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Non-Performing Assets (A Study With Reference To Public Sector Banks)

KEYWORDS: NPAs, PSBs, loan assets, Gross NPA, Net NPA

Dr.T.R.Gurumoorthy	B.Sudha
Professor, International Business and Commerce, Alagappa University, Karaikudi.	Assistant Professor, Department of Commerce, Sri Sarada Niketan College for Women, - Karaikudi

ABSTRACT *In the liberalized economy, Banking and Financial sector get high priority. The banks in India are facing the problem of Non-Performing Assets (NPAs). The earning capacity and profitability of the banks are highly affected because of the existence of NPAs. Moreover the non-performance or non-receipt of interest and principal blocked banks money in the form of funds and is not available for further use of banking business and thus the profit margin of the banks goes down. In this connection bank must aware of the problems and recovery legislations of NPAs. Compared to Private Sector Banks and Foreign banks, Public Sector Banks (PSBs) are highly affected by this three letter virus NPA, because whose objectives have been more social than economic. This paper analyzes the classification of loan assets in PSBs, composition of NPAs in different sectors and NPAs position in PSBs. In this study, it is observed that PSBs exercised stringent control measures to reduce the level of NPAs.*

1. Introduction

Banking in India originated in the last decade of the 18th century. Commercial banks occupy a major part of the banking in India. They are the oldest form of banking institution having large volume of operations over a vast area. They are having very good net-work of branches even in rural and semi-urban areas. Now they are not only engaged in their traditional business of the accepting and lending money but have diversified their activities into new fields of operations like merchant banking, leasing, housing finance, mutual funds and venture capital. They have introduced a number of innovative schemes for mobilizing deposits. In addition to the above they are providing valuable services to their customers, issuing drafts, travellers cheques, gift cheques, accepting valuables for safe custody and modern banking facilities.

Since the process of liberalization and reform of the financial sector were set in motion in 1991, banking has undergone significant changes. The underlying objective has been to make the system more competitive, efficient and profitable. A strong banking sector is important for flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. Non-performing asset (NPA) is one of the major concerns for banks in India. NPAs reflect the performance of banks. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The NPA growth involves the necessity of provisions, which reduces the overall profits and shareholders' value.

2. Significance of the study

Providing loans for economic activities is the social responsibility of banking. Credit dispensation activity is considered to be major part of funding apart from raising resources through fresh deposits, borrowings and recycling of funds received back from borrowers. Lending is generally encouraged because it has the effect of funds being transferred from the system to productive purposes, which results into economic growth. However lending involves credit risk, which arises from default by the borrowers. The process of credit cycle is affected by non-recovery of loans along with interest. Thus, loan losses and requirement of provisioning for loss affect the banks profitability on a large scale. Though complete elimination of such losses is not possible, but banks can always aim to keep the losses at a low level.

3. Objectives of the study

The specific objectives of the study are as follows

√ To analyze the classification of loan assets in Public Sector Banks.
√ To analyze the composition of NPAs in different sectors.

4. Research Methodology

The present study concentrated on PSBs only. For this study secondary data have been collected. The data are collected from annual report of RBI publications including Trend and Progress of Banking in India, Statistical Tables relating to Banks in India, Articles and Papers relating to NPAs published in different journal and magazines were studied and data available on internet and other sources have also been used.

5. Analysis

Non-performing Assets (NPAs) - Meaning

Assets which generate periodical income are called as performing assets. Assets which do not generate periodical income are called as non-performing assets. NPAs are further classified into sub-standard, doubtful and loss assets based on the criteria stipulated by RBI. An asset, including a leased asset becomes non-performing when it ceases to generate income for the bank for a specified period of time. The RBI guidelines regarding classification of assets and its provisioning with effect from March 31, 2005 are as follows.

5.1 Classification of Loan Assets

Standard Assets: Standard assets generate continuous income and repayments as and when they fall due. So a standard asset is a performing asset. Such assets carry a normal risk and are not NPAs in the real sense. Hence, no special provisions are required for Standard Assets.

Sub-Standard Assets: A sub-standard asset was one, which was considered as non-performing for a period of 12 months.

Doubtful Assets: All those assets which are considered as non-performing for period of more than 12 months are called as Doubtful assets.

