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Managing NPAs in India - Challenges and Remedies

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ABSTRACT— *The issue of NPA is faced by many countries. But India as it is developing, this problem is very huge. In past few years, NPAs are growing at very high rate. Indian Government has taken some measures, but it was not very effective. Growth in NPA is directly impacting our Indian economy. Banking profitability also has adverse impact of NPA. Managing NPA is one of the biggest challenges of banking sector. To overcome this problem policies which help in fast recovery of NPA needs to be introduced. NPA rate is high due to Wilful defaults, lending money to priority sector, corrupt politicians etc. Due to Bank's involvement in solving NPA issue, banks are not able to perform their basic functions i.e. taking deposits and lending money. In this paper, we have discussed the concept of NPA, its causes, impact, tools used and preventive measure to avoid this problem to get insight of dealing with NPAs.*

Keywords— *Non-Performing Assets, Wilful Default, Banking Sector, Securitization, SARFAESI Act, Lok Adalat.*

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I. INTRODUCTION

Performing assets are those assets which helps in revenue generating whereas non-performing assets does not generate any revenue. When borrowers do not meet their debt obligation, that is, he/she defaults in making payment of principal or interest or both to a lender for a long period as per agreed terms and conditions of a loan agreement, that debt leads to NPA of an organization. Therefore, NPA do not earn any revenue in any form for the organization. After long period of default in payment, borrower will be insisted by lender to liquidate pledged asset given as mortgage at the time of loan agreement. In case, there were no pledged asset, then the loan will be written off as bad debt and after writing off lender will sell this loan to collection agencies at concession. This loan is an asset for a bank but when it stops generating revenue for the bank, it will become NPA for a banking organization. NPAs are usually facility of credit provided by bank on which interest amount or instalment is "past due" for more than or equal to 2 quarters. Any amount which is due but unpaid for 30 days or more under any credit provided by a bank is known as "past due". In December 2015 public bank NPAs was Rs. 3.61 lakh crore. At the end of 4th quarter i.e. in March 2016, situation gets more worse and combined loss of twenty public banks was Rs. 16272.34 crore. In corresponding quarter, net profit of public banks was Rs. 4,063.58 crore (Pro. D.S. Rathore, 2016).

II. WHAT IS NPA?

Non- performing Assets are those assets of any bank or finance company which stops generating revenue for the organization. NPAs are assets which RBI classifies them as substandard assets, doubtful assets or loss assets. From the date, 31st March 2004 NPAs are:

- Unpaid instalment or interest of term for more than 90 days.
- Inactive OD or CC account for more than 90 days.
- unpaid amount on bill discounted or purchased for more than 90 days.
- unpaid amount of principal or interest for two harvest seasons but not exceeding 2.5 years when loan is granted for agricultural purpose.
- any amount which needs to be paid but is unpaid for 90 days or more in case of other accounts (Sukul, 2017).

On 31st March 2001, the concept of NPA came into picture and instead of 90 days NPA definition first considered 180 days of non-payment of any amount due. Afterwards, in march 2004, with the intention to adopt best international practices and to increase transparency it changed to 90 days overdue (ZAFAR, MAQBOO, & S.M.KHALID, 2013).

III. GROSS NPA & NET NPA

Gross NPA are unrecovered granted money for which provision have been created and it is still shown in the books of account of the bank. As per RBI, it is a total amount of all NPAs held on balance sheet date. It reflects quality of credit granted by the bank. It consists of all types of non-performing assets i.e. sub-standard, doubtful assets and loss assets. Formula used for the calculation of Gross NPA (PARMAR, 2014):

Gross NPAs Ratio = Gross NPAs / Gross Advances

Net NPAs are those on which provision amount has been already deducted. Net NPAs is the true reflection of banks' condition. As per guidelines provided by RBI, bank as must make certain provision as recovery and writing off process is very slow. Formula used for the calculation of Net NPA (PARMAR, 2014):

Net NPAs = Gross NPAs – Provisions / Gross Advances – Provisions

IV. CLASSIFICATION OF NPA

As per RBI guidelines, Bank classify their non-performing assets into 3 categories:

