Non Performing Assets And Its Management
(A Comparative Study Between Public And Private Sector)

Bhanu Uday Somisetti ; Dr. P. Raja Babu ; K.Venkateswara Kumar
Assistant Professor K L University

ABSTRACT

Today banking has to play very prominent and crucial role in developing countries like India. In the Indian financial system banks acts as a financial intermediary or institution serves different services to accelerate the economic growth of the country. To improve the financial health of the banks various norms have been introduced at regular intervals. It is quite clear that generally the good health of a bank is reflected in better return on assets. The Non-Performing assets not only reduce the profitability of the banks by writing of the principal amount, as well as the amount of interest on advances and it is also a threat to the stability of the bank. This article mainly focuses on the causes and how a bank manages Non-Performing Assets (NPAs) under the guidelines of RBI.

KEYWORDS: Non-Performing Assets, Financial Institutions, Profitability, Banking Sector, Economic Growth, Reserve Bank of India (RBI).

I. INTRODUCTION

All assets do not perform uniformly. In some cases, assets perform very well and the recovery of principal and interest happen on time while in other cases there may be delays in recovery or no recovery at all because of one reason or the other. Similarly, an asset may exhibit good quality performance at one point of time and poor performance at some other point of time. NPAs refer to loans which are at risk of default. Reserve Bank of India (RBI) defines “An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. Banks have to classify their assets as performing and non-performing in accordance with RBI's guidelines. Under these guidelines an asset is classified as non-performing:

- If any amount of interest or principal installments remains overdue for more than 90 days in respect of term loans.
- In respect of overdraft or cash-credit an asset is classified as non-performing if the account remains out of order for a period of 90 days and
• In respect of bills purchased and discounted account, if the bill remains overdue for a period of more than 90 days.

### III. CLASSIFICATION OF NPAs

According to the RBI guidelines banks must classify their assets on an on-going basis into the following four categories:

1) **Standard assets:** Standard asset service their interest and principal installments on time, although they occasionally default up to a period of 90 days. Standard assets are also called performing assets. They yield regular interest to the banks and return the due principal on time and thereby help the banks earn profit and recycle the repaid part of the loans for further lending. The other three categories (sub-standard assets, doubtful assets and loss assets) are NPAs and are discussed below.

2) **Sub-standard assets:** Sub-standard assets are those assets which have remained NPAs (i.e., if any amount of interest or principal installments remains overdue for more than 90 days) for a period up to 12 months.

3) **Doubtful assets:** An asset becomes doubtful if it remains a sub-standard asset for a period of 12 months and recovery of bank dues is of doubtful.

4) **Loss assets:** Loss assets comprise assets where a loss has been identified by the bank or the RBI. These are generally considered uncollectible. Their realizable value is so low that their continuance as bankable assets is not warranted.

‘If banks do not classify an asset as NPAs, they naturally have more money to earn interest income on their advances. 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.

### III. KEY RATIOS FOR ASSET QUALITY

There are two key ratios for measuring bank asset quality.

1) **Gross Non-Performing Assets (GNPAs):** Gross NPAs is the sum of all loan assets that are classified as NPAs as per RBI guidelines. Gross NPA Ratio is the ratio of gross NPA to gross advances (loans) of the bank.
2) **Net Non-Performing Assets (NPA) ratio:** Net NPAs are calculated by deducting provisions from gross NPAs. The net NPA to advances (loans) ratio is used as a measure of the overall quality of the bank’s loan book.

Net non-performing assets = Gross NPAs – Provisions  
NPA ratio = Net non-performing assets / Advance

**IV. CAUSES FOR IMPLICATION OF HIGH NPAS IN THE BANK**

Banks with high level of NPAs have lesser funds to give loans and advances, i.e. lesser funds their interest income has to be reduced. Another negative impact of high NPAs:

i. High level of provisioning (banks are required to keep aside a portion of their operating profit as provisions, higher NPAs will increase the amount of provision thereby impacting the profitability)

**Provisioning Norms:**

a. **For substandard loans,** a general provisioning of 15% on the total outstanding amount is made if the loan is secured, for unsecured loans the total provisioning that needs to be done is 25% of the outstanding balance;

b. **For doubtful assets,** provisioning of 100% on the total outstanding amount is made if the loan is unsecured, for secured loans the total provisioning is in the range of 25% to 100 % of the outstanding balance depending upon the period for which the asset has remained doubtful;

c. **Loss assets** should be completely written off. If loss assets are permitted to remain on the books for any reason, 100 % of the outstanding amount should be provisioned.

ii. The burden of maintaining the capital adequacy ratio;

iii. Increased pressure on Net Interest Margin (NIM);

iv. Reduce competitive position;

v. Continuous draining of profits;

vi. Negative impact of goodwill with the bank;

vii. Restricted cash flow by the bank due to the provision of a fund created against the NPA.

