Term Project

ON

Trends of NPA in Indian Banking Sector

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DECLARATION

I **Megha Goel** student of EMBA 2014-2016 batch of Delhi School of Management, Delhi Technological University, Bawana road, Delhi-42 declare that term project **Trends of NPA in Indian Banking Sector** submitted in partial fulfilment of Executive MBA programme is the original work conducted by me. The information and data given in the report is authentic to the best of my knowledge.

This Report is not being submitted to any other University for award of any other Degree, Award and Fellowship.

Megha Goel

Place: New Delhi
Date: 08/05/2016

CERTIFICATE

This is to certify that, this Project Report which is submitted by **Megha Goel** in partial fulfillment of the requirement for the award of degree MBA in DSM - DTU, Delhi is a record of the candidate own work carried out by her under my supervision.

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EXECUTIVE SUMMARY

Since the introduction of economic liberalization and financial sector reforms, Banks are under growing pressure to bring down their NPAs (Non Performing Assets) so as to improve their performance and viability. What is bothering the bankers today is the management of NPAs. Over the period this problem has aggravated alarmingly and therefore needs urgent remedial actions, so in this context a good number of circular instruction/guidelines have been issued by bank/Reserve Bank of India.

Reserve Bank of India, in the year 1991, appointed a committee under the Chairmanship of Sh. M.Narsimham to examine and give recommendation for Income Recognition, Asset Classification and Provisioning of loan assets of Banks and Financial Institutions. The Committee examined the issues and recommended that a policy of Income Recognition should be objective and based on record of recovery rather than on subjective considerations. On the basis of the recommendations of the Narsimhan Committee, RBI had issued guidelines to all Scheduled Commercial Banks on Income Recognition, Assets Classification and Provisioning in April, 1992 which have been modified from time to time by the RBI on the basis of experience gained and suggestions received from various quarters. The Prudential Norms for Income Recognition, Asset Classification and Provisioning have come into effect from the accounting year 31.03.1993.

Similarly, guidelines were issued by the Reserve Bank of India in March, 1994 to All India Financial Institutions viz. IDBI, ICICI, IFCI, AXIS Bank and IIBI. Separate guidelines were also issued by the RBI on Prudential Norms to Non-Banking Financial Companies in June, 1994 and to Regional Rural banks in March, 1996. They have adopted these guidelines for the purpose of Income Recognition and Assets Classification from the accounting year 1995-96.

However, guidelines relating to provisioning for RRBs have been made effective from the financial' year ended 31.03.1997. The definition of NPAs is also gradually becoming tough for RRBs to cover all advances like Commercial Banks. Although most of-the guidelines relating to RRBs are similar to that of Commercial Banks, they have been made applicable in a phased manner for RRBs.

Indian Banks Functionally diverse and geographically widespread, have played a crucial role in the socio- economic progress of the country. Banks extend credit to differen types of borrowers for many different purposes. For most customers, bank credit is the primary source of available debt financing.

For banks good loans are the most profitable assets. Return comes in the form of loan interest, fee income and investment and the most prominent assumed risk is credit risk. Credit risk involves inability or unwillingness of customer or counterpart to meet commitments in relation to lending once a loan is overdue and ceases to yield income it would become a Non Performing Asset.

Proper management and speedy disposal of NPAs is one of the most critical tasks of banks today. The problem of Non Performing Assets [NPAs] in banks and financial institutions has been a matter of grave concern not only for the banks but also the real economy in general, as NPAs can choke further expansion of credit which would impede the economic growth of the country. Any bottleneck in the smooth flow of credit is bound to create adverse repercussions in the economy. NPAs are not therefore the concern of only lenders but also the public at large.

Granting of credit for economic activities is the prime duty of banking. Apart from raising resources through fresh deposits, borrowings and recycling of funds received back from borrowers constitute a major part of funding credit dispensation activity. Lending is generally encouraged because it has the effect of funds being transferred from the system to productive purposes, which results into economic growth. However lending also carries a risk called credit risk, which arises from the failure of

borrower. Non-recovery of loans along with interest forms a major hurdle in the process of credit cycle. Thus, these loan losses affect the bank's profitability on a large scale. Though complete elimination of such losses is not possible, but banks can always aim to keep the losses at a low level.

Non-performing Asset (NPA) has emerged since over a decade as an alarming threat to the banking industry in our country sending distressing signals on the sustainability and insurability of the affected banks. The positive results of the chain of measures affected under banking reforms by the Government of India and RBI in terms of the two Narasimhan Committee Reports in this contemporary period have been neutralized by the ill effects of this surging threat. Despite various correctional steps administered to solve and end this problem, concrete results are eluding. It is a sweeping and all pervasive virus confronted universally on banking and financial institutions. The severity of the problem is however acutely suffered by Nationalised Banks, followed by the SBI and the all India Financial Institutions

Objective of Study

- Understand the concept of non performing assets of banks.
- To know the reason for an asset becoming NPA
- To know Preventive Measures
- To evaluate NPAs (Gross and Net) and related ratios in different banks and interpret various NPA related ratios for aggregates of Public Sector, Private Sector banks in India
- To analyze financial performance of banks at different level of NPA
- Understand the Impact of NPAs on profitability of public sector and private sector banks.
- Tools to manage NPAs
- Offer suggestions based on findings of the study in public sector and private sector bank.

Research Methodology

Information is of immense importance for success of business and commerce in the modern world. The ability to gather, analyze, evaluate, present and utilize information is therefore is a vital skill for the manager of today.

In order to accomplish this project successfully I took following steps:-

a) Data Collection:

- The analysis is done with the help Secondary data (from internet site and journals), book on Financial Management by various authors.
- The data is collected mainly from websites, annual reports, World Bank reports, research reports, pubications, already conducted survey analysis, database available, Catalogues and presentations. etc.

b) Analysis:

The analysis is done using pie charts, line charts etc. to study the share of investing banks.

Limitations of the Study

a) Shortage of time

Time was short for research, so that is very difficult can get the knowledge about everything

b) Information not sufficiently available

The source of data collection is secondary so the information available is not sufficient.

c) No direct source of information available

The information is collected from indirect sources so in some information data is not available.

d) Secondary data

Information may not reliable because of secondary data

Introduction

1.1 Introduction of banking sector in India

India cannot have a healthy economy without a sound and effective banking system. The banking system should be hassle free and able to meet the new challenges posed by technology and other factors, both internal and external.

In the past three decades, India's banking system has earned several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to metropolises or cities in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main aspects of India's growth story.

The government's regulation policy for banks has paid rich dividends with the nationalization of 14 major private banks in 1969. Banking today has become convenient and instant, with the account holder not having to wait for hours at the bank counter for getting a draft or for withdrawing money from his account.

1.2 Structure of banking sector in India

Commercial Banks can be classified into:

1) Public Sector Bank
    a) State Banks & its associate banks
    b) Nationalized banks

2) Private Sector Banks
    a) Old Generation
    b) New Generation
    c) Local Area Banks

3) Foreign Banks
    a) Representative Office

4) Regional Rural Banks

5) Co-Operative Banks

The structure of the Indian banking system that developed during the pre-independence period was without any purposive control and direction. There were

no comprehensive banking laws except the Bank Charter Act. 1876 which regulated the three presidency bank and the Indian companies Act, 1913 provided some safeguards against bank failures.

In India the British Government started a central Bank called the Reserve Bank of India as a Private sector in 1935. After Independence, the new National Government nationalized it by passing the Reserve Bank of India Act in 1949 has some provisions to foster a sound and healthy banking system in India. To regulate the banking business the Act vested enormous powers of supervision and control in the hands of the reserve bank of India.

Reserve Bank is the banker to the banks-commercial, co-operative and Regional Rural Banks. This relationship is established once the name of a bank is included in the second schedule to the Reserve Bank of India Act, 1934. Such banks, called the scheduled banks, are entitled to avail of the facilities of refinance from the Reserve Bank.

Since 1966 the state co-operative Banks have also been made eligible or inclusion in the second schedule to the Act. The Regional Rural Banks, established since 1975, also enjoy the status of scheduled banks. The public sector banks have been notified as scheduled banks by the central government. The category of scheduled banks thus includes:-

a) Commercial banks – Indian and foreign
b) State co-operative Banks
c) Regional Rural Banks

Scheduled Bank means a bank included in the second schedule to the Reserve Bank of India. Act,1934. The Reserve Bank is empowered to include in the second schedule the name of a bank which carries on the business of banking in India and which satisfies the following conditions laid down in section 42(a).

It must have a paid-up capital and reserves of an aggregate value of not less than Rs.5 lakhs;

It must satisfy the Reserve Bank that its affairs are not being conducted in a manner detrimental to the interest of its depositors, and It must be:-

(a) a state co-operative bank, or
(b) a company as defined in the companies Act, 1956, or
(c) an institution notified by the central government in this behalf, or
(d) a corporation or a company incorporation by or under any law in force in any place outside India.

1.3 History of Banking in India

The first bank in India, though conservative, was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases:

- Early phase of Indian banks, from 1786 to 1969
- Nationalization of banks and the banking sector reforms, from 1969 to 1991
- New phase of Indian banking system, with the reforms after 1991

Phase 1

The first bank in India, the General Bank of India, was set up in 1786. Bank of Hindustan and Bengal Bank followed. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840), and Bank of Madras (1843) as independent units and called them Presidency banks. These three banks were amalgamated in 1920 and the Imperial Bank of India, a bank of private shareholders, mostly Europeans, was established. Allahabad Bank was established, exclusively by Indians,

In 1865.Punjab National Bank was set up in 1894 with headquarters in Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank,and Bank of Mysore were set up. The Reserve Bank of India came in 1935.

During the first phase, the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1,100 banks, mostly small.

To streamline the functioning and activities of commercial banks, the Government of India came up with the Banking Companies Act, 1949, which was later changed to the Banking Regulation Act, 1949 as per amending Act of 1965 (Act No. 23 of 1965).

The Reserve Bank of India (RBI) was vested with extensive powers for the supervision of banking in India as the Central banking authority. During those days, the general public had lesser confidence in banks. As an aftermath, deposit mobilization was slow. Moreover, the savings bank facility provided by the Postal department was comparatively safer, and funds were largely given to traders.

Phase 2

The government took major initiatives in banking sector reforms after Independence. In1955, it nationalized the Imperial Bank of India and started offering extensive banking facilities, especially in rural and semi-urban areas. The government constituted the State Bank of India to act as the principal agent of the RBI and to handle banking transactions of the Union government and state governments all over the country. Seven banks owned by the Princely states were nationalized

In 1959 and they became subsidiaries of the State Bank of India. In 1969, 14 commercial banks in the country were nationalized. In the
second phase of banking sector reforms, seven more banks were nationalized in 1980. With this, 80 percent of the banking sector in India came under the government ownership.

Phase 3

This phase has introduced many more products and facilities in the banking sector as part of the reforms process. In 1991, under the chairmanship of M Narasimham, a committee was set up, which worked for the liberalization of banking practices. Now, the country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and net banking are introduced. The entire system became more convenient and swift. Time is given importance in all money transactions.

The financial system of India has shown a great deal of resilience. It is sheltered from crises triggered by external macroeconomic shocks, which other East Asian countries often suffered. This is all due to a flexible exchange rate regime, the high foreign exchange reserve, the not-yet fully convertible capital account, and the limited foreign exchange exposure of banks and their customers.

Reserve Bank of India (RBI)

The central bank of the country is the Reserve Bank of India (RBI). It was established in April 1935 with a share capital of Rs 5 crore on the basis of the recommendations of the Hilton Young Commission. The share capital was divided into fully paid shares of Rs 100 each, which was entirely owned by private shareholders in the beginning. The government held shares of nominal value of Rs 220,000.

The RBI commenced operation on April 1, 1935, under the Reserve Bank of India Act, 1934. The Act (II of 1934) provides the statutory basis of the functioning of the Bank. The Bank was constituted to meet the following requirements:-

- Regulate the issue of currency notes
- Maintain reserves with a view to securing monetary stability
- Operate the credit and currency system of the country to its advantage

Indian Banks' Association (IBA)

The Indian Banks" Association (IBA) was formed on September 26, 1946, with 22 members. Today, IBA has more than 156 members, such as public sector banks, private sector banks, foreign banks having offices in India, urban co-operative banks, developmental financial institutions, federations, merchant banks, mutual funds, housing finance corporations, etc.

