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IMPACT OF NON-PERFORMING ASSETS ON INDIAN BANKING SYSTEM

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ABSTRACT

The Indian banking sector experienced a dramatic transformation following the initial stage of economic liberalisation, and credit management gained widespread recognition. The banking industry plays a crucial role in the financial services sector by directing funds toward constructive uses, facilitating the transfer of cash from units with surpluses to those with deficits, and assisting the government's economic and financial policies. The most urgent problem that banks are currently facing is non-performing assets (NPAs), which pose a threat to the entire financial system in addition to being a liability for the banks. Banks' capacity to lend more is restricted by the growing amount of non-performing assets (NPAs), which reduces interest revenue and strains fund recycling. The growing amount of non-performing assets has made banks more watchful and cautious when extending credit to customers. Taking into consideration the major public sector banks that are coping with the rising number of non-performing assets (NPAs), this study aims to evaluate the Impact and Comparative Analysis between NPAs and the Indian Banking System (public and private sector banks). Banks are now managing non-performing assets proactively with the RBI's assistance. Banks must adopt a number of actions to lower the amount of non-performing assets (NPA) in order to strengthen the Indian banking sector.

Keywords: *Banking, Non-Performing Assets, Substandard Assets, Doubtful Assets, Loss Assets, Lending, Public Sector Bank, Private Sector Bank.*

Introduction

India's banking system was remodeled in conjunction with the 1991 economic liberalization policies through the Narsimham Committee reforms, which were prompted by the country's economic crisis in the 1990s and the subsequent need for loans from the World Bank and IMF. NPAs, or non-performing assets, should be decreased, among other recommendations made by the Narsimham Committee. A liability that is nearly always present in the banking sector is non-performing assets. The success of the banks depends on the procedures followed when handling non-performing assets (NPAs) and keeping their quantity within requirements. Hence, developing and putting into practice an effective monitoring and control policy supported by appropriate legal reforms is the only approach to control the number of non-performing assets (NPAs) in banks. ***According to the Reserve Bank of India***, "An asset becomes non-performing when it ceases to generate income for the bank. Earlier an asset was considered as non-performing asset (NPA) based on the concept of 'Past Due'. A 'non-performing asset' (NPA) was defined as credit in respect of which interest and/or instalment of principal has remained 'past due' for a specific period of time."

The banking sector faces significant challenges from non-performing assets (NPAs), also referred to as bad loans, particularly in emerging nations like India. NPAs are loans that have not been repaid for a predetermined amount of time—typically 90 days or longer—and are in danger of defaulting. Since these assets result in a loss of revenue and have the potential to cause lower profitability and financial instability, they pose a serious threat to banks

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Non-Performing Assets (NPA)

- **What is NPA (Definition)**

Non-Performing Assets (NPA) are loans or advances that the borrower has not repaid for at least 90 days. Put another way, non-performing assets (NPAs) are loans for which the lender is not receiving any revenue because the borrower has neglected to make interest and principal payments. Because NPAs can affect a bank's or financial institution's stability and profitability, they are a serious concern.

- **Categories of NPAs**

Banks classify non-performing assets into three categories based on how long they have been none performing:

  - **Substandard Assets:** When a loan or advance is non-performing for less than or equal to 18 months, the asset is referred to as a substandard asset.
  - **Doubtful Assets:** When an asset remains non-performing for more than 18 months, it is classified as a questionable asset. Compared to inferior assets, they carry a larger risk.
  - **Loss Assets:** When an asset is identified as a loss but hasn't been written off by the bank, internal or external auditors, or the RBI inspection, it's referred to be a loss asset.

- **Causes of NPA**
  - **Lending Practices of Banks:** The poor lending practices of banks caused the financial crisis of 2008. When making loans, banks are required to adhere to certain guidelines and laws. They should appropriately abide by the bank's credit policy.
  - **Business Risk:** The Corporation may occasionally experience issues with its own operational environment, which could lead to losses.
  - **Environmental Risk:** Environmental issues like droughts and cyclones can occasionally occur, preventing farmers and agribusiness owners from receiving the necessary yield.

