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MANAGEMENT OF NON-PERFORMING ASSETS (NPA): A STUDY OF INDIAN COMMERCIAL BANKS

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Abstract

The banking sector in India currently has non-performing assets (NPAs) that are both much lower than those of several economies and equivalent to those of numerous advanced economies. The RBI lists the decline in non-performing assets (NPAs) as one of the main accomplishments of the banking industry of India in the past year. However, the growing number of NPAs continues to be a major issue for the Indian banking industry. In general, Indian commercial banks have a propensity to understate their non-performing assets (NPA) ratios. One approach is to "ever-green" advancements by using subtle methods. The NPAs have negatively impacted banks' earnings potential and profitability. One of India's largest economic challenges is reducing non-performing assets (NPAs) in banks. This study aims to provide a basic diagnosis of the way commercial banks in India manage their non-performing assets (NPAs). Eventually, it has pinpointed a few of the gaps regarding the significant amount of bank non-performing assets (NPAs) and suggested tactics to address the unchecked outbreak of commercial bank viruses.

The single biggest source of concern for the Indian banking industry in recent years has been non-performing assets (NPAs). According to the Narsimham Committee (I), priority sector lending contributed to the accumulation of bank non-performing assets (NPAs) and was the primary cause of the commercial banking industry's deteriorating profitability and losses in India.

The main roles of banks can be categorized as taking deposits from the general public and lending the mobilized deposits to deserving borrowers because banks are typically the custodians and distributors of money in the nation. This makes the banker the custodian of the public's excess funds. The banking industry plays a crucial role in driving economic growth and development and guiding the economy out of the underdevelopment trap and onto the path of development. In light of this, the banking industry is seen as a crucial provider of financial services, facilitating the creation of development plans by directing capital toward useful endeavors. The goal of this study is to examine how each bank contributes to the industry's nonperforming assets (NPA) by examining its growth pattern.

Keywords: NPA, RBI, Banking sector, Service sector, Economy, Development

Introduction

The foundation of any financial system is the banking industry. The sound state of an economy as a whole is guaranteed by the banking industry's efficient operation. Banks establish credit through the act of collecting deposits and making loans. Resources are raised through recycling the money that borrowers give in the form of principal repayments and interest on their loans. This loan flow

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is hampered, nevertheless, by the accumulation of non-performing assets (NPAs). Both the expansion of credit and the banks' profitability are hampered by it. NPAs are the primary metric used to assess the banking industry's performance. The main source of funding for banks comes from interest on loans, advances, and principal payments.

The banking industry is negatively impacted by the creation of substandard loans on their books since it compromises the stability and size of the balance sheet. Profitability is lowered by having to set aside a sizable portion of earnings for questionable and problematic loans. Even more of a burden to banks is the rising carrying cost of non-performing assets (NPAs), which could have been invested in anything else profitable. The financial institutions also want to raise their net worth, thus they want to maintain a certain level of capital adequacy. Even while this is bad news for the banking industry, it is evident from recent newspaper reports that the industry has suffered greatly as a result of this problem. The RBI has addressed the issue posed by non-performing assets. Non-performing assets (NPAs) are dealt with by a variety of legal remedies, including the Insolvency and Bankruptcy Code, 2016, Lok Adalats, Debt Recovery Tribunals (DRTs), and the SARFAESI (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest) Act.

Literature Review

Meenakshi and Mahesh (2010) investigated the banking sector reforms and NPAs in Indian commercial banks in order to investigate the trends in NPAs in India from a variety of angles and to clarify how prompt identification and self-monitoring have been able to significantly reduce NPA. The study examined many facets of non-performing assets (NPAs) and concluded that increasing NPAs are the primary cause of the current global financial crisis as well as a contributing factor to the economic crisis.

Barge (2012) looks into the critical need of early loan monitoring and management. The study suggests several measures of a non-performing asset. These include better supervision of the money's ultimate use, disclosure of the borrower's credit history, and support for borrowers to grow their entrepreneurial skills.

Gupta and Chauhan (2012) address the factors that contribute to non-performing assets (NPA) and offer an empirical method for analyzing profitability indicators on NPA. Utilizing statistical tools such as regression analysis, data visualization, correlation, and DEA, all empirical findings were determined.

According to Singh (2013)'s analysis of Indian commercial banks' NPA positions, low-quality loans are a significant issue for public sector banks, whose numbers have been steadily rising over time. The primary source of funding is provided by loans intended for micro businesses and initiatives aimed at reducing poverty.

Murari (2014) examined the effectiveness of NPA management by banks in the public and private sectors. The findings show that the gross and net non-performing assets (NPAs) of public sector banks have been steadily rising relative to those of private sector banks and that the mean NPAs of public and private sector Indian banks differ statistically significantly.

