GROWING NPA'S: AN ANALYSIS OF THE MAGNITUDE, COMPOSITION AND IMPACT OF NON PERFORMING ASSETS WITH REGARD TO PUBLIC SECTOR BANKS IN INDIA

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Abstract: A healthy and growing economy is dependent on a robust banking system. The Indian economy embodies tremendous potential which needs to be regulated and guided via a resilient banking apparatus. However, India's banking system is vulnerable to the problem of Non-Performing Assets (NPAs). Indian banks have shown constant and drastic increase in the number of NPAs in their portfolios. This not only dents the performance of banks but hinders their lending operations. The study analyses current data available on NPAs to understand how they proliferate and to formulate suggestions on how NPAs can be tackled. The study is primarily motivated by a need to analyze the magnitude and composition of NPAs in the public sector banks. Secondly it sets out to provide a brief overview of the meaning, causes and impact of NPAs in the Indian banking sector. The methodology adopted is to collate and analyze data on NPAs from secondary data sources. The study has been limited to Public Sector banks and the time frame of the study is from 2006 to 2016. Analysis has been undertaken using simple statistical tools. Key findings are that NPAs have grown significantly after 2010. Additionally, it shows that NPAs of nationalized banks are much larger than SBI and its erstwhile Associate Banks. The study suggests that banks must exercise prudence and vigilance while approving loans. In addition, banks should actively pursue the conduct of Recovery Camps and a strategy of selling off loss making assets to other players could be pursued by banks.

Keywords: Banking, Non-Performing Assets, Public Sector Banks, SBI, State Bank Associates.

Introduction: There are few things that are as crucial to a healthy and growing economy as a robust banking system. Banks provide the framework to channel and focus the potential of an economy in meaningful ways. An economy like India's, in spite of the occasional setback, embodies tremendous potential which needs to be regulated and guided via a resilient banking apparatus. However, India's banking system has, for the lion's share of its history, been insulated from systemic shocks by being tied to a closed economy. This leaves the Indian banking sector vulnerable to number of chronic problems that arise from the transition to an open economy. Among these, the problem of Non-Performing Assets (NPAs) have been the most trenchant and substantial.

Despite being 'assets' in name, Non-Performing Assets are a drain on the resources of the bank. Ideally banking policy ought to strive to continually lessen the number of NPAs systematically; eliminating them completely if possible. In practice, Indian banks have shown constant and drastic increase in the number of NPAs in their portfolios. This not only dents the performance of banks but hinders their lending operations.

Objectives of the Study: The present study focuses on NPAs in conjunction with the Indian banking sector. The major objectives of this study are twofold. It aims to:

1. Provide a brief overview of the meaning, causes and impact of NPAs in the Indian banking sector.
2. Analyze the magnitude and composition of NPAs in the public sector banks.

Methodology Adopted: The methodology adopted by this study is to collate and analyze data on NPAs from secondary data sources such as publications of the RBI including various editions of 'Statistical Tables Relating to Banks in India' and 'Reports on the Trend and Progress of Banks in India'. Other data sources like various journals and publications relating to NPAs have also been included in the study. The study has been limited to Public Sector banks (including SBI and its erstwhile Associate Banks and Nationalized Banks). It is expected that such an analysis will provide sufficiently detailed overview of NPAs in Indian banks. The time frame of the study is from 2006 to 2016. Analysis has been undertaken using simple statistical tools.

Review of Literature: D. S. Rathore et.al. (2016) cites the main reasons for rise in NPAs as sluggishness in domestic growth in the recent past, slow recovery in the global economy and continuing uncertainty in global markets leading to lower exports of various products such as textiles and leather. A study by Mayur Rao and Ankita Patel (2015) reveals that the percentage of Gross NPA to Gross advances is increasing for public banks. According to an article authored by Manish Kapoor (2014), NPAs have disrupted the supply line of credit to potential borrowers, thereby having a negative effect on capital formation and arresting economic activity in the country. The author also finds that at the micro level, the unsustainable level of NPAs has eroded the profitability of banks through reduced interest income and provisioning requirements, besides restricting the recycling of funds leading to serious asset-liability mismatches. Dr. Jasbir Singh (2013), in his study states that the main reason for the high percentage of NPAs is the target-oriented approach, which deteriorates the qualitative aspect of lending. NPAs put detrimental impact on the profitability, capital adequacy ratio and credibility of banks.