- **Impact of NPA**
  - **Liquidity:** The issue of non-performing assets (NPAs) is affecting banks. They are not making up the money they loaned the borrower. Money will be blocked during those periods. For brief periods, banks lack sufficient cash on hand.
  - **Credit Loss:** When a bank's nonperforming assets (NPA) are problematic, they lose market value and goodwill, which further lowers the bank's market credit rating.
  - **Profitability:** NPA affects both the current and total profitability for the financial year.

Difference between NPA and NPL

Difference between Non-performing Asset (NPA) and Non-performing loan (NPL):-

Non-performing Asset (NPA)	Non-performing loan (NPL)
When a borrower fails to pay back the debt for an extended length of time, NPAs are recorded on the bank's balance sheet.	The borrower has been in default for a while and hasn't paid any bills or instalments.
NPAs affect the lender financially	If a borrower hasn't made a payment for 90 days, the loan is deemed non-performing in the banking industry.
NPAs are another indicator of a bank's financial health.	Loans that are less than 90 days past due and have dubious prospects of recovery may be deemed non-performing by the International Monetary Fund (IMF).
The length of the repayment period determines how NPAs are classified.	Banks also sell non-performing loans (NPLs) to other banks and maybe to investors.

Objective

- Impact of NPA’s on public and private sector banks.
- Effect of return on assets and other factors on the profitability of public and private sector banks.
- Comparative analysis between public and private sector banks.
- To find out the problems arising due to NPA in Indian banking system

Research Methodology

This research report uses secondary data to provide a descriptive analysis. Information has been gathered from several sources, books, research papers, and journals. The researcher uses straightforward calculations, graphs, and tables to explain the data and arrive at conclusions.

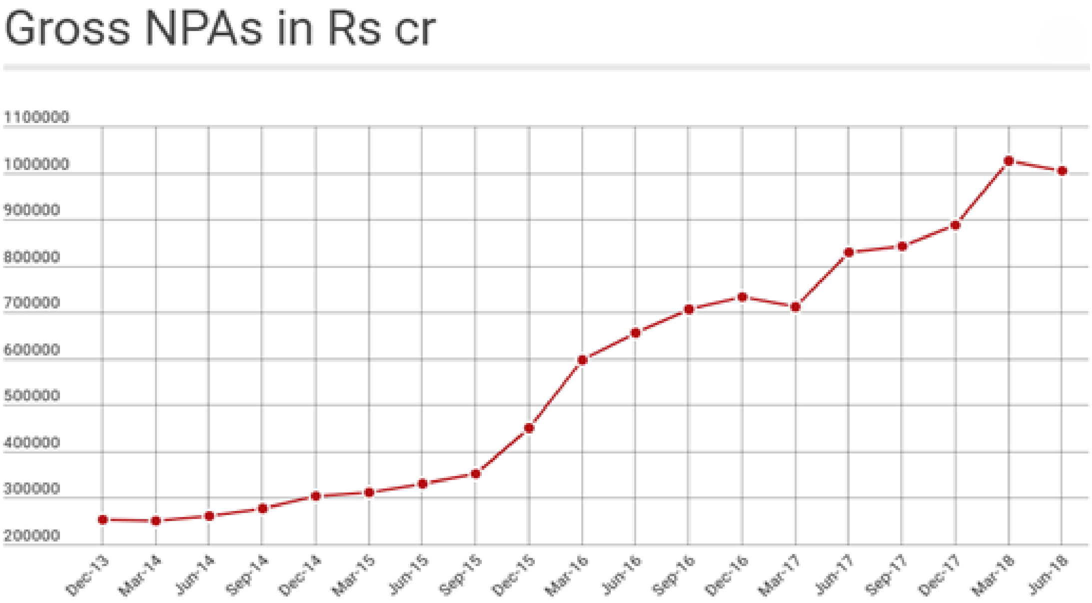
Trends and Differences in NPAs across Public Sector and Private Sector Groups in India

