International Journal of Scientific Research in Science and Technology
Available online at : www.ijsrst.com
OPEN ACCESS
Print ISSN: 2395-6011 | Online ISSN: 2395-602X
doi : https://doi.org/10.32628/IJSRST24254411

Non-Performing Assets - Content Analysis and Suggestions for Resolution

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ARTICLEINFO

Article History:

Accepted: 02 Feb 2024
Published: 13 Feb 2024

Publication Issue :
Volume 11, Issue 1
January-February-2024
Page Number :
489-499

ABSTRACT

Non-performing assets also known as Bad Loans have played havoc with financials of Scheduled Commercial Banks (SCBs) in India from 2015 to 2022. The NPAs started piling up after an abnormal growth in advances of these banks in the developmental phase unleashed by the Government of India after the 2008 Global crises. The period witnessed a rise in manufacturing and infrastructure project financing imbued with over optimism of promoters for success and profitabilty. Banks vied with one another to share a piece of pie for opportunities in sectors like Iron and Steel, Mining, Aviation and Road Construction. The spurt in advances of banks also witnessed a simultaneous rise in their bad loans. NPAs have impacted negatively the financial performance of various Indian banks over the years (Sharma & Dhiman 2023). Though Non-Performing Assets cannot be wiped off completely from the advances portfolio of the banks yet it is important to control this critical parameter of financial performance of the banking sector. Management of NPAs is significant for bank profitability and growth of the economy. Bad debts or NPAs are not always created due to the fault of a bank. Though managements of different banks try their best to reduce NPAs but due to various macroeconomic, borrower related and at times bank related specific factors it is not possible to eliminate these altogether from the banking book. However prudent board policies, proper pre-sanction appraisal of borrowers and post sanction forensic audit of disbursements to large borrowers by the banks can go a long way in curbing the menace of bad loans.

Keywords : PSBs, NPAs, Growth, Reasons

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I. INTRODUCTION

To bring banking to the masses, major private sector banks in India numbering 20 were nationalised in the year 1969 and 1980 by an ordinance and subsequently through an act of parliament. Many new generation private sector scheduled banks also came into existence after the financial sector reforms of 1992. The banking sector in India now comprises of Scheduled Commercial Banks (SCBs), Cooperative Banks and Local Area Banks. Nationalised Banks, State Bank of India, Private Sector Banks and Foreign Banks are categorized as SCBs.

Government having full control over the managements of 'Nationalised Banks' after 1980 directed these banks to open branches in unbanked areas to widen their reach for credit delivery and make them accessible to the common man. Such nationalised banks were directed to adhere to 'Priority Sector' targets for agriculture, small scale industry and small businesses for boosting economic activity. Accordingly these banks served the important social purpose of upliftment of rural poor and giving a fillip to the small businesses, agriculture, small and medium industry.

The expansion of needs of society to grow economically made its dependence heavy on banks. Banks too grew in size with passage of time by opening more and more branches to expand business for earning higher incomes. With growing economic development and credit needs of the society banks too focused on higher credit deployment rather than keeping surplus money in low yielding government securities. The bad loans or non-performing assets also started growing due to default by traders and industry. Banks world over grapple with Non-performing Loans (NPLs) as bad loans are known internationally. There cannot be a situation that a bank has zero non-performing assets. The quantum of such undesirable assets may vary from bank to bank. Any rise in such bad assets is a concern for the bank managements and their regulators.

1.1 Concept of Non-Performing Loans

As per RBI policy guidelines, when an asset, including a leased asset, ceases to generate income for the bank it is called a non-performing asset. Accordingly a non-performing asset is defined as a credit facility in respect of which the interest and/or instalment of principal has remained 'past due' for a period of more than 90 days. The guidelines relating to classification of various credit facilities as non-performing are issued by Reserve Bank of India through Master Circulars to banks.

