Int. j. adv. multidisc. res. stud. 2023; 3(5):640-643

Received: 08-08-2023
Accepted: 18-09-2023

International Journal of Advanced Multidisciplinary Research and Studies

ISSN: 2583-049X

Non Performing Assets of Indian Commercial Banks: A Study

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Abstract

Banking industry is the backbone of our economy and playing a crucial role for the development of the nation. This industry is experiencing significant difficulties due to rise of Non-Performing Assets (NPAs). The increase in NPAs has a direct influence on bank's profitability. A high degree of NPAs indicate a high possibility of credit defaults. This paper is an attempt to study Non-Performing Assets status, impact and trends of NPAs in Indian scheduled commercial banks.

Keywords: NPAs, Scheduled Commercial Banks, Banks Profitability

1. Banking Industry-Overview

The current Indian banking sector is made up of 12 public sector banks, 22 private sector banks, 46 foreign banks, 56 regional rural banks, 1485 urban cooperative banks, and 96,000 rural cooperative banks. 14 major banks were nationalized in 1969 and six more banks were nationalized in 1980. There is an increase of bank assets since 2020 and also the combined assets of both the public and private sector banks.

Basel Norms

The Basel Committee on Banking Supervision (BCBS) implemented the Basel Norms as the standards for global banking laws. These standards aim to harmonize international financial legislation and enhance the global banking system. Basel I, II, and III are the three guidelines that the Basel Committee had released to achieve its goal.

	BASEL I	BASEL II	BASEL 2.5	BASEL III
Date of issue	1988	2004 -implemented in EU under CRD 2006	2011	2010 (proposed) 2013-2019 (implementation period)
Purpose	• contained a set of minimum capital requirements for banks	• "three pillars" concept was introduced • more risk sensitive	• adds market risk capital requirements	• created in respond to the global financial crisis
The main area of focus	• credit risk (default risk) • **risk-weighting of assets (RWA)** introduced by creating the classification system grouped a bank's assets into **5 risks categories:** - 0% - cash/central bank/ government debt - 20% - development bank debt/OECD bank debt… - 50% - residential mortgages - 100% - private sector debt - Some assets given no rating	• **"three pillars" concept was introduced:** I. **Minimum capital requirements** (for credit, market, operational risk) **II. Supervisory review** III. **Market discipline** (based on market disclosure) **Calculation on minimum capital requirements:** **I. Credit risk:** -The Standardised Approach -The Internal Rating Based Approach (IRB) -Securitisation Framework **II.Operational risk** **III. Trading Book Issues** (inc. market risk)	• stressed value-at-risk • a new trading book framework with an Incremental Risk Capital Charge (IRC) • a new measure to correlate trading activities - Comprehensive Risk Measure (CRM)	• Credit Risk • Market Risk • Operational Risk • Liquidity Risk **+2 new liquidity ratio:** - Liquidity Coverage Ratio - Net Stable Funding Ratio
CAR- capital adequacy ratio	**8% of the RWA** • Tier 1 Capital (Equity Capital and retained earning) - equal or more than **4%** • Tier 2 Capital -Subordinated Debt • Total Capital: Tier 1 + Tier 2 - equal or more than **8%**	• The total capital ratio must be **no lower than 8%** • Tier 2 capital is limited to 100% of Tier 1 capital.	———	• CET 1 2% -> **4%** • Capital Conservation Buffer 2.5% -> **7%** • Counter-cyclical Buffer between **0% - 2.5%** • Leverage Ratio - **3%** own funds

Source: Reserve Bank of India

Fig 1: Basel Norms

Objectives of the Study

1. To study non-performing assets and the underlying reasons for the emergence of NPA's.
2. To study the impact of Non Performing Assets on the operations of the commercial banks.
3. To know what steps are being taken by the Indian banking sector to reduce the NPA's and to examine the current status of NPAs.

2. Literature Review

Sunil b. Kapadia, Venu V. Madhav (2019) in their article "**Non- Performing Assets in Indian Scheduled Commercial Banks: Origination and Impact on Economy**" opined that the root cause for the rise in NPA's is the 2008 Global financial crisis other than lending to priority sector. Several measures were taken to curb NPA's through BIFR/SICA, Lok Adalats, DRTs, OTS, SARFAESI etc, yet there is no concrete solution has been identified in tackling NPA's. They found that how NPA's level has risen in Scheduled Commercial Banks post 2008 financial crisis. It is further concluded that with the establishment of National Company of Law Tribunal (NCLT) there is a chance that resolution process could be a much needed solution in case of default promoters. **Praveen S Kambar (2019)** in his paper "**A Study of rising Non Performing Assets (NPAs) in the Indian Banking Sector and its adverse effects**" had concluded that the banking sector is not only to provide financial resources to the different needy sectors but also acting as an agent of finance intermediation. According to the suggestions of the experts creation of a single 'bad loan' under consolidation bank can be resolved in a simple and faster decision making after consideration of complexities and the number of lenders in different sectors. It is further observed in the past that most of the private banks go for co-operative sector either being wounded or merged with the other banks. **Manisha Raj, Aashita Jain, Shruti Bansal, Tanya Verma (2018),** in their research article on "**Non-Performing Assets: A Comparative study of SBI & ICICI Bank from 2014-2017"**, analyzed the impact of NPA on Profitability position and performance of the selected banks. On the basis of completion, SBI has shown higher NPAs because of its nature of existence when compared to ICICI Bank. It is concluded that ICICI has a high degree of negative correlation but it has shown insignificant correlation coefficient due to the impact of other factors on profitability of any banks other than NPAs.