The IBA has the following functions:-

- Promote sound and progressive banking principles and practices.
- Render assistance and to provide common services to members.
- Organize co-ordination and co-operation on procedural, legal, technical, administrative,and professional matters.
- Collect, classify, and circulate statistical and other information.
- Pool expertise towards common purposes such as cost reduction, increased efficiency,
- Productivity, and improving systems, procedures, and banking practices.
- Project good public image of banking through publicity and public relations.
- Encourage sports and cultural activities among bank employees.

Banking Activities

- Retail banking, dealing directly with individuals and small businesses.
- Business banking, providing services to mid-market businesses.
- Corporate banking, directed at large business entities.
- Private banking, providing wealth management services to high net worth individuals.
- Investment banking, activities in the financial markets, such as "underwrite" (guarantee the sale of) stock and bond issues, trade for their own accounts,

make markets, and advise corporations on capital market activities like mergers and acquisitions.

- Merchant banking is the private equity activity of investment banks.
- Financial services, global financial institutions that engage in multiple activities such as banking and insurance.

1.4 Introduction of NPA

ASSET CLASSIFICATION:

Assets are classified into following four categories:-

a) Standard Assets:
b) Sub-standard Assets
c) Doubtful Assets
d) Loss Assets

Standard Assets:-Standard assets are the ones in which the bank is receiving interest as well as the principal amount of the loan regularly from the customer. Here it is also very important that in this case the arrears of interest and the principal amount of loan do not exceed 90 days at the end of financial year. If asset fails to be in category of standard asset that is amount due more than 90 days then it is NPA and NPAs are further need to classify in sub categories.

A debt obligation where the borrower has not paid any previously agreed upon interest and principal repayments to the designated lender for an extended period of time. The non-performing asset is therefore not yielding any income to the lender in the form of principal and interest payments. For example, a mortgage in default would be considered non-performing. After a prolonged period of non-payment, the lender will force the borrower to liquidate any assets that were pledged as part of the debt agreement. If no assets were pledged, the lenders might write-off the asset as a bad debt and then sell it at a discount to a collections agency.

An asset becomes non-performing when it ceases to generate income for the bank. A non-performing asset (NPA) is defined generally as a credit facility in respect of which interest and / or installment of principal has remained "past due" for two quarters or more. An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. It was, however, decided to dispense with past due".

Year ending March 31	Specified period
1993	Four Quarters
1994	Three Quarters
1995 Onwards	Two quarters

An amount due under any credit facility is treated as 'past due' when it has not been paid within 30 days from the due date. Due to the improvements in the payment and settlement systems, recovery climate, up gradation of technology in the banking sector, etc, it was decided to dispense with the 'past due' concept, with effect from 31st March, 2001. Accordingly, as from that date, a NPA shall be an advance where, Interest and/or installment of principal remain overdue for a period of more than 180 days in respect of a term loan

i. The account remains 'our of order' for a period of more than 180 days, in respect of an overdraft/cash credit

ii. Interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agriculture purposes

iv. Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

With a view to move towards international best practices, it has been decided to adopt the '90 days' overdue norm for identification of NPAs, from 31st March, 2004.

1.5 Why assets become NPA

A several factors is responsible forever increasing size of NPAs in PSBs. The Indian banking industry has one of the highest percents of NPAs compared to international levels.

A few prominent reasons for assets becoming NPAs are as under :-

- Lack of proper monitoring and follow-up measures.
- Lack of sincere corporate culture. Inadequate legal provisions on foreclosure and bankruptcy.
- Change in economic policies/environment.
- Non transparent accounting policy and poor auditing practices.
- Lack of coordination between banks/FIs.
- Directed landing to certain sectors.
- Failure on part of the promoters to bring in their portion of equity from their own sources or public issue due to market turning unfavorable.
- Criteria for classification of assets
- Classification of agricultural and non-agricultural loans is required to be done into

<u>'Out of Order' Status</u>

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for six months as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

<u>Overdue'</u>

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

Classification of NPAs

Banks are required to classify NPAs further into the following three categories based on the period for which the asset has remained non-performing and the reliability of the dues:-

i. Sub-standard Assets: A sub-standard asset is one which has remained NPA for a period less than or equal to 18 months. In such cases, the current net worth of the borrower, or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full. Such assets will have well defined credit weakness that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the bank will sustain a loss.

ii. Doubtful Assets: A Doubtful Asset which has remained NPA for a period exceeding 18 months. It has all the weaknesses inherent to a sub-standard asset with the added characteristic that the collection or liquidation in full on the basis of currently known facts is highly questionable and improbable.

iii. Loss Assets: A loss asset is one where a loss has been identified by the bank or, internal or external auditors but the amount has not been written off wholly.

Guidelines for Classification of NPAs

Broadly speaking, classification should be done taking into account the degree of well defined credit weaknesses and the extent of dependence on collateral security for realization of dues.

Banks should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high value accounts.

Accounts with temporary deficiencies: These should be classified based on the past recovery records. Accounts regularize near about the balance sheet date: These accounts should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness based on available data, it should be deemed as an NPA.

Asset classification should be borrower-wise and not facility-wise: If a single facility to a borrower is classified as NPA, others should also be classified the same way, as it is difficult to envisage only a solitary facility becoming a problem credit and not others.

Advances under consortium arrangements: Classification here should be based on the recovery record of the individual member banks. Accounts where there is erosion in the value of the security: If there is a significant (i.e. the realizable value of the security is less than 50% of that assessed by the bank during acceptance) the account may be classified as NPA.

Narsimhan Committee's Recommendations

Committee on Financial System (CFS) Narsimhan committee which reported in 1991, meanwhile major changes have taken place in the domestic, economic and institutional science, indicating the movement towards global integration of financial services. Committee has presented second generation reforms:-

a) To strength the foundation of financial system.

b) Related to this, streamlining procedures, upgrading technology and human resource development.

c) Structural changes in the system.

1) It is recommended that an asset be classified as doubtful if it is in the sub standard category for 18 months in the first instance and eventually for 12 months as loss if it has been so identified but not written off. These norms, which should be regarded as the minimum, may be brought into force in a phased manner.
2) Corporations and FIs should avoid the practice of "ever greening" by making fresh advances to their troubled constituents only with a view to settling interest dues and avoiding classification of the loans in question as NPAs. The committee notes that the regulatory and supervisory authorities are paying particular attention to such breaches in the adherence to the spirit of the NPA definitions and are taking appropriate corrective action.
3) The committee believes that objective should be to reduce the average level of net NPAs for all bank's to below 5% by the year 2000 and 3% by 2002. These targets cannot be achieved in the absence of measure to tackle the problem of backlong NPAs on one time basis and the implementation of strict prudential norms and management efficiency.
4) There is no denying the fact that any effort at financial restructuring in the form of having off NPAs portfolio from the books of the corporation or measures to

initiate the impact of high level of NPAs must go hand with operational restructuring. Cleaning up the balance sheets of banks would thus make sense only if simultaneous steps are taken to prevent of limit the reemergence of new NPAs.

5) Direct credit has a proportionately higher share in NPA portfolio of corporations and has been one of the factors in erosion in the quality of asset portfolio. There is a continuing need of Financial Corporations to extend Credit to SSI sector, which is important segment of national economy but on commercial considerations and on basis of credit worthiness. Government feels reluctant to accept the recommendation for reducing the scope of directed credit under priority sector because timy sector of industry and small businesses have problems with regard to obtaining credit and some remaining may be necessary for this sector. A poverty alleviation and employment generation schemes. Given the special needs of these sectors, the current practice may continue.
6) With regard to income recognition in India, income stops occurring when interest/installment of principal is not paid within 180 days. However, we should move towards international Practices in this regard and introduce the norm of 90 days in a phased manner by the 2002.
7) As an incentive to Bank is to make specific provision, the consideration be given to making such provisions tax deductible.
8) Banks should pay greater attention to asset liability management to avoid mismatch and to cover, among others, liquidity and interest rate risks.
9) It should be encouraged to adopt statistical risk management techniques like value at risk in respect of balance sheet term which are susceptible to market price fluctuation, Forex rate volatility and interest rate changes. While the RBI and IDBI may initially, prescribe certain normative models for market risk management, the ultimate objective should be that of building up their models and RBI blacklisting them for their validity on a periodical basis.
10) There is a need for a greater use of computerized system than at present.

Computerization has to be recognized as an indispensable tool for improvement in customer service, the institution and operation of better control systems, greater efficiency in information technology.

11) State Financial Corporations at present are over regulated and over administered. Supervision should be based on evolving prudential norms and regulations which should be adhered to rather than excessive control over administrative and other aspects of organisation and functioning. Internal audit and internal inspection systems should be strengthened.
12) The main issues with regard to operations of Bank's are to ensure operational flexibility and measure of competition and adequate internal autonomy in matters of loan sanctioning and internal administration.
13) This calls for some re-examination and the present relevance of directed credit programme ablest in respect of those who are able to stand on their own feet and to whom the directed credit programmes with the element of interest concessionality that has accompanied has become a source of economic rent. It is recommended that directed credit sector be redefined to comprise the small and marginal farmers, the tiny sector of industry, small business and transport operators, village and cottage industry, rural artisans and other weaker sections.
14) The credit target for this redefined priority sector should hence forth be fixed at 10% of aggregate credit which would be broadly in line with the credit flows to these sectors at present.

The committee believes that the balance sheets of banks and FIs should be made more transparent and full disclosure made in Balance sheet. This is to be done in phased manner.

Factors for Rise in NPAs

The banking sector has been facing the serious problems of the rising NPAs. But the problem of NPAs is more in public sector banks when compared to private sector banks and foreign banks. The NPAs in PSB are growing due to external as well as internal factors.

a) External Factors :-

1) Ineffective recovery tribunal

The Govt. has set of numbers of recovery tribunals, which works for recovery of loans and advances. Due to their negligence and ineffectiveness in their work the bank suffers the consequence of non-recover, their by reducing their profitability and liquidity.

2) Willful Defaults

There are borrowers who are able to payback loans but are intentionally withdrawing it. These groups of people should be identified and proper measures should be taken in order to get back the money extended to them as advances and loans.

3) Natural calamities

This is the measure factor, which is creating alarming rise in NPAs of the PSBs. every now and then India is hit by major natural calamities thus making the borrowers unable to pay back there loans. Thus the bank has to make large amount of provisions in order to compensate those loans, hence end up the fiscal with a reduced profit.

Mainly ours farmers depends on rain fall for cropping. Due to irregularities of rain fall the farmers are not to achieve the production level thus they are not repaying the loans.

4) Industrial sickness

Improper project handling, ineffective management, lack of adequate resources, lack of advance technology, day to day changing govt. Policies give birth to

industrial sickness. Hence the banks that finance those industries ultimately end up with a low recovery of their loans reducing their profit and liquidity.

5) Lack of demand

Entrepreneurs in India could not foresee their product demand and starts production which ultimately piles up their product thus making them unable to pay back the money they borrow to operate these activities. The banks recover the amount by selling of their assets, which covers a minimum label. Thus the banks record the non recovered part as NPAs and has to make provision for it.

6) Change on Govt. policies

With every new govt. banking sector gets new policies for its operation. Thus it has to cope with the changing principles and policies for the regulation of the rising of NPAs.

The fallout of handloom sector is continuing as most of the weavers Co-operative societies have become defunct largely due to withdrawal of state patronage. The rehabilitation plan worked out by the Central government to revive the handloom sector has not yet been implemented. So the over dues due to the handloom sectors are becoming NPAs.

b) Internal Factors :-

1) Defective Lending process

There are three cardinal principles of bank lending that have been followed by the commercial banks since long:-

i. Principles of safety
ii. Principle of liquidity
iii. Principles of profitability

i. Principles of safety :-

By safety it means that the borrower is in a position to repay the loan both principal and interest. The repayment of loan depends upon the borrowers:-

a) Capacity to pay
b) Willingness to pay

Capacity to pay depends upon:-

- Tangible assets
- Success in business

Willingness to pay depends on:-

- Character
- Honest
- Reputation of borrower

The banker should, there fore take utmost care in ensuring that the enterprise or business for which a loan is sought is a sound one and the borrower is capable of carrying it out successfully .he should be a person of integrity and good character.

