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Non-performing Assets Management and Its Impact on Indian Economy

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Introduction

Banking as we see in India today originated in the late 18th century. Bank of Hindustan and the General Bank of India were among the first banks ever established in India. The largest and the oldest bank which is still in existence is the State Bank of India (SBI) earlier known as the Bank of Calcutta. This was one of the three banks founded by a presidency Government; the other two were the Bank of Bombay in 1840 and the Bank of Madras in 1843. The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955. For years, the presidency banks had acted as quasi-central banks, until the Reserve Bank of India was established in 1935, under the Reserve Bank of India Act, 1934. Since then, the Indian Banking industry has seen revolution of unfathomable scale such as Banks being nationalized in 1969, introduction of CBS - moving on from maintaining records in ledgers to computers, Internet Banking – providing access of banking at the palm of accounts holders, introduction of third-party products like insurance, mutual funds, etc., mergers of banks and so on. Over 80% of Indians hold bank accounts and the number is growing day-by-day since the banking facility is now being also provided to people staying in remote areas through Business Correspondents and Village Level Entrepreneurs who facilitate the customers with opening of savings bank account, opening of fixed deposit accounts, carrying out transactions, passbook printing, issuing mini statements, etc.

Main Words: Non-performing Assets, Reasons of NPA, Kisan Credit Card, Early Warning Signals , Credit Risk Management

Indian Banking System may come have long way since its inception but the fundamental of banking has remained the same, that is, to accept the deposits from account holders at a certain rate of interest and lend the money to the needy and earn interest, this little interest margin between accepting and lending is what banks used to rely upon as their source of income.

But the odds have not always been in favor of Indian Banking Industry. Bank's have been susceptible to frauds, loans turning into Non-performing assets, mismanagement of funds, corruption, etc and hence, to protect the banks from losses which could arise due to aforementioned factors, the banks release new guidelines/circulars frequently and alter their policies from time to time after studying such cases. Given the circumstances, the banks may control a few challenges faced by them up to an extent except for one – loans turning into NPA, which is one of the biggest factors due to which few

Objectives:

- To study the NPA curve in Indian Banks.
- Impact of NPAs on Indian Economy.
- To study the ways in which Indian Banks should be strengthened in order to

effectively manage NPAs.

Research Methodology:

The approach used in order to cover the topic is Descriptive Research. Since now the results are declared by banks quarterly on public domains, the information is easily accessible on all the major web portals. It has been attempted to cover the topic with an overall view through studying the information available online, in books, newspapers, through feedbacks received in surveys and through personal interaction with the higher management staff members of top banks in India. In order to understand the real issues faced by banks on grass root level, personal interaction with bank staff members became an integral part of this research, which could be achieved through recommendations from one's friends or family members.

banks have been imposed with Prompt Corrective Action (PCA) - where the banks could not lend any further and must focus on recovering bad loans, banks have been merged/amalgamated into each other in order to manage the NPAs effectively and in a focused way.

Indian banks are increasingly focusing on adopting integrated approach to risk management. The NPAs (Non-Performing Assets) of commercial banks has recorded a recovery of Rs. 4,00,000 crores in FY19, which is highest in the last four years. State-run banks are seen being the worst-affected among bank groups with their Gross Non-Performing Assets (GNPA) ratio expected to increase to per cent by September 2021 under the baseline scenario from 9.7 per cent in September 2020. and to a high of 17.6 per cent in a severe stress scenario.

What are Non-Performing Assets (NPA)?

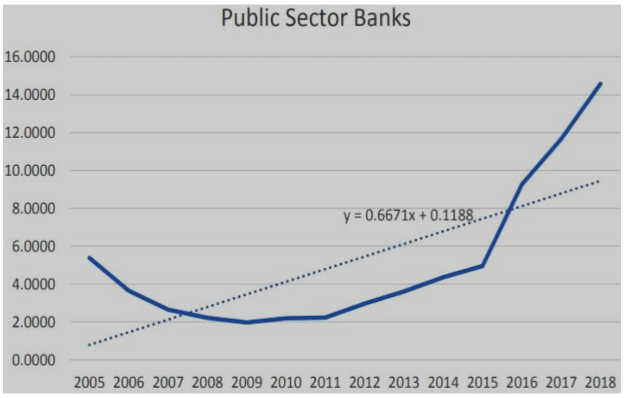
- Funds lent by banks to individuals or companies as loans when remain unpaid by borrowers turn into non-performing assets. They are also termed as bad assets.
- In India, the RBI monitors the entire banking system and as defined by the country's central bank, if for a period of more than 90 days, the interest or installment amount is overdue then that loan account can be termed a Non-Performing Asset.