3. Non Performing Assets

Anything possessed is referred to as an asset. Because the interest paid on the loans is the bank's most important source of income, a loan is an asset for banks.

The asset for the bank becomes "non-performing" when clients, whether corporate or retail, are unable to pay the interest since it is not producing any income for the bank. NPAs are therefore defined by the RBI as assets that stop producing revenue for them.

Non-Performing Assets, or NPAs, are like a cancer worm that has been slowly but surely devouring India's banking sector. NPAs are subprime loans held by banks or other financial institutions where the principle, interest, or both are past due. Usually, this period lasts 90 days or longer. Like any other business, banks also need to make a profit, but NPA reduces their operating margin.

Classification of Non Performing Assets

- **Sub-standard Assets:** NPAs have aged <= 12 months.
- **Doubtful Assets:** When the NPAs have aged > 12 months.
- **Loss Assets:** An asset which is identified by Bank or by internal/external auditor/RBI as loss assets which has a lower salvage value.

Types of NPAs

Banks are obliged to periodically state their NPA figures to the RBI and to the public.

In the bank's standalone financial statements, NPA statistics are disclosed.

- GNPA: Gross non-performing assets are a precise sum. It provides information about the overall amount of gross non-performing assets held by the bank for a specific quarter or financial year, as applicable.
- NNPA: Net non-performing assets stands for NNPA. The bank's provisions will be deducted from the total NPA to calculate NNPA. As a result, net NPA provides the precise value of non-performing assets following particular allowances made by the bank.

4. Reasons for NPAs

We find Numerous Reasons for Rise of NPAs in India, which are

- Historical factors
- Relaxed lending norms
- Poor Contingency Plan
- Poor Restructuring and loan servicing
- Unforeseen conditions
- The problem of Wilful Defaulters
- Poor Governance
- Unsustainable Competition

5. Impact of NPAs

- Rising NPAs harm the bank's reputation which leads to public distrust of banks. Depositors' cash may be withdrawn, causing banks to run out of liquidity.
- Due to a lack of liquidity, banks are not able to lend for other productive activities in the economy.
- A decrease in investment may lead the economy to stagnate, resulting in unemployment, inflation, a bear market, and other negative consequences.
- In order to maintain profit margins, banks are forced to boost interest rates, further damages the economy.
- If a bank starts incurring losses and the underlying issues are not fixed, the issue might become chronic and destroy depositor confidence.

6. Strategies for Reduction of NPAs

In India, NPAs are not a recent concern, and the government has made several efforts to deal with them on the legal, financial, and regulatory levels. In 1991, the Narasimhan Committee proposed a variety of actions to address nonperforming assets (NPAs). Some of these were applied in real life.

The Debt Recovery Tribunals (DRTs)-1993-Debt Recovery Tribunals (DRTs) are established under the Recovery of Debts and Bankruptcy Act (RDB Act) of 1993. These are established for a variety of purposes, including debt recovery, insolvency resolution, and individual bankruptcy.

Credit Information Bureau–2000-TransUnion CIBIL Limited was formerly known as Credit Information Bureau (India) Limited. It was started in 2000 and it is the first credit information company in India. It collects and keeps data on loans and credit cards from both private people and companies.

Lok Adalats–2001- Lok Adalat institutions help banks resolve disputes involving accounts categorised as "doubtful" or "loss," with an outstanding amount of Rs. 5 lakh for Lok Adalat compromise settlement.

Compromise Settlement–2001- A compromise settlement is a negotiated settlement in which the borrower offers to pay and the bank agrees to accept a lesser sum than the full amount owing to the bank under the applicable loan contract as a complete and final settlement of its dues.

SARFAESI Act–2002 The SARFAESI Act of 2002 set out to recover non-performing assets (NPAs) from banks and financial institutions in a prompt and efficient manner. Financial organizations and banks are given permission to sell residential and commercial property at auction if a borrower fails on their commitment.

ARC (Asset Reconstruction Companies) A type of financial company known as a "asset reconstruction business" purchases a bank's debtors at a price that is mutually acceptable to both parties and then attempts to collect the debts or associated securities on its own. The bank's debts that are categorized as Non-Performing Assets are partially assumed by the ARCs.