**V. OBJECTIVE OF THE STUDY**

The main objectives of the study are given below:

- To study the concept of Non-Performing Assets in the banking sector
To analyze the performance of banks under the concept of NPAs
To understand how a bank manages its NPAs and
To study various channels to recover the NPAs

VI. REVIEW OF LITERATURE

1. Chandan Chatterjee, Jeet Mukherjee and Dr. Ratan Das, (2012) ‘Management of non-performing assets - a current scenario’ in their study they evident that the NPAs have a negative influence on the achievement of capital adequacy level, funds mobilization and deployment policy, banking system credibility, productivity and overall economy. And they also compare the performance of public, private and foreign banks and they present that the public sector banks are facing more problems with NPAs rather than others.

2. Amit Kumar Nag, (2015) ‘Appraisal of non-performing assets in the banking sector: An Indian perspective’ the author of this article done a comparative study by taking ten private, public and foreign banks. This article reveals the performance of various banks and he suggested some measures to overcome NPAs difficulty.

3. Rajeshwari Parmar, (2014) ‘Non-Performing Assets (NPAs): A Comparative Analysis of SBI and ICICI in this study the author takes a comparative study between SBI & ICICI banks and construct a relation between Net profit and Net NPAs. The author found that there is a positive relation. In case of SBI means that as profits increase NPA also increase because of mismanagement on the side of the bank and the other side of the coin ICICI bank got a negative relation which indicates that amount of NPA decreases and Profits will increase more by the amount not becoming NPA. So, they conclude that when compare to SBI (PSB), ICICI (Private bank) manages NPAs efficiently.

4. Dr. Sonia Narula and Monica single, (2014) ‘Empirical Study on Non-Performing Assets of Bank’ in this article the authors conduct a study on private bank i.e., Punjab National Bank (PNB). It is concluded that when PNB Gross and Net NPA compared with
total advances we get the result that there is mismanagement on the side of PNB. While analyzing the impact of NPA level on PNB we derived the conclusion that there is a positive relation between Net Profits and NPAs of PNB. It simply means that as profits increases NPA also increases. It is because of the mismanagement on the side of the bank.

VII. ANALYSIS AND INTERPRETATION

Table: 01 shows Gross, Net advances and net NPAs of Public and Private Sector banks during the period of 2003-14. It is found that gross, net advances and Net NPAs of public and private sector banks were raised more ten times during the period of 2003-14 whereas the ratio between Net NPAs and Net advances, Total assets have been increasing between 2010 and 2014 for public sector banks whereas private sector banks have been decreasing. It is clearly indicated that when increasing loans and advances as a result Net NPAs also increases.

TABLE: 01 COMPARATIVE ANALYSIS ON GROSS, NET ADVANCES AND NET NPAS BETWEEN PUBLIC AND PRIVATE SECTOR BANKS IN INDIA

(Amount in Billion)