Defining NPAs and their Impact on Banks: At the outset, it is important to derive an adequate definition of what constitutes a Non-Performing Asset with regard to banks. NPA's are a classification of loans with defaulted payments pending or having arrears in scheduled payment of principal or interest. A viable loan is usually reclassified as an NPA if it has been in default for a period of at least 90 days. The standard period of 90 days may not apply in case the terms and conditions set for a particular loan are different.

Once a loan has been classified as an NPA on the bank balance sheet, three distinct burdens can be seen as arising from it. Firstly, the nonpayment of principal or interest directly affects the cash flow of the bank; decreasing earnings. This may also translate into smaller budgets for the bank; especially if the number of NPAs on the bank's roster is high. Secondly, the bank will have to set aside loan loss provisions in order to cover losses that may arise from the bad loan. This further eats into the capital available for lending. Thirdly, once the losses from the loan are determined, the bank will be constrained to write off the losses against its earnings. This three-fold impact of NPAs on banks make them especially harmful to profitable and efficient bank operations.

What causes NPAs? The reasons why a loan might turn into an NPA are many and are often specific to that loan. Nevertheless, a few commonly observed causes of NPAs can be identified as follows.

- Studies have shown that around 80% of NPAs are due to willful defaulters. Due to lack of stringent legal penalties for loan non-repayment, there is a widespread tendency to avail loans and renege on repayment. Additionally, till April 2017, there were no strict laws to recover NPAs.
- One of the causes of NPAs is laxity on part of the bank in making proper background checks (including field visits) before granting the loan. Banks may not properly inquire into the repaying capacity of the borrowing firms or individuals, resulting in NPAs. Sometimes banks may take the popular perception of a company as having sound finances at face value and grant loans. Corruption and nepotism may also result in firms or individuals securing loans against bad securities like a business facing losses.
- Since banks are not immune from political coercion, they may be forced to grant loans by political outfits.
- Lack of proper follow-up after granting loans also results in NPAs. The borrower may have spent the loan for purposes other than for which the loan was granted. In other cases, the money may be spent unprofitably. Often, the end use of the funds granted is unclear. One well known example is that of Deccan Chronicle Holdings Limited (DCHL) which availed loans to the tune of almost 5000 crores, most of which was invested in financing the companies cricket team for the IPL, luxury cars and bonuses for executives.
- Large loans to industries are often granted by a consortium of banks led by a major bank. If the leading bank makes an erroneous judgment in granting a loan, all banks (including small banks with limited capital) will bear the burden of NPAs. Thus the consortium model is not immune to NPAs.
- When a firm that has been granted a loan is unable to become profitable, banks may pump more money into it in an effort to make it recover. In many cases, such efforts fail and the loan may end up becoming an NPA.

Impact of NPAs: We have already seen the direct tri-fold impact of having NPAs on a bank's balance book. The effects of NPAs are not limited to the individual banks from which these loans have been sanctioned. There are finer ramifications on the banking sector as a whole and the economic and financial system of the country. A few of these may be highlighted here.

- With the growing number of NPAs, a scarcity of funds may arise in Indian security markets. As the NPA of the banks will rise, it will bring a scarcity of funds in the Indian security markets. Banks may hesitate to lend money if chances of its recovery are in doubt.
- Stakeholders in banks, including shareholders will see a decrease in the value of their investments as banks take on more and more NPAs. With the performance of banks that are listed on the market being affected, it could translate to lower economic health of the entire market.
- As the market loses faith in the ability of banks to recover loans, banks will be forced to increase lending rates recover their losses. This directly affects consumers whose loans are tied to floating rates or those who plan on availing loans in the future.
- With loans at a premium, infrastructure development projects, startups, agricultural and industrial investments etc. will suffer resulting in national economic growth.
- When NPAs increase in the long run, it will drag down demand in the economy. This will also translate into lower growth rates and higher inflation as capital will become costlier. When sustained, this has the potential to evolve into a vicious circle resulting in an economic crisis.