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Prasad (2015) provides an explanation of the time series projection approach and ratios used in NPA management. This study's focus was mostly on Jharkhand's PSBs' NPA management. With the use of graphs and statistics, the study explained the causes of non-performing assets (NPAs) and offered some suggestions for reducing their amount.

According to Wakhare, Borhade, and Jadhav (2016), banks should adhere to stringent credit evaluation procedures and efficient control systems even though the level of non-performing assets (NPAs) is decreasing but is still concerning. The banks must evaluate the borrowing companies' potential consequences from a realistic, functional, and economic standpoint before making a loan. The study concludes that non-performing assets (NPAs) are a persistent issue in the Indian banking sector, with PSBs having historically recorded higher levels of NPA.

NPAs in India's banking industry as well as the factors contributing to their rise have been examined by Mittal and Suneja (2017). They have said that while the government has implemented several measures to lessen the issue of non-performing assets (NPAs), bankers had to take the initiative and implement organized procedures to handle NPAs. Before approving the loan, consideration should be given to the ROI of the proposed project and the creditworthiness of the customers.

In his article, Mukhopadhyay (2018) talked on how to solve India's problems with non-performing assets. In order to address the issue of non-performing assets (NPAs), he has proposed that the RBI use a flexible and inventive approach that is specific to each affected bank and should not be based on a single model.

In their investigation of Turkish banks' efficiency between 2002 and 2017, Partovia and Matousek (2019) utilised a modified data envelopment analysis (DEA) method that estimated the efficiency using a directional distance function model, and they considered non-performing loans (NPLs) as an undesirable outcome. According to the study, banks' efficiency is negatively impacted by non-performing loans (NPLs).

Research gap

An overview of the aforementioned literature so indicates that there are multiple studies on non-performing assets in the banking industry. Furthermore, the paper's primary focus is on individual banks as well as bank groupings. This is done in an effort to pinpoint the banks that have been making the most contributions to the banking industry's NPA problem. Therefore, the paper tackles a current issue—NPAs—while also being pertinent. The study contributes fresh insights to the banking literature, enabling readers to better understand banks' positions.

Scope of the study

In essence, commercial banks are businesses, and their main goal is to increase their credibility and profitability. They produce enough surpluses to support expansion and raise the value for shareholders. In today's competitive environment, a commercial organization's ability to operate and survive is primarily measured by its profit margin. Therefore, return on equity, return on assets, and profit per employee is used to determine how efficient a bank is. Investors believe that their money is bestowed upon only lucrative banks. RBI places a strong emphasis on banks' profitability and offers a number of suggestions for lowering NPAs, which have a negative impact on it. Since

Indian commercial banks' social and economic goals have changed, it is crucial to evaluate their profitability performance and identify corrective actions to lower NPA in the wake of the new banking philosophy. The remaining three types of assets—sub-standard, dubious, and loss—are classed as non-performing assets (NPAs). Standard assets are recognized as performing assets. Analyzing commercial banks' NPA management is so crucial.

Objectives of the study

- To create policies for the effective and efficient handling of non-performing assets.
- To assess the effectiveness of the NPA management strategies used by banks.
- To assess the scope and amount of scheduled commercial banks' nonperforming assets (NPAs) in India.

Research Methodology

The goal and results of the research might determine how the term "research" is defined. This research is categorized as exploratory and inferential, or causal research, based on the study's purpose. This thesis examines the different banks' approaches to managing non-performing assets, which is why it is referred to as causal research. This includes looking at the NPA trend analysis across the study period as well as the effectiveness of the tools and approaches the banks have used to control NPA.

This research is also inferential in nature because we have tried to establish a connection between the non-performing assets (NPA) and the profitability of the selected banks in our analysis. The relationship was not only established, but it also attempted to determine the extent to which NPAs affect bank profitability.

Sample Size and Sampling Method:

The market capitalization of each bank that operates in the public and private sectors was used to gather the samples for this study. Market capitalization is the term used to describe the market value of the company's stocks. The reason this was selected for the study is that the market capitalization accurately represents the company's performance. The market capitalization increases as performance increases. The public and private sector banks have therefore been listed according to market capitalization for the purposes of this study.

