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A STUDY OF NON PERFORMING ASSETS (NPA's): A PROFIT CUTTER TO BANKING STRUCTURE

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ABSTRACT

Non Performing Asset (NPA's) perhaps a big economical issue for all developing countries including India, specially in recent years when kingfisher airlines turns to be insolvent and promoters runaway leaving behind a huge amount unpaid on banking system. Probably the above incidence is the one which actually gain attention of a common man towards non performing Asset and bankers, economist and government started giving serious consideration to NPA management. NPA is like a double edge sword which attacks from 2 sides. One NPA accounts are those advances which do not generate any income, on the other hand banks need to create provision for the same as well as spent a considerable amount on recovery measure. There are many research conducted on the topic of Non Performing Assets (NPA) management, considering particular bank or Banks, comparative study of public Banks, Private Banks or Foreign Banks etc. This Research paper attempts to define out the meaning of Non Performing Assets, types of NPA, Their Classification, Reasons of NPA, and Measures required for NPA Management.

KEYWORDS: *Non Performing Assets (NPA), Banks, Reasons, Measures.*

Introduction

The India is one of the fast developing countries in Asia continental and on the map of the world. As for any developing economy the Banking Structure is basic pillar. India also has large Banking Structure that covers not only urban areas but almost 40% to 45% of rural area. However, still the largest portion is not covered under the Banking Structure. Presently, there are four types of banking institutions in India. These are:

- Commercial banks, which includes Public Sector Banks and Private Banks.
- Regional rural banks
- Co-operative banks
- Development banks or 'term-lending institution'

RBI acts as the Central Bank of the Country

Banks Engages primarily in two functions viz. Accepting deposits from public and lending the money to public. Lending is the functions that provides Income source to Banks through which they meet their expenses and pays interest credits to their deposit holders. However the major concern and problem area to bank is Losses that occurs due to heavy NPA's (Non Performing Assets) in Advances, which curtails Maximum portion of the Income of the Banks.

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The total NPA of all scheduled commercial banks in India had swollen from Rs. 47,300 crores to Rs. 70,904 crores during the five years from March 1997 to March 2002, as per the Reserve Bank's annual reports on trends and progress of banks in India. Against these, banks had provided for Rs. 35,358 crores or roughly half the total by 2002. Still, the net NPA was as high as Rs. 35,546 crores and represented 5.5 per cent of the total advances; this is high compared to around 2 per cent for banks in advanced countries. Through this article we tried to find out the reasons of heavy NPA's and the suggestion to reduce the Heavy NPA's.

What is NPA?

Non Performing Asset means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines issued by RBI.

According to RBI guidelines, an account shall be classified as NPA as per the below mentioned criteria:

Type of Loan	Overdue period required to convert the Debt into NPA
Term Loan	Interest and/or principal remain overdue for a period of more than 90 days
Overdraft/Cash Credit	Remains 'out of order' for a period of more than 90 days i.e. either no credit to the Account (in case of overdraft) or Outstanding balance exceeds the sanctioned limit (in case of Cash Credit) for continuous period of 90 days
Bills purchased and discounted	Bill remains overdue for a period of more than 90 days
Agricultural Advances	• For short duration Crops: Interest and/or principal remains overdue for two harvest seasons or crop season • For long duration Crops: overdue Period is one harvest or crop season • Here Long Duration Crops means where crop season is longer than 1 year. A crop which is not a long duration Crop is a short duration Crop.
Securitisation Transaction	Amount of Liquidity Facility remains outstanding for more than 90 days
Derivative Transaction	Overdue receivables representing positive mark to market value of a derivative contract remains unpaid for a period of 90 days from the specified date for payment
Any other	Any amount to be received, remains overdue for a period of more than 90 days

Further Classification of Advances

Performing Assets (PA)	Standard assets	This does not disclose any problems and does not carry more than normal risk. (i.e. any Asset other than NPA)
Non Performing Assets (NPA)	Sub-standard asset	Classified as NPA for a period not exceeding 12 months.
	Doubtful assets	Remained NPA for a period exceeding 12 months, but not determined as loss asset by bank or internal auditor.
	Loss assets	Where loss has been identified by bank or by the internal or external auditors or by the RBI Inspection, but the amount has not been written off, wholly or partly

In India, the banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management. The NPA are considered as an important parameter to judge the performance and financial health of banks. If a bank has high NPA ratio then its performance is considered as weak than that of a bank with lower NPA ratio. It creates a bad effect on good will and equity value of the bank. Considering all the above facts banking industry has to give more importance to NPA and to structure proper remedial solutions.