- **Sub- standard assets**: From the date 31^{st} March 2005, these assets remained as NPA for a year or less. In this situation, recovery of dues from the borrower, guarantor or securities are not enough for bank. These assets lead to the losses as these endanger the liquidation process if deficits appropriation not done properly.
- **Doubtful Assets:** From the date 31^{st} March 2005, if assets remained in substandard asset category for more than a year than these assets will be called as doubtful assets. In addition to risk which we had in sub-standard assets, these assets make the probability of collection and liquidation highly questionable.
- **Loss Asset:** Loss has already been recognised through the inspection process by RBI or auditors but amount still needs to be written off completely (ZAFAR, MAQBOO, & S.M.KHALID, 2013).

V. CAUSES OF NPA

A. Major causes of NPAs in Indian Public Sector Banks:

Supremacy of banking sector in the country is most essential factor for prospered economy as banking sector also affects other sectors directly or indirectly. In the pressure to survive in competition and earn huge profits results in higher NPAs and costs. One of the main causes of NPA is directed loan system in which it is mandatory for banks to lend 40% of their loans to priority sector. In current scenarios, most of the NPAs fall under the category of doubtful or loss assets and this is due to complex and time consuming legal practices, postponement in solving the current problems with the intention to use political influence to window dress the earnings and manipulate the debtors and not due to the absence of stringent practical norms (ZAFAR, MAQBOO, & S.M.KHALID, 2013).

B. Macro Percpective behind NPAs Causes:

This is bitter truth of banking sector that banks give loans based on political influence and considerations and not based on project viability, commercial considerations, past records of the party or business perspective. Consequently, loans become NPAs. Another factor is lending or waiving off the loans to weaker sections or farmers by the government also impacts NPA growth rate. Depositor's money in bank wasted like this because of greediness of politicians and depositors are forced to pay higher tax or interest to bridge losses which directly impact the market image of the bank. Several programs conducted for poverty elimination like IRDP, SEPUP, PMRY, RREP etc. failed to fulfil the objective of the program. Large amount of loan sanctioned under these schemes was misused due to wrong political practices, lending without checking authenticity of the purpose of borrower and banks were unable to recover these granted loan amounts. Banks assets major part is loan granted by them and because of the poor repayment these assets are deteriorated at faster rate. (ZAFAR, MAQBOO, & S.M.KHALID, 2013).

C. Other Reasons:

There are several internal and external factors:

1. **Internal factors:** Deficiency in project appraisals in terms of economic viability, technical feasibility, implementation and Deficiency in project management in terms of production, marketing, labour and finances, funds borrowed for one purpose and used for another, unable to recover, corporate inefficiency in raising funds through equity, wilful default, frauds, management issues etc.
2. **External Factor:** Huge investments was made with the aim of globalisation which was not utilized properly due to uncertain liberalisation strategies, credit portfolio mostly consists of traditional industries, sick industries, lethargic legal system was also the reason for NPA. Other external factors were: Unavailability of raw materials, shortage in power supply, lack of transportation facilities, financial

blockages, varying government regulations like taxes, natural calamities, increased expenses, market saturation, product obsolescence, fall in demand etc.

The only reason for NPAs in commercial banks is inefficient and politically biased legal system of India. Due to incapability of banks to recover money and file suit results in unproductive assets which would have contributed larger portion of bank funds. Out of cases filed of Rupees one crore only one case results in rational conclusion. FITCHIBCA which is international rating agency stated, "legal system of India is more inclined towards buyers and not works in favour of banks". Pannir Selvam committee of IBA said on the topic of NPA "court takes decades of time to give decisions after that execution of court verdict becomes difficult task. For flourishing economy, it is important to recognize the wilful defaulters. Wilful defaulters have created problems for small and medium scale enterprises to take easy credit from bank due to deliberate defaults, banks have become more cautious towards taking any risk. (ZAFAR, MAQBOO, & S.M.KHALID, 2013).

Meaning of Wilful Default: Wilful default means borrower has not used the fund for the purpose it was borrowed, or borrower has not paid his instalment without any genuine reason or he has sold the secured assets without informing the bank.

