Changes suggested as per first draft submission:

1. Elaborate report by including comparison of NBFCs with Public Sector Banks with regard to NPAs.
2. Review research papers published in general journals to understand styling of literature review chapter.
3. Write proper conclusion in executive summary.

Changes suggested as per second draft submission:

1. Add sources
2. Do one-to-one mapping of literature review in references.

Action taken:

1. Comparison of 3 NBFCs with 3 PSBs has been included in Chapter- Analysis and Findings.
2. As suggested, literature review chapter has been rewritten.
3. Executive summary has been rewritten to convey gist of research.
4. Sources have been mentioned for each para and table included.
5. Mapping has also been done.

MAJOR RESEARCH REPORT

on

A Study of Non-Performing Assets of NBFCs and a comparison with Public Sector Banks

Submitted By

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2K22/DMBA/88

Under the guidance of

Prof. P.K. Suri

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Declaration by the student

I, Nishita Bansal, student of Delhi School of Management hereby declare that the Major Research Report on "A Study of Non-Performing Assets of NBFCs and a comparison with Public sector Banks", submitted in partial fulfilment of requirements for the award of degree of Masters of Business Administration (MBA) is the original work done by me. I also confirm that neither I nor any other person has submitted this project report to any other institution or university for any other degree or diploma.

Nishita Bansal
Place: New Delhi
Date: 23rd March, 2024

CERTIFICATE

This is to certify that the report titled **“A Study of Non-Performing Assets of NBFCs and a comparison with Public sector Banks”** has been submitted by **Nishita Bansal**, Roll No. **2K22/DMBA/88** of MBA batch 2022-24 to Delhi School of Management, Delhi Technological University, Bawana Road, Delhi-42 in partial fulfillment of the requirement for the award of the Degree of Masters of Business Administration.

Signature of Guide

Place: New Delhi
Date:

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I have put in all my efforts to ensure that the project is completed in the best possible manner and also ensured that the project is error free.

Nishita Bansal
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EXECUTIVE SUMMARY

A study is conducted to analyse major causes of occurrence of NPAs in NBFCs and find out ways adopted to effectively manage rising levels of NPAs. Exploratory research is being carried out wherein data is collected from secondary sources such as Annual Reports, statutory fillings and RBI publications. The main objective of this study is to understand why NPAs are drawing so much attention in corporate sector. For the study, three major NBFCs are taken into consideration- Indian Renewable Energy and Development Agency Limited (IREDA), REC Limited and Power Finance Corporation (PFC). All these three NBFCs are Central Public Sector Undertakings, fall into same category of NBFCs i.e. NBFC-ND-SI, non-deposit taking and systematically important as per RBI Master Circular. For data analysis, financial statements of last 5 financial years have been reviewed to find out NPA level in each CPSE. Annual report and corporate governance practices of these companies have been reviewed to identify measures adopted to reduce rising NPAs. Articles and research papers have also been reviewed to find out underlying causes and ways that can help these NBFCs to manage their advances.

It is found that probable causes of NPAs in NBFCs include borrower creditworthiness, economic downturns, and sector-specific risks. To manage NPAs effectively, NBFCs should focus on strengthening collection processes, conducting regular asset quality reviews, and implementing prudent underwriting practices. Diversification of loan portfolios and restructuring options for struggling borrowers can also mitigate NPA risks. Overall, proactive measures are essential to navigate the challenges posed by NPAs and sustain financial health.

Banks typically implement stringent follow-up procedures for non-performing assets, including regular monitoring, restructuring, and recovery through legal channels. NBFCs often focus on personalized approaches, such as flexible repayment options and closer client relationships, but may have fewer resources for legal recourse, relying more on negotiation and proactive risk management.

All three banks have made efforts to reduce their Net NPA balances over the chosen period. NPA ratios of banks are higher, indicating relatively higher credit risk compared to CPSE NBFCs like IREDA, REC, and PFC, which maintain consistently lower NPA ratios. This suggests potentially stronger risk management practices within CPSE NBFCs.

CONTENTS

Chapter 1

INTRODUCTION

1.1 Non-Performing Assets

As per the RBI Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances dated April 1, 2022, a Non-Performing Asset is defined as:

i. An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

ii. A non-performing asset (NPA) is a loan or an advance where;

- interest and/ or instalment of principal remains overdue for a period of more than 90 days in respect of a term loan,
- the account remains 'out of order' as indicated below, in respect of an Overdraft/Cash Credit (OD/CC),
- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops,
- the instalment of principal or interest thereon remains overdue for one crop season for long duration crops,
- the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of the Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021.
- in respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

Out of Order' status:

An account shall be treated as 'out of order' if:

The outstanding balance in the account remains continuously in excess of the sanctioned limit/drawing power for 90 days, or

The outstanding balance in the account is less than the sanctioned limit/drawing power but there are no credits continuously for 90 days, or the outstanding balance in the account is less than the sanctioned limit/drawing power but credits are not enough to cover the interest debited during the previous 90 days period.

1.2 Categories of NPAs

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

i. Substandard Assets
ii. Doubtful Assets
iii. Loss Assets

1.1.1 Substandard Assets:

With effect from March 31, 2005, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

1.2.2 Doubtful Assets:

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.

1.2.3 Loss Assets:

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection, but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

1.3 Types of NPA

1.3.1 Gross NPAs:

These 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 nonstandard assets like as sub-standard, doubtful, and loss assets. It can be calculated with the help of following ratio:

Gross NPAs Ratio =Gross NPAs/Gross Advances

1.3.2 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:

Net NPAs = Gross NPAs – Provisions for unpaid debt

1.3 NBFCs OVERVIEW

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Financial activity as principal business is when a company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI. The term 'principal business' is not defined by the Reserve Bank of India Act. The Reserve Bank has defined it so as to ensure that only companies predominantly engaged in financial activity get registered with it and are regulated and supervised by it. Hence if there are companies engaged in agricultural operations, industrial activity, purchase and sale of goods, providing services or purchase, sale or construction of immovable property as their principal business and are doing some financial business in a small way, they will not be regulated by the Reserve Bank. Interestingly, this test is popularly known as 50-50 test and is applied to determine whether or not a company is into financial business.