Classification of NPAs

NPAs are generally classified into two categories:

- Gross NPA
- Net NPA

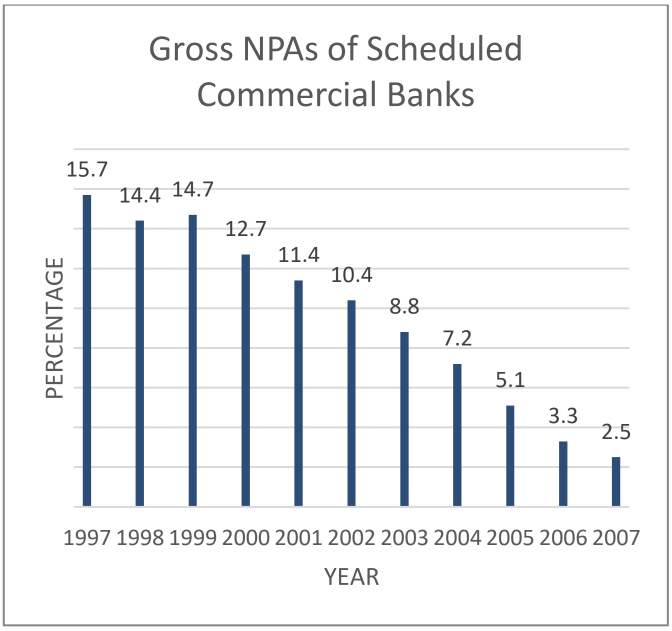
Gross NPA is the total of all sums due by a borrower to the bank on date when the account is termed as non-performing which may include the principal and interest or both.

Gross NPA minus the provisions held in the accounts are termed as Net NPA in terms of regulation.

1.2 Growth of non-performing assets

The expansion of needs of society to grow economically made its dependence heavy on banks. With growing economic development and credit needs of the society banks too focused on higher credit deployment rather than parking surplus money in low yielding but safe government securities. With growing economy the non-performing assets also started looking up due to default by traders and industry. Diversion of bank funds for unproductive uses and personal needs of borrowers is considered as a significant reason for accounts turning non-performing. Due to debt-waiver schemes announced by the government the farmers who were regular in repayments to banks too started making defaults on their agricultural loans. Banks world over grapple with bad loans or Non-performing Loans (NPLs) as these are known internationally. There cannot be a situation that a bank has zero non-performing assets. The quantum of such undesirable assets may vary from bank to bank. Any rise in such bad assets is a concern for the bank managements and their regulators.

Banking business though looking very attractive and profitable has its own challenges The foremost being to keep the deposits mobilised from public safe and returning it to them timely on demand with the contracted rate of return. Profits have to be generated by judicious deployment of capital and the deposits (liabilities) in avenues which give higher return than to be paid to depositors. Shareholders have also to be given a reasonable return on their equity which is expected to be more than the bank deposit rates. Public sector banks have the added responsibility to do social lending, the objective for which these were nationalised. Directed lending by the government and the regulator did not leave these banks much space for profitable lending. Many researchers have pointed to the fact that priority sector lending generated huge NPAs for the banks. However others have observed that this may not be an accurate finding (Swamy2013). It is very interesting to note that Scheduled Commercial Banks in India were also having a high incidence of NPAs in the nineties when economic reforms were being enunciated in the country. The non- performing assets touched a high of 15.7 percent in 1997. A committee constituted by the Government in the same year to examine the possibility of Capital Account Convertibility recommended to bring down this level but due to moral hazards, the bad loans were not allowed to be hived off and sold to Asset Reconstruction Companies by banks as suggested by NC-I. Accordingly banks were made responsible for reduction of Non-performing assets through recovery by regular follow-up. As government holding was brought down through Initial Public Offers and listing of shares in different nationalised banks, these were subjected to same disclosure requirements as other listed companies. Accordingly there was an urgent need to curb the menace of non-performing assets in banks to present an investor friendly scenario. With enforcement of regulation Non-Performing Assets of SCBs were brought down to 11.4 in 2001 and to 2.5% in 2007 (Figure 1.2.1):



(Data Source: RBI)

Figure 1.2.1: Gross NPAs of Scheduled Commercial Banks

There was economic turmoil in the aftermath of bankruptcy of 'Lehman Brothers' in September 2008 resulting in a global crisis. Government of India in order to boost the economy initiated large scale government sponsored investment in industries like iron ore and coal mining, power generation, roads and ports (air and sea) development, airlines, steel production, telecom and other infrastructure. This brought prospects of growth to the Indian economy. It was mostly the Public Sector Banks which made a beeline in the loan syndication meetings to garner share of advances in large green field projects as above with huge capital investment outlays. Private sector banks which were convenors of meetings for syndication of loans focussed on non-interest income due to their risk aversion. These private banks thus pocketed substantial non-fund business from such new entrepreneurs besides hefty fees as arrangers and syndicators.