Corporate Debt Restructuring-2005 It is the reorganization of an insolvent company's current obligations to its creditors. Restoring a company's liquidity is the main objective of a corporate debt restructuring in order to help it avoid bankruptcy.

5:25 rule–2014 The 5:25 method enables banks to make long-term loans of 20–25 years while refinancing them every 5–7 years in order to meet project cash flow.

Joint Lenders Forum – 2014 when a loan worth more than Rs 100 crore is found to be a stressed asset, the Joint Lender's Forum is a specialized organization of lender institutions created to speed up decisions. The RBI published guidelines for the development of JLFs for the efficient management of stressed assets in 2014.

Mission Indradhanush–2015 As part of Mission Indradhanush for PSBs, public sector bank operations will be reorganized to enable them to compete with private sector banks.

Strategic debt restructuring (SDR)-2015 The Strategic Debt Restructuring Scheme, of the Reserve Bank of India (RBI), enables banks that have provided loans to firms to convert a portion of the entire outstanding loan amount plus interest into sizeable shareholder shares in the business.

Asset Quality Review–2015 In 2015–16, an original evaluation known as the Asset Quality Review (AQR) was carried out. The riskiness of the assets in a portfolio is assessed by asset quality rating. The evaluated banks exhibited greater levels of non-performing assets (NPAs) or asset quality deterioration, according the RBI's Asset Quality Report (AQR).

Sustainable structuring of stressed assets (S4A)-2016 The S4A Scheme enables lenders (banks) to buy stock in the stressed project in order to undertake a thorough financial restructuring of major debted firms. Large projects can have their finances restructured under the strategy, which also helps lenders manage stressed assets.

Insolvency and Bankruptcy code Act-2016 As non-performing debts increased, the Insolvency and Bankruptcy Code, 2016 (IBC) was implemented. By creating a consolidated structure for swiftly resolving individual, corporate, and partnership insolvencies, it seeks to address non-performing assets.

Pubic ARC vs. Private ARC–2017 The plan is based on the success of a comparable organization during the 1997 East Asian Crisis, and is referred to as PARA (Public Asset Rehabilitation Organization) in the economic study.

Bad Banks–2017 A "bad loan," one that has not been returned within the time limit stipulated or when projected payments have gone behind, is referred to as a non-performing asset (NPA) in the banking business. Any structure that enables the division of performing assets from non-performing assets, either on or off the balance sheet, is referred to as a "bad bank" in this context.

Recapitalisation of Banks The restructuring of a company's debt to equity ratio is known as recapitalization. Recapitalization aims to stabilize a corporation's capital structure. Due to their fragile balance sheets, public sector banks should receive equity capital injections from the government.

Prompt Corrective Action- The Prompt Corrective Action (PCA) strategy is intended to restore a lender's profitability, capital, and asset quality. The Reserve Bank of India (RBI) uses PCA to take action when a lender displays signs of distress.

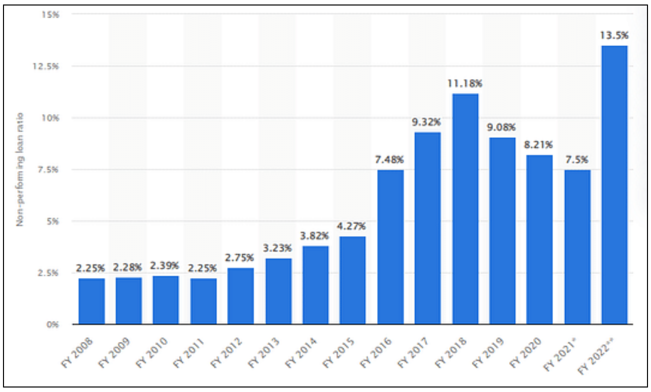

Fig 2: Trends of NPAs

- The Reserve Bank of India and the federal government's numerous actions, including the Insolvency and Bankruptcy Code and the repeal of earlier programs like the 5:25 rule, led to a decline in the NPA starting in FY 2018.
- The nation was anticipated to experience a rise in defaulted debts as a result of the coronavirus (COVID-19) epidemic's consequences and the lockdown.
- Based on the figure for September 2020, the Reserve Bank of India forecast three possibilities for the fiscal year 2022 till September 2021.
- In the basic case, the GNPA-ratio would increase to a new high of 13.5%.

7. Conclusion

In conclusion, it can be claimed that banks may greatly reduce their NPAs by implementing preventative steps, such as taking the corporate body's credit score into account before lending. Additionally, thanks to current laws like the

IBC (Insolvency and Bankruptcy Code) and SARFAESI as well as RBI guidelines, banks now have a post facto redressal procedure that is quicker than the usual drawn-out recovery process in the courts after loans have become NPAs. On the observation of statistical reports of RBI, NPAs growth rate is declining which is a positive sign but still RBI need to control more strategically to make all strategies successful in reduction of NPAs.

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