7) **Inappropriate technology**

Due to inappropriate technology and management information system, market driven decisions on real time basis can not be taken. Proper MIS and financial accounting system is not implemented in the banks, which leads to poor credit collection, thus NPA. All the branches of the bank should be computerized.

8) **Improper SWOT analysis**

The improper strength, weakness, opportunity and threat analysis is another reason for rise in NPAs. While providing unsecured advances the banks depend more on the honesty, integrity, and financial soundness and credit worthiness of the borrower.

- Banks should consider the borrowers own capital investment it should collect credit information of the borrowers from :-

a) From bankers.
b) Enquiry from market/segment of trade, industry, business.
c) From external credit rating agencies.

- Analyze the balance sheet - True picture of business will be revealed on analysis of profit/loss a/c and balance sheet.
- Purpose of the loan

When bankers give loan, he should analyze the purpose of the loan. To ensure safety and liquidity, banks should grant loan for productive purpose only. Bank should analyze the profitability, viability, long term acceptability of the project while financing.

9) Poor credit appraisal system

Poor credit appraisal is another factor for the rise in NPAs. Due to poor credit appraisal the bank gives advances to those who are not able to repay it back. They should use good credit appraisal to decrease the NPAs.

10) Managerial deficiencies

The banker should always select the borrower very carefully and should take tangible assets as security to safe guard its interests. When accepting securities banks should consider the:-

1. Marketability
2. Acceptability
3. Safety
4. Transferability.

The banker should follow the principle of diversification of risk based on the famous maxim "*do not keep all the eggs in one basket";* it means that the banker should not grant advances to a few big farms only or to concentrate them in few industries or in a few cities. If a new big customer meets misfortune or certain traders or industries affected adversely, the overall position of the bank will not be affected.

11) Absence of regular industrial visit

The irregularities in spot visit also increases the NPAs. Absence of regularly visit of bank officials to the customer point decreases the collection of interest and principals on the loan. The NPAs due to willful defaulters can be collected by regular visits.

12) Re loaning process

Non remittance of recoveries to higher financing agencies and re loaning of the same have already affected the smooth operation of the credit cycle**.**

Underlying reason for NPA in India

An internal study conducted by RBI shows that in the order of prominence, the following factor contribute to NPAs :-

a) Internal Factor

Diversion of funds for:-

1) Expansion/diversification /modernization
2) Taking up new project
3) Helping /promoting associate concerns time/cost overrun during the projectimplementation stage
4) Business Failure
5) Inefficiency in management
6) Slackness in credit management and monitoring
7) Inappropriate Technology/technical problem
8) Lack of coordination among lenders

b) External Factor

1) Recession
2) Input/power storage
3) Price escalation
4) Exchange rate fluctuation
5) Accidents and natural calamities, etc.
6) Changes in government policies in excise/ import duties, pollution control orders, etc.
7) Some other factors also affected to NPA which are mention below in detail:

Liberalization of economy/removal of restriction/reduction of tariffs

A large number of NPA borrowers were unable to compete in a competitive market in which lower prices and greater choices were available to consumers. Further, borrowers operating in specific industries have suffered due to political, fiscal and social compulsions, compounding pressures from liberalization.

Lax monitoring of credit and failure to recognize Early Warnings Signals

It has been stated that approval of loan proposal is generally thorough and each proposal passes through many levels before approval is granted. However, the monitoring of sometimes complex credit files has not received the attention it

needed which meant that early warning signals were not recognized and standard assets slipped to NPA category without banks being able to take proactive measures to prevent this. partly due to this reason, adverse trends in borrowers performance were not noted and the position further deteriorated before action was taken.

Over optimistic promoters

Promoters were often optimistic in setting up large projects and in some cases were not fully above board in their intentions. screening procedures did not always highlight these issues. often projects were set up with the expectation that part of the funding would be arranged from the capital markets which were booming at the time of the project appraisal. When the capital markets subsequently crashed, the requisite funds could never be raised, promoter often lost interest and lenders were left stranded with incomplete/unviable projects.

Directed lending

Loans to some segment were dictated by Governments policies than commercial imperatives**.**

Highly Leveraged borrowers

Some borrowers were under capitalized and over burdened with debt to absorb the changing economic situation in the country. Operating within a protected marked resulted economic situation in the country. Operating within a protected market resulted in low appreciation of commercial/market risk.

Funding mismatch

There are said to be many cases where loans granted for short terms were used to fund long term transactions.

High Cost of Funds

Interest rates as high as 20% were not uncommon. Coupled with high leveraging and falling Denmark, borrowers could not continue to service high cost debt.

NPA Rules for bank

General Rules

In line with the international practices and as per the recommendations made by the committee on Financial system (Chairman Shri M. Narasimham), the Reserve Bank of India has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks so as to move towards greater consistency and transparency in the published accounts.

The policy of income recognition should be objective and based on record of recovery rather than on any subjective considerations. Likewise, the classification of assets of banks has to be done on the basis of objective criteria which would ensure a uniform and consistent application of norms. Also, the provisioning should be made on the basis of classification of assets based on the period for which the asset has remained non–performing / overdue as also availability of security and its realizable value.

Norms for treating loans / advances as NPA

Treatment of agricultural advances

In respect of advances granted for agricultural purposes where interest payment is onhalf-yearly basis synchronizing with harvest, banks should adopt the agricultural season as the basis. In other words, if interest has not been paid during the last two seasons of harvest (covering two half-years) after the principal has become overdue then such an advance should be treated as NPA. This norm is applicable to all direct agricultural advances listed in the Annexure. In respect of agricultural advances other than those
specified in the Annexure, identification of NPA would be done on the same basis as non-agricultural advances which at present is the 180 days delinquency norm. Crop loans for each season, viz., Rabi and Kharif has to be treated as separate account and IRAC norms have to be applied accordingly.

Treatment of advances for allied agricultural activities as well as non farm sector

Credit facilities granted for other allied agricultural activities as well as for non-farm sector activities should be treated as NPA if amounts of installments of principal and / or interest remain outstanding for a period of two quarters from the due date.

Project / Housing Loans, etc

In case of projects (industry, plantation, etc.) where moratorium is given for payment, [loan becomes due only after moratorium or gestation period is over] such a loan becomes overdue if installment is not paid on due date. Similarly, in the case of housing loans or similar advances granted to staff members where interest is payable after recovery of principal, such loans should be classified as NPA when there is a default in repayment of principal on due date of payment and overdue criteria will be the basis for classification of assets.

Consortium advances

In respect of consortium advances each bank is required to classify the borrowal accounts according to its own recovery i.e., on the record of recovery of the individual member banks. The banks participating in the consortium should therefore, arrange to get their share of recovery transferred from the lead bank of the consortium.

Treatment of different facilities to borrower as overdue (NPA)

Short-term agricultural advances are granted by SCBs / CCBs to CCBs PACS respectively for the purpose of on-lending. In respect of such advances as well as advances for other purposes, if any, granted under on-lending system, only that particular facility which became irregular should be treated as NPA and not all the other facilities granted to them.

Crop loans for each season, viz., Rabi and Kharif have to be treated as separate account and accordingly IRAC norms have to be applied. In respect of all other direct loans and advances granted to a borrower, all such loans will become NPA even if one loan A/c becomes NPA.

'Out of order status'

In respect of cash credit / over draft facility an account should be treated as „out of order", if the outstanding balance remains continuously in excess of the sanctioned limit / drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit / drawing power, but there are no credits continuously for six months as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as „out of order".

Performance of the account as on the date of Balance Sheet

The performance of the account as on the date of Balance Sheet only has to be taken into account for the purpose of NPA. Subsequent developments should not be considered for determining NPAs. 2.10. If interest and / or installment of principle has remained unpaid for any two quarters out of the four quarters ending 31 March

of the year concerned, the credit facility should be treated as NPA although the default may not be continuously for two quarters during the year.

Provisioning Norms on the basis of Asset Classification

Need for provisioning

Provisioning is necessary considering the erosion in the value of security charged to the banks over a period of time. Therefore, after the assets of CCBs / SCBs are classified into various categories (viz., standard, sub-standard, doubtful and loss assets) necessary provision has to be made for the same. The details of provisioning requirements in respect of various categories of assets are mentioned below:-

Standard Asset

When the IRAC norms were introduced in the year 1996-97, no provisioning was required in respect of standard assets. From the year ended 31 March 2000, banks are required to make provision on Standard assets at a minimum of 0.25% of the total outstanding in this category. The provision made on Standard assets may not be reckoned as erosion in the value of assets and will form part of owned funds of the bank. The advances granted against term deposits. National Savings Certificate (NSC) eligible for surrender, Kisan Vikas Patra (KVP) Indira Vikas Patra (IVP), Life policies, Staff loans would attract provision of 0.25% prescribed for Standard assets.

The provision towards standard assets need not be netted from gross advances and should be shown separately as “Contingent provision against Standard Assets” under “Other liabilities and provisions – others”.

Sub-standard Asset

A general provision of 10% of total outstanding in this category may be made.

Doubtful Assets

100% is to be made to the extent to which the advance is not covered by realizable value of securities to which the bank has a valid recourse and the realizable value is estimated on a realistic basis. Over and above item (a), provision is to be made depending upon the period for which an asset has remained overdue, 20% to 50% of the secured portion on the following basis:-

Loss Asset

The entire loss asset should be written off. If the assets are permitted to be retained in the books for any reasons, 100% of the outstanding thereof should be fully provided for:-

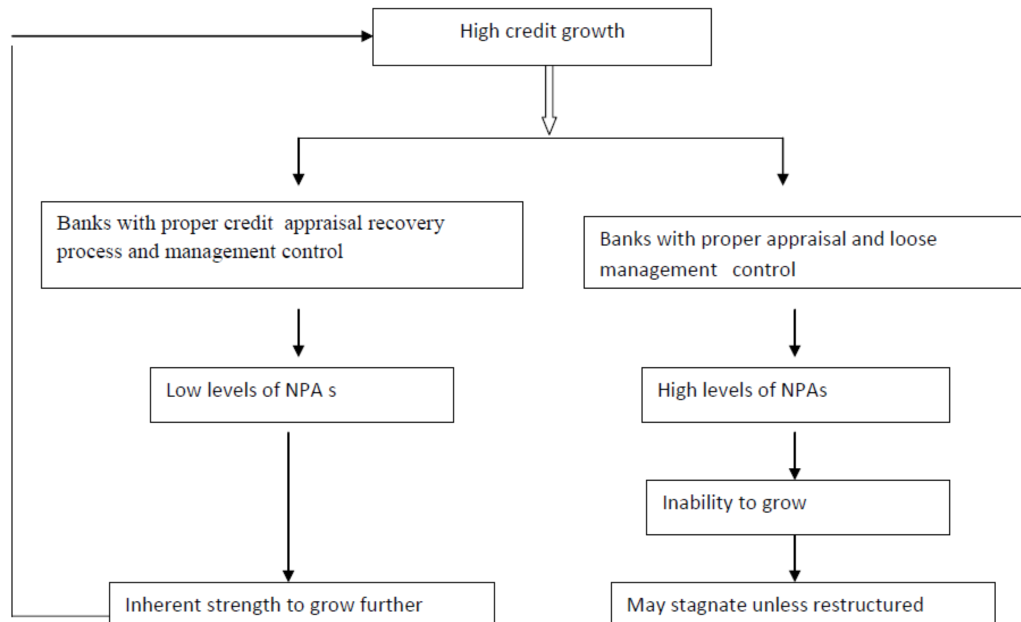
Provision for other assets/ outstanding liabilities

Loss in respect of cash balances/ deposits with other banks, amounts in branch adjustment accounts, frauds and embezzlements, and depreciation on building, furniture and vehicles, etc. may be assessed and fully provided for as per the existing practice.