For both public and private sector banks in India, non-performing assets are a major concern. The amount of non-performing assets (NPAs) in these two industries varies significantly, though. India's public sector banks have more non-performing assets (NPAs) than private sector banks. There are a number of reasons for this, including the absence of autonomy, political meddling, and antiquated managerial techniques. In public sector banks, the gross non-performing asset (NPA) ratio climbed from 7.5% in 2015 to 11.3% in 2018, as reported by the Reserve Bank of India (RBI). The gross non-performing asset (NPA) ratio of private sector banks, on the other hand, rose from 3.7% in 2015 to 4.2% in 2018. In 2018, the net non-performing asset (NPA) ratio for public sector banks was 4.6%, compared to 0.9% for private sector banks.

Year	Gross NPA Ratio of Public Sector Bank	Net NPA Ratio of Public Sector Bank	Gross NPA Ratio of Private Sector Bank	Net NPA Ratio of Private Sector Bank
2015	7.49%	4.63%	2.43%	0.83%
2016	9.32%	5.94%	3.45%	1.38%
2017	11.24%	7.17%	4.18%	1.50%
2018	12.90%	8.96%	4.08%	1.19%
2019	11.63%	7.53%	3.42%	0.81%
2020	7.52%	2.91%	3.18%	0.78%

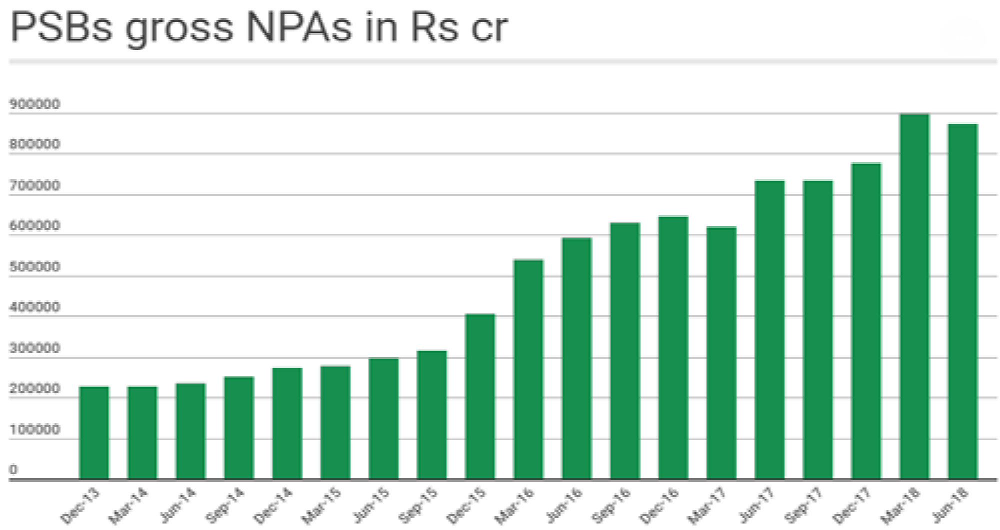
Note: The data is sourced from the Reserve Bank of India's (RBI) Financial Stability Report (FSR) released in July 2021.