There was a steep rise in lending and consequent growth of advances especially in Public Sector Banks. The advances of Scheduled Commercial Banks rose from Rs 43. 58 lakh crore in 2011 to 84.71 lakh crore in 2017. The Public Sector Banks too witnessed a sharp spike in advances from 33.47 lakh crore in 2011 to 58.66 lakh crore in 2017. Having more than 70 percent share in credit business of SCBs from 2011 to 2017 which can be termed as large it is but logical that PSBs too had a higher share in non- performing assets.

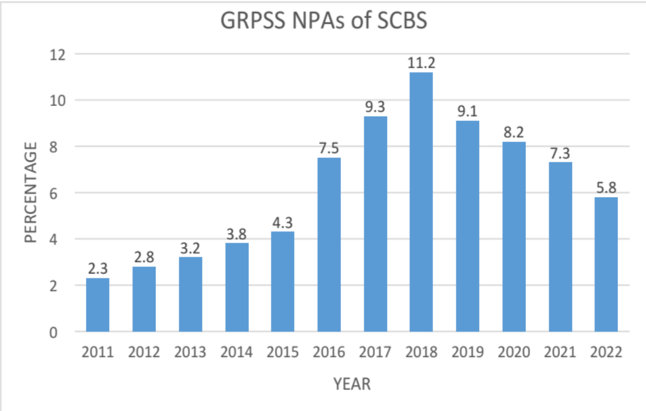


Figure 1.2.2 Gross Non-Performing Loans of SCBs

The figure 1.2.2 explains that NPAs of banks in the country grew from 2.3 percent of total advances in 2011 to 11.2 in 2018 percent (more than quadrupled) in a span of 8 years. However it is noteworthy that in a short period of 3 years the NPAs more than tripled from 3.8 percent in 2014 to 11.2 percent in 2018. The accounts which were stressed came to the fore in this period and were booked as NPAs. The steep increase in NPAs from 2014 to 2018 is due to forcing of banks to be transparent by RBI and undertaking inspection of major accounts of all banks by way of AQR:

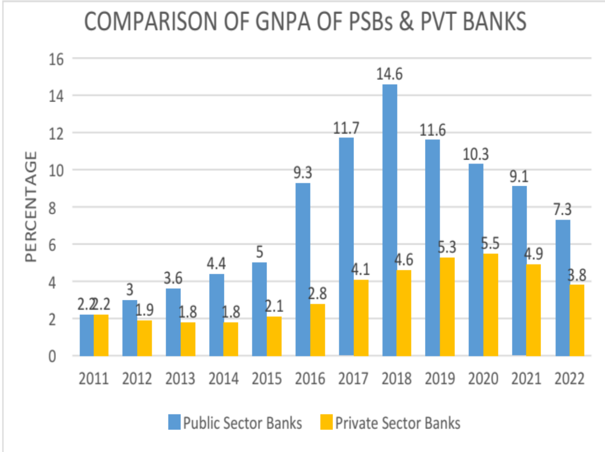


Figure 1.2.3 Gross NPAs of Public Sector & Private Sector Banks

2. Reasons for Growth of Non-Performing Assets

In the context of Reasons for NPAs the comment of Ex-Governor, Reserve Bank of India **Rajan (2018**) is significant stating that 'I have not seen a study that has unearthed the precise weight of all the factors responsible'. The comment speaks volumes for the all inclusive reasons of non- performing loans of banks. However a content analysis of the banking literature brings to the fore many reasons relating to the three categories namely Business environment (ER) Borrowers (BR) and the Bank itself (IR) as under:

Reasons of Non-Performing Assets (CODES FOR CONTENT ANALYSIS)

External Reasons (ER)