1.3.1 Categories of NBFCs:

NBFCs are categorized a) in terms of the type of liabilities into Deposit and Non-Deposit accepting NBFCs, b) non deposit taking NBFCs by their size into systemically important and

other non-deposit holding companies (NBFC-NDSI and NBFC-ND) and c) by the kind of activity they conduct.
Within this broad categorization, the different types of NBFCs are as follows:

I. Asset Finance Company (AFC): An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively.

II. Investment Company (IC) : IC means any company which is a financial institution carrying on as its principal business the acquisition of securities,

III. Loan Company (LC): LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

IV. Infrastructure Finance Company (IFC): IFC is a non-banking finance company a) which deploys at least 75 per cent of its total assets in infrastructure loans, b) has a minimum Net Owned Funds of ₹ 300 crore, c) has a minimum credit rating of ‘A ‘or equivalent d) and a CRAR of 15%.

V. Systemically Important Core Investment Company (CIC-ND-SI): CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:-

(a) it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;

(b) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;

(c) it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

(d) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.

(e) Its asset size is ₹ 100 crore or above and

(f) It accepts public funds

VI. Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC) : IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

VII. Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI): NBFC-MFI is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets which satisfy the following criteria:

a. loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding ₹ 1,00,000 or urban and semi-urban household income not exceeding ₹ 1,60,000;

b. loan amount does not exceed ₹ 50,000 in the first cycle and ₹ 1,00,000 in subsequent cycles;

c. total indebtedness of the borrower does not exceed ₹ 1,00,000;

d. tenure of the loan not to be less than 24 months for loan amount in excess of ₹ 15,000 with prepayment without penalty;

e. loan to be extended without collateral;

f. aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs;

g. loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower

VIII. Non-Banking Financial Company – Factors (NBFC-Factors): NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

IX. Mortgage Guarantee Companies (MGC) - MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is ₹ 100 crore.

X. NBFC- Non-Operative Financial Holding Company (NOFHC) is financial institution through which promoter / promoter groups will be permitted to set up a new bank .It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

Systemically Important NBFCs- NBFCs whose asset size is of ₹ 500 cr or more as per last audited balance sheet are considered as systemically important NBFCs. The rationale for such classification is that the activities of such NBFCs will have a bearing on the financial stability of the overall economy.

1.3.2 Difference between a bank and NBFC

NBFCs lend and make investments and hence their activities are akin to that of banks; however, there are a few differences as given below:

i. NBFC cannot accept demand deposits;

ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;

iii. deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

1.3.3 Registration requirement of NBFCs

In terms of Section 45-IA of the RBI Act, 1934, no Non-banking Financial company can commence or carry on business of a non-banking financial institution without obtaining a certificate of registration from the Bank and without having a Net Owned Funds of ₹ 25 lakhs (₹ Two crore since April 1999). However, in terms of the powers given to the Bank, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI, Insurance Company holding a valid Certificate of Registration issued by IRDA, Nidhi companies as notified under Section 620A of the Companies Act, 1956, Chit companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982, Housing Finance Companies regulated by National Housing Bank, Stock Exchange or a Mutual Benefit company.

1.4 ABOUT THE CHOSEN NBFCs

1.4.1 IREDA:

Indian Renewable Energy Development Agency Limited (IREDA) is a Mini Ratna (Category – I) Government of India Enterprise under the administrative control of Ministry of New and Renewable Energy (MNRE). IREDA is a Public Limited Government Company established as a Non-Banking Financial Institution in 1987 engaged in promoting, developing and extending financial assistance for setting up projects relating to new and renewable sources of energy and energy efficiency/conservation with the motto: “ENERGY FOR EVER”

IREDA has been notified as a “Public Financial Institution” under section 4 ‘A’ of the Companies Act, 1956 and registered as Non-Banking Financial Company (NBFC) with Reserve Bank of India (RBI).

IREDA’s mission is “Be a pioneering, participant friendly and competitive institution for financing and promoting self-sustaining investment in energy generation from Renewable Sources, Energy Efficiency and Environmental Technologies for sustainable development.”

IREDA’s Motto is “Energy for Ever.”

Source: https://www.ireda.in/background

1.4.2 REC

REC is a 'Maharatna' company under the administrative control of the Ministry of Power, Government of India, and is registered with RBI as Non-Banking Finance Company (NBFC), Public Financial Institution (PFI) and Infrastructure Financing Company (IFC).

REC was incorporated in 1969 in the backdrop of severe drought and famine in the country, to energise agricultural pump-sets for irrigation purposes, thereby reducing the dependency of agriculture on monsoons. From its humble beginnings, REC has evolved and expanded its financing mandate to cover the entire Power-Infrastructure sector comprising Generation, Transmission, Distribution, Renewable Energy and new technologies like Electric Vehicles, Battery Storage, Green Hydrogen etc. More recently REC has also diversified into the Non-Power Infrastructure sector comprising Roads & Expressways, Metro Rail, Airports, IT Communication, Social and Commercial Infrastructure (Educational Institution, Hospitals), Ports and Electro-Mechanical (E&M) works in respect of various other sectors like Steel, Refinery, etc.

REC provides long terms loans and other financing products to State, Centre and Private Companies for creation of infrastructure assets in the country**.**

REC funds its business with market borrowings of various maturities, including bonds and term loans apart from foreign borrowings. REC enjoys highest Domestic Rating of “AAA” for long-term borrowing from IRRPL, CRISIL, and ICRA. On international basis, REC holds rating of “Baa3” from Moody’s and “BBB-” from Fitch, both at par with sovereign ratings**.**

Source: REC LTD - Corporate Profile (recindia.nic.in)

1.4.3 PFC

Power Finance Corporation Ltd. is a Schedule-A Maharatna CPSE, and is a leading Non-Banking Financial Corporation in the Country. PFC's registered office is located at New Delhi and regional offices are located at Mumbai and Chennai.