Comparative Analysis of PVB (Private Banks) and PSB (Public Sector Banks) of NPA



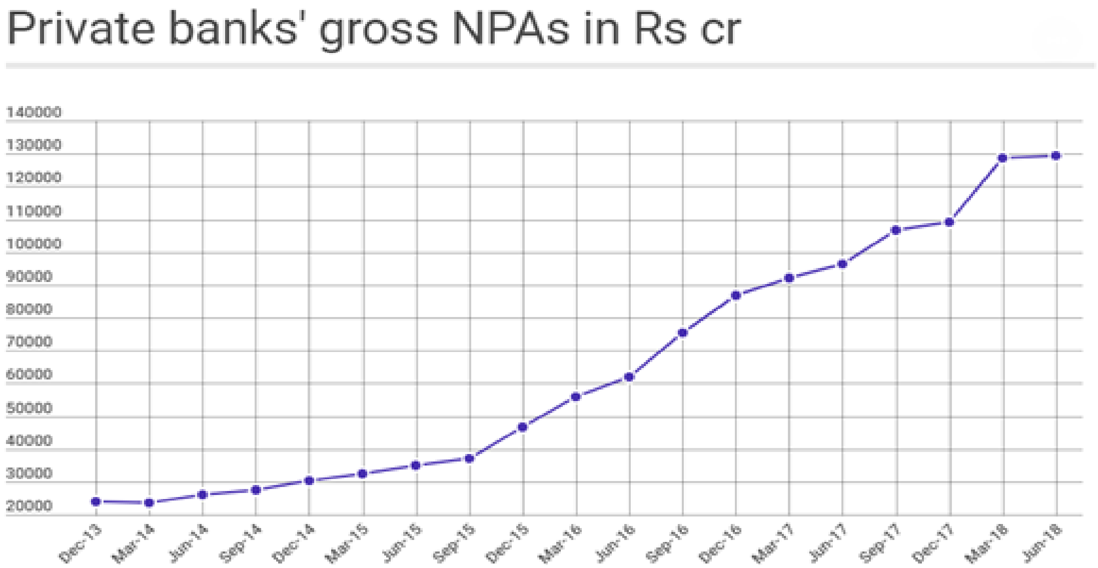
Source: RBI report for assessment year 2017-2018

The gross non-performing assets (NPA) in 2013 were Rs. 2,52,275 crore, a rise from 2014. September 2014, exactly one year later, saw the NPA reach Rs. 2,78,458 crores. Moving forward, the NPA increased significantly in March of 2016 to reach Rs. 5,95,636 crores. Following that, there was a specific percentage decrease in March of 2017 compared to December of the previous year, when it was Rs. 7,32,976 crores instead of Rs. 7,11,436 crores. At the close of the fiscal year, March 2018 totalled Rs. 8,86,460 crores, or roughly 10,25,229 crores, which was sixteen percent more than December 2017 . decreased by a certain percentage to Rs. 10,03,404 crores in the month of June 2018.



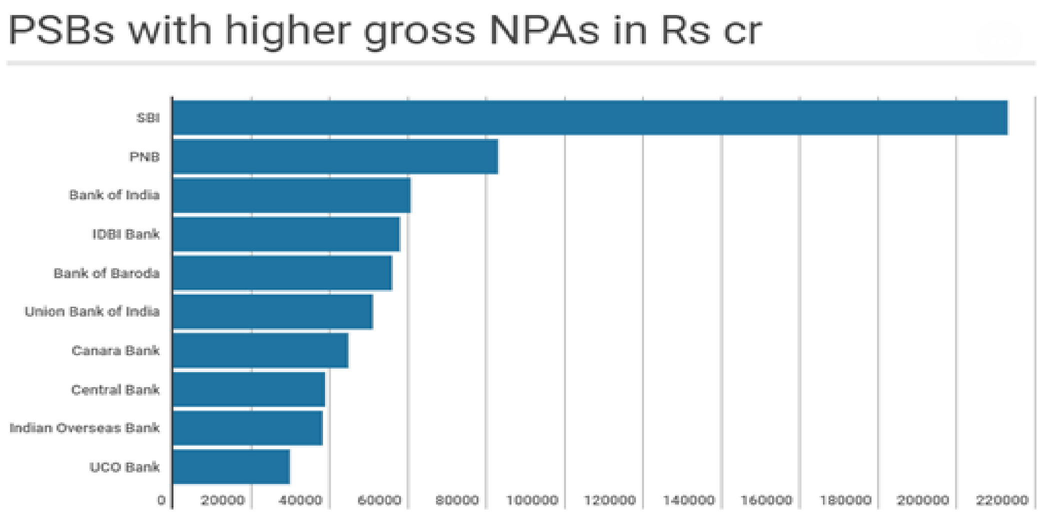
Source: RBI report for assessment year 2017-2018