Reasons for the Rise in NPA levels

- There are various types of credit facilities provided by the banks to individuals and firms viz. retail loans which include housing loan, vehicle loan, education loan, personal loan. Agricultural loans consisting of Kisan Credit Card, tractor loan, fisheries, animal husbandry, dairy farming, etc and business loans – loans provided to individuals or firms/companies under MUDRA scheme, MSME loans and loans to large corporates.
- The retails loans predominantly consist of facilities where the borrower is provided with the funds based on his needs at once and the borrower must repay the loan in form of deposits of a certain amount at the contracted rate of interest every month, generally referred to as Equated Monthly Installment (EMI). If the borrower fails to pay the EMI for continuously 3 months then that loan account is deemed as NPA.
- The MSME sector or the business loans where working capital is provided to the borrower in form of cash credit or overdraft, if the borrower fails to repay the interest amount for continuously 3 months or does not carry out sufficient turnover for 3 months or fails to submit the financials such as balance sheet, stock statements, etc, even then these accounts may turn into NPA.
- Agricultural loans, which come under Priority Sector such as Kisan Credit Cards have been exempted from the criteria of 3 months and are given a timeframe of 3 years to repay the loan amount.
- From 2000-2008, the Indian economy was in a boom phase and banks, especially public sector banks, started lending extensively to companies.
- However, with the financial crisis in 2008-09, corporate profits decreased, and the Government banned mining projects. The situation became serious with the substantial delay in environmental permits, affecting the infrastructure sector – power, iron, and steel – resulting in volatility in prices of raw materials and a shortage of

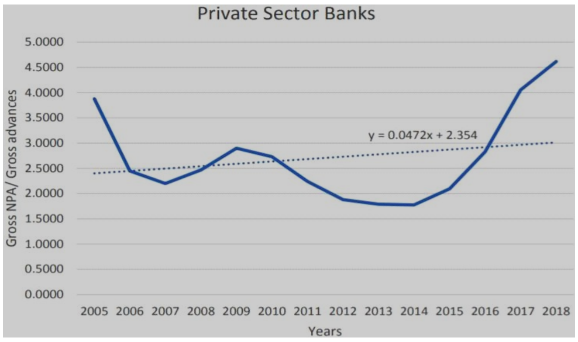
supply.

- Another reason is the relaxed lending norms adopted by banks, especially to the big corporate houses, foregoing analysis of their financials and credit ratings.
- Psychological factors–Debt waiver to agricultural loans announced by Uttar Pradesh was a great initiative by the state government which could boost the income of farmers, encourage them to repay the loans and restore their faith in banks – all these factors made the lives of farmers more prosperous and gave them a sense of confidence and hope, but did it really? Surprisingly, this scheme had a colossal impact on the mindset of farmers which made them question themselves that whether is it rationale to repay the loan amount. The debt waiver scheme provided coverage of up to Rs.1 lac, that is, the government was willing to waive off maximum of Rs. 1 lac from the amount outstanding in the loan account but there was a catch. If a borrower had deposited a certain sum in his loan account during the financial year 2016-17, the same will be reduced from the eligible amount of Rs. 1 lac. Simply put, a person who repaid his loan amount fully was deprived of debt waiver scheme and the one who didn't repay the loan was fully covered. This caused a paradigm shift in the mentality of borrowers and the loans which were being repaid timely are now turning into NPAs with hope that the debt waiver scheme will once again be implemented, and the borrowers may avail its full benefits without having to deduct the amount from eligible amount which was repaid by them during a certain period. Borrowers also bring up examples of the likes of Nirav Modi and Vijay Mallya.
- Uttar Pradesh being an agricultural state which can produce 7 crore tonnes of foodgrain, which is 20% of the country's total production, such mindset could turn out to be fatal and could pile up NPAs on a humungous scale.
- Year 2020 has seen one of the deadliest viruses of 21st century, which crippled the economies of countries within months. Banks have remained imperative in restoring India's economy during these tough times by providing moratorium periods for loans to customers, who were relieved of the financial obligation for 6-7 months. However, the dues of such installments and the interest not charged during this period were transmuted in the form of loans which were then to be repaid by the borrowers within 6 months. So, in a way borrowers were paying interest on interest which defeats the whole purpose of providing financial relief to the borrowers owing to outbreak of COVID-19 and is contradictory to what the government had promised earlier.



(Vrinda Batra1, Dr. Neetika Batra2, Trends and Differences in NPAs across Bank Groups in India, ISSN 0975-6477 Volume 12, Number 1 (2020), pp. 1-17)

The above graph shows that the NPAs of public sector banks are showing an increasing trend. The growth rate is 0.66% p.a.



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From the above graph, it is evident that the

NPAs of private sector banks are growing at a much lower rate of 0.047% p.a. as compared to 0.66% p.a. of public sector banks.