Causes for non-performing assets

Given that bank lending is the primary driver of the nation's economic expansion, the high percentage of non-performing assets (NPAs) in banks and other financial institutions has raised serious concerns. Any disruption in the easy flow of credit, mostly caused by the growing non-performing assets (NPAs), is certain to have a negative impact on the economy. After years of functioning in a closed market, the Indian financial system is now confronted with the demands of an open economy. One way or another, a safe haven prevented banks from ever having to learn complex treasury operations and asset liability management techniques. However, a mix of social banking and directed lending pushed profitability and competitiveness to the sidelines. Unsustainable NPAs were the end outcome, which increased the effective cost of banking services. The notion of directed lending is mentioned as a crucial feature and a contributing element to the accumulation of non-performing assets (NPAs) in Indian banks in all of the venues where international multilateral organizations and rating agencies have interacted with the RBI and the government.

Government related causes

The Indian government has introduced several credit initiatives, including Mudra, DRI loans for underprivileged groups, and Stand up India, among others, to assist banks in providing small business loans to women entrepreneurs, SC/ST and minority populations, and small business owners without any security. Even though these are commendable attempts from a development standpoint, many dishonest borrowers still use these kinds of tactics to defraud banks and other financial institutions. The various government entities are backing a percentage of the loan. Deliberately seeking loans to obtain the subsidy fund, some borrowers opt not to repay their debts, leading to non-performing assets (NPAs).

Recovery of NPA in commercial banks

The Indian government saw that the customary methods of recovery, such enforcing securities and collecting debts by letters, were laborious and time-consuming. In 1981, then, the government set up a committee under the leadership of Shri Tiwari to accelerate the recovery of non-performing assets. The Committee looked at several strategies for collecting non-performing assets (NPAs) and suggested creating "Special Tribunals" to expedite the process. This suggestion was later supported by the Narasimham Committee (1991), which established an Asset Reconstruction Fund. It was recommended that the Indian government use this fund, through special legislation if needed, to acquire the non-performing assets (NPAs) from banks and other financial institutions at a reduced cost.

Legal actions have allowed banks to recoup non-performing assets (NPAs), which is encouraging for them. The RBI and the Central Government have taken action to reduce the number of new non-performing assets (NPAs) and to establish the legal and regulatory framework necessary to support the recovery of already-existing NPAs. The "SARFAESI Act" and "Debt Recovery Tribunals (DRTs)" have shown to be the most successful avenues for banks to pursue in order to retrieve bad loans, out of all the channels of recovery available to them.

Gross NPA and Net NPA of Commercial Banks

(Gross NPA and Net NPA of Commercial Banks for last 5 years)

	Advances		Non-Performing Assets			
Year	Gross Advances	Net advances	Gross NPA Amount	% of Gross Advance	Net NPA Amount	% of Gross Advance
2017-18	7564572	7387683	323234	4.4	175739	2.5
2018-19	8174123	7895687	611879	7.6	349879	4.5
2019-20	8477542	8117423	791695	9.4	433133	5.6
2020-21	9268952	8747456	1039536	10.3	520734	7.0
2021-22	1028745	9702345	936947	9.7	355173	6.7

(Source: www.rbi.org.in)

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The percentage of gross non-performing assets (NPA) to gross advances includes interest suspense accounts, which are parked accounts where interest is owed after an account becomes non-performing. The bank uses these accounts in accordance with accounting procedures, debiting interest from customer accounts and crediting interest to suspense accounts. Gross non-performing assets (NPA) indicate the caliber of bank loans, however net NPA reveals the true financial strain on banks.

Income, Expenses, provision and net profit of Commercial banks 31.03.2022

Banks	Total Income	Total Expenses	Operating Profit	Provision	Net Profit/Loss
Public Sector Banks	775803.82	626000.02	149803.80	216411.81	-66608.01
Private Sector Banks	467145.50	340533.32	126612.18	98991.16	27621.02
Foreign Banks	69821.45	43067.35	26754.10	12246.26	14507.84
Small Finance Banks	10908.89	8745.70	2163.20	1081.42	1081.78
Total	1323679.66	1018346.39	305333.28	328730.65	-23397.37

(Source: www.rbi.org.in)

Table demonstrates how well the commercial banks are doing in terms of operational profit. The operational profit is as high as Rs 3.05 lakh crore on the balance sheet as of FY 31.03.2022, indicating a consistent growth of nearly 4.5%, or Rs 0.13 lakh crore. However, the provision of Rs 3.28 lakh crore had such a negative impact on net profit that commercial banks had to absorb a loss of Rs 23397.37 crores for the fiscal year.

Preventive measures to avoid NPA

Credit Information Bureau of India Limited (CIBIL)-2000

CIBIL was established in 2000 through the main goal of giving monetary organizations evidence on fraud, identity theft, etc. to help banks avoid having bad loans turn into bad loans. The credit information business CIBIL Limited is a tool for choosing a qualified borrower to keep the loan from being non-performing. It compiles and keeps track of loan and credit card payback histories for both private citizens and business entities. Banks and other lenders provide their records about the borrower to CIBIL once a month. With the use of this data, CIBIL has created a CIBIL Score and produced reports for specific people. This makes it possible for lenders to assess and approve loan applications in light of the borrower's prior credit history.