Reasons for an Asset Turning NPA

One of the primary reasons for NPA could be that the lending decision was, ab initio, incorrect. Seasoned bankers would scoff at this as a preposterous statement, but the reality has to be faced. A major portion of bank lending is to industries and trade; this segment accounted for over 53 per cent of gross bank credit, excluding loans to food procurement agencies of governments, as at the end of March 2002, vide RBI data. A major portion of bad debts arose out of lending to the priority sector, at the dictates of politicians and bureaucrats. If only banks had monitored their loans effectively, the bad debt problem could have been contained, if not eliminated.

However in general The causes of NPA includes lack of proper pre-enquiry by the bank for sanctioning loan to a customer, non performance of the business or the purpose for which the loan has taken, some willful defaulters, fraud, loans sanctioned for agricultural purposes, sluggish legal system, change in government policies. The reasons were generally classified into two:

- Overhand component – due to environmental reasons, business cycle etc
- Incremental component – due to internal bank management, credit policy, term of credit etc.

Solutions to Come Out from Problem of NPA

- **Restructuring of finance**

Bank has to increases the number of installment by minimizing the quantum of installment in order to recover the loan. Restructuring may be at following stages:

- Before commencement of commercial production,
- After commencement of commercial production but before the asset has been classified as sub-standard;
- After commencement of commercial production and the asset has been classified as sub-standard.

In Rescheduling of principal and/or interest, there could be 'sacrifice' on part of the banks. Re-schedulement of installments of only principal amount at first two stages would not cause a standard asset to be classified in the sub-standard provided the loan/credit facility is fully secured. Even the Re-schedulement of the interest at first two stages would not cause the standard asset to be classified as sub-standard, if the sacrifice of interest measured in present value term is either written off or fully provided.

In case of Re-schedulement / Re-fixation of terms of loan after classification of asset as sub-standard the asset would be continued to be classified in the same category if the loan/credit facility is fully secured. Where there is sacrifice of interest, the same would have to be written off or provided for. Sub-standard accounts subjected to restructuring can be upgraded to standard category only after a period of one year from the date of first payment of interest or principal as per rescheduled term subject to satisfactory performance during the period. On such up-gradation, the provision made earlier can be reversed after taking into account he interest sacrificed.

- **Lok Adalats**

Lender and borrowers were brought face to face to negotiate a settlement.

- **Debt Recovery Tribunal**

It was set up under the recovery of debts due to banks and Financial Intuitions Act, 1993 with exclusive jurisdiction to try and dispose of matters pertaining to recovery of debts due to bank and financial assets. It has the potential of playing a significant role in NPA realization.

- **Corporate debt restructuring**

Corporate debt restructuring mechanism was introduced as a platform for handling large NPA, with a potential to give long term package of financial and management restructuring. It rephrases the loan servicing obligation of the borrower and some concession in the interest rate.

- **SARFAESI Act**

SAREAESI Act is the preferred route for finding solution to NPA when compared to the other methods which were discussed above. There was no legal provision for facilitating securitization of financial assets of bank and FIs or power to take possession of securities and sell them. This resulted in slow recovery of defaulting loan and mounting levels of NPA of bank and FIs and a need was felt for keeping pace with changing commercial practice and financial sector reforms. Keeping with this an enabling legislative and regulatory frame work was put in place with the enactment of the securitization and Reconstruction of Financial assets and Enforcement of Security interest Act,2002.The primary objective of act is reduction of NPA levels of banks/FIs and unlocking value from distressed assets in the banking and financial system.