With a view to ensuring full disclosure on the profitability and net worth of the bank, Items not provided for or items of liabilities where inadequate provisions have been made (e.g. Gratuity, Provident Fund, Income Tax, Interest accrued on deposits/ borrowings, etc.), Inspecting Officers should specify the same to arrive at the unprovided for expenditure and treat them as actual expenditure for the purpose of arriving at the net worth.

Credit growth and NPA life cycle

NPAs are largely a fallout of banks activities with regard to advance, both at the management and implementation levels .The credit appraisal system, monitoring of end -usage of funds and recovery procedures**.**



It also depends on the overall economic environment, the business cycle and the legal environment for recovery of defaulted loan since the overall environment is more or less same for all banks, Non performing loans of individual banks are mainly a result of management controls and systems put in place by them

Bank with an efficient credit appraisal and loan recovery system will grow stronger over the years. Such banks have good management controls and also inherent strengths in terms of a highly motivated staff, good checks and balance, which are further enhance by a regulatory and supervisory system.

As the growth in advances is largely determine by the economic and business environment, such banks will be able to push their credit portfolio aggressively, especially when economy is booming. Also, as such banks have a diversified credit portfolio, it would act as a cushion during economic downturns. This will results in lower NPAs, allowing them to grow stronger and even adopt a more aggressive growth strategy and their by, withstand marginally higher incidences of default.

However, a bank without inherent strength will not be able to push their credit portfolio the way the want to. They are characterized by poor management control,

inadequate credit appraisal and even low levels of motivation among the staff. When such banks push their advances portfolio, chances of their assets quality deteriorating are higher. since assets quality will be visible only after credit disbursal, which it self depends on the regulatory definition of NPAs, any deteriorating will be reflected after a time lag. Thus, bank without inherent strength will have higher NPA levels, especially when the economy has seen above average credit growth.

PROBLEMS DUE TO NPA

1) Owners do not receive a market return on there capital .in the worst case, if the banks fails, owners loose their assets. In modern times this may affect a broad pool of shareholders.

2) Depositors do not receive a market return on saving. In the worst case if the bank fails, depositors loose their assets or uninsured balance.

3) Banks redistribute losses to other borrowers by charging higher interest rates, lower deposit rates and higher lending rates repress saving and financial market, which hamper economic growth.

4) Non performing loans epitomize bad investment. They misallocate credit from good projects, which do not receive funding, to failed projects. Bad investment ends up in misallocation of capital, and by extension, labour and natural resources.

Non performing asset may spill over the banking system and contract the money stock, which may lead to economic contraction. This spill over effect can channelize through liquidity or bank insolvency:-

1) When many borrowers fail to pay interest, banks may experience liquidity shortage. This can jam payment across the country.
2) Illiquidity constraints bank in paying depositors
3) Undercapitalized banks exceed the banks capital base.

The three letters Strike terror in banking sector and business circle today. NPA is short form of "Non Performing Asset". The dreaded NPA rule says simply this: when interest or other due to a bank remains unpaid for more than **90 days**, the entire bank loan automatically turns a non performing asset. The recovery of loan has always been problem for banks and financial institution. To come out of these first we need to think is it possible to avoid NPA, no can not be then left is to look after the factor responsible for it and managing those factors.

- Interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

As a facilitating measure for smooth transition to 90 days norm, banks have been advised to move over to charging of interest at monthly rests, by April 1, 2002. However, the date of classification of an advance as NPA should not be changed on account of charging of interest at monthly rests. Banks should, therefore, continue to classify an account as NPA only if the interest charged during any quarter is not serviced fully within 180 days from the end of the quarter with effect from April 1, 2002 and 90 days from the end of the quarter with effect from March 31, 2004.

IMPACT OF NPAS ON BANKS:-

In portion of the interest income is absorbed in servicing NPA. NPA is not merely non-remunerative. It is also cost absorbing and profit eroding.

In the context of severe competition in the banking industry, the weak banks are at disadvantage for leveraging the rate of interest in the deregulated market and securing remunerative business growth. The options for these banks are lost. "The spread is the bread for the banks". This is the margin between the cost of resources employed and the return therefrom." This is the margin between the cost of resources employed and the return thereform. In other words it is gap between the return on funds deployed (Interest earned on credit and investments) and cost of funds employed (Interest paid on deposits).

When the interest rates were directed by RBI, as heretofore, there was not option for banks. But today in the deregulated market the banks decide their lending rates and borrowing rates. In the competitive money and capital Markets, inability to offer competitive market rates adds to the disadvantage of marketing and building new NPA has affected the profitability, liquidity and competitive functioning of banks and finally the psychology of the bankers in respect of their disposition towards credit delivery and credit expansion.

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 amount 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, routine payments and dues.

- **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 it's goodwill and brand image and credit which have negative impact to the people who are putting their money in the banks.

- **Impact on Productivity:**

High level of NPAs effect the productivity of the banks by increasing the cost of funds and by reducing the efficiency of banks employees. Cost of funds is increased because due to non-availability of sufficient internal sources they have to rely on external sources to fulfill their future financial requirements. Productivity of employees is also reduced because it keeps staff busy with the task of recovery of overdue. Instead of devoting time for planning for development through more credit and mobilization of resources the branch staff would primarily be engaged in preparing a large value of returns and statements relating to sub-standard, doubtful and loss assets, preparing proposal for filing of suits, waivement of legal action, compromise, write off or in preparing DICGC claim papers etc.

- **Impact on other Variables:**

High level of NPAs also leads to squeezing of interest spread, when asset becomes an NPA for the first time it adversely affects the spread by not contributing to the interest income and from the second year onwards it will have its impact on the bottom line of the balance sheet because of provisioning to be made for it and not have incremental effect on the spread.

Now a days Govt. does not encourage liberal capital support to be given to banks. Banks are required to bring their own capital by issuing share to the public, whereas high level of NPAs leads to lower profits hence less or no profits available for equity shareholders hence lower EPS and fall in the value of share. During the year 2001-02 share of 12 public sector banks were traded on the NSE out of which share value of three PSBs have decreased. Low market value of shares has also forced the banks to borrow heavily debt market to build Tier II capital to meet capital adequacy norms, putting severe pressure on their profit margins.

REASONS FOR NPA:

Reasons can be divided in to two broad categories:-

a) Internal Factor:-

Internal Factors are those, which are internal to the bank and are controllable by banks.

1. Poor lending decision:
2. Non-Compliance to lending norms:
3. Lack of post credit supervision:
4. Failure to appreciate good payers:
5. Excessive overdraft lending:
6. Non – Transparent accounting policy:

b) External Factors:-

External factors are those, which are external to banks they are not controllable by banks:-

1. Socio political pressure:
2. Chang in industry environment
3. Endangers macroeconomic disturbances
4. Natural calamities
5. Industrial sickness
6. Diversion of funds and willful defaults
7. Time/ cost overrun in project implementation
8. Labour problems of borrowed firm
9. Business failure
10. Inefficient management
11. Obsolete technology
12. Product obsolete

Types of NPA

a) Gross NPA
b) Net NPA

Gross NPA:
Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on Balance Sheet date. ***Gross NPA reflects the quality of the loans made by banks.*** It consists of all the non standard assets like as sub-standard, doubtful, and loss assets. It can be calculated with the help of following ratio:

$$\textbf{Gross NPAs Ratio} = \frac{\textbf{Gross NPAs}}{\textbf{Gross Advances}}$$

Net NPA:
Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. ***Net NPA shows the actual burden of banks.*** Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high. It can be calculated by following:-

$$\textbf{Net NPAs} = \frac{\textbf{Gross NPAs – Provisions}}{\textbf{Gross Advances - Provisions}}$$

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

1) Financial:

a) Non-payment of the very first installment in case of term loan.
b) Bouncing of cheque due to insufficient balance in the accounts.
c) Irregularity in installment.
d) Irregularity of operations in the accounts.
e) Unpaid overdue bills.
f) Declining Current Ratio.
g) Payment which does not cover the interest and principal amount of that installment.
h) 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:-

a) Overdue receivables.
b) Stock statement not submitted on time.
c) External non-controllable factor like natural calamities in the city where borrower conduct his business.
d) Frequent changes in plan.
e) Nonpayment of wages.
f) Causes For NPA

Table 1. Causes for Non Performing Asset (NPA)

Borrower	Bank	Other
➢ Too ambitious Project ➢ Heavy borrowing ➢ Poor credit collection ➢ Poor quality management ➢ Willful Default ➢ Depend on Single customer ➢ Fail to bring required Fund ➢ Lack of Proper Planning	➢ Poor credit appraisal ➢ Non inspection of unit ➢ Defective lending process ➢ Lack of trained staff ➢ System overloaded ➢ Lack of commitment to recovery ➢ Lack of technical support ➢ Inefficient recovery system	➢ Lack of infrastructure ➢ Lack of Government support ➢ Government policies ➢ Changes related to Banking amendments ➢ Natural Calamities ➢ Recession and variation in economic conditions.

3) Attitudinal Changes:

a) Use for personal comfort, stocks and shares by borrower.
b) Avoidance of contact with bank.
c) Problem between partners.

4) Others:

a) Changes in Government policies.
b) Death of borrower.
c) Competition in the market.

GUIDELINES BY RBI

Guidelines of Government and RBI for Reduction of NPAs

1) Compromise settlement schemes:

The RBI/Government of India have been constantly goading the banks to take steps for arresting the incidence of fresh NPAs and have also been creating legal and regulatory environment to facilitate the recovery of existing NPAs of banks. More significant of them, I would like to recapitulate at this stage.

* The broad framework for compromise or negotiated settlement of NPAs advised by RBI in July 1995 continues to be in place. Banks are free to design and implement their own policies for recovery and write-off incorporating compromise and negotiated settlements with the approval of their Boards, particularly for old and unresolved cases falling under the NPA category. The policy framework suggested by RBI provides for setting up of an independent Settlement Advisory Committees headed by a retired Judge of the High Court to scrutinise and recommend compromise proposals.

* Specific guidelines were issued in May 1999 to public sector banks for one time non discretionary and non discriminatory settlement of NPAs of small sector. The scheme was operative up to September 3, 2000. [Public sector banks recovered Rs. 668 crore through compromise settlement under this scheme].

* Guidelines were modified in July 2000 for recovery of the stock of NPAs of Rs. 5 crore and less as on 31 March 1997. [The above guidelines which were valid up to June 30, 2001 helped the public sector banks to recover Rs. 2600 crore by September 2001].

An OTS Scheme covering advances of Rs. 25000 and below continues to be in operation and guidelines in pursuance to the budget announcement of the Hon'ble

Finance Minister providing for OTS for advances up to Rs. 50,000 in respect of NPAs of small/marginal farmers are being drawn up.

2) Lok Adaltas:

Lok Adalats help banks to settle disputes involving accounts in 'doubtful" and "loss" category, with outstanding balance of Rs. 5 lakh for compromise settlement under Lok Adalats. Debt Recovery Tribunals have now been empowered to organize Lok Adalats to decide on cases of NPAs of Rs. 10 lakhs and above. The public sector banks had recovered Rs. 40.38 crore as on September 30, 2001, through the forum of Lok Adalat. The progress through this channel is expected to pick up in the coming years particularly looking at the recent initiatives taken by some of the public sector banks and DRTs in Mumbai.

3) Debt Recovery Tribunals:

The Recovery of Debts due to Banks and Financial Institutions (amendment) Act, passed in March 2000 has helped in strengthening the functioning of DRTs. Provisions for placement of more than one Recovery Officer, power to attach defendant's property/assets before judgement, penal provisions for disobedience of Tribunal's order or for breach of any terms of the 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 the times to come

4) Circulation of information on defaulters:

The RBI has put in place a system for periodical circulation of details of willful defaults of borrowers of banks and financial institutions. This serves as a caution list while considering requests for new or additional credit limits from defaulting borrowing units and also from the directors/proprietors/partners of these entities. RBI also publishes a list of borrowers (with outstanding aggregating Rs. 1 crore and above) against whom suits have been filed by banks and FIs for recovery of their funds, as on 31st March every year. It is our experience that these measures had not contributed to any perceptible recoveries from the defaulting entities. However, they serve as negative basket of steps shutting off fresh loans to these defaulters. I strongly believe that a real breakthrough can come only if there is a change in the repayment psyche of the Indian borrowers

5) Recovery action against large NPAs:

After a review of pendency in regard to NPAs by the Hon'ble Finance Minister, RBI had advised the public sector banks to examine all cases of willful default of Rs 1 crore and above and file suits in such cases, and file criminal cases in regard to willful defaults. Board of Directors are required to review NPA accounts of Rs. 1 crore and above with special reference to fixing of staff accountability.

