loan, because of mounting NPAs. This study highlights the reasons for assets becoming NPA and remedial measures to be taken. Due to innovative and pro active steps taken by banks, mostly private & foreign banks, NPA levels have reduced considerably. However, Public Sector Banks have not been as successful as Private & Foreign Banks in managing their NPAs.

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