Data Analysis:

1. Gross NPAs of SBI & Associate Banks

The composition of NPAs of SBI & Associate Banks are analysed below. The table below shows the percentage increase or decrease of NPAs in SBI & Associate Banks over the last decade (2006-16).

Table 1: Gross NPAs of SBI & Associate Banks

Year	Gross NPAs (in Billions of Rs)	Percentage Change
2006	131.93	-
2007	125.56	-4.38
2008	152.2	21.22
2009	178.74	17.44
2010	218.31	22.14
2011	281.4	28.90
2012	456.94	62.38
2013	599.67	31.24
2014	798.17	33.10
2015	735.08	-7.90
2016	1219.68	65.92

Source: Department of Banking Supervision, RBI

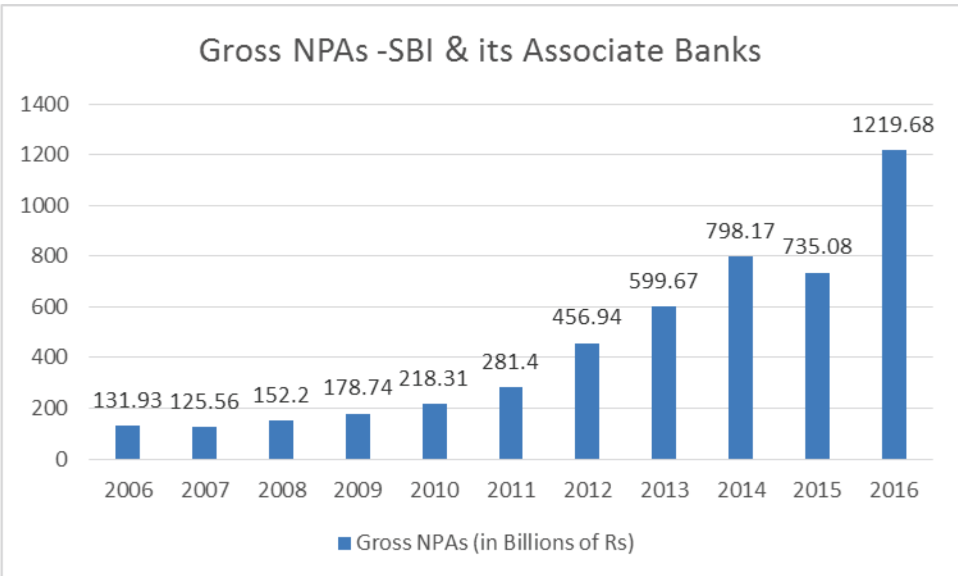

Fig. 1

Source: Department of Banking Supervision, RBI

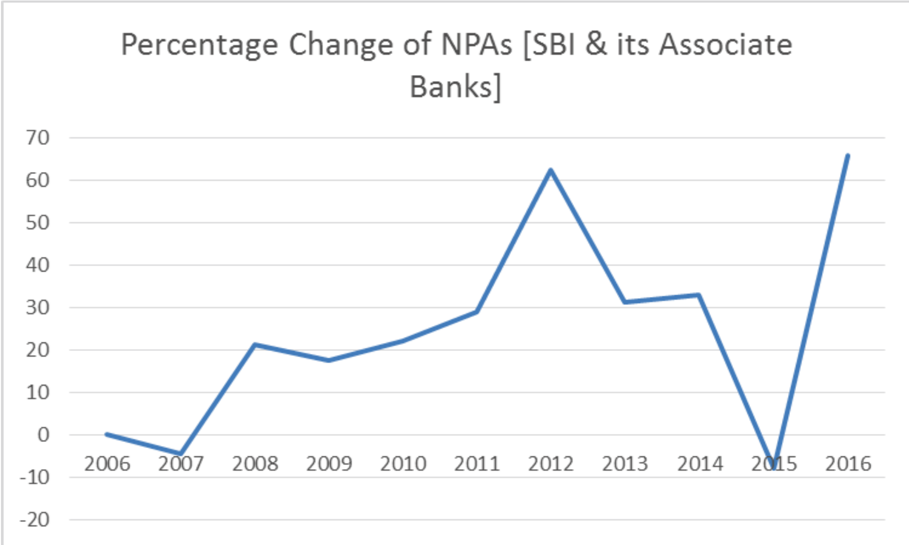

Fig. 2
Source: Department of Banking Supervision, RBI

As the data shows, the gross NPAs of SBI & its associate banks was Rs 131.93 billion in 2006. After showing a slight decline in 2007 to Rs 125.56 billion (-4.38%), the percentage change in NPAs has shown a fluctuating trend in following years. During 2008, the percentage change was 21.22% increase. In 2009, it the pace at which NPAs were added had slackened slightly to 17.44%. However, this slowing down was not sustained as it increased to 22.14% in 2010. In 2011 the percentage increase was very high i.e. 62.38%, meaning that banks were taking on bad loans much faster. Then, in 2013 and 2014, the percentage increase in NPAs slightly declined to 31.24% and 33.10% respectively. During 2015, the gross amount of NPAs as a whole declined by 63.09 billion rupees indicating a reduction from the previous year by 7.90%. But in 2016, the percentage change has shown an increasing trend, growing by 65.92% compared to the previous year.

Gross NPAs of Nationalized Banks: Apart from SBI and its erstwhile associates, there are a number of banks that are nationalized and follow regulative guidelines fixed by the RBI. The growth of NPAs in these banks can also be analyzed to gain more insight into how the problem affects banks with different managerial traditions. The table below shows the percentage increase or decrease of NPAs in Nationalized Banks over the years.

Table 2: Gross NPAs of Nationalized Banks

Year	Gross NPA (in Billions of Rs)	Percentage Change
2006	281.85	-
2007	257.49	-8.64
2008	243.8	-5.32
2009	261.58	7.29
2010	354.62	35.57
2011	429.4	21.09
2012	667.95	55.55
2013	959.22	43.61
2014	1474.48	53.72
2015	2049.59	39.00
2016	4179.88	103.94