<table>
<thead>
<tr>
<th>YEAR (End March)</th>
<th>Gross Advances</th>
<th>Net Advances</th>
<th>Net NPAs</th>
<th>Net NPAs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public Sector</td>
<td>Private Sector</td>
<td>Public Sector</td>
<td>Private Sector</td>
</tr>
<tr>
<td>2002-03</td>
<td>5778.13</td>
<td>947.18</td>
<td>5493.51</td>
<td>895.15</td>
</tr>
<tr>
<td>2003-04</td>
<td>6619.75</td>
<td>1195.11</td>
<td>6313.83</td>
<td>1151.06</td>
</tr>
<tr>
<td>2004-05</td>
<td>8778.25</td>
<td>1274.20</td>
<td>8489.12</td>
<td>1236.55</td>
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<tr>
<td>2005-06</td>
<td>11347.24</td>
<td>2325.36</td>
<td>11062.88</td>
<td>2300.05</td>
</tr>
<tr>
<td>2006-07</td>
<td>14644.93</td>
<td>3252.73</td>
<td>14401.46</td>
<td>3218.65</td>
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<tr>
<td>2007-08</td>
<td>18190.74</td>
<td>4124.41</td>
<td>17974.01</td>
<td>4067.33</td>
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<tr>
<td>2008-09</td>
<td>22834.73</td>
<td>4547.13</td>
<td>22592.12</td>
<td>4468.24</td>
</tr>
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</table>
While comparing public and private sector banks with NPAs, public sector banks are back to regulate NPAs and there is a need for proper management of NPAs because to increase the profitability and productivity. Last month, Finance Minister Arun Jaitley had said that though NPAs in the banking sector was a cause of concern, there was no ground to “panic”. Due to NPAs is the challenging for the banking sector and its impact on the economy slowed down. He had said the NPA was mainly in sectors like highways, steel, and textiles.

**Central Bank of India** has topped the list of public sector banks with maximum bad loans, including restructured assets as a percentage of total advances. According to the data provided by the RBI to the Finance Ministry, Central Bank of India's 21.5 per cent assets are either bad or have been restructured to save them turning non-performing assets (NPAs). The other banks, which have significant amounts of gross NPAs and restructured loans include

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Sector</th>
<th>Private Sector</th>
</tr>
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<tbody>
<tr>
<td>2002-03</td>
<td>1.8</td>
<td>0.2</td>
</tr>
<tr>
<td>2003-04</td>
<td>1.6</td>
<td>0.4</td>
</tr>
<tr>
<td>2004-05</td>
<td>1.4</td>
<td>0.6</td>
</tr>
<tr>
<td>2005-06</td>
<td>1.2</td>
<td>0.8</td>
</tr>
<tr>
<td>2006-07</td>
<td>1.0</td>
<td>1.0</td>
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<tr>
<td>2007-08</td>
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<td>2008-09</td>
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<tr>
<td>2012-13</td>
<td>0.2</td>
<td>2.2</td>
</tr>
<tr>
<td>2013-14</td>
<td>0.4</td>
<td>2.4</td>
</tr>
</tbody>
</table>

Sources: RBI Bulliton
United Bank of India (19.04 per cent), Punjab & Sind Bank (18.25 per cent) and Punjab National Bank by 17.85 per cent as on December 2014. Indian Overseas Bank, State Bank of Patiala, Allahabad Bank and Oriental Bank of Commerce all have bad and restructured loans in excess of 15 per cent. The rising bad loans have become a major concern for the Reserve Bank as well as the government. Most of the restructured loans are from the corporate sector. The top 30 defaulters are sitting on bad loans of Rs 95,122 crore, which is more than one-third of the gross non-performing assets of PSU banks at Rs 2, 60,531 crore as on December 2014.

VIII. STRATEGIES FOR RECOVERY

i) Debt Restructuring

Once a borrower faces difficulty in repaying loans or paying interest, the bank should initially address the problem by trying to verify whether the financed company is viable in the long run. If the company project is viable, then rehabilitation is possible by restructuring the credit facilities. In a restructuring exercise, the bank can change the repayment or interest payment schedule to improve the chances of recovery or even make some sacrifices in terms of waiving interest etc.

The RBI has separate guidelines for restructuring loans. A fully secured standard/sub-standard/ doubtful loan can be restructured by rescheduling of principal repayments and/or the interest element. The amount of sacrifice, if any, in the element of interest, is either written off or provision is made to the extent of the sacrifice involved. The sub-standard accounts/doubtful accounts which have been subjected to restructuring, whether in respect of a principal installment or interest amount are eligible to be upgraded to the standard category only after a specified period.