PFC is under the administrative control of the Ministry of Power. PFC was conferred the title of a 'Maharatna CPSE' in Oct.,2021, and was classified as an Infrastructure Finance Company by the RBI on 28th July,2010.

PFC plays a crucial role in the rise of India as a global player. Increasingly, a country's development is gauged by measuring its energy usage. With a large fraction of our nation still, unfortunately, without any access to electricity, PFC will become an increasingly important factor in the years to come.

PFC is a listed Government company and a public financial institution under the Companies Act. It is registered with the RBI as a non-deposit taking systemically important NBFC and was classified as an IFC in July 2010.

Source: Power Finance Corporation (pfcindia.com)

1.5 ABOUT THE CHOSEN PUBLIC SECTOR BANKS

Public sector banks (PSBs) are financial institutions where the majority ownership and control rest with the government. In the context of India, public sector banks are those in which the government holds a significant stake, typically more than 50%. These banks play a crucial role in the country's banking and financial system, serving various segments of society and contributing to economic development.

1.5.1 The State Bank of India (SBI)

State Bank of India (SBI) a Fortune 500 company, is an Indian Multinational, Public Sector Banking and Financial services statutory body headquartered in Mumbai. The rich heritage and legacy of over 200 years, accredits SBI as the most trusted Bank by Indians through generations.

SBI, the largest Indian Bank with 1/4th market share, serves over 48 crore customers through its vast network of over 22,405 branches, 65,627 ATMs/ADWMs, 76,089 BC outlets, with an undeterred focus on innovation, and customer centricity, which stems from the core values of the Bank - Service, Transparency, Ethics, Politeness and Sustainability.

The Bank has successfully diversified businesses through its various subsidiaries i.e SBI General Insurance, SBI Life Insurance, SBI Mutual Fund, SBI Card, etc. It has spread its presence globally and operates across time zones through 235 offices in 29 foreign countries.

Growing with times, SBI continues to redefine banking in India, as it aims to offer responsible and sustainable Banking solutions.

The origin of the State Bank of India goes back to the first decade of the nineteenth century with the establishment of the Bank of Calcutta in Calcutta on 2 June 1806. Three years later the bank received its charter and was re-designed as the Bank of Bengal (2 January 1809). A unique institution, it was the first joint-stock bank of British India sponsored by the Government of Bengal. The Bank of Bombay (15 April 1840) and the Bank of Madras (1 July 1843) followed the Bank of Bengal. These three banks remained at the apex of modern banking in India till their amalgamation as the Imperial Bank of India on 27 January 1921.

Primarily Anglo-Indian creations, the three presidency banks came into existence either as a result of the compulsions of imperial finance or by the felt needs of local European commerce and were not imposed from outside in an arbitrary manner to modernise India's economy. Their evolution was, however, shaped by ideas culled from similar developments in Europe and England, and was influenced by changes occurring in the structure of both the local trading environment and those in the relations of the Indian economy to the economy of Europe and the global economic framework. *Source: https://bank.sbi/web/about-us*

1.5.2 Bank of Baroda

Bank of Baroda (BoB) stands as one of India's premier banking institutions, with a rich heritage dating back to its establishment in 1908 in the princely state of Baroda (now Vadodara). Over the decades, it has evolved into a global financial powerhouse, serving millions of customers across diverse segments.

Bank of Baroda (BOB) is a government of India owned Multinational Public Sector Bank headquartered in Vadodara, Gujarat. It is the second largest Public Sector Bank in India after State Bank of India, with 153 million customers(March 2023), a total business of US$291 billion(March 2024), and a global presence of 100 overseas offices. Based on 2023 data, it is ranked 586 on the Forbes Global 2000 list.

The Maharaja of Baroda, Sayajirao Gaekwad III, founded the bank on 20 July 1908 in the princely state of Baroda, in Gujarat. The Government of India nationalized the Bank of Baroda, along with 13 other major commercial banks of India, on 19 July 1969 and the bank was designated as a profit-making public sector undertaking (PSU).

In line with its commitment to innovation, BoB has embraced digital transformation to enhance customer experience and operational efficiency. The bank offers internet banking, mobile banking, and digital wallet services, empowering customers with convenient and secure banking solutions. Furthermore, BoB has invested in advanced technologies like artificial intelligence and data analytics to drive insights, improve risk management, and personalize offerings.

Beyond its core banking activities, BoB is actively involved in supporting socioeconomic development initiatives. The bank participates in government schemes aimed at financial inclusion, such as the Pradhan Mantri Jan Dhan Yojana (PMJDY), and prioritizes lending to sectors like agriculture, micro, small, and medium enterprises (MSMEs), and affordable housing.

BoB places a strong emphasis on corporate governance, risk management, and compliance, ensuring transparency, accountability, and integrity in its operations. The bank's leadership is committed to upholding the highest standards of ethics and professionalism, fostering trust and confidence among stakeholders.

In recent years, BoB has undergone significant organizational restructuring and strategic initiatives to adapt to the evolving banking landscape. It has focused on rationalizing its branch network, optimizing costs, and enhancing digital capabilities to stay competitive in a rapidly changing environment.

Looking ahead, BoB is well-positioned to capitalize on emerging opportunities in India's dynamic banking sector. Driven by inclusive growth and prosperity across the nation and beyond, the bank continues to be a trusted partner for individuals, businesses, and communities thanks to its strong infrastructure, customer-centric approach, and legacy of excellence.

Source: [Bank of Baroda - Wikipedia]

1.5.3 Punjab National Bank

Punjab National Bank (abbreviated as PNB) is an Indian government public sector bank based in New Delhi. It was founded in May 1894 and is the second-largest public sector bank in India in terms of its business volumes, with over 180 million customers, 12,248 branches, and 13,000+ ATMs.

PNB has a banking subsidiary in the UK (PNB International Bank, with seven branches in the UK), as well as branches in Hong Kong, Kowloon, Dubai, and Kabul. It has representative offices in Almaty (Kazakhstan), Dubai (United Arab Emirates), Shanghai (China), Oslo (Norway), and Sydney (Australia). In Bhutan, it owns 51% of Druk PNB Bank, which has five branches. In Nepal, PNB owns 20% of Everest Bank, which has 122 branches. PNB also owns 41.64% of JSC (SB) PNB Bank in Kazakhstan, which has four branches.