Loss Assets: A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

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Table-1
Classification of Loan Assets of PSBs-2005-2011
(Amount in Rs. crore)

Assets	2005 Rs	2006 Rs	2007 Rs	2008 Rs	2009 Rs	2010 Rs	2011 Rs
Standard assets	824253 (94.6)	1029493 (96.1)	1335175 (97.2)	1656585 (97.7)	2059725 (97.9)	2462030 (97.7)	3008757 (97.7)
Sub-standard assets	10838 (1.2)	11394 (1.1)	14147 (1.0)	16870 (1.0)	19521 (0.9)	27688 (1.1)	33614 (1.1)
Doubtful assets	29988 (3.4)	24804 (2.3)	19945 (1.5)	19167 (1.1)	20715 (1.0)	24685 (1.0)	31919 (1.0)
Loss assets	5771 (0.7)	5181 (0.5)	4510 (0.3)	3712 (0.2)	3803 (0.2)	4928 (0.2)	5514 (0.2)
Total NPAs	46597 (5.4)	41379 (3.9)	38602 (2.8)	39749 (2.3)	44039 (2.1)	57301 (2.3)	71047 (2.3)
Total Advances	870850	1070872	1373777	1696334	2103763	2519331	3079804

Source: Statistical Tables Relating to Banks in India

Table 1 presents the data pertaining to classification of loan assets of PSBs during the year 2005 to 2011. The amount of standard assets showed an increasing trend during the stated period. In the initial year 2005 the ratio of standard assets to total advances stood at 94.6 percent. It increased to 97.7 percent in 2011. The ratio of sub-standard to total advances showed a decreasing trend, it was 1.2 percent in 2005 and reduced to 1.0 percent in 2009. Later on it slightly increased to 1.1 percent in 2011. The ratio of doubtful assets to total advances showed a decreasing trend recording the percentage 3.4 in 2005 and 1.0 percent in 2011. The ratio of loss assets to total advances showed a decreasing trend from 0.7 percent in 2005 to 0.2 percent in 2011. The total NPAs to total advances ratio reduced from 5.4 percent in 2005 to 2.3 percent in 2011. Though the amount of NPAs is increased from Rs.46595 crore in 2005 to Rs.71047 crore in 2011, its percentage to total assets has been reduced from 5.4% to 2.3%. It shows the effectiveness of follow-up actions of PSBs in monitoring NPAs. Total advances of Public Sector Banks is increased from Rs.870850 crore in 2005 to Rs.3079804 crore in 2011. The percentage of standard assets in total assets remains at 97 to 98 percent. It shows that loan portfolio of Public Sector Banks is performing productively and lending is recovered and revenue is generated.

5.2 Provisioning Norms

Provision is allocating money every year to meet possible future loss. RBI guidelines for NPAs provision are as follows.

S.No	Type of Assets	Provisions
1.	Standard Assets	0.25% for all type Standard Advances
2.	Sub-Standard Assets	10% for all type Standard Advances
3.	Doubtful Assets	
	-Up to One Year	100% of Unsecured Advances and 20% of Secured Advances
	-One to Three Year	100% of Unsecured Advances and 30% of Secured Advances
	-More than Three Year	100% of Unsecured Advances and 50% of Secured Advances
4.	Loss Assets	100% of Unsecured Advances and 100% of Secured Advances

Table-2
Composition of NPAs of PSBs-2005-2011
(Amount in Rs. crore)

Sectors	2005 Rs	2006 Rs	2007 Rs	2008 Rs	2009 Rs	2010 Rs	2011 Rs
Priority sector	23397 (49.1)	22374 (54.1)	22954 (59.5)	25287 (63.6)	24318 (55.2)	30848 (53.8)	41245 (58.1)
Non-priority sector	23849 (50.0)	18664 (45.1)	15158 (39.3)	14163 (35.6)	19251 (43.7)	25929 (45.3)	29525 (41.5)
Public sector	450 (0.9)	341 (0.8)	490 (1.3)	299 (0.8)	474 (1.1)	524 (0.9)	278 (0.4)
Total	47696	41379	38602	39749	44043	57301	71048

Source: Reports on Trend and Progress of Banking in India

Table-2 indicates that the share of NPAs in the priority sector to total NPAs of PSBs is increased marginally to 58.1 percent in 2011 from 49.1 percent in 2005. However, the share of NPAs of Non-priority sector is declined from 50 percent in 2005 to 41.5 percent in 2011. There has been a rise and fall trend in public sector NPAs to total NPAs, in the initial period 2005 it was 1.0 percent and reduced to 0.4 percent in 2011.

5.3 Causes of NPA

√ Investing in high risk assets to earn high income.
√ Wilful default by the borrowers.
√ Fraudulent practices like advancing loans to ineligible persons, advances without security or references etc.
√ Most of the funds are diverted unnecessary expansion and diversion of business.
√ Many internal reasons like inefficient management, inappropriate technology, labour problems, marketing failure, etc. resulting in poor performance of the companies
√ External reasons like a recession in the economy, infrastructural problems, price rise, delay in release of sanctioned limits by banks, delay in settlement of payments by government, natural calamities, etc.