6) Corporate Debt Restructuring (CDR):

Corporate Debt Restructuring mechanism has been institutionalised in 2001 to provide a timely and transparent system for restructuring of the corporate debts of Rs. 20 crore and above with the banks and financial institutions. The CDR process would also enable viable corporate entities to restructure their dues outside the existing legal framework and reduce the incidence of fresh NPAs. The CDR structure has been headquartered in IDBI, Mumbai and a Standing Forum and Core Group for administering the mechanism had already been put in place. The experiment however has not taken off at the desired pace though more than six months have lapsed since introduction. As announced by the Hon'ble Finance Minister in the Union Budget 2002-03, RBI has set up a high level Group under the Chairmanship of Shri Vepa Kamesam, Deputy Governor, RBI to review the implementation procedures of CDR mechanism and to make it more effective. The Group will review the operation of the CDR Scheme, identify the operational difficulties, if any, in the smooth implementation of the scheme and suggest measures to make the operation of the scheme more efficient.

7) Credit Information Bureau:

Institutionalisation of information sharing arrangements through the newly formed Credit Information Bureau of India Ltd. (CIBIL) is under way. RBI is considering the recommendations of the S.R.Iyer Group (Chairman of CIBIL) to operationalise the scheme of information dissemination on defaults to the financial system. The main recommendations of the Group include dissemination of information relating to suit-filed accounts regardless of the amount claimed in the suit or amount of credit granted by a credit institution as also such irregular accounts where the borrower has given consent for disclosure. This, I hope, would prevent those who take

advantage of lack of system of information sharing amongst lending institutions to borrow large amounts against same assets and property, which had in no small measures contributed to the incremental NPAs of banks.

8) Proposed guidelines on willful defaults/diversion of funds:

RBI is examining the recommendation of Kohli Group on willful defaulters. It is working out a proper definition covering such classes of defaulters so that credit denials to this group of borrowers can be made effective and criminal prosecution can be made demonstrative against willful defaulters.

9) Corporate Governance:

A Consultative Group under the chairmanship of Dr. A. Ganguly was set up by the Reserve Bank to review the supervisory role of Boards of Banks and financial institutions and to obtain feedback on the functioning of the Boards vis-a-vis compliance, transparency, disclosure, audit committees etc. and make recommendations for making the role of Board of Directors more effective with a view to minimising risks and overexposure. The group is finalising its recommendations shortly and may come out with guidelines for effective control and supervision by bank boards over credit management and NPA prevention measures.

10) Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SRFAESI Act), 2002:

The Act provides, inter alia for enforcement of security interest for realisation of dues without the intervention of courts or tribunals. The Security Interest (Enforcement) Rules, 2002 has also been notified by Government to enable Secured Creditors to authorise their officials to enforce the securities and recover the dues from the borrowers. **SRFAESI Act (SRFAESI)** provides the formal legal basis and regulatory framework for setting up Asset Reconstruction Companies (ARCs) in India. In addition to asset reconstruction and ARCs, the Act deals with the following largely aspects:-

a. Securitization and Securitization Companies
b. Enforcement of Security Interest
c. Creation of a central registry in which all securitization and asset reconstruction transactions as well as any creation of security interests has to be filed.

The Reserve Bank of India (RBI), the designated regulatory authority for ARCS has issued Directions, Guidance Notes, Application Form and Guidelines to Banks in April 2003 for regulating functioning of the proposed ARCS and these Directions/ Guidance Notes cover various aspects relating to registration, operations and funding of ARCS and resolution of NPAs by ARCS. The RBI has also issued guidelines to banks and financial institutions on issues relating to transfer of assets to ARCS, consideration for the same and valuation of instruments issued by the ARCS. Additionally, the Central Government has issued the security enforcement rules ("Enforcement Rules"), which lays down the procedure to be followed by a secured creditor while enforcing its security interest pursuant to the Act. The Act permits the secured creditors (if 75% of the secured creditors agree) to enforce their security interest in relation to the underlying security without reference to the Court after giving a 60 day notice to the defaulting borrower upon classification of the corresponding financial assistance as a non-performing asset. The Act permits the secured creditors to take any of the following measures:-

a) Take over possession of the secured assets of the borrower including right to

transfer by way of lease, assignment or sale;

b) Take over the management of the secured assets including the right to transfer by way of lease, assignment or sale;
c) Appoint any person as a manager of the secured asset (such person could be the ARC if they do not accept any pecuniary liability);
d) Recover receivables of the borrower in respect of any secured asset which has been transferred. After taking over possession of the secured assets, the secured creditors are required to obtain valuation of the assets. These secured assets may be sold by using any of the following routes to obtain maximum value :-
   i. By obtaining quotations from persons dealing in such assets or otherwise interested in buying the assets;
   ii. By inviting tenders from the public;
   iii. By holding public auctions; or
   iv. By private treaty.

Under the SRFAESI Act ARCS can be set up under the Companies Act, 1956. The Act designates any person holding not less than 10% of the paid-up equity capital of the ARC as a sponsor and prohibits any sponsor from holding a controlling interest in, being the holding company of or being in control of the ARC. The SRFAESI and SRFAESI Rules/ Guidelines require ARCS to have a minimum net-owned fund of not less than Rs. 20,000,000. Further, the Directions require that an ARC should maintain, on an ongoing basis, a minimum capital adequacy ratio of 15% of its risk weighted assets. ARCS have been granted a maximum realization time frame of five years from the date of acquisition of the assets. The Act stipulates several measures that can be undertaken by ARCs for asset reconstruction. These include:

a) Enforcement of security interest;

b) Taking over or changing the management of the business of the borrower;

c) The sale or lease of the business of the borrower;

d) Settlement of the borrowers' dues; and

e) Restructuring or rescheduling of debt.

ARCS are also permitted to act as a manager of collateral assets taken over by t he lenders under security enforcement rights available to them or as a recovery agent for any bank or financial institution and to receive a fee for the discharge of these functions. They can also be appointed to act as a receiver, if appointed by any Court or DRT.

11) **Focus on Cash Flows*:-***

While financing, at the time of restructuring the banks may not be guided by the conventional fund flow analysis only, which could yield a potentially misleading picture. Appraisal for fresh credit requirements may be done by analyzing funds flow in conjunction with the Cash Flow rather than only on the basis of Funds Flow.

12) **Management Effectiveness*:-***

The general perception among borrower is that it is lack of finance that leads to sickness and NPAs. But this may not be the case all the time. Management effectiveness in tackling adverse business conditions is a very important aspect that affects a borrowing unit's fortunes. A bank may commit additional finance to an aling unit only after basic viability of the enterprise also in the context of quality of management is examined and confirmed. Where the default is due to deeper malady, viability study or investigative audit should be done – it will be useful to have consultant appointed as early as possible to examine this aspect. A proper techno- economic viability study must thus become the basis on which any future action can be considered.

13) **Multiple Financing*:-***

During the exercise for assessment of viability and restructuring, a **Pragmatic and unified approach** by all the lending banks/ FIs as also sharing of all relevant

information on the borrower would go a long way toward overall success of rehabilitation exercise, given the probability of success/failure.

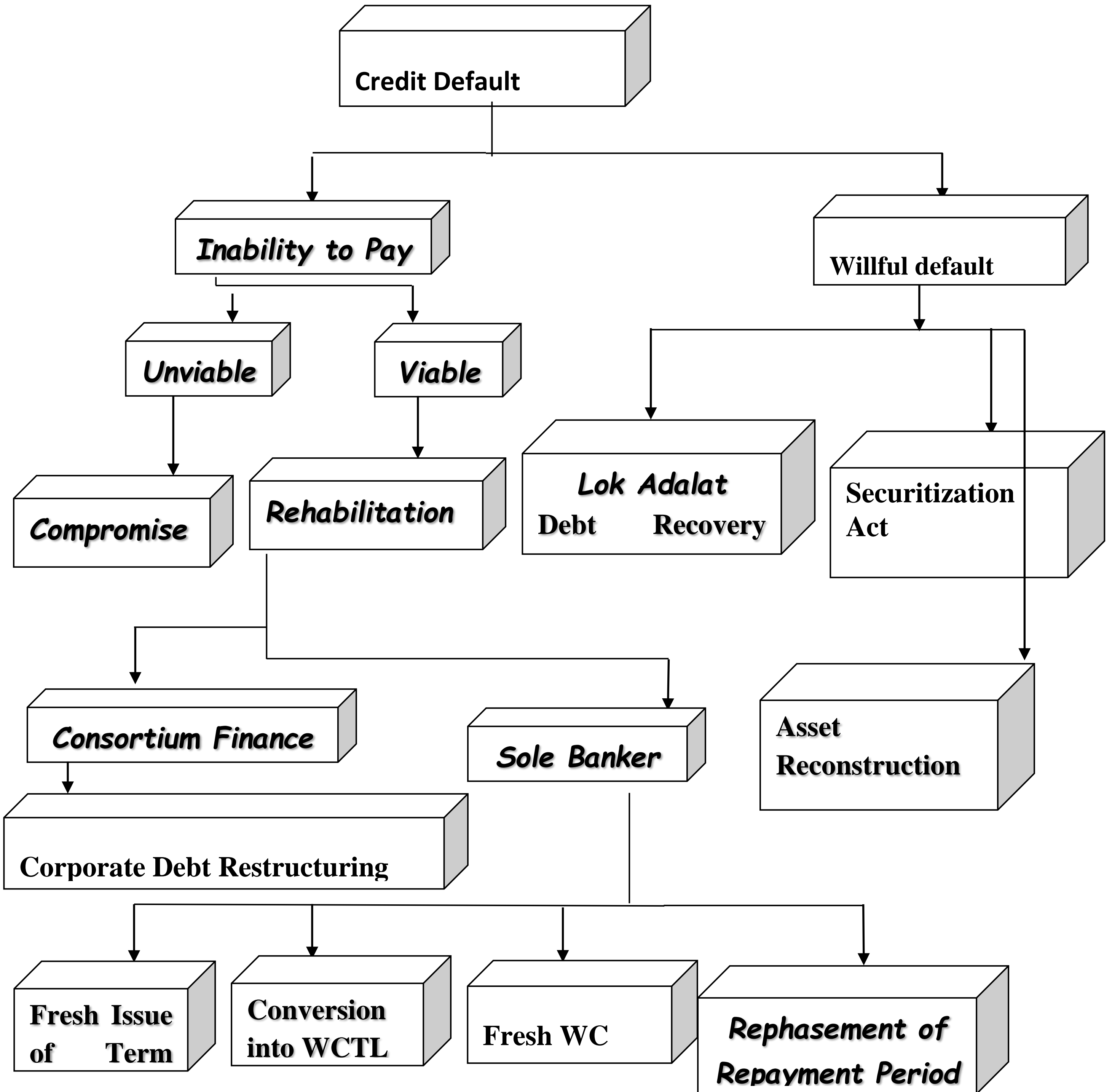
In a forum of lenders, the priority of each lender will be different. While one set of lenders may be willing to wait for a longer time to recover its dues, another lender may have a much shorter timeframe in mind. So it is possible that the letter categories of lenders may be willing to exit, even a t a cost – by a discounted settlement of the exposure. Therefore, any plan for restructuring/rehabilitation may take this aspect into account.