Punjab National Bank is a Public sector undertakings in India (PSU) working under the government of India regulated by the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949. It was registered on 19 May 1894 under the Indian Companies Act, with its office in Anarkali Bazaar, in pre-independent India (present-day Pakistan). The founding board was drawn from different parts of India professing different faiths and of varying backgrounds, with the common objective of creating a truly national bank that would further the economic interest of the country. PNB's founders included several leaders of the Swadeshi movement such as Dyal Singh Majithia and Lala Harkishen Lal, Lala Lalchand, Kali Prosanna Roy, E. C. Jessawala, Prabhu Dayal, Bakshi Jaishi Ram, and Lala Dholan Dass. Lala Lajpat Rai was actively associated with the management of the Bank in its early years. The board first met on 23 May 1894. The bank opened for business on 12 April 1895 in Lahore.

In 1951, the Bank took over the assets and liabilities of Bharat Bank Ltd. and became the second largest bank in the private sector. In 1962, it amalgamated the Indo-Commercial Bank with it. From its dwindled deposits of Rs. 43 crores in 1949 it rose to cross the Rs. 355 crores mark by the July 1969. Its number of offices had increased to 569 and advances from Rs. 19 crores in 1949 to Rs. 243 crores by July 1969 when it was nationalised.

Since inception in 1895, PNB has always been a "People`s bank" serving millions of people throughout the country and also had the proud distinction of serving great national leaders like Sarvshri Jawahar Lal Nehru, Gobind Ballabh Pant, Lal Bahadur Shastri, Rafi Ahmed Kidwai, Smt. Indira Gandhi etc. amongst other who banked with us.

Source: Punjab National Bank | (pnbindia.in)

Chapter 2

LITERATURE REVIEW

Market failure, willful defaults, poor follow-up and supervision, non-cooperation from banks, poor legal framework, lack of entrepreneurial skills, and diversion of funds are actually the reasons of NPAs. (**Das, S.,2010)**

The road to reducing NPAs requires a multi-pronged approach, involving prudent lending practices, robust risk management, and a conducive regulatory environment. To effectively manage NPAs, it's imperative for regulatory authorities to continue refining the regulatory framework and legal processes. **(Agrawal, Vineeta, 2023)**

The Indian banking sector has been facing serious problems of raising Non- Performing Assets assets are one of the major concerns for scheduled commercial banks in India.
(Vivek Rajbahadur Singh., 2016)

Money is getting blocked lead to lack of enough cash in hand which lead to borrowing money for short period of time from outside which lead to additional cost to the bank. Difficulty in operating the functions of bank is another cause of NPA. Due to lack of money Routine payments and dues are not paid on time**. (Dr. Sonia Narula, 2014)**

The level of NPAs is high with all banks currently and the banks would be expected to bring down their NPA. This can be achieved by good credit appraisal procedures, effective internal control systems along with their efforts to improve asset quality in their balance sheets.
(C.S. Balasubramaniam, 2019)

There has been increased concern about the continued deterioration in the asset quality of Indian public sector banks in recent times. Reserve Bank of India's Financial Stability Report 2017 acknowledged that the risks to the Indian banking sector have been increasing in the post-recession period, particularly, the risk of accumulating non-performing assets (NPAs).

(Dhananjay Kadanda & Krishna Raj, 2018)

Both public and private sector banks had adopted measures such as debt restructuring, asset sale, and strategic debt restructuring to manage their NPAs. However, the study found that private sector banks were more proactive in taking such measures, which helped them manage their NPAs more effectively. **(Karthikeyan and Subramaniam, 2020)**

Higher levels of NPAs were associated with lower profitability in both public and private sector banks. Private sector banks were more successful in managing their NPAs, which helped them maintain higher profitability compared to public sector banks**. (Singhal and Singh, 2017)**

Corporate governance practices such as board independence, CEO duality, and audit committee size had a significant impact on the level of NPAs in both public and private sector banks. The study found that private sector banks had better corporate governance practices, which helped them manage their NPAs more effectively**. (Singh and Nigam, 2021)**

The moratorium scheme introduced by the bank previously provided a 90 day period after which, upon non-payment, an asset would be classified as a NPA. That time period has been increased to 180 days, which, at first sight, would assist the consumer by preventing further strain on personal liquidity, but considering the elongated repayment timing and personal asset classification post moratorium period, there is a high chance of creation of further NPA. **(Mishra, H., 2020)**

Chapter 3

RESEARCH METHODOLOGY

Research methodology is the systematic way of doing the research to solve the problem. The research methodology organizes the components of the study in a way that is most likely to lead to valid answers to the sub problems that have been posted. Research methodology is the specific procedures or techniques used to identify, select, process, and analyse information about a topic. In a research paper, the methodology section allows the reader to critically evaluate a study's overall validity and reliability. It also indicates the general pattern for organizing procedures for the development of the tool, pilot study and the procedure for data collection and plan for data analysis.

3.1 Research Design

Exploratory research design was used to meet objectives of this study. Qualitative methods are used for in-depth exploration and understanding of Non-Performing Assets of various NBFCs in India.

3.2 Problem Statement

The study tries to discuss the reasons of the NPA in NBFCs and also analyses the problems, with a suitable solution. The main subject matter of this paper is to understand the significant difference of the NPA occurrence, and management of NPA.

3.3 Objectives of the study

- To study the reasons for occurrence of NPAs in NBFCs.
- To find the ways to effectively manage increasing NPAs in NBFCs.
- To draw a comparison between NPA levels and methodology adopted by NBFCs with those of public sector banks.

3.4 Scope of the study

The scope of the study is in between the financial year 2018-2023 for three NBFCs- Power Finance Corporation Ltd., Indian Renewable Energy Development Agency Limited and REC Limited and three banks- SBI, Bank of Baroda and Punjab National Bank.