- **Well Developed Capital Markets**

Numerous papers have stressed the criticality of a well developed capital market in the restructuring process. A capital market brings liquidity and a mechanism for write off of loans. Without this a bank may seek to postpone the NPA problem for fear of capital adequacy problems and resort to tactics like ever greening. Monitoring by bondholders is better as they have no motive to sustain uneconomic activity. Further, the banks can manage credit risk better as it is easier to sell or securitize loans and negotiate credit derivatives. India debt market is relatively under developed and attention should be focused on building liquidity and volumes. (Toshiki, Kanomori, 2001)

- **Contextual Decision making**

Regulations must incorporate a contextual perspective (like temporary cash flow problems) and clients should be handled in a manner which reflects true value of their assets and future potential to pay. The top management should delegate authority and back the decisions of this kind taken by middle level managers.

- **Legal Issues**

There have been instances of banks extending credit to doubtful debtors (who willfully default on debt) and getting kickbacks for the same. Ineffective Legal mechanisms and inadequate internal control mechanisms have made this problem grow – quick action has to be taken on both counts so that both the defaulters and the authorizing officer are punished heavily. Without this, all the mechanisms suggested above may prove to be ineffective. (Muniappan, 2002)

- **Regular Training Program**

Executives have to undergo regular training program on credit and NPA management. It is very useful and helpful to the executives for dealing the NPAs properly.

- **Recovery camps**

The banks should conduct regular or periodical recovery camps in the bank premises or some other place, such type of recovery camps reduced the levels of NPA in the banks

- **Spot Visit**

The bank officials should visit to the borrower's business place / borrowers field regularly or periodically.

- **Other Methods**

such as Persistent phone calls or Media announcement.

Provisioning for Loans and Advances

Banks also require to make provision on the Advances as one of the Prudential Norms requirement. This is required to ensure that Losses arising due to NPA is not shown as loss of one years rather shall be spread over to number of years. Provision to be made is as follows -

- **Loss assets**

  Should be written off or 100% provision should be made for the amount outstanding.
- **Doubtful assets**
  - Full provision to the extent of the unsecured portion should be made. The R.V. of the security available should be determined on realistic basis.
  - In regard to the secured portion, no provision needs to be made towards the guaranteed portion by DICGC (Deposit Insurance And Credit Guarantee Corporation) or ECGC (Export Credit Guarantee Corporation). over & above guaranteed portion should be provided for as per the period for which asset has remained doubtful:

Period for which Advance has been considered as doubtful	**% of Provision**
Up to 1 years	25
More than 1 year and up to 3 years	40
More than 3 years	100

- **Sub-standard assets**

15%* on total outstanding should without making any allowance for DICGC/ECGC cover and securities available. An additional provision of 10% is required to be made on 'unsecured exposure'. (However "Unsecured Exposure" in respect of infrastructure Loan Accounts classified as Substandard, in case of which certain safeguards are available will attract only additional provision of 5%).

Unsecured exposure is defined as 'an exposure where the realizable value of security is not more than 10% of the outstanding exposure (fund based and non-fund based).

- **Standard assets**

General provision of a minimum of 0.40% of total standard asset should be made, but for Agriculture and SME sector the rate is .25%. However, the basis reason of becoming NPA is not any one. The combination and packet of problems has made the NPA problem much bigger then it would have been if those other factors had not existed. However adaptation of various corrective measures as suggested above and prudential norms guided by RBI will definitely help to reduce the level of NPA.

Conclusion

Various Reasons for generation of NPA has been discussed in detail. Further the measures required for reducing NPA's has also been discussed. The Analysis shows that there is not only one factor that contributes in generation of NPA. The multiple effect of all factors including social factors works together. However the major weaker portion is on part of banks management such as lacking of proper internal control system for evaluation of creditworthiness of borrower, sanctioning to risky projects and lack of proper recovery mechanism. Non evaluation of position of borrower on regular basis is another factor. However, various measures on part of banks such as restructuring of Advances, Corporate Debt Restructuring, recovery camps etc. and on part of Government such as SARFAESI Act, 2002, Lok Adalats, Debt Recovery Tribunal etc. helping prominently in reducing the size of NPA's and gearing up the process of recovery from defaulted accounts. Indian Banks are still not ready for affording huge NPA's. Hence Management of Indian Banks shall pay special attention towards NPA management. Timely action on part of government and introducing new legislations are also required.

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