The gross non-performing asset (NPA) of public sector banks in 2013 was Rs. 2,28,244 crores. By the end of December 2014, the percentage of non-performing assets had increased to Rs. 2,72,706 crores. As of March 2016, the sum has increased to Rs. 5,39,955 crores over the preceding year. There has been a minor, progressive growth and drop in the public sector banks' gross between December 2016 and June 2017. The gross non-performing assets (NPA) exceeded Rs. 9,00,000 crores by the end of March 2018 . The gross non-performing asset (NPA) decreased from Rs. 9,00,000 crores at the start of the fourth quarter to Rs. 8,74,071 crores.



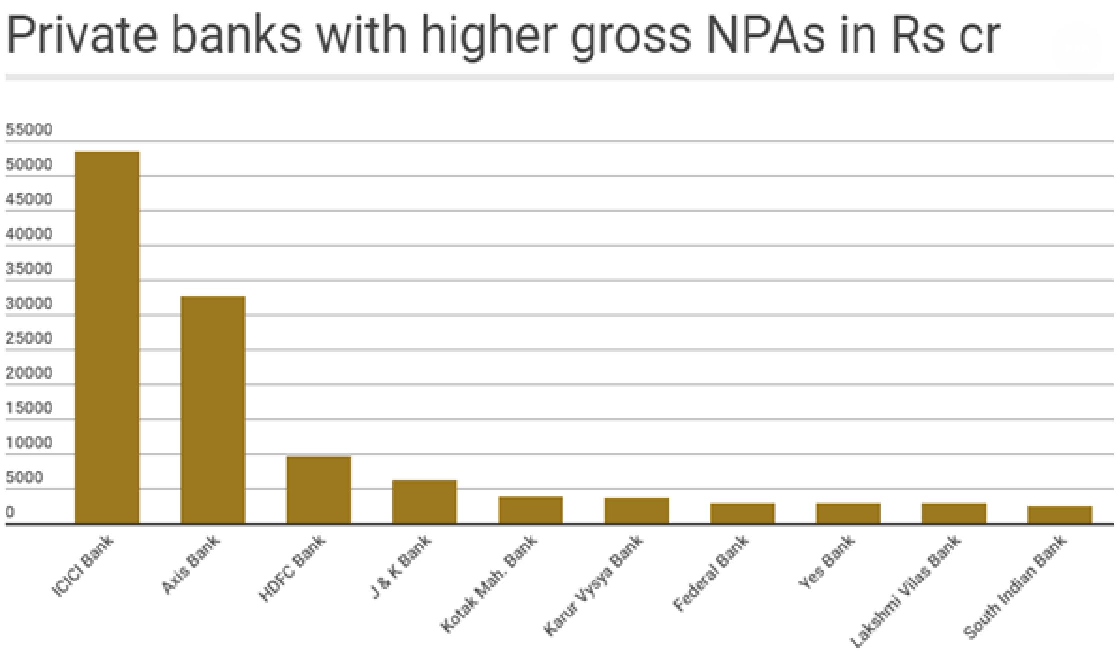
Source: RBI report for assessment year 2017-2018

The gross non-performing assets (NPA) of private banks increased to Rs. 24,031 crores in December of 2013. The gross non-performing assets (NPA) of private banks continued to rise at the conclusion of the March 2016 fiscal year compared to the previous fiscal year, 2014–2015. The gross non-performing assets (NPA) for September 2016 was around Rs. 75,492 crores. The largest loss for private banks was reported in March of 2018, when revenue increased to Rs. 1,28,627 crores. In March 2018, the combined value of 18 private sector banks increased by Rs. 19,446 crores, or 17.9%, to 1.28 lakh crore.