3.5 Data Collection

Secondary Data has been collected to fulfil the purpose of this research. Data has been collected using:

- Company Reports: Annual reports, financial statements, and official publications have been reviewed to understand the company's performance, strategies, and goals.
- Academic Journals and Articles: Published research papers and articles related to occurrence and management of NPAs have been reviewed.

3.6 Data Analysis

The analysis of the data is completed and presented systematically with the use of Microsoft excel and Microsoft word. The various tools which were used for presentation are:

- Line graph
- Pie chart

Chapter-4

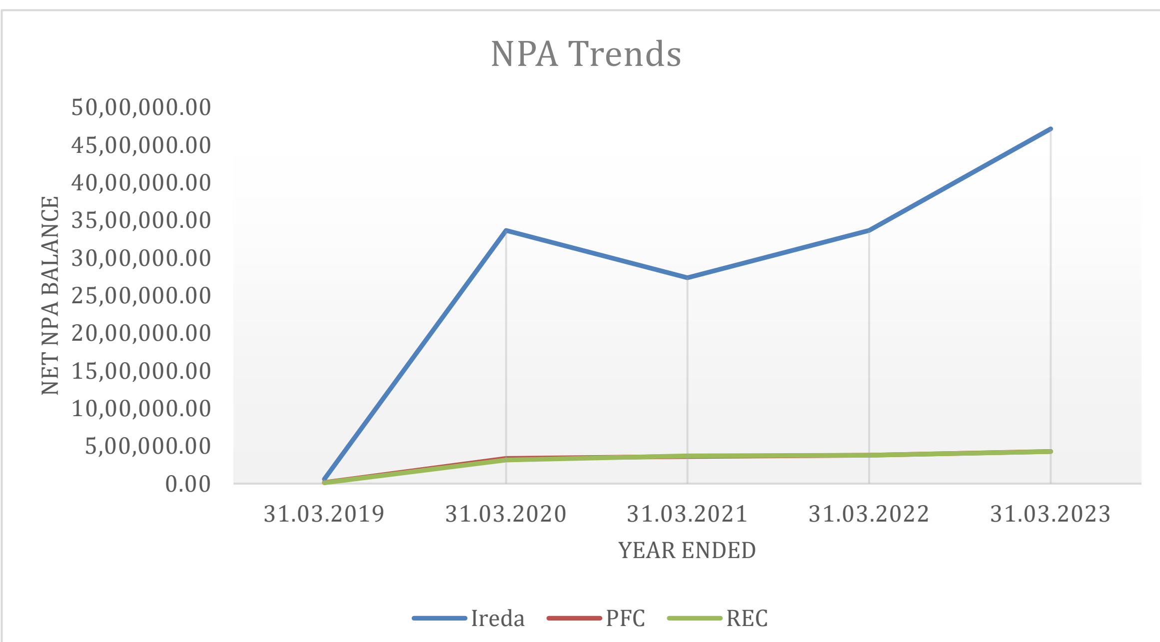
ANALYSIS AND FINDINGS

4.1 NPA trends of NBFCs during the financial year 2018-2023

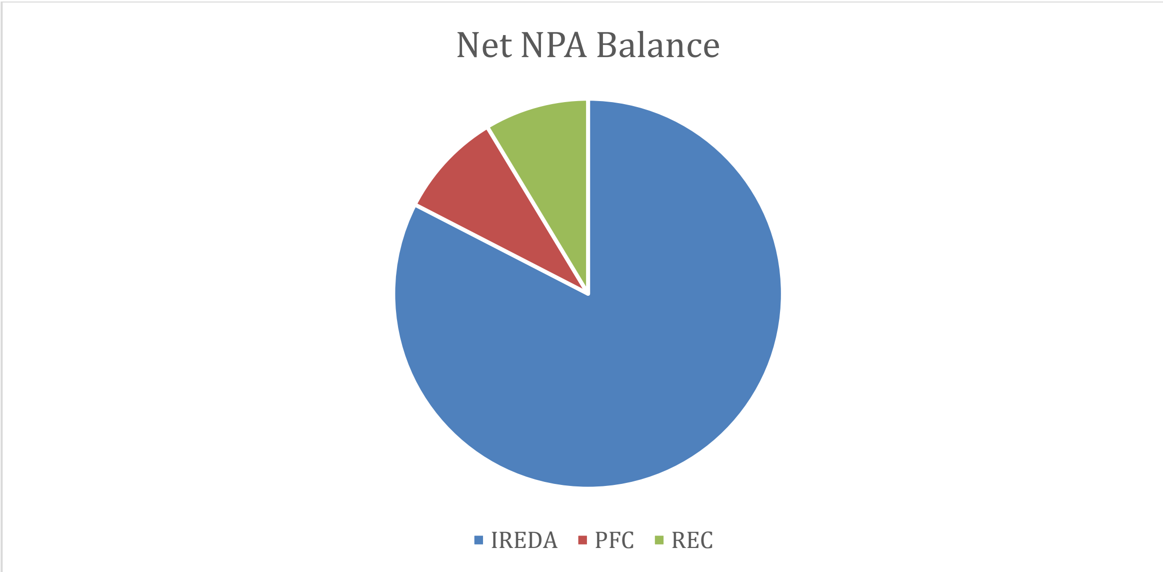
(*Rs. in crore*)

Net NPA Balance for the year ended	IREDA	PFC	REC
31.03.2019	59,595.92	14,519.30	10,650
31.03.2020	33,62,958.38	3,33,932.13	3,13,034.79
31.03.2021	2,734,212.13	3,60,067.74	3,67,870.33
31.03.2022	33,62,958.38	3,78,201.04	3,75,999.48
31.03.2023	47,13,293.32	4,26,853.81	4,25,166.38

Source: Annual Reports



Source: own analysis



Source: own analysis

Interpretation:

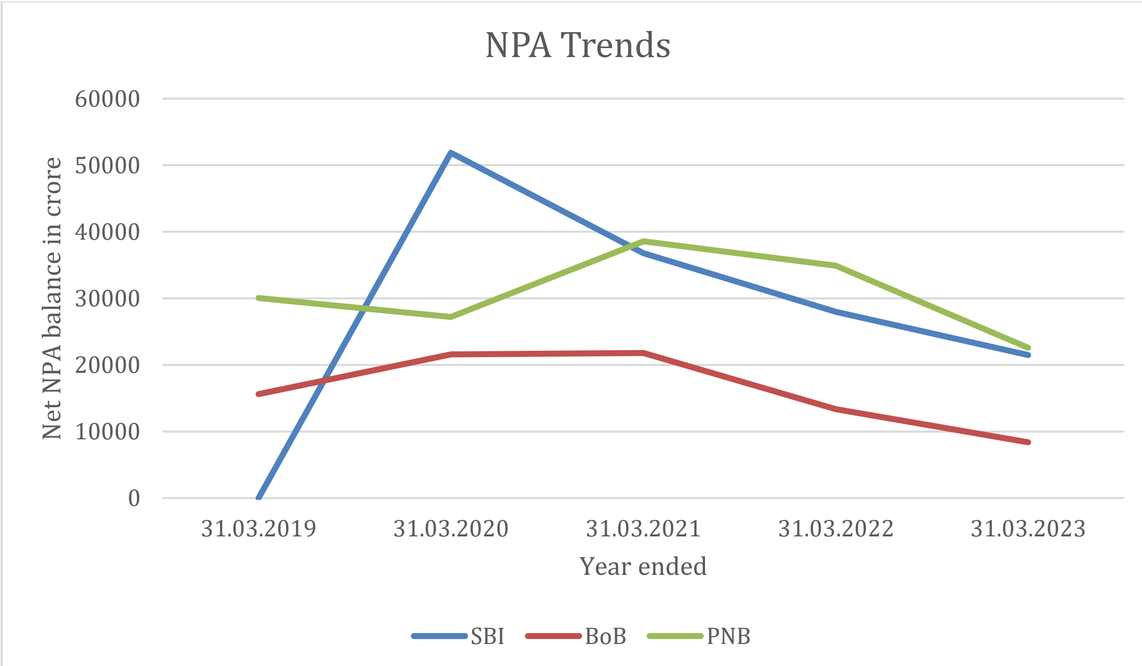
- IREDA has largest accumulated NPA balance.
- Net NPA balance is increasing since last 3 financial years in IREDA.
- PFC and REC Limited have managed to keep their NPA levels nearly constant since last 4 financial years.

4.2 NPA trends of Banks during the financial year 2018-2023

(*Rs. in crore*)

Net NPA Balance for the year ended	SBI	BoB	PNB
31.03.2019	65,894.74	15,609.50	30,037.66
31.03.2020	51,871.30	21,576.59	27,218.89
31.03.2021	36,809.72	21,799.88	38,575.70
31.03.2022	27,965.71	13,364.65	34,908.73
31.03.2023	21,466.64	8,384.32	22,585.04

Source: year-ended financial reports



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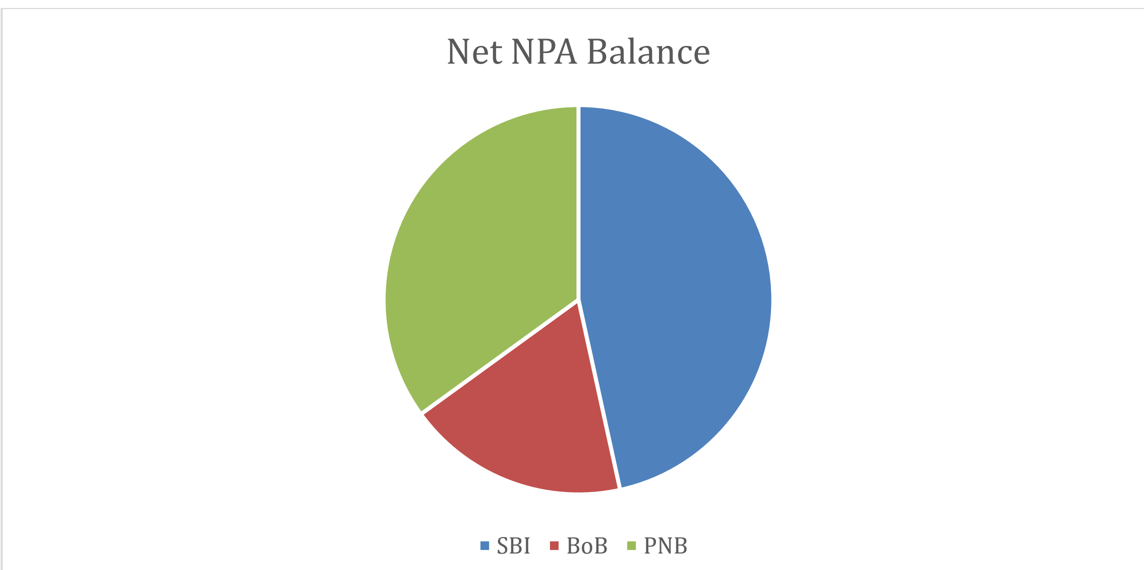

Source: own analysis

Interpretation:

- SBI has largest accumulated NPAs.
- NPA levels of all the three chosen banks are reducing.

4.3 Formation of Committees

It is found that NBFCs have formed Committees to manage increasing level of NPAs. As per the law, it is not mandatory for any company to form this committee but to effectively monitor rising NPAs, they have voluntarily formed Committees to conduct meetings on regular basis to review borrowings.

IREDA has a duly constituted NPA & Stressed Assets Resolution Committee to review the status of stress assets and NPAs of the Company.

It has also constituted Review Committee for Non-Co-operative Borrower and Wilful defaulter to reduce the level of potential NPAs and keep a check on borrower's payment actions.

PFC and REC has not formed any special Committee for NPAs.

4.2.1 Terms of Reference of NPA & Stressed Assets Resolution Committee:

The main tasks/responsibilities of the NPA & Stressed Assets Resolution Committee is to review the status on stress assets and NPAs with action taken report.