Recent Developments and Ways to Tackle NPA

- **Early Warning Signals (EWS)** – Banks have been implanting programs that could study the repayment history of loans and could predict that if the account could fall into NPA category at the end of month so that bank may act upon it quickly and may prevent the slippage of account into NPA.
- **Insolvency and Bankruptcy Code (IBC)** – With the RBI's push for the IBC, the resolution process is expected to quicken while continuing to exercise control over the quality of the assets. There will be changes in the provision requirement, with the requirement for the higher proportion of provisions going to make the books better.
- **Credit Risk Management** – This involves credit appraisal and monitoring accountability and credit by performing various analyses on profit and loss accounts. While conducting these analyses, banks should also do a sensitivity analysis and should build safeguards against external factors.
- **Involvement of local administrative bodies in recovery** – A large chunk of NPAs lies in the government sponsored schemes wherein a certain part of the loan is repaid by the government in form of subsidy. Since these are collateral free loans, the banks have no way to recover the funds if the borrower stops repaying the loan amount after receiving subsidy. These loans are mostly allotted by the local administrative authorities to branches of various banks and closely monitor the pendency of such loan proposals to be disposed off. But no support is provided by these administrative authorities at district level to banks when such loans turn into NPA.
- **Tightening Credit Monitoring** – A proper and effective Management Information System (MIS) needs to be implemented to monitor warnings. The MIS should ideally detect issues and set off timely alerts to management so that necessary actions can be taken.
- **Amendments to Banking Law to give RBI more power** – The present scenario allows the RBI just to conduct an inspection of a lender but doesn't give them the power to set up an oversight committee. With the amendment to the law, the RBI will be able to monitor large accounts and create oversight committees.
- **Strengthening of bank branches by providing them with adequate staff** – In current scenario of ever-changing banking system and addition of more and more customers to each bank branch with banks introducing third party products, where lucrative offers are made to staff members in order to complete the targets and providing unrealistic targets to bank branches, it is inevitable that at certain point, the process of recovery and effective credit monitoring is bound to be disdained. Special departments and task force must be setup in bank branches and well-trained staff members must be deputed in order to effectively monitor the credit portfolio.
- **Stricter NPA recovery –** Government needs to amend the laws and give more power to banks to recover NPA. Adequate police force must escort the branch officials during recovery of bad assets.
- **Government to maintain transparency while implementing policies –** Two of the biggest examples as cited earlier – UP government's debt waiver scheme 2017 and providing moratorium period to borrowers due to outbreak of COVID-19 were not implemented as projected, this created a sense of scepticism amongst the bank customers who remained uncooperative with the banks.
- **Corporate Governance Issues** – Proper power must be given to banks to hire and fire the executives at the topmost level in banks so that the deserving and capable candidates are given the opportunity to handle the burning issues effectively.
- **Accountability** – Lower-level executives are often made accountable today;

however, major decisions are made by senior-level executives. Hence, it becomes particularly important to make senior executives accountable if Indian banks are to tackle the problem of NPAs.

The banks should also consider raising capital to address the problem of NPA.

- **Using unclaimed deposits** – Similar to provisions for unclaimed dividends, the government may also create a provision and transfer unclaimed deposits to its account. These funds, in return, can be transferred to banks as capital.
- **Monetization of assets held by Banks** – In this case, banks with retail franchisees should create value by auctioning a bank assurance association rather than running it themselves as an insurance company. The current set-up blocks capital inflows and does not generate much wealth for the owners.
- **Make Cash Reserve Ratio (CRR) attractive** – RBI asks Indian banks to maintain a certain limit on CRR on which the RBI does not pay interest. Hence, banks lose out a lot on interest earnings. If the CRR is made more financially rewarding for banks, it can reduce capital requirements.
- **Disinvestment** – Disinvestment does not necessarily mean privatization; banks may raise capital by selling off some of its shares and attract private investors while remaining a public sector undertaking.

Conclusion –

Looking at the previous trend of NPA level in Indian Banks, it can be assumed that the graph of NPAs will remain on a rise in the coming times which seems daunting. The rising level of NPAs is a burning issue not only for small-sized banks but also for big banks and RBI must incorporate new policies and must circumvent a way to speed up the recovery process and get rid of unwanted formalities which are followed before initiating recovery proceedings. As per the guidelines, given by the RBI, banks are required to keep some amount as provision depending on their asset quality thereby leading to declining profitability of the banks. Hence, it impacts not only the profitability level of these banks but also affects the shareholders' wealth. The Insolvency and Bankruptcy Code of 2016 is playing an important role with regard to recovery of assets of those creditors whose case has been filed with the National Company Law Tribunal. It is also imperative to mention that the borrowers must also be counselled and educated about the ramifications once their accounts have turned into NPA. On the other hand, Indian economy has been reviving slowly and has shown a positive growth even during the pandemic in the last year. In the end, the banks must be empowered and must be provided with necessary support and infrastructure in order to deal with stressed assets effectively.

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