The three-digit CIBIL Score, which ranges from 300 to 900, is calculated from your credit history using information from your CIBIL Report's "Accounts" and "Enquiries" sections. Your chances of having your loan application approved are higher if your score is closer to 900. The lender will review your application together with other information to assess your creditworthiness. A bank or financial institution may choose to reject an application with a low CIBIL score, saving both time and money by not considering it further.

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Prompt Corrective Action (PCA)-2017

The PCA structure grants the regulator the authority to set restrictions on dividend distributions, branch expansion, and lending. This approach was developed in 2002 by the RBI as a systematic early intervention mechanism for banks. Due to low asset quality, declining profitability, and non-performing assets (NPAs) in the Indian banking industry, the banks were either undercapitalized or susceptible. The Financial Sector Legislative Reforms Commission and the Financial Stability and Development Council in India submitted recommendations, which led to a reevaluation of the policy in 2017. There are two types of restrictions: required and voluntary. Mandatory restrictions include things like dividend, branch, and director salary caps; discretionary ones include things like lending and deposit caps.

The PCA standards used capital, asset quality, and profitability as their three main performance indicators for banks. When a bank's capital adequacy ratio (CAR) is judged to be inadequate or its non-performing assets (NPAs) to be high, corrective action is taken against the bank. The capital adequacy ratio, or CAR, is the ratio of a bank's available capital to its risk-weighted credit exposures. When a bank's NPA surpasses 10% or its CAR is less than 9%, the RBI has placed the bank under PCA. Four of the eleven Indian banks that were governed by PCA remain so. While the Bank of India, Bank of Maharashtra, Oriental Bank of Commerce, Allahabad Bank, Corporation Bank, and IDBI Bank escaped from PCA in two phases, the Central Bank of India, IDBI Bank, Indian Overseas Bank, and UCO Bank are still on the RBI's watch list. Following their separate mergers with Bank of Baroda and Punjab National Bank, Dena Bank and United Banks left PCA.

Recovery of NPA in commercial banks

The Indian government saw that the customary methods of recovery, such as enforcing securities and collecting debts by letters, were laborious and time-consuming. In 1981, then, the government set up a committee under the leadership of Shri Tiwari to accelerate the recovery of non-performing assets. The Committee examined several approaches to the collection of NPAs and recommended the establishment of "Special Tribunals" in order to facilitate the process. The Narasimham Committee (1991), which created an Asset Reconstruction Fund, later endorsed this idea. It was suggested that the Indian government use this fund to purchase non-performing assets (NPAs) at a discounted price from banks and other financial institutions, with the requirement for specific legislation if necessary.

The Tiwari and Narasimham Committees' recommendations led to the establishment of the Debt Recovery Tribunal (DRT) and Asset Reconstruction Company (ARC) across the nation. "Rescheduling and restructuring of banks, Corporate Debt Restructuring (CDR) and recovery through conducting Lok Adalats at a discount rate to NPA borrowers, Civil Courts, Debt Recovery Tribunals, and Compromise Settlement" are some of the different steps done to reduce non-performing assets (NPAs). To hasten rehabilitation, the government also enacted a few legal amendments.

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Conclusion

The Indian banking sector is essential to the country's economic growth. Recessions and booms are regular occurrences in economies, and banks often adjust to these swings by adjusting loan demand. Since non-performing assets (NPAs) are the result of investment-related risks and cannot be completely avoided in any economic system, experts and past experiences suggest that NPAs are an intrinsic part of the banking system. However, the economy as a whole is negatively impacted when the number and quantity of non-performing assets (NPAs) persist without being acknowledged and remedied and begin to impede regular bank lending. Any banking activity that inevitably has an impact on public finances is undesirable, as is the case with non-performing assets (NPA). Therefore, implementing sufficient regulatory and compressive reforms in bank supervision and regulations is crucial. The research's success is determined by the insightful and practical findings that are derived from the study.

By stopping the recycling of money, non-performing assets (NPA) inevitably because a bottleneck in the otherwise unhindered flow of credit in the intended direction and negatively affect the economy. As a result, banks constantly feel pressure to steer clear of poor loans and stop the addition of new NPA. Since NPAs are essentially inevitable, managing them at the lowest feasible level is, in fact, the largest problem facing the banking industry worldwide. Banks and other financial organizations classify loans and advances as "performing and non-performing assets" mostly based on how well they are repaid or whether they are past due for a predetermined period. According to the Reserve Bank of India's current criteria, performing assets are referred to as standard assets.

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