4.3 Review Committee for Non-Co-operative Borrower and Wilful defaulter

During the FY 23, the Company has constituted a Review Committee for Non-Co-operative Borrower and Wilful defaulter in its 357 Board meeting held on April 18, 2022, in accordance with the RBI Circular.

4.3.1 Terms of Reference of Review Committee for Non-Co-operative Borrower

The main tasks/responsibilities of the Review Committee for Non Co-operative Borrower and Wilful defaulter is to review and declare the borrower as wilful defaulter or Non Co-operative Borrower.

4.4 Probable causes of occurrence of NPAs in NBFCs

Non-Performing Assets (NPAs) in Non-Banking Financial Companies (NBFCs) can arise due to various factors:

I. Borrower Creditworthiness: NBFCs provide loans to a wide variety of borrowers, such as corporations, small enterprises, and private citizens. NPAs result from borrowers experiencing financial difficulties or failing to make loan repayments. A borrower's creditworthiness, ability to repay, and financial situation are all important factors.

II. Economic Downturns: Borrowers may find it difficult to fulfill their financial obligations during recessions. Job cuts, company losses, and income reductions can lead to loan defaults, which increase non-performing assets (NPAs).

III. Lack of Collateral: Unlike banks, NBFCs frequently make loans with little to no collateral. NPAs could result from NBFCs' inability to collect their debts if borrowers default.

IV. Industry-Specific Hazards: Certain industries are more vulnerable to changes in the economy than others, including small businesses, real estate, and infrastructure. NPA risks may be higher for NBFCs that are heavily exposed to these industries.

V. Liquidity Challenges: Long-term loans are funded by short-term borrowings for NBFCs. Their capacity to recover loans and manage non-performing assets may be impacted if they experience liquidity constraints or refinancing disruptions.

VI. Regulatory Changes: NBFCs are impacted by regulatory standards pertaining to NPA recognition and provisioning. Reported non-performing assets (NPAs) are impacted by recent Reserve Bank of India (RBI) changes that mandate stricter NPA classification and daily recognition.

VII. Collection Efficiency: Effective loan collection processes are crucial. Weak collection mechanisms can lead to delayed recoveries and NPAs.

VIII. Asset-Liability Mismatch: Mismatch between the maturity of NBFCs’ assets (loans) and liabilities (borrowings) can create liquidity stress, affecting their ability to manage NPAs.

IX. Risk Management Practices: Inadequate risk assessment, poor underwriting standards, and lack of robust risk management practices contribute to NPAs.

X. External Shocks: Unforeseen events like natural disasters, pandemics (e.g., COVID-19), or regulatory changes impact borrowers' ability to repay loans, leading to NPAs.

Sources: https://www.crisil.com/
(PDF) Non-Performing Assets (NPA) in Indian Banking: Causes, consequences, and remedial measures (researchgate.net)

4.5 Strategies to manage NPAs in NBFCs

NBFCs can take several measures to reduce their rising Non-Performing Assets (NPAs). Here are some strategies they can consider:

I. **Strengthen Collection Processes**: NBFCs should enhance their collection mechanisms to recover dues promptly. This involves regular follow-ups, effective communication with borrowers, and timely reminders for payments.

II. **Form Committees to regularly review rising levels of NPAs:** Just like Audit Committee, Nomination and Remuneration Committee and others as prescribed under The Companies Act, 2013, NBFCs can form special committees to focus and review NPA levels.

III. **Economic Revival Focus**: NBFCs should closely monitor economic trends and adapt their lending practices accordingly. Cash flows improves as economy booms.

IV. **Asset Quality Review**: NBFCs regularly assess assets quality in their loan portfolio. This assists to identify potential NPAs early and take corrective actions promptly.

V. **Restructuring and Rescheduling**: Offer restructuring options to borrowers facing temporary financial difficulties. This can help prevent accounts from slipping into NPAs.

VI. **Risk-Based Lending**: Implement robust risk assessment models to evaluate borrowers' creditworthiness. Avoid lending to high-risk segments without adequate collateral.

VII. **Diversify Loan Portfolios**: “NBFCs should diversify their loan portfolios across different sectors and customer segments. Over-reliance on a specific segment can lead to higher NPAs if that sector faces challenges.”

VIII. **Prudent Underwriting Practices**: Ensure rigorous due diligence before disbursing loans. Evaluate borrowers’ repayment capacity, credit history, and collateral thoroughly.

IX. **Macro-Economic Factors**: Keep an eye on macro-economic indicators. A favorable economic environment can positively impact asset quality.

Sources: (29) Navigating the NPA Challenge: Addressing Non-Performing Assets in India's NBFC Industry. | LinkedIn
www.crisil.com
Strict NPA rules for NBFCs: Experts analyse impact on industry (cnbctv18.com)

4.6 Tools and techniques for NPA recovery

For recovery of NPA there are different tools are available. The important purpose of these tools are to recover the loan amount from borrower. These tools can be use according to loan amount.

- **Lok Adalats 2001**: Lok Adalats is a mechanism to settle matters relating to recovery of dues, out of court. These are convened by Debt Recovery Tribunals / Debt Recovery Appellate Tribunals. Lok Adalats have no judicial powers. It is a mutual forum for the bank and the borrower to meet and arrive at a mutual settlement. Once the settlement is signed by both the parties, the same is placed before the court. The court would then pass a suitable decrees / orders as per the terms of settlement. Such decrees cannot be challenged in the next higher courts. At present, accounts in doubtful and loss category with outstanding above Rs. 5.00 lacs can be referred to Lok adalat. Lok Adalats Proved to be quite effective for speedy justice and recovery of small loans tracking repayment schedules and conducting periodic reviews of borrower's financial health.

- **Debt Recovery Tribunals (DRT 1993):** Under the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993 banks approach the Debts Recovery Tribunal (DRT) whereas, under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002 borrowers, guarantors, and other any other person aggrieved by any action of the bank can approach the Debts Recovery Tribunal (DRT). Debts Recovery Tribunal is located across the country. Some cities have more than one Debts Recovery Tribunals.