To create an institutional mechanism for the restructuring of corporate debt the RBI has devised a Corporate Debt Restructuring (CDR) system. The objective of this framework is to ensure a timely and transparent mechanism for the restructuring of corporate debts of viable entities facing problems.

ii) Other recovery options
If rehabilitation of debt through restructuring is not possible, banks themselves make efforts to recover. For example, banks set up special asset recovery branches which concentrate on recovery of bad debts. Private and foreign banks often have a collection unit structured along various product lines and geographical locations, to manage bad loans. Very often, banks engage external recovery agents to collect past due debt, who make phone calls to the customers or make visits to them. For making debt recovery, banks lay down their policy and procedure in conformity with the RBI directives on the recovery of debt. The past due debt collection policy of banks generally emphasizes on the following at the time of recovery:

- Respect to customers
- An Appropriate letter authorizing agents to collect
- Due notice to customers
- Confidentiality of customers' dues
- Use of simple language in communication and maintenance of records of communication

In difficult cases, banks have the option of taking recourse to file cases in courts, Lok Adalats, Debt Recovery Tribunals (DRTs), One Time Settlement (OTS) schemes, etc. DRTs have been established under the Recovery of Debts due to Banks and Financial Institutions Act, 1993 for expeditious adjudication and recovery of debts that are owed to banks and financial institutions. Accounts with loan amount of Rs. 10 lakhs and above are eligible for being referred to DRTs. OTS schemes and Lok Adalats are especially useful to NPAs in smaller loans in different segments such as small and marginal farmers, small loan borrowers and SME entrepreneurs. If a bank is unable to recover the amounts due within a reasonable period, the bank may write off the loan. However, even in these cases, efforts should continue to make recoveries.

iii) SARFAESI Act, 2002

Banks utilize the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) as an effective tool for NPA recovery. It is possible where non-performing assets are backed by securities charged to the Bank by way of hypothecation or mortgage or assignment. Upon loan default, banks can seize the securities (except agricultural land) without intervention of the court. The SARFAESI Act, 2002 gives
powers of "seize and desist" to banks. Banks can give a notice in writing to the defaulting borrower requiring it to discharge its liabilities within 60 days. If the borrower fails to comply with the notice, the Bank may take recourse to one or more of the following measures:

- Take possession of the security for the loan
- Sale or lease or assign the right over the security
- Manage the same or appoint any person to manage the same

The SARFAESI Act also provides for the establishment of asset reconstruction companies regulated by the RBI to acquire assets from banks and financial institutions. The Act provides for sale of financial assets by banks and financial institutions to asset reconstruction companies (ARCs). The RBI has issued guidelines to banks on the process to be followed for sales of financial assets to ARCs.

iv) Through website

The present era is the internet era, RBI provide website like www.NPAsource.com to sell the mortgaged assets banks and ARCs can conduct an auction through this website in an effective manner.

EX. RECOMMENDATIONS

In the above study it can be concluded with some proper recommendations to manage NPAs with an efficient and effective manner. Some of the recommendations can be provided by dividing before advancing and after advancing explained as follows:

1) Before advancing

- The bank should find the proper reasons prior to provide loans and should verify the purpose of loan required by the borrower.
- The bank should verify the financial strength of the borrower whether he can repay or not.
- The bank should go for credit analysis, i.e., Credit execution and administration, Credit appraisals with the help of CIBIL (Credit Information Bureau India Limited). They should concentrate on short term funds rather than long term because chance to repay will high and working capital will be adequate.
- Diversification of funds is needed means by investing total in one area you can reduce the risk through diversification to various sources.
- Banks are under the control of RBI nowadays the regulatory authority is easing the norms on PSBs there is chance of easing the more norms to reduce NPAs.
- Banks should go their policies and procedures strictly.
- They should go with proper collateral security.

2) After advances:

- Need to keep an eye on borrower whether he is paying proper payments are not.
- If proper repayment is not there banks should critically examine and analyze the reasons behind time overrun.
- Creation of separate department for recovery of loans with a proper officer.
- Some studies reveal that bank officials are hesitant to sell bad loans because they fear this might be perceived as an admittance of failure to recover the loan. To sell bad loans to ARCs (Asset Reconstruction Companies) leads some recoveries.
- There is a need to strengthen and fasten the recovery of loans by banks.
- Bank officials should frequently visit the unit and should verify the physical position of assets and how it manages because if one unit/branch fails affects the total productivity of the entire bank.
- Banks should go with various recovery strategies and recovery options to manage NPAs in an effective and efficient manner.
- They should have proper monitor and manage to control NPAs.

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