Source: RBI report for assessment year 2017-2018

The State Bank of India holds the top spot among public sector banks, having a gross non-performing asset (NPA) of Rs 2,12,840 crores. Following the Nirav Modi scandal, Punjab National Bank's (PNB) non-performing assets have increased to the highest level in comparison to PNB's prior year. IDBI, the top industry bank, outperformed the other public sector banks. In March of this year, the value of the Oriental Bank of Commerce and Bank of India fell by approximately Rs. 1,920 crores, while the Oriental Bank of India fell by Rs. 1,417 crores.



Source: RBI report for assessment year 2017-2018

Axis Bank expanded by Rs. 9,428 crore, or 37%, in March 2018 to Rs. 34,249 crores, trailing behind industry leader ICICI Bank, which tops the list with Rs. 53,465 crores. The gross NPA ratios for the Federal Bank and Yes Bank are around Rs. 2869 crores and Rs. 2824 crores, respectively. Finally, compared to other private sector banks, South Indian Bank has the lowest gross percentage of non-performing assets on the graph, with gross bad loans totaling Rs. 2,552 crores .

The Problems caused by NPAs

The efficiency of banks is also evaluated by the rate of return on their assets because non-performing assets (NPAs) do not create interest revenue for banks and institutions are required to make provisions for NPAs from current profits. NPAs are one of the main obstacles to the socioeconomic development of emerging nations like India. The bank's financial stability is impacted by the high number of non-performing assets (NPAs). In order to strengthen their internal control and risk management system, banks must work hard. The following are some effects of the high level of non-performing assets on banking operations. Continuous decline in interest income and providing provision for doubtful debts to write off bad debts from current profits affect the bank's profitability adversely.

The ROI (return on investment) decreases as well.

The cost of capital will increase as a result of the inclusion of NPAs, which also messes up the computation of capital adequacy ratios.

The bank's total interest income will decrease and it will only be recorded based on receipts.

The high risk, high amount of non-performing assets, and unclear return will drive up the cost of capital.

A high percentage of non-performing assets negatively impacts not just banking operations but also other parties.

Non-performing loans (NPAs) improperly divert financing from profitable ventures, eclipsing the economy's potential for production in the process.

NPAs have a negative impact on the financial system and lower the money supply, which eventually causes the economy to decline. It occurs when a large number of borrowers neglect to pay both the principle and interest. Lack of liquidity may affect banks, and as a result, it may impede payments across the nation.

Conclusion and Suggestion

In India, non-performing assets (NPAs) pose a serious problem for the banking industry, impacting both public and private banks. The economic downturn, fraud and wilful default, political meddling, insufficient credit evaluation, inefficient recovery procedures, and inadequate risk management are the main causes of non-performing assets (NPAs). Private sector banks have lower NPA levels than public sector banks do. They have a detrimental impact on the banks' earnings. They have an impact on the financial expansion of the economy as well as the bank's financial success. Because the financial system is essential to our economic growth, banks must focus on managing nonperforming assets (NPAs) in order to increase profitabilityA growing NPA suggests a significant volume of credit defaults, which impacts a bank's solvency, profitability, and liquidity. Public sector banks are largely impacted by the nonperforming asset (NPA) issue. Given that Indian banks primarily rely on interest revenue from borrowed money, the availability of capital is directly impacted when deposits turn into non-performing assets (NPAs) as a result of past-due payments.

Therefore, in order to address this issue, strict policies ought to be implemented. To speed up the resolution of outstanding cases, the government should also make further measures. With the effective use of Lok Adalats, Debt Recovery Tribunals, and the SARFAESI Act, banks were able to control their non-performing assets (NPAs).

Suggestion

Suggestions for Reducing NPAs:

- Create a loan recovery policy and NPA reduction plans.
- Establish dedicated recovery cells after crucial branches for recovery are identified at the head office, zonal office, and regional office levels.
- Establish recovery goals and create an action planner with a deadline.
- Choose appropriate methods for resolving each NPA's issue.
- Track the execution of the time-bound action plan.
- Monitor the action plan and, if necessary, make adjustments to the original plan while taking corrective action when needed.

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