- **Sarfaesi ACT, 2002**: The full form of SARFAESI Act as we know is Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. Banks utilize this act as an effective tool for bad loans (NPA) recovery. It is possible where nonperforming assets are backed by securities charged to the Bank by way of hypothecation or mortgage or assignment. SARFAESI is effective only for secured loans where bank can enforce the underlying security e.g. hypothecation, pledge and mortgages.

- **Asset recovery construction industry limited (Arcil)**: The word asset reconstruction company is a typical used in India. Globally the equivalent phrase used is "asset management companies". The word "asset reconstruction" in India were used in Narsimham I report where it was envisaged for the setting up of a central Asset Reconstruction Fund with money contributed by the Central Government, which was to be used by banks to shore up their balance sheets to clean up their non-performing loans. ARC has been set up to provide a focused approach to Non-Performing Loans resolution issue by:-

a. Isolating Non Performing Loans (NPLs) from the Financial System (FS),
b. Freeing the financial system to focus on their core activities and c. Facilitating development of market for distressed assets.

Sources Multidisciplinary Journal | International Journal of Applied Research (allresearchjournal.com)

4.7 Comparison of NPAs in NBFCs with NPAs in Public Banks

To compare public sector banks and CPSE NBFCs with regard to NPAs, a number of terms and parameters have been evaluated.

4.7.1 NPA Ratio

NPAs can also be expressed as a percentage of total advances. It gives us an idea of how much of the total advances are not recoverable. It denotes asset quality and credit risk exposure. It also provides insights into their relative asset quality and risk management effectiveness.

(in %)

Entity	31.03.2023	31.03.2022	31.03.2021	31.03.2020	31.03.2019	Average
SBI	0.67	1.02	1.5	2.23	3.01	1.69
BoB	0.89	0.02	3.09	3.13	3.33	2.09
PNB	2.72	4.8	5.73	5.78	6.56	5.12
IREDA	0.93	0.92	0.90	1.22	0.21	0.84
REC	0.91	0.92	0.92	0.90	0.04	0.74
PFC	0.96	0.96	0.90	0.92	0.05	0.76

Source: https://www.moneycontrol.com/
Annual Reports for year 2018-2023

For Banks:

- State Bank of India has an average of 1.69%.
- Bank of Baroda has an average of 2.09%.
- Punjab National Bank has an average of 5.12%.

For CPSE NBFCs:

- IREDA has an average of 0.84%.
- REC has an average of 0.74%.
- PFC has an average of 0.76% over the chosen 5 year period.

Interpretation:

It can be observed that NPA ratios of SBI are lower than those of PNB and BoB. Over the taken time horizon, the NPA ratios of each of these banks have decreased, indicating an improvement in the quality of their assets.

BoB's NPA ratios vary widely, from extremely low (0.02%) to comparatively high (3.33%). This suggests that the bank managed its assets at different levels over different time periods. PNB consistently shows higher NPA ratios compared to other banks, with an average of 5.12%. This indicates relatively weaker asset quality management within PNB compared to SBI and BoB.

CPSE NBFCs, represented by IREDA, REC, and PFC, generally exhibit lower NPA ratios compared to banks. These NBFCs maintain relatively stable and low NPA levels, suggesting robust risk management practices.

Overall, banks tend to have higher NPA ratios compared to CPSE NBFCs, indicating potentially higher credit risks associated with bank loans compared to NBFC lending activities.

The decreasing trend in NPA ratios across both banks and CPSE NBFCs over the years suggests an overall improvement in asset quality and risk management practices within the financial sector.

4.7.1 Differences in provisioning

Banks maintain provisions for NPAs based on regulatory guidelines, typically higher due to their size and systemic importance. Indian public sector banks collectively owed approximately 5.42 trillion Indian rupees in non-performing assets in fiscal year 2022.

NBFCs follow a more dynamic provisioning model, influenced by their risk appetite and business focus. The NBFCs-ND-SI are required to make provision of impairment loss as per Ind AS 109 and not required to follow the Prudential norms relating to income recognition, asset classification and provisioning (IRACP norms) for Bad and Doubtful debts in terms of Directions 2016. In the financial year 2022, the gross non-performing assets (GNPA) of non-banking financial companies (NBFCs) stood at 3.8 percent.

While banks prioritize stringent provisioning to bolster financial stability, NBFCs balance provisioning with their agility in managing risks tailored to their portfolios and clientele.

Source: IREDA's Audit Report, year 2022-23
India: gross NPA public sector banks 2022 | Statista
India: GNPA of NBFC 2023 | Statista

Chapter-5

CONCLUSION

The research highlights a concerning trend of increasing NPAs in IREDA over the past three financial years, contrasting with PFC and REC Limited's ability to maintain relatively stable NPA levels. While NBFCs like IREDA have voluntarily formed committees to address NPAs, PFC and REC Limited have not followed suit. Probable causes of NPAs in NBFCs include borrower creditworthiness, economic downturns, and sector-specific risks. To manage NPAs effectively, NBFCs should focus on strengthening collection processes, conducting regular asset quality reviews, and implementing prudent underwriting practices. Diversification of loan portfolios and restructuring options for struggling borrowers can also mitigate NPA risks. Overall, proactive measures are essential to navigate the challenges posed by NPAs and sustain financial health.

Banks typically implement stringent follow-up procedures for non-performing assets, including regular monitoring, restructuring, and recovery through legal channels. NBFCs often focus on personalized approaches, such as flexible repayment options and closer client relationships, but may have fewer resources for legal recourse, relying more on negotiation and proactive risk management.

All three banks have made efforts to reduce their Net NPA balances over the chosen period. However, PNB faced more significant fluctuations, suggesting potential challenges in managing asset quality effectively. SBI and BoB demonstrated relatively more consistent improvements, indicating successful implementation of strategies to address NPAs. Monitoring NPA trends is crucial for assessing the financial health and risk management capabilities of banks, as it directly impacts profitability and stability. When the comparisons are made, it is noticed that Banks like SBI and BoB are making progress in reducing NPAs, PNB faces challenges in managing asset quality effectively. On the other hand, CPSE NBFCs demonstrate relatively lower and stable NPA ratios, indicating sound risk management practices within this sector.

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