Source: Department of Banking Supervision, RBI

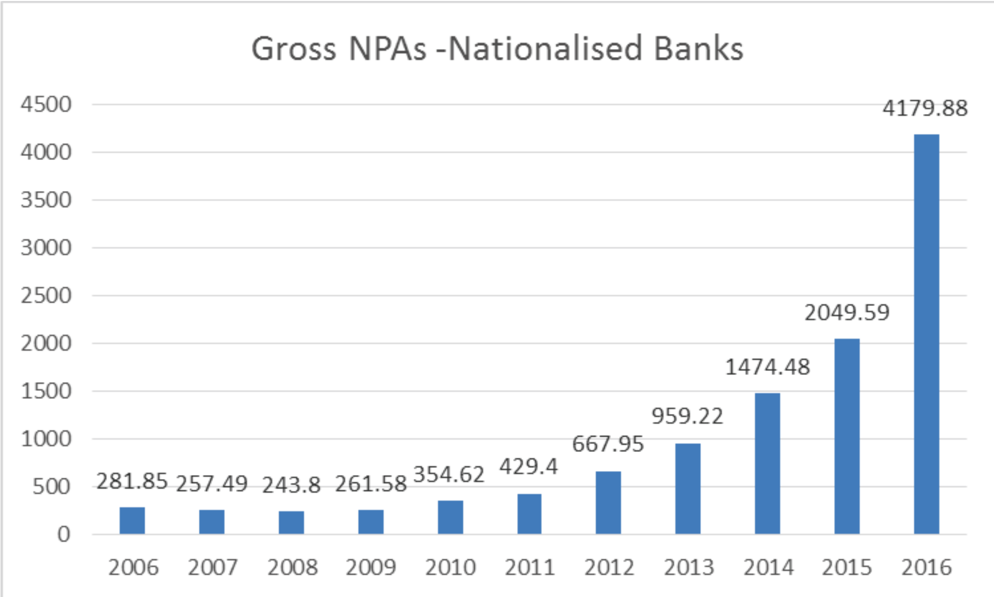

Fig. 3
Source: Department of Banking Supervision, RBI

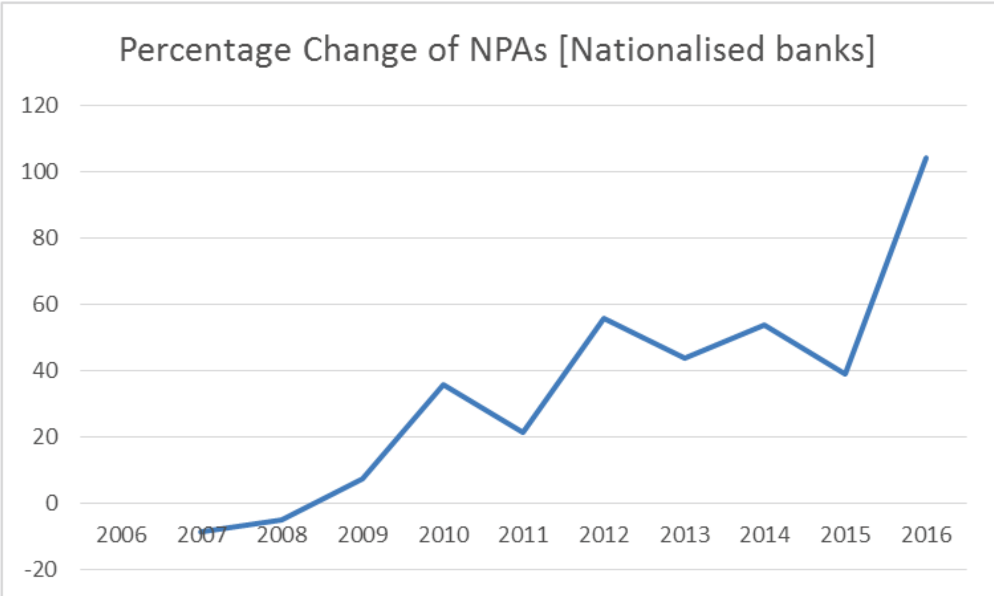

Fig. 4
Source: Department of Banking Supervision, RBI

In scrutinizing the data, it can be seen that in 2006, the gross NPAs of nationalized banks was Rs 281.85 billion and in 2007 it declined to Rs 257.49 billion in 2007 i.e. a percentage decline of 8.64%. It again declined by 5.32% in 2008. But then onward, the trend of NPAs has been increasing over the years. The percentage increase in NPAs was the highest in 2016 (103.94%, representing a doubling of bad debt) and was lowest in 2009 (7.29%).

2. Total NPAs of SBI & Associates and Nationalized Banks

Collating the data discussed above, it is possible to derive a composite account of NPAs in public sector banks (including the SBI and erstwhile associates) in India. The table below shows the percentage increase or decrease of NPAs in public sector banks over the last decade.

Table 3: Total NPAs of Public Sector Banks

Year	Gross NPAs of SBI & Associates (Rs Billion)	Gross NPAs of Nationalized banks (Rs Billion)	Total NPAs of Public Sector Banks (Nationalized Banks + SBI and Associates) (Rs Billion)	Percentage Change
2006	131.93	281.85	413.78	-
2007	125.56	257.49	383.05	-7.43
2008	152.2	243.8	396	3.38
2009	178.74	261.58	440.32	11.19
2010	218.31	354.62	572.93	30.12
2011	281.4	429.4	710.8	24.06
2012	456.94	667.95	1,124.89	58.26
2013	599.67	959.22	1,558.90	38.58
2014	798.17	1474.48	2272.64	45.78
2015	735.08	2049.59	2784.68	22.53
2016	1219.68	4179.88	5399.57	93.90