As per RBI, following are the four situations which will be considered as Wilful default:

- When borrower has ability pay his due instalment, but he does not pay. It will consider as deliberate intention of borrower defaulting in making payment.
- Funds are used for some other purpose which is totally different from the purpose mentioned to bank or financial institution at the time of borrowing.
- All the borrowed funds have been drained off and there is no proper justification for the utilisation of borrowed money.
- When secured asset has been sold off without giving any information to bank or financial institution. In case of guarantee of wilful defaulter given by group of companies, then these companies also considered as wilful defaulters (Sathisha HK, 2016).

VI. IMPACTS OF NPAS ON BANKS

NPAs has direct impact on the bank's profitability. Banks' profitability gets affected in following ways:

- **Liquidity position:** NPAs forces bank to raise resources at higher cost because NPA cause mismatch between the total liabilities and total assets (Dr. Raj Kumar Mittal, 2017).
- **Undermine bank's image:** Profitability also gets affected by the undermine image of the bank which is caused due to high level existence of NPA in banks.
- **Effect on funding:** NPAs also causes scarcity of funds for lending money to the needful borrower.
- **Rise in cost of capital:** NPAs raise cost of capital as more working capital is required (Dr. Raj Kumar Mittal, 2017).
- **High risk:** NPA also impacts the risk-taking capabilities of the bank (Dr. Raj Kumar Mittal, 2017)
- **Effect on income:** NPA does not earn any interest so, this badly impacts the income of the bank.
- **Declining productivity:** NPAs not only affect income it also increases cost in terms of time consumed, money consumed, and manpower consumed affects the profitability, as staff involve in preparing all the documentation required, planning and implementing funds mobilization whose outcome is nothing.
- **Effect on ROI and profitability**: As NPA affects the earning capacity which negatively impacts the ROI (Dr. Raj Kumar Mittal, 2017).
- **Ultimate burden on society:** NPA puts burden on other borrowers as in order cover up their losses bank will charge high rate of interest from them (Dr. Raj Kumar Mittal, 2017)**.**
- **Effect on capital adequacy:** NPAs badly impacts the capital adequacy ratio as NPA increase the need for creating higher provisions (Singh, 2016).
- **Impacting share price:** Sometimes NPA decrease price of share even below book value (Singh, 2016).
- **Impact lending capacity:** NPAs makes it difficult for the bank to lend further as there is no flow of funds and no earning of interest (Pro. D.S. Rathore, 2016).

Some Facts and Figures

1. Scheduled commercial banks' gross NPAs in 2000-01 were Rs. 708 Billion and increased to Rs. 2642 Billion in 2012-13.
2. Scheduled commercial banks' net NPAs in 2000-01 were Rs. 355 Billion and increased to Rs. 986 Billion in 2012-13.
3. NPAs was highest in 2001-02 that was 5.5% of net advances and was lowest in 2007-08 & 2008-09 that was 1.0% of net advances. In the year 2013-14, it was 2.2% of net advances.
4. From the year 2001-02 to 2013-14, average net NPAs was approx. 2.0%
5. In 2008, 1,86,535 cases were filed in Lok Adalat and in 2014 this number was increased to 16,36,957.

6. Scheduled commercial banks' NPAs recovered through Lok Adalat during the period 2008-2014 were Rs. 2535 crores.
7. Scheduled commercial banks' NPAs recovered through DRTs during the period 2008-2014 were Rs. 27231 crores.
8. Scheduled commercial banks' NPAs recovered through SARFAESI Act during the period 2008-2014 were Rs. 77241 crores.
9. The factors which leads to increased rate in NPAs were wilful default, ineffective recovery & defective process of lending and these increased NPAs negatively impacted ROI of the bank (Singh, 2016).