- **ER 1-** Decline in GDP, high inflation, recession and the resultant slowing economy, business environment , over optimism for fresh investments and natural calamities
- **ER 2-** Abrupt Change of Government Policies/ Regulations
- **ER 3-** Moral Hazard, Regulatory Forbearance, Excessive Risk Taking , Political and Social Implications
- **ER 4-**Malfeasance/Wrong doing
- **ER 5-**Transformation of major term lending institutions into universal banksas commercial

banks' lack of expertise to appraise projects of various industries

- **ER 6-** Adverse Exchange Rate movements resulting in huge losses for projects which did not exercise hedging options. Externalisation problems from countries having difficult balance of payments position and consequent restrictions on remittances of payments for imports , Non-payment and overdues in other countries, Disputes in Terms of Trade, Interest Rate Hike
- **ER 7-**Raw Material / Power Shortages and price increase
- **ER 8** Asset Quality Review by Regulator to reflect true state of NPAs
- **ER 9-** Delay in payment of dues by Government Departments
- **ER 10-**Lack of Efficient Legal System and absence of Bankruptcy Laws

INTERNAL REASONS (IR)

- **IR 1-** Incompetent Boards**,** Credit Policy of Banks, Inadequate Risk Assessment , Excess exposure to Corporate, Rapid Credit Growth, Weak Corporate Governance, Connected Lending, Corporate Bank Nexus, Inefficient operations
- **IR 2-** Due diligence of borrower, Lack of effective coordination between banks & financial institutions in respect of Large Value Projects at the implementation stage, Non –sharing of information with other banks/ members of Consortium about borrower
- **IR 3-** Weak appraisal of credit needs, Collateral based lending Vs Cash, Unrealistic Terms of Credit (Repayment and Moratorium**),** Lack of knowledge & training of staff
- **IR 4-** Collateral based lending/ Low collaterals
- **IR 5-** Delay in sanction and disbursement of working capital funds / limits
- **IR 6-** Poor post sanction follow up and supervision(Slackness on the part of the credit management staff in their post sanction follow up to detect and prevent diversion of funds), Lack of advanced collection system
- **IR 7** Non-transparent accounting policy and poor auditing practices
- **IR 8-** Directed and target oriented credit (as per Government priorities) to lend to priority sectors of economy
- **IR 9-** Use of technology (System based) to crystallize bad loans as per NPA norms to bring about transparency as directed by the regulator resulted in massive NPAs.
- **IR 10-** Mismatching of maturity of deposits and tenor of loan products

BORRPWER RELATED (BR)

- **BR 1-** Lack of Planning **/**Incompetent Management & Lack of Entrepreneurship/ failure in financial administration
- **BR 2-** Unscrupulous borrowers with dubious integrity having resorted to Diversion of short term funds for long term uses and/or to unrelated businesses and/ or misused the Restructuring Norms
- **BR 3-**In case of External Commercial Borrowing (ECB)/ Foreign Currency Loan (FCL) keeping the position unhedged
- **BR 4-** Wrong choice of technology/ Technical problems, product obsolescence and business failure
- **BR 5-**Management / Labour Disputes
- **BR 6-**Lack of Interest , Non cooperation to bring further equity
- **BR 7-**Wilful Default
- **BR 8-** Fraud (Siphoning of money), Over-invoicing of project-cost
- **BR 9-** Time and Cost Overrun
- **BR10** - Poor credit collection, Dependence on Single Customer

2.1 Content Analysis

A content analysis (using ATLAS ti software) crystallises the following broad categories / codes of reasons for growth of Non-Performing Assets in banking institutions worldwide :

The ten codes each incorporating different reasons for generation of Non-Performing Assets (Annexure-I) under the three categories as above are enumerated by the various authors on pages in their respective papers as per references /bibliography as under:

EXTERNAL REASONS (ER) OF NON-PERFORMING ASSETS

ER 1-The external reasons ER 1 attributed for growth of NPAs in the banking system are explained by Abel and Szakadat p-3, Ahmed and Jagdeeshwaran p-4, Erdas p-16, G.P Muniappan p-5, Jolevski p-5, Joseph et al., p-1, Kalpesh Gandhi p-3, Korde & Laghate p-10, Nir Klein p-7, Raghuram Rajan p-1, Santi Maji p-3, Sulagna Das & Abhijit Dutta p-3, Swamy p-9.

ER 2- Ahmed Fareed p-2, Bhasin p-6, Joseph et al., p-1, Raghuram Rajan p-2, Tandon et al.,p-3, Wadhwa & Ramaswamy p-2.

ER 3 - Aristobulo Juan p-8, Arpita Ghosh p-32, Ashly Lynn Joseph p-3, Barseghyan p-3, Berger & Young p-6, Fofack p-10, Joseph et al., p 9, Nir Klein p-21, Sheng p-13, Swamy p-7

ER 4 -Raghuram Rajan p-3, Sengupta & Vardhan p-14.