14) Inability to Pay

Consortium arrangements

Asset classification of accounts under consortium should be based on the record of recovery of the individual member **banks** and other aspects having a bearing on the recoverability of the advances**.** Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account will be treated as not serviced in the books of the other member banks and therefore, be treated as NPA. The banks participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead bank or get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

Tools for recovery of NPAs



DATA ANALYSIS AND INTERPRETATION

Non Performing Assets (NPAs) in Public & Private Sector Banks

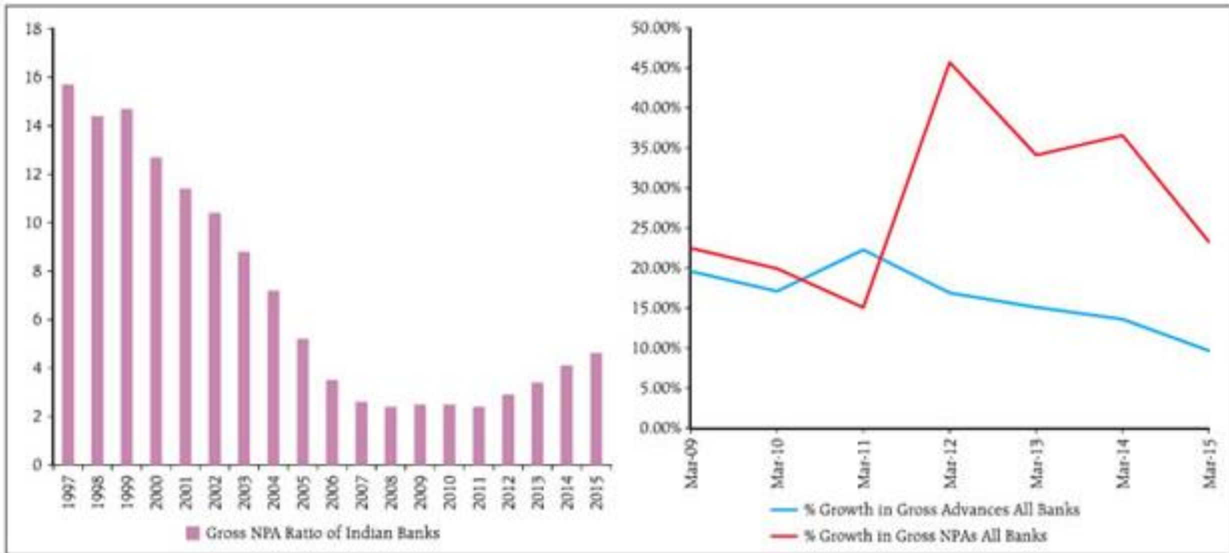
Public Sector Banks (PSBs) in India have performed rather poorly over the past 3-4 years. For the most part this has been on account of Non Performing Asset (NPA) related worries which have so far been brushed under the carpet. The current level of NPAs as disclosed by most public sector banks are far from reality and made possible because of the flexibility enjoyed by PSBs in terms of disclosure requirements.

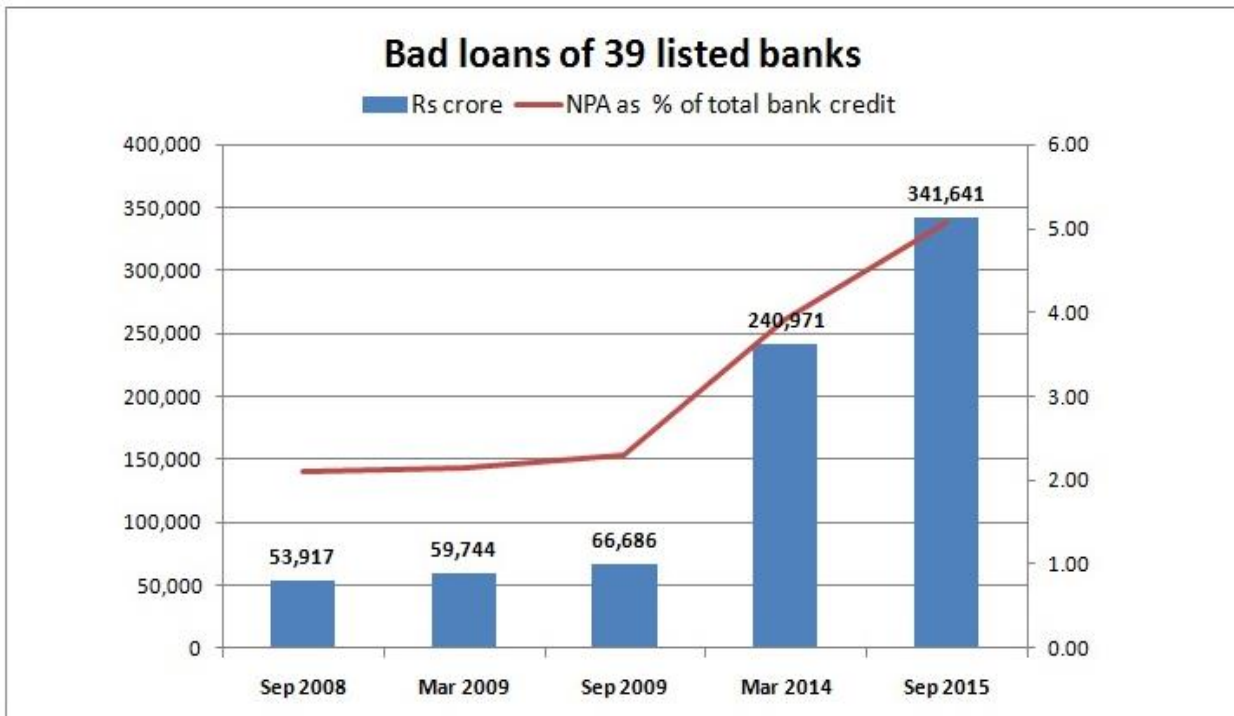
Poor credit appraisal, over leveraging and the practice of giving fresh loans to pay off the old ones and leaving the mess for the successor are some of the practices that are prevalent in the Public banking system. **Over the last decade, the share of Public sector banks in banking loans has risen only marginally. However, their share in gross NPAs has gone up at an alarming rate**. In contrast, the Private sector banks have more than doubled their share in loans while their contribution to gross NPAs has grown at a lesser rate.

Public Sector Bank	NPAs (Q3 FY2015)	Private Sector Bank	NPAs (Q3 FY2015)
Corporation Bank	3.27%	Yes Bank	0.10%
Dena Bank	3.33%	HDFC Bank	0.26%
Central Bank of India	3.[illegible]%	Ra[illegible]akar Bank	0.31%
Oriental Bank of Commerce	3.6[illegible]%	In[illegible] Ind B[illegible]	0.32%
Andhra Bank	3.7[illegible]%	Axis [illegible]nk	0.44%
Punjab National Bank	3.82%	Karur Vysya Bank	0.73%
Allahabad Bank	3.89%	Kotak Mahindra	0.83%
UCO Bank	4.25%	South Indian Bank	1.04%
Indian Overseas Bank	5.52%	ICICI Bank	1.12%
United Bank of India	8.50%	City Union Bank	1.31%

NPAs

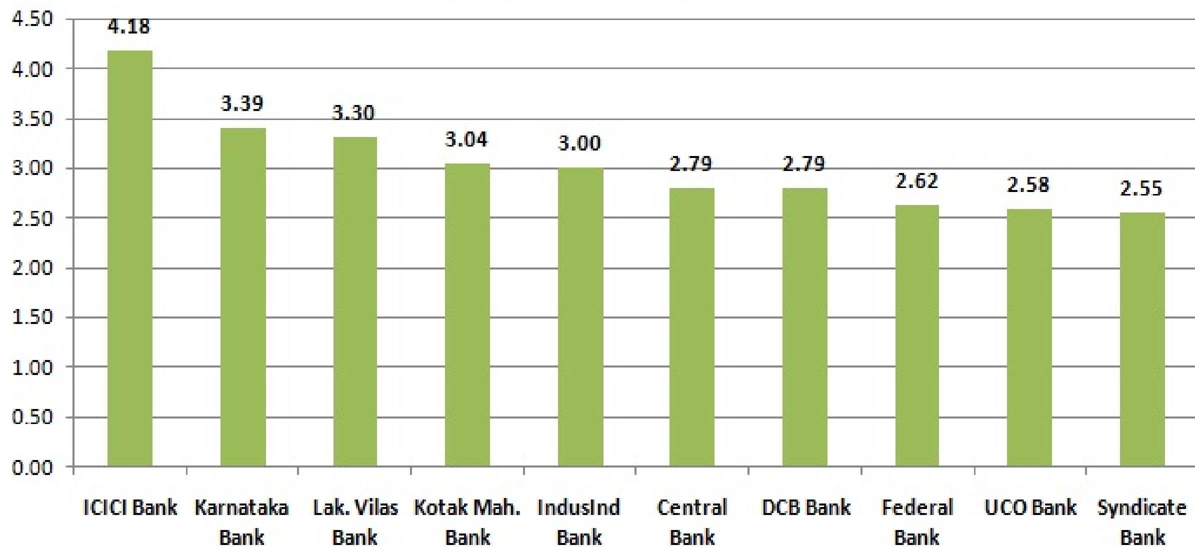
From Rs 53,917 crore, Indian banks gross non-performing assets (GNPAs) in September 2008 (just before the 2008 global financial crisis broke out following the collapse of Lehman Brothers), the bad loans have now grown to Rs 3,41,641 crore in September 2015. In other words, the total GNPAs of banks, as a percentage of the total loans, has grown from 2.11 per cent to 5.08 percent.

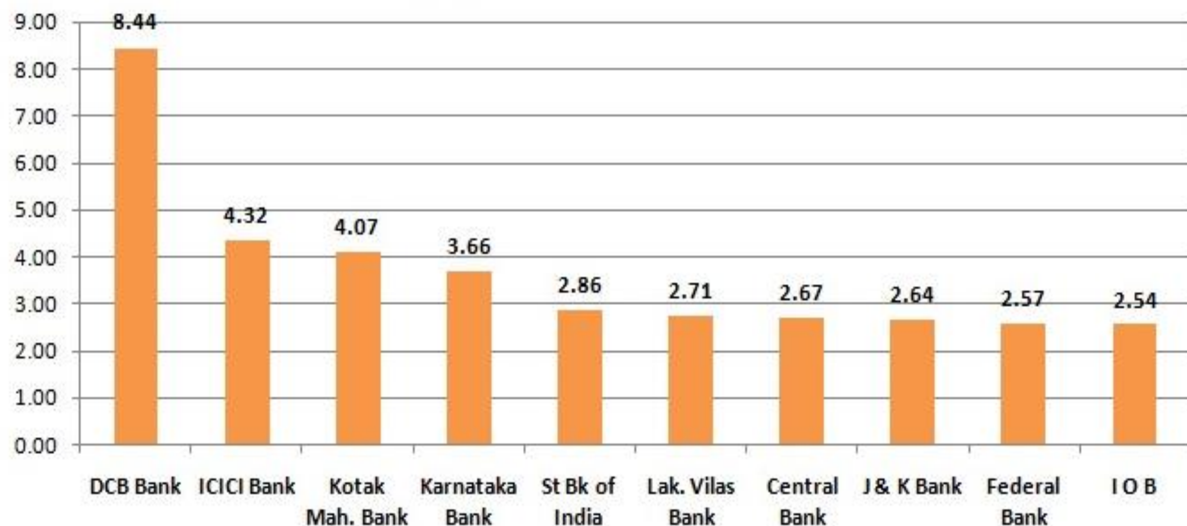




In the pre-crisis period, private banks topped the list of banks with highest NPAs (see the chart). A quick look at the top ten NPA scorers in September 2008 shows ICICI Bank at the top.