VII. REMEDIES TO RESOLVE NPA ISSUE

1. RBI should revise their policies of monitoring system and credit appraisal (Dr. Raj Kumar Mittal, 2017).
2. Strengthening of the process of recovery is required (Singh, 2016).
3. To ensure the credit amount provided are used for the same purpose it has taken for, bank needs to conduct inspection at regular intervals (Dr. Raj Kumar Mittal, 2017).
4. Regular reviewing of all loan accounts (Dr. Raj Kumar Mittal, 2017).
5. Give training to bank staff so that they can deal with issues related to credit appraisal & monitoring (Dr. Raj Kumar Mittal, 2017).
6. There is possibility that bank can go for one-time settlement which leads to compromising their terms and conditions of the agreement. Banks can also choose Lok Adalat or Debt Recovery tribunals. Apart from this, Banks now-a-days managing NPAs through SARFAESI Act (Dr. Raj Kumar Mittal, 2017).
7. Severe investigation needed before granting loan to a customer (Dr. Raj Kumar Mittal, 2017).
8. If situations are beyond the control of the borrower than they can rearrange the account (Dr. Raj Kumar Mittal, 2017).
9. Conduct regular meeting with staff for discussing strategies for recovering the dues (Singh, 2016).
10. Provide guidance to entrepreneur about the effective utilization of funds and entrepreneur skills which helps to bank to build relation with the customers and it becomes easy for the staff to keep record of the utilized fund (Singh, 2016).
11. RBI can give defaulters name in the official gazette & newspapers which will create awareness among other financial institutions and banks (Singh, 2016).

VIII. TOOLS USED IN INDIA FOR RESOLVING NPA ISSUE

A. Managing NPAs through securitization

The biggest challenge for any financial institution or bank is to control increasing rate of NPAs of this century where globalization is the primary goal. Financial companies face major problem in recovering the granted credit amount and difficulty in the enforcement of securities. A huge amount of bank's fund is blocked in unproductive assets Before implementation of Securitizing Act, finance companies must enforce their charged securities through court which was complicated process. In present law, there was no provisions for hypothecation. Government of India passed act in 1993 named as Recovery of Debts Due to Banks and Financial Institutions Act to control NPAs complexities. But this effort of government was failed as NPA problem was huge and in front that problem this act was not effective enough. To deal with this problem Indian financial and banking sector needs more efficient and effective Acts. To overcome this difficult situation, Indian government introduced SARFAESI Act, 2002. This Act brought major changes in legal system of India in terms of recovering amount from NPAs. This Act provides authority to secured lenders that they can possess the security or sell the secured asset or takeover the management of secured asset or appoint a person as a manager of the secured asset. SARFAESI Act also establish ARCs to recover amount of NPAs. In the year 2002 the main aim was to legalize securitization, recreate the financial asset and implement the security charge. Before 2002, there was no law regarding securitization, possession and selling the secured asset. SARFAESI Act which was introduced in 2002 for solving this problem, at that time gross NPAs were 14% of the entire advances and net NPAs were 7% of the entire amount. In April 2004, provision of SARFAESI Act 2003 that borrower requires to deposit 75% of their liabilities in case if he/she wants to file appeal against the asset attachment was removed by the Supreme Court. The amendment in SARFAESI Act was made in 2004 to recover the debt of secured creditors as soon as possible and to persuade against the borrower for delaying the payment of dues. SARFAESI Act, 2002 makes it easier to get payments from small borrowers but it was difficult to collect payment from big defaulters as they have granted consortium loans, so bank must take consent from secured creditors before issuing the notice as they represent 75% of total debt. Banks main function is to take deposits and give loans and not to file suits or possess and sell assets. ON 4th April 2005, RBI issued guidelines on the securitization of standardized assets and in July 2005 RBI issued guidelines for NPAs secondary market. On 2nd Febuary,2006, RBI issued guidelines for protecting the investor interests**.** In May,2007 Bombay High Court passed the judgement in favor of possession of secured asset and made the process easier as a result it has boosted confidence among bankers for speed recovery. As per Securitization Act, there is no requirement of giving any notice or hearing to a borrower or third party if permission is already granted by Chief Judicial Magistrate regarding the possession of assets**.** Banking sector will be benefited from this act in future as SARFAESI Act have proved to be most effective for banks in terms of recovery among all options **(**ZAFAR, MAQBOO, & S.M.KHALID, 2013)**.**

B. **LOK ADALATS 2001**

When matter needs to be resolved without the involvement of court, Lok Adalat is the best option. Debt Recovery Tribunals convened the Lok Adalat. These Adalat do not have any legal powers. This is a forum for the mutual settlement between the borrower and the bank. Once both the parties signed the agreement of settlement, the same is presented in front of court. The court will then pass its decision according to the settlement agreement. After this passed decision cannot be challenged in the higher court. The cases which are above Rs. 5 lacs can be taken to Lok Adalat and more over this has been effective for small and fast recoveries (Rathod, 2018).