ER 5 – Mukhopadhaya Abhijit p-8, Sengupta & Vardhan p-13, Shakti Kanta Das p-3.

ER 6 -- Bhasin p-6, Bock & Demyanets p-6 & 9, Fofack p-8, Jolevski p-5, Joseph et al., p-7 & 10, Kalpesh Gandhi p-3, Nir Klein p-5, Prashant Reddy p-8 & 12.

ER 7- Ahmed Fareed p-2, Ashly Lynn Joseph p-3, Dahiya & Bhatia p-3, GP Muniappan p-5.

ER 8-Mukhopadhya Abhijit p-4, Sheng p-13

ER 9- Shakti Kanta Das p-4

ER 10-Dahiya & Bhatia p-3, Dhananjaya & Krishna Raj p-1, Evelyn Richard p-5, Prashant Reddy p-8 , 12 & 14, Rashmi p-3, Adhikary B.K p-3.

INTERNAL REASONS (IR) OF NON-PERFORMING ASSETS

IR 1- Alshebmi p-3, Ari etal., p-13, Aristobulo p-5 & 6, Berger & Young p-6, Bhasin p-3, Dhananjaya p-2, Erdas p-2, Fogalia p-1, GP Muniappan p-6, Jolevski p-5, Kalpesh Gandhi p-3, Louzis et al., p- 8 &10, Mukhopadhhya Abhijit p 2 &3, Nir Klein p-21, Raghuram Rajan p-3, Ranjan & Dhall p-7, Santi Maji p-4 & 5, Sengupta & Vardhan p-14, Shakti Kanta Das p-3 & 4, Sheng p-12, Swamy p-8, Tamal Dutta Chaudhuri p-8.

IR 2- Alshebmi p-4, Beaton p-4, GP Muniappan p-5, Tamal Dutta Chaudhuri p-8, Tandon et al., p-3.

IR 3-Abel & Szakadat p-3, Ahmed & Jagdeeshwaran p-4, Evelyn Richard p-5, Fofack p-8, Fogalia p-1, Korde & Laghate p-9, Ranjan &Dhall p-2, Rashmi p-3, Tamal Dutta Chaudhuri p-9.

IR 4-Barseghyan p-3, Beaton p-4, Ranjan & Dhall p-10, Tamal Dutta Chaudhuri p-9

IR 5- Bamoria & Jain p-2

IR 6- Ahmed & Jagdeeshwaran p-4, Ari, Chen & Ratnovski p-12, Dhananjaya & Krishna Raj p-2, GP Muniappan p-6, Korde & Laghate p-10, Ranjan & Dhall p-8, Sulagna Das & Abhijit Dutta p-3, Adhikary B.K p-3.

IR 7-Tamal Dutta Chaudhuri p-8

IR 8-Sulagna Das & Abhijit Dutta p-3, Swamy p-8, Tamal Dutta Chaudhuri p-8

IR 9-Kalpesh Gandhi p-3, Shenbagavalli p-3

IR 10-Chandrasekhar & Jayanti Ghosh p-3 and p-4

BORRPWER RELATED (BR) REASONS OF NON-PERFORMING ASSESTS

BR 1- Evelyn Richard p-5, GP Muniappan p-5

BR 2- Bamoria & Jain p-2, Evelyn Richard p-1 and p-3, Joseph Edson et al., p-1, Tamal Dutta Chaudhuri p-8, Tandon, Chaturvedi & Vidyarthi p-4, Wadhwa & Ramaswamy p-2

BR 3- Bock & Demyanets p-9, Nir Klein p-21

BR 4- Ahmed Fareed p-2, Ahmed & Jagdeeshwaran p-4, Berger & Young p-5, Kalpesh Gandhi p-3, Shenbagavalli p-6

BR 5- Ahmed Fareed p-2, Dahiya & Bhatia p-3, Dhananjaya & Krishna Raj p-2

BR 6- Ashly Lynn Joseph p-3

BR 7- Dhananjaya K p-2, Korde & Laghate p-10, Mukhopadhaya Abhijit p-2, Shenbagavalli p-6

BR 8- Aristobulo Juan p-5, Bamoria & Jain p-2, Mukhopadhay Abhijit p-2, Raghuram Rajan p- 2
BR 9- Bhasin p-6 , Kalpesh Gandhi p-3, Ranjan & Dhall p-6, Sulagna Das & Abhijit Dutta p-3, Wadhwa & Ramaswamy p-2
BR 10- Rao & Patel p -3.