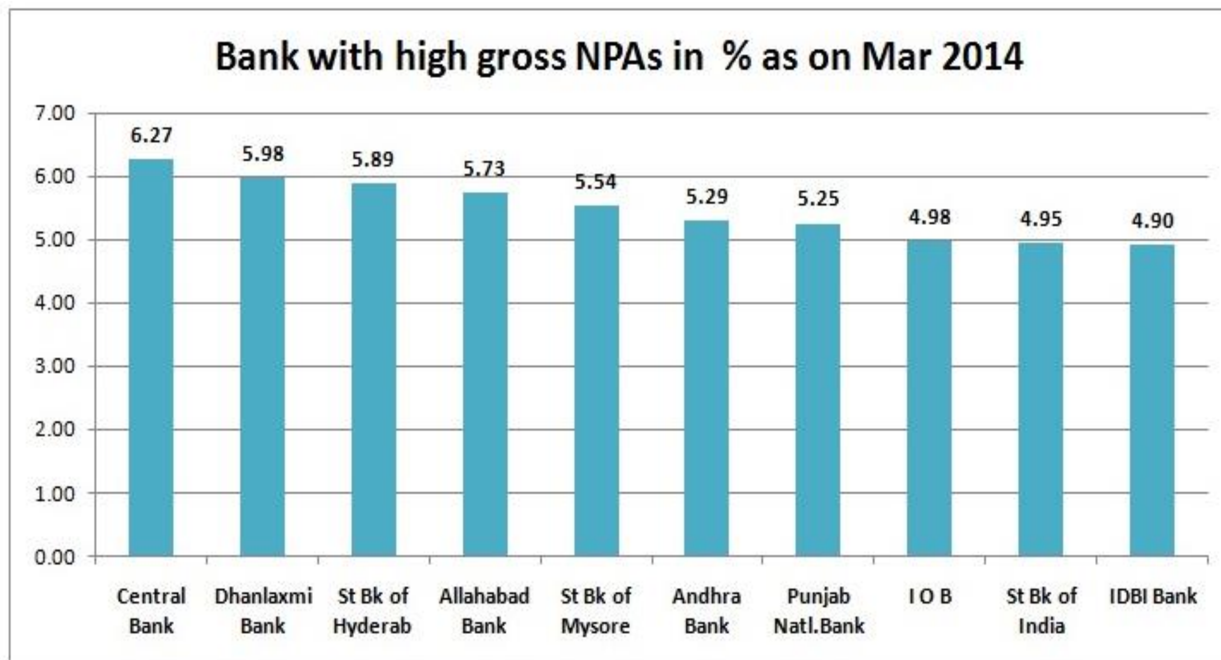
This was followed by small and medium-sized private sector banks such as Karnataka Bank, Lakshmi Vilas Bank, Kotak Mahindra and IndusInd Bank. Among the few sarkari banks that figure in the list are Central Bank, Uco Bank and Syndicate Bank.



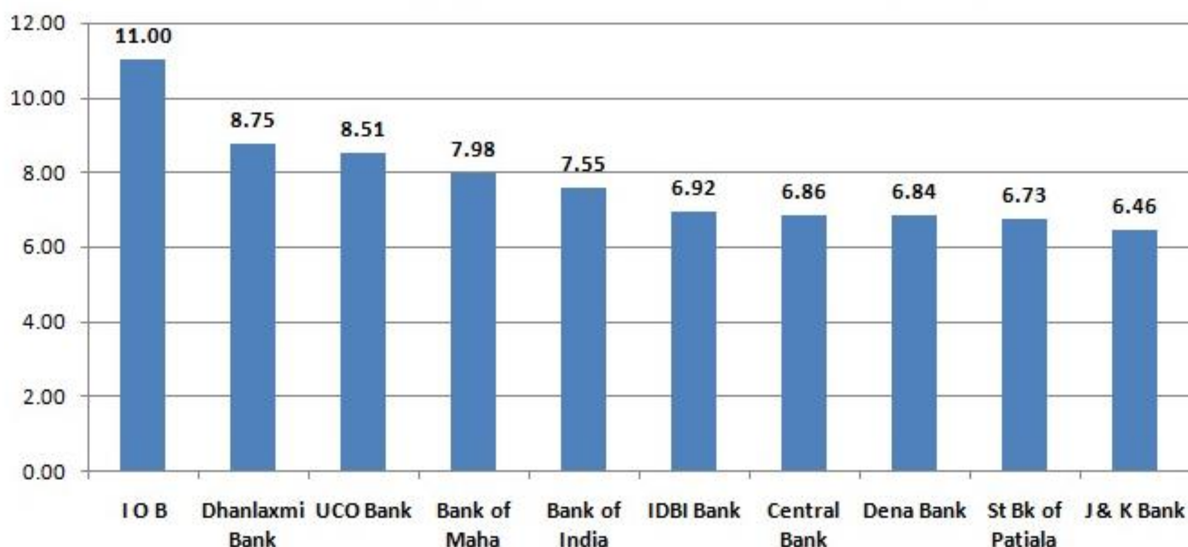


By March 2009, a few months before the Congress-led UPA II assumed power, the scene began changing gradually. More state-run banks began appearing in the picture. The country's largest lender by assets, State Bank of India (SBI) and Indian Overseas Bank found place in the list of top NPA scorers. Still private sector lenders

figured prominently in the list with ICICI and DCB Bank leading the pack. To be sure, there is no direct link between the ascension of UPA-II and the increase in the NPA picture, but this is when the state-run banks began feeling the heat of NPAs.



Things had worsened to a great extent by March 2014, incidentally, months before the **Narendra Modi** government assumed power at the Centre with a landslide victory over the Congress-led UPA government. The bad loan troubles of government banks began to hit hard despite the best efforts by banks to cover up possible NPA stock to restructured loan category. The list now is dominated mostly by public sector banks, with eight out of ten banks being government owned.



Non Performing Asset (NPA) | Public Sector Banks | Private Sector Banks

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Andhra Bank	3.70%	Axis Bank	0.44%
Punjab National Bank	3.82%	Karur Vysya Bank	0.73%
Allahabad Bank	3.89%	Kotak Mahindra	0.83%
UCO Bank	4.25%	South Indian Bank	1.04%
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RBIs Proposed Relaxation – An Even Bigger Worry

In order to help PSBs struggling with high NPAs, RBI proposed relaxed norms on April 6th 2015. Accordingly, banks are now spared from classifying certain assets as NPAs for two more years. This will reduce the amount of loans which need to be classified as bad loans.

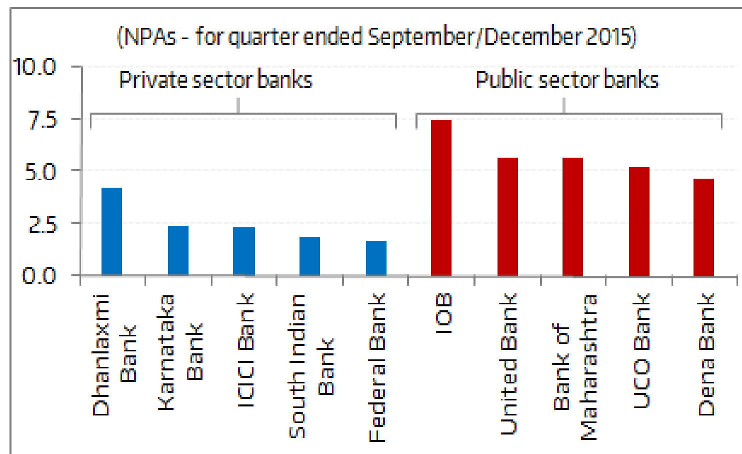
In other words, banks can now go easy on provisioning against these bad loans. Less provisioning helps banks in not only reporting higher net profit but more importantly the banks effectively have more capital to deploy. This is because once an asset has been classified as NPA, it reduces the advance-able deposit available with the bank.

IF BANKS DO NOT CLASSIFY AN ASSET AS NPA, THEY NATURALLY HAVE MORE MONEY TO ADVANCE TO EARN INTEREST INCOME ON. IF A LARGE PORTION OF NPAs GOES UNREPORTED, THE BANK COULD REACH A SITUATION WHERE IT HAS ADVANCED MORE MONEY THAN IT HAS AVAILABLE – A TECHNICAL BANKRUPTCY.

By giving this leverage ultimately RBI is delaying the inevitable, at some point of time the NPA bubble will burst.

Private vs Public Comparison of NPA Positions

On This Day - 8 February 2016



www.equitymaster.com

Source: Business Standard, Capitaline

Interpretation: From the above it is observed that net NPA of public sector banks has a declining trend up to year 2006-07 and after that it has a rising trend in 2010-15. The same trend has been observed in both Private and Foreign Sector Banks. The declining trend from 2004 to 2007 of NPA was due to the implementation of Securitization Act (2002).

Total Gross NPA to Total Gross Advances (Rupees in Billions) As on 31st March

Bank Name	Year	Gross NPAs	Total Gross Advances	Percent Share
Public Sector Banks	2009	440.32	20,986.33	2.1
	2010	572.93	25,124.39	2.28
	2011	710.8	30,599.53	2.32
	2012	1,124.89	35,503.89	3.17
	2013	1,558.90	40,558.74	3.84
Private Sector Banks	2009	168.9	5,200.77	3.25
	2010	173.87	5,851.10	2.97
	2011	179.75	7,329.53	2.45
	2012	183.21	8,812.16	2.08
	2013	199.92	10,466.65	1.91

Interpretation:

The Ratio of Gross NPA to Gross Advances for Public sector banks is increasing and decreasing ratio of Private sector Banks, it can be seen the ratio in Private sector banks for 2012 and 2013 as compared to other banks is less, showing the efforts taken by Private Banks.

Data Analysis of SBI

Year	Gross NPA		Net NPA	
	Rs.	Percentage to Gross Advances	Rs.	Percentage to Net Advacnes
2002-03	13506.07	9.34	6183.00	4.49
2003-04	12667.21	7.75	5441.73	3.45
2004-05	12455.73	5.96	5348.89	2.64
2005-06	9628.14	3.60	4911.41	1.88
2006-07	9998.22	2.92	5257.72	1.56
2007-08	12837.36	3.04	7424.33	1.78
2008-09	15588.66	2.84	9552.02	1.76
2009-10	19534.89	3.09	10870.7	1.72
2010-11	25326.29	3.34	12346.0	1.63
2011-12	39676.46	4.57	15818.5	1.82
2012-13	51189.39	4.75	21956.8	2.10
2013-14	61605.35	4.95	31096.7	2.57
2014-15	56725.34	4.25	27590.8	2.12

NPAS IN RELATION TO ADVANCES

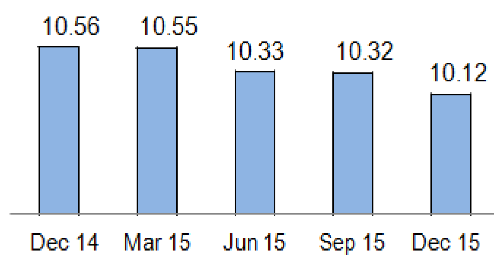
Gross NPAs and Net NPAs

Source: Compiled from SBI Annual Reports

A close scrutiny of the Table uncovers the fact that SBI has been spectacularly managing the gross NPAs segments. An international standard of gross NPAs shows that it would be 2 to 3 per cent. The gross NPAs which stood at 9.34 per cent in the year 2002-03 gradually slipped down to 2.84 per cent in the year 2008-09 and afterwards it was increased as 4.95 per cent in 2013-14.