C. **Debt Recovery Tribunals (DRT 1993)**

As per RDDBFI Act,1993 banks approach to DRT for recovery of their loan and as per SARFAESI Act, 2002 aggrieved party like guarantor, borrower or any person which was affected by the action of the bank can approach to DRT. DRT are available all over the country. In fact, there is more than one DRT in some cities. Cities like New Delhi, Mumbai & Calcutta have 3 DRTs. Chandigarh & Ahmedabad have 2 DRTs. One DRT is at Bangalore, Allahabad, Aurangabad, Coimbatore, Cuttack, Ernakulam, Guwahati, Ranchi, Vishakhapatnam, Pune, Patna, Nagpur, Hyderabad, Jabalpur, Lucknow and Madurai (Rathod, 2018).

D. **Asset Recovery Construction Industry LTD(ARCIL)**

Asset reconstruction company word only used in India. In rest of the world this term is used as asset management companies. In Narasimha I report "asset reconstruction" word was used and in this Central Government will contribute the amount in Asset Reconstruction Fund which afterwards used by the bank to clear their NPAs from the balance sheet. This was introduced with the focus of (Rathod, 2018):

(a) Removing NPAs from the Financial System
(b) Focus should be on core activities
(c) Enabling Market development.

E. **Corporate Debt Restructuring (CDR 2005)**

CDR is basically restructuring the debt obligation of the company, it is done by decreasing the interest rate and increasing the duration of the payment (Rathod, 2018).

F. **Credit Information Bureau – 2000**

For avoiding NPA situation, strong information system should be there so that loan will be provided to right person. CIB provides information of all the defaulters to banks (Rathod, 2018).

G. **Joint Lenders Forum - 2014**

This is created with the intention to avoid lending by the different banks to the same individual. Mostly people take loan to pay loan of other bank, this forum helps in preventing this type of situation (Rathod, 2018).

H. **Bad Banks - 2017**

This usually take stressed loan of public sector bank and handle according to flexible mechanism. This usually helps public sector bank to improve their balance sheet and provide loan to new and development projects (Rathod, 2018).

IX. TOOLS USED IN INDIA FOR RESOLVING NPA ISSUE

Following are symptoms which indicate that loan can be converted into NPA (Pallab Sikdar, 2013):

- Default in making payment of initial instalment
- Cheque bounced because of insufficient funds
- Irregular payments
- Overdue bills which are unpaid
- Reducing current ratio
- Partial payment of the instalment
- Amount transferred to parent or sister company from their company’s own account
- Borrower is in the process of shutting down business or not actively doing their business
- Receivables are overdue
- Delay in submitting statement of stock

- Regularly changing plans
- Wages are unpaid
- Not responding to bank
- Partners dispute in the business
- Government policies have been changed
- Death of borrower
- Market competition is very high

Preventive measures can be taken (Pallab Sikdar, 2013):
- If response is delayed for longer period, there is higher possibility of NPA
- Along with fund flow analysis, cash flow analysis is also required to take right decision of lending the credit
- It is not necessary NPAs are due to lack of fund, it could be due to poor management policies as well
- Integrated approach should be adopted by all the banks while performing the assessment of viability and banks should share all the relevant information with each other regarding the borrowers.

X. CONCLUSION

Managing NPAs are one of the major issues of the banking industry as it is directly related to the earnings of the banks which results in poor economic growth. Banks need to take serious measures to solve this problem and RBI should make such policies in which recovery of defaulted money becomes easy and simple. However, till now government has took many steps to overcome this problem but still there is scope for improvement in their strategies. Banks also need to adopt proactive approach so that situation of NPA can be prevented because prevention is always better than cure. Recovery process needs to be faster. Problem of recovery is with large borrowers and not with small. So, this area needs much more attention of Indian Government to get flourishing economy.

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