3. SUGGESTIONS FOR REDUCING NON-PERFORMING ASSETS OF PUBLIC SECTOR BANKS:

-Pre-sanction appraisal as to the 'cash generating capacity' of the project and its overall viability should be an essential aspect of providing financial assistance to a borrower.

-Projected plan for new units/ expansion of existing units should be compared with the growth in production of peer companies.

-Lack of Pre-sanction appraisal and Post-sanction Credit monitoring has contributed to the burgeoning of NPAs of Public Sector Banks in the past as confirmed by the 'Content Analysis' in this study. It is therefore critical that PSBs give due importance to these two important aspects of credit dispensation.

-Qualitative periodic appraisal of financial statements understanding the unhealthy developments in borrowal accounts can put the banks on guard and should lead to cessation of further disbursements.

-Early symptoms of sickness should be discussed with borrower / member banks in consortium accounts without losing precious time .A remedial plan of action like necessity of a 'Restructuring Feasibility Study' should be undertaken at early stages of weakness for revival of borrowal companies.

-Periodic / regular inspections of the unit , hypothecated/pledged primary securities and verification of collateral security must be undertaken at regular intervals in terms of sanction. At the time of sanction attempts be made to get charged the residential house/s , Guest houses of individual borrower/ companies besides primary securities as these are highly priced and carries sentimental value to the borrowers.

-Stock audit by external professionals like Chartered Accountants at least once in a year for large borrowal accounts must be implemented.

-The banks should undertake 'Forensic Audit' post-Disbursement of High Value Loans (Rs.100 crores and above) to avoid diversion of funds leading to incidence of NPAs.

-Timely valuation of assets charged to the bank must be got done at least once in three years.

-ASM (Agency for Specialized Monitoring) should be appointed for accounts over 150 Crore exposure to undertake concurrent review and monitor end use of funds by the borrower .

-Recalling the advance should not be delayed in cases when it appears /proved that borrower is diverting bank funds for some other purpose or is diluting the securities offered.

-Timely initiation of all recovery actions simultaneously be done after recalling the advance. The action should be followed up regular by concerned officials till a logical conclusion.

-Bank officials should focus to take physical possession of securities within vested powers by laws like SARFAESI for improving success rate of sale of securities to fetch better realisation.

-E-auction of properties should be conducted with proper publicity and with reasonable period of notice to attract more bidders.

-Examination of Wilful and Fraud type of accounts should be done promptly in a time bound manner to bring the borrower to negotiating table for settlement of loan account.

-Initiation of legal action on the personal guarantor and corporate guarantor for individual and companies respectively must be initiated faster as a pressure tactic.

-Filing of CAVEAT as remedial measure to delay legal action by the borrowers. This will prevent granting of relief , if any, to the borrowers filing claims against the banks.

-Detective agencies can be approved and hired to locate attachable properties /assets of the NPA borrowers/ guarantor not disclosed earlier for bank record .

-Transfer of NPA accounts to NARCL/ ARCs should be expedited for their early resolution/ sale to bidders as delay in sale /disposal of assets may erode the underlying value substantially.

-Instead of putting emphasis on improvement of Net Interest Margin (NIM), the banks should focus more on high rated corporate accounts. This may require lending at lower interest rates but will ensure safety of funds and avoiding write off of bad assets and thus improve profitability

-The top management of PSBs should have a tenure of at least 3-4 years to make them accountable for Bad Lending within Head Office Powers as bulk of the wilful Defaulters are the borrowal accounts having sanction of loans at Corporate Office.

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Cite this Article

Dr. Parmod Kumar Sharma, Dr. Babli Dhiman, "Non-Performing Assets - Content Analysis and Suggestions for Resolution", International Journal of Scientific Research in Science and Technology (IJSRST), Online ISSN : 2395-602X, Print ISSN : 2395-6011, Volume 11 Issue 1, pp. 489-499, January-February 2024. Available at doi :
https://doi.org/10.32628/IJSRST24254411
Journal URL : https://ijsrst.com/IJSRST24254411