Source: Department of Banking Supervision, RBI

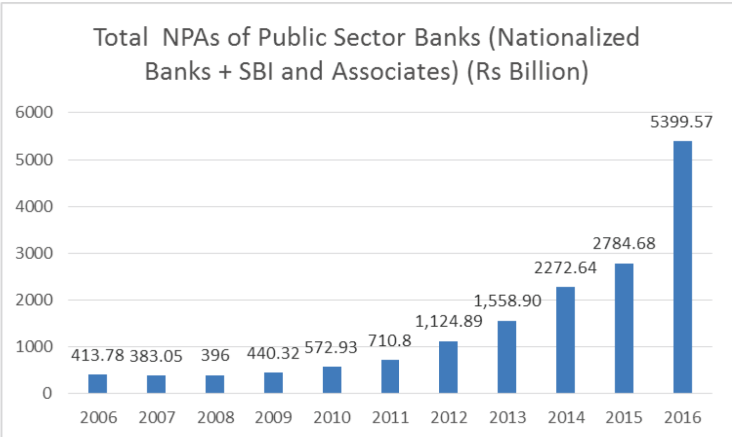

Fig. 5

Source: Department of Banking Supervision, RBI

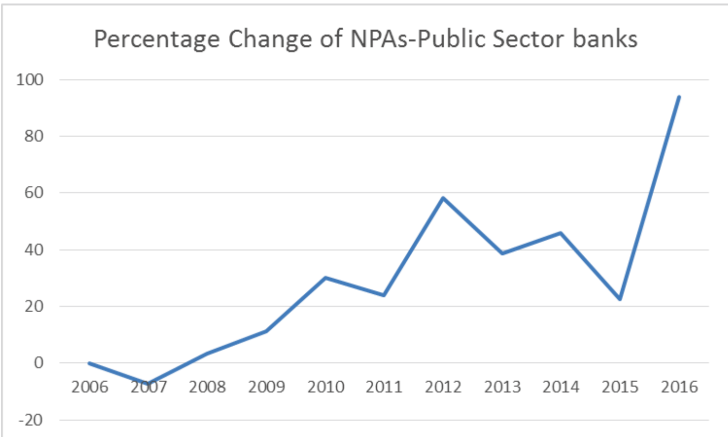

Fig. 6

Source: Department of Banking Supervision, RBI

From the data above, it can be understood that the total NPAs of public sector banks comprising of both SBI and erstwhile Associates and Nationalized banks has increased from Rs 413.78 billion in 2006 to Rs 5399.57 billion in 2016. The percentage increase was highest in 2016 (93.90%) and lowest in 2008 (3.38%). Although the gross NPAs showed a slight decline in 2007, this trend could not be sustained in subsequent years.

Findings: It is possible to derive certain insights regarding the growth of NPAs from the analysis presented above. The key findings are enumerated as follows.

1. The Non-Performing Assets of public sector banks is showing an increasing trend over the years.
2. Among the public sector banks, the amount of NPAs is higher in Nationalized banks than SBI and its erstwhile Associate Banks.
3. NPAs have grown significantly after 2010.
4. Higher NPAs are a symptom of the defective lending system of public sector banks.
5. Growing NPAs may threaten the credibility and soundness of the banking system.

Suggestions: In the light of the above findings a few corrective measures may be suggested to bring down the proliferation and impact of NPAs.

1. Banks must exercise prudence and vigilance while approving loans. The repayment capacity of the borrower must be assessed in a foolproof manner before loans are granted. However, this process must be streamlined so as not to cause undue delay for the borrower.
2. Banks should actively pursue the conduct of Recovery Camps whereby borrowers may be encouraged to pay off outstanding dues. Incentives may be given to bring back defaulters to the banking system.
3. In case the borrower is unable to repay interest or principal on a loan, a negotiation can be attempted with the borrower before the loan becomes an NPA. For this more robust communication and negotiation platforms will have to be established linking banks to their borrowers.
4. Where negotiations cannot remedy the situation, there must be a provision for expedited resolution of cases through Debt Recovery tribunals. This will help banks avoid unnecessary delay in debt recover and will also cut much of the losses banks suffer due to delay of foreclosure proceedings.
5. A strategy of selling off loss making assets to other players could be pursued by banks. This may reduce the burden of NPAs on the bank balance sheet.

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