5.4 Reporting of NPAs

√ Every year on 31st March, Banks must report on NPAs after completion of audit. The NPAs would relate to banks' global portfolio, including advances at the foreign branches.

√ Whenever NPAs are reported to RBI, the amount held in interest suspense account, should be shown as a deduction from gross NPAs as well as gross advances while arriving at the net NPAs. Banks which do not maintain Interest Suspense account for parking interest due on non-performing advance accounts, may furnish the amount of interest receivable on NPAs as a foot note to the report.

√ The amount of technical write off, if any, should be reduced from the outstanding gross advances and gross NPAs to eliminate any distortion in the quantum of NPAs being reported.

5.5 Gross NPA and Net NPA

Gross NPA is an advance which is considered irrecoverable, requires provisioning and which is still held in banks' books of account. A distinction between Gross NPA and Net NPA is, Net NPA is calculated by deducting items like interest due but not recovered, part payment received and kept in suspense account from Gross NPA

Table-3
Non-Performing Assets as percentage to Total Assets and as percentage to Advances of PSBs-2005-2011

Year	Gross NPAs		Net NPAs	
	Percent to Total Assets	Percent to Gross Advances	Percent to Total Assets	Percent to Net Advances
2005	2.8	5.7	1.0	2.1
2006	2.1	3.6	0.7	1.3
2007	1.6	2.7	0.6	1.1
2008	1.3	2.2	0.6	0.8

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2009	1.2	2.0	0.6	0.7
2010	1.3	2.2	0.7	1.1
2011	1.4	2.2	0.7	1.1

Source: Statistical Tables Relating to Banks in India

Data presented in the Table-3 reveals the decreasing trend in Gross NPAs and Net NPAs during the study period. This shows that there is a significant improvement in NPAs recovery by PSBs. But at the end of the study period Gross NPAs to Total Assets ratio increased from 1.2 percent in 2009 to 1.4 percent in 2011. Similarly, in case of Gross NPAs to Gross Advances ratio it was 5.5 percent in 2005 and reduced to 2.0 percent in 2009, again in 2011 it increased to 2.2 percent. In case of Net NPAs to Total Assets ratio it was 1.0 percent in 2005 and reduced to 0.7 percent in 2011. Net NPAs to Gross advances ratio reduced considerably from 2.1 percent in 2005 to 0.7 percent in 2009. Again it increased to 1.1 percent in 2010 and 2011.

6. Conclusion

Banking system plays a very important role in the economic life of the nation. The health of the economy is closely related to the soundness of its banking system. Complete elimination of NPA in PSBs is not possible because government business and development schemes are mostly routed through the PSBs, but banks can always aim to keep the losses at a low level. Non-Performing Assets may not turn banks into Non-Performing Banks; instead steps should be taken to convert Non-Performing Assets into Now-Performing Assets. As far as old NPAs are concerned, a bank can remove it on its own or sell the assets to Asset Management Companies (AMCs) to clean up its balance sheet. For preventing fresh NPAs, the bank itself should adopt proper policies. It is better to avoid NPAs at the budding stage of credit consideration by putting in place of rigorous and appropriate credit appraisal mechanisms. PSBs should be well versed in proper selection of borrower or project and in analyzing the financial statement. To review a loan application the bank uses "5-Cs" which is as follows.

5-Cs

A safety and soundness examiner also reviews a bank's lending activity by rating the quality of a sample of loans made by the bank. When a bank reviews a loan application, it uses the "5-Cs" to assess the quality of the applicant. The 5-Cs stands for:

- Capacity - measures the borrower's ability to pay, including borrower's payment source and amount of income related to debt.
- Collateral - what are the bank's options if the loan is not paid? What asset can be turned over to the bank, what is its market value, and can it be sold easily? A valuable asset might be a house or a car.
- Condition - this refers to the borrower's circumstances. For example, if a furniture storeowner is asking for a loan, the banker would be interested in how many chairs and sofas the store is expected to sell in the area over the next five years.
- Capital - the applicant's assets (house, car, and savings) minus liabilities (home mortgage, credit card balance) represent capital. If liabilities outweigh assets, the borrower might have difficulty repaying a loan if his regular source of income unexpectedly decreases.
- Character - measures the borrower's willingness to pay, including the borrower's payment history, credit report and information from other lenders.

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