Net Profit –a SnapshotKey Performance Indicators: Performance Ratios

Rs in Crores	Q3FY16	Q3FY15	YOY %	9MFY16	9MFY15	YOY %
Operating Profit	**9598**	**9387**	**2.25**	**29066**	**26778**	**8.55**
Total Provisions	**8483**	**6477**	**30.96**	**20379**	**17418**	**17.00**
Loan Loss	7645	4810	58.93	14845	12922	14.88
Standard Assets	175	370	-52.81	1162	606	91.76
Investment Depreciation	26	47	-43.65	155	-506	
Other Provisions	104	101	2.97	147	258	-42.97
Income Tax	533	1150	-53.61	4069	4138	-1.66
Net Profit	**1115**	**2910**	**-61.67**	**8687**	**9360**	**-7.19**

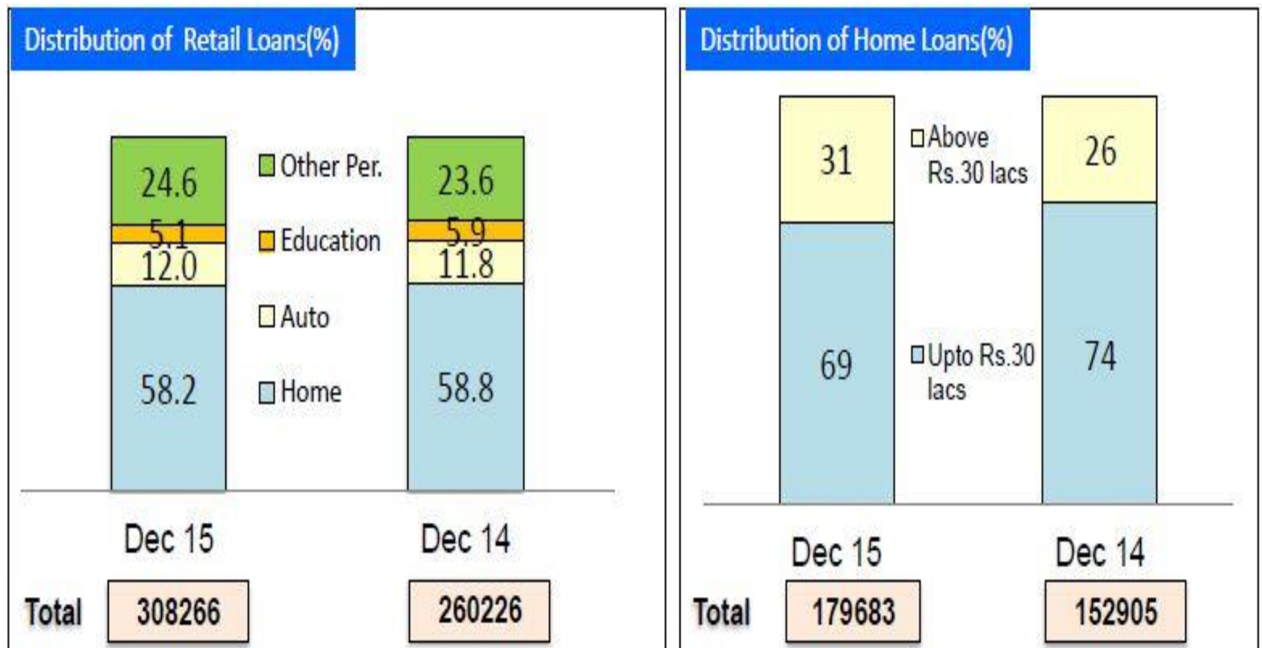


Source: Compiled from SBI Annual Reports

Interpretaion:

1) EPS,ROA,ROE have declined marginally in Dec 15 against previous quarters
2) Book Value have increased from Dec 14 to Dec 15
3) Yeild on Advances is gradually decreasing in every quarter.

Retail Advance



	March 14	Dec 14	March 15	Dec 15
Credit Cost	0.51	0.65	0.41	0.41

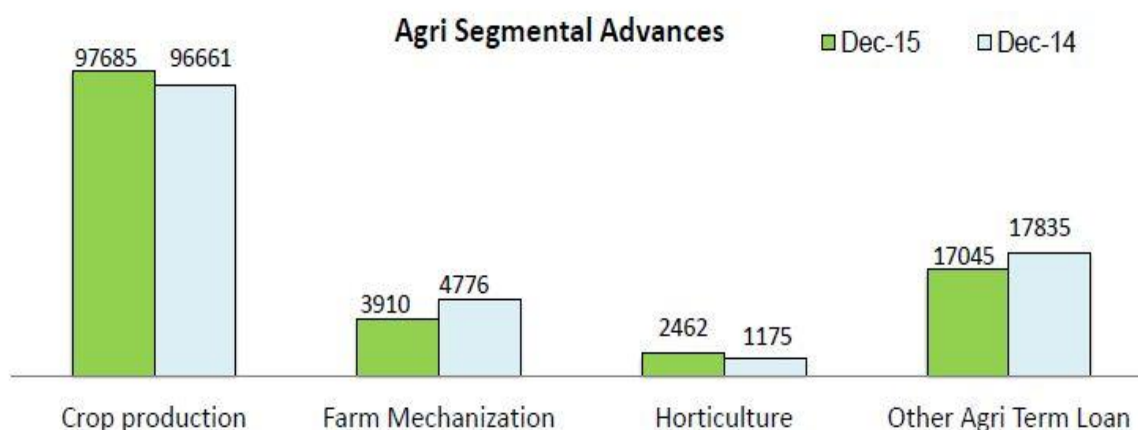
Level	Home	Auto	Education	Other Per.	Total
Dec 14	152905	30701	15295	61325	260226
Mar 15	159237	32149	15464	65579	272429
Dec 15	179683	37119	15732	75731	308266
YOY Growth Abs.	26778	6418	437	14406	48040
YOY Growth %	17.51	20.91	2.86	23.49	18.46

Source: Compiled from SBI Annual Reports

Interpretation:
Retail Advances have marginally increased with YOY Growth of 18.46% with least in Education of only 2.86%.

Agri Advance:

Rs. in Crores

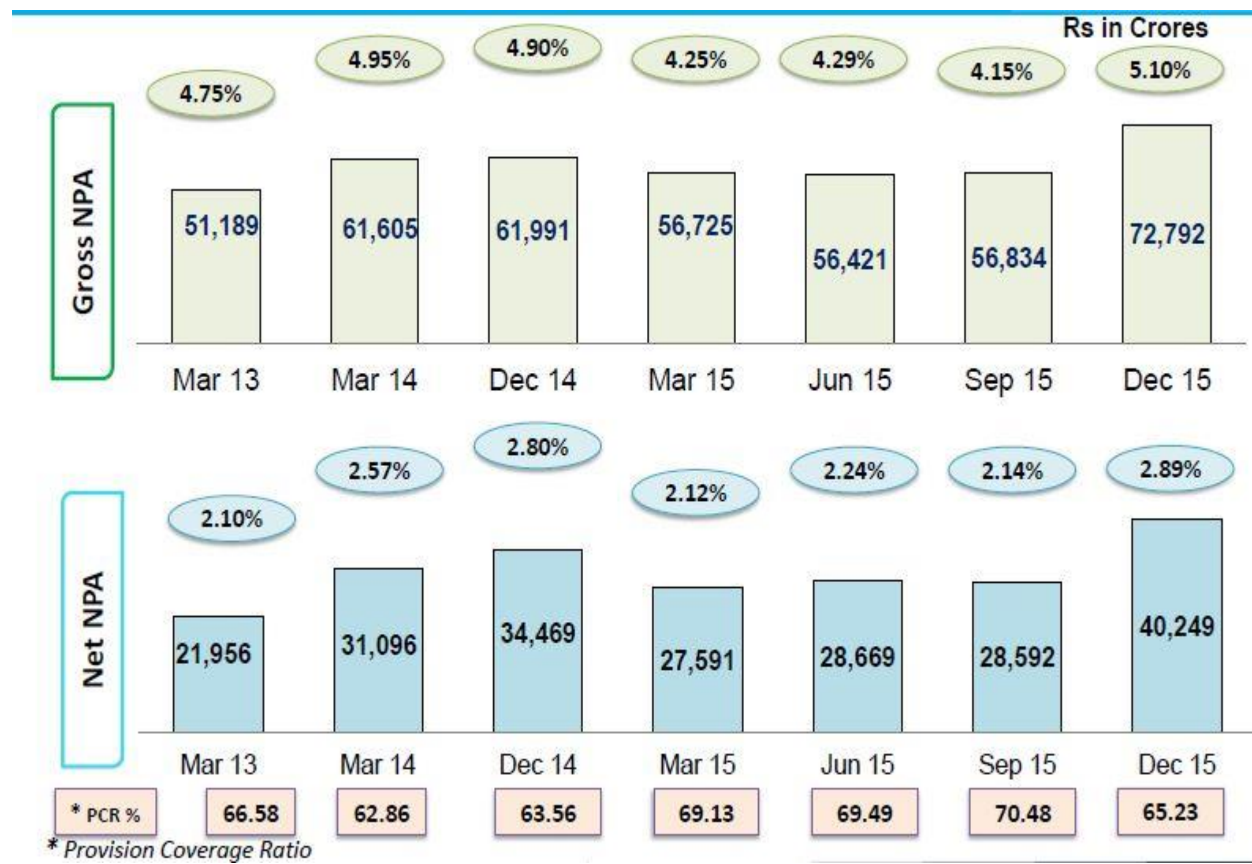


Level	Crop / Production	Investment/ Allied Credit	Risk Mitigated Products (Out of A & B)				
			Collateralized by Gold	Other Products (New)	Total	Share %	Agri
	(A)	(B)	Amt.	Amt	Amt		Total
Dec-14	96661	23786	42101	87	42188	35.02	120447
Mar-15	95651	24131	40546	227	40773	34.03	119782
Dec-15	**97685**	**23417**	**38208**	**552**	**38760**	**32.00**	**121102**
YOY Abs.	1024	-369	-3893				655
YOY %	1.06	-1.55					0.54

Source: Compiled from SBI Annual Reports

Interpretation:
There is no significant growth seen in Agri advances in FY16 in comparison FY15.

NPAs Advance



Source: Compiled from SBI Annual Reports

Interpretation:

Gross NPA and Net NPA has seen sharp rise in quarter Dec 15 from the previous quarter Sep 15.

Gross NPA exceeding the mark of 5% significantly.

This sharp rise is also due to sharp change in PCR% from around 70% to 65%.

Gross NPAs

Rs in Crores

Break-up of Gross NPAs

Sector	Dec 15		Dec 14	
	NPA	Ratio %	NPA	Ratio%
Large Corporate	8121	2.64	1074	0.49
Mid Corporate	30710	14.33	26,430	11.85
SME	17785	8.41	16,427	8.05
Agri	10329	8.50	12,100	10.04
Retail	3154	1.02	3,082	1.19
International	2693	1.01	2,878	1.28
Total	**72792**	**5.10**	**61,991**	**4.90**

Sector-wise Gross NPAs to Total Gross NPAs %

Source: Compiled from SBI Annual Reports

Inerpretation:
The rise in NPA is basically because of increase in NPA in Large Corporates from 1074cr in Dec14 to 8121cr.

Recommendations

- **Credit administration**: banks have to strengthen their credit administrative machinery and put in place effective credit risk management systems to reduce the fresh incidence of NPAs.
- Capacity of DRTs should be enhanced.

- **Perception:** The mindset of the borrowers needs to change so that a culture of proper utilization of credit facilities and timely repayment is developed.

- Large exposure on big corporate or single project should be avoided

- Operating staff should scrutinize the level of inventories/receivables regularly and insist that cash recoveries should more than offset the fresh write-offs in NPAs

- All banks should keep stringent check on advance being made to real estate & housing segment as these segment contributed highly towards the NPA in 2009 & 2015.

- Uneven scale of repayment schedule with higher repayment in the initial years normally should be preferred.

- Private sector should focus more on recovery of sub-standard & doubtful assets.

- Public sector banks should increase their non-interest income, as rise in NPA due to default in interest income may affect the profits drastically.

- Operating staff should scrutinize the level of inventories/receivables regularly and insist that cash recoveries should more than offset the fresh write-offs in NPAs

CONCLUSION

A strong banking sector is important for a flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. NPA is one of the biggest problems that the Indian Banks are facing today. The emphasis so far has been only on identification and quantification of NPAs rather than on ways to reduce and upgrade them. If the proper management of the NPAs is not undertaken it would hamper the business of the banks. If the concept of NPAs is taken very lightly it would be dangerous for the Indian banking sector. 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.

There is also a general perception that the prescriptions of 40% of net bank credit to priority sectors and large corporate,have led to higher NPAs, due to credit to these sectors becoming stickly managers of rural and semi-urban branches generally sanction these loans. In the changed context of new prudential norms and emphasis on quality lending and profitability, mangers should make it amply clear to potential borrowers that banks resources are scare and these are meant to finance viable ventures so that these are repaid on time and relevant to other needy borrowers for improving the economic lot of maximum number of households.

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 hampers economic growth.

Hence selection of right borrowers, viable economic activity, adequate finance and timely disbursement, correct and use of funds and timely recovery of loans is absolutely necessary pre conditions for preventing of minimizing the incidence of new NPAs.

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