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# Management of Non-Performing Assets of Public Sector Banks in India

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**Abstract**

Public sector banks by their nature are Government owned banks and therefore their banking obligations have to be focused on the Government economic programme. However, for the continued existence of the public sector banks, management of NPA's has been considered as one of the major criteria. For this purpose coefficient of correlation has been used to analyze the relationship between total advances with gross NPA's and net NPA's of public sector banks in India. Non- performing assets is an important issue in this study because it have not only affected the productivity and the profitability of banks, but also ruined the image of the Indian banking and the outlet on the very value system of the society. The study is limited to the period if six years, i.e. from 2009 to 2014. The study is based on secondary data collected from RBI reports on trend and progress of banking in India. The objective of the study is to analyze the relationship between Total Advances with gross NPA's and net NPA's of public sector banks in India.

**Keywords:** Total Advances, Gross Non-Performing Assets, Net Non-Performing Assets.

**Introduction**

It was in the year 1991-1992 that the Government of India took project for financial development and accordingly put down the foundation for evolution from developing economy to potential economy. These plans consequent generates from time to time, provided superior movement for in general reform and transforming of the financial sector in the country. Opening of the economy required accounting standards, restructuring to recover equivalent stage among international accounting model and global accounting practices carry out in the Indian economy. This changing picture spread-out need for transparency in the current position of public and private sector financial institutions. In no times, concept of competently control of non-performing assets became necessary.

Opening of prudential norms concerning income recognition, asset classification and provisioning formed a large depression not only in profitability of public sector banks but also threw focus on shortage of capital. Rapidly top level of management in each public sector banks had to classify active and probable NPA's arranged for provisioning even by gaining significant losses and taking into account essential steps for eye-catching slippages from performing assets. Therefore, an application under taken by PSB's in late 1991-92 and early 2000 made credit risk supervision, especially motivating subject gives many scopes in asset management in recent circumstances of financial sectors.

**Public Sector Banks in India**

It was in 1969 under a vibrant leadership of late Smt. Indira Gandhi, 14 most important banks were nationalized by the inductive outline of main share holding of Government of India. In this political result, the honesty of Government to reroute capital flow into untouched rural and semi urban economy bubble. By way of the Government presumptuous control of the management of these 14 nationalized banks, the action map for rural economic development had been quickly joined up under a flag of 20 point economic agenda to be employed by all nationalized banks.

**Review of Literature**

Central Bank of India via.RBI also issued descriptive circulars and guideline. Most of daily, weekly, fortnightly and monthly publication carried an article in bold form giving special importance in above issues. Therefore, IBA bulletins, RBI guideline, PSB's handbook and extract from various seminars on the subject to literature review. There are many research performed on the subject of Management of Non-Performing

Assets in Public Sector Banks in India, following are the review of few literatures about the NPA management conducted for Banks in India.

**Sambasiva Rao (2002)** stated that on the social economic obligations of state owned PSB's and policy maker and has commented on proposing certain steps for recovery in accounts with wilful defaulter, authorised seizure agencies attach property of relatives and evolve such system under which promoters cant become rich when the organisation is deteriorating. The paper also stated measures in which accountability of professionals like Charted Accountant (C.A) should be fixed for either concealing facts in the balance sheet or fixing accountability of lawyers for giving convenience legal opinion.

**Dr. K.C. Chakraborty (2005)** the author had concluded that in the ultimate analysis, Banks have to face several challenges in managing NPAs. Besides ensuring better scrutiny of the credit proposals before sanction, Banks need to watch closely and monitor the assets from the beginning. In fact, NPA management begins right from the selection of borrowers. A continuous and consistent monitoring mechanism is a must for ensuring the best quality of the asset. Early warning signals or symptoms of any sickness should be addressed immediately and appropriate remedial action implemented.

**Jyoti Sharma (2010)** stated that varieties of avenues are available to banks and financial institutions in India to recover funds blocked in NPA and to use them for productive purposes. However, practically it is observed that they face many hurdles in this task resultant to borrower taking benefit of escape in the existing law. Therefore, there is a need to remove such obstacle faced by the banks and financial institutions by bringing in suitable changes in the current legal structure.

**Rajput, N. Arora, A.P. Kaur, B (2012)** in this paper, study has been made on management of NPA in public sector banks in India under strict guideline prescribed by RBI relating to prudential norms for income recognition, provisioning and assets classification. NPA is an important indicator to show performance and position of banks in India. Higher the provision for doubtful assets decreasing the margin of profit. Reduction of non performing assets show the reliability of banks.

**Objectives of the Study**

1. To consider an evaluate quality of quantum growth in total advances vis-à-vis status of growth in Gross NPA's and Net NPA's
2. To analyse impact of growth in Gross NPA's and Net NPA's over assets quality in credit portfolio of banks
3. To review percentage growth in both Gross NPA's and Net NPA's

**Research Hypothesis**

To achieve the above objectives, following hypothesis are formulated and tested

**H0 : Null Hypothesis**

There is no significant relationship between total advances and gross non-performing assets and net non-performing assets of public sector banks

**H1 : Alternative Hypothesis**

There is significant relationship between total advances and gross non-performing assets and net non-performing assets of public sector banks

**Research Methodology**

The study considered primary data collected through specially arrange visits with the official and directors of VAMNICOM (Vaikunth Mehta National Institute of Co-operative Management, Pune and Centre for Monitoring Indian Economy (CMIE). Secondary data collected from the annual report and website of central bank (RBI) and from literature review.

**Period of Study**

The paper discusses management of non-performing assets of public sector banks in India from period of 2008-09 to 2013-14.

**Concept of Non-Performing Assets**

This income recognition norms and assets classification with provisioning norms made balance sheet structure of PSB's so transparent and clear at par with international practices, that global financial organisation got attracted towards Indian Banks in particular and emerging market in general. The Public Sector Banks represent the backbone of the Indian financial system and have admirably managed where key financial indicators compete with the global benchmark standard and hence such status being a fresh with growth in the Indian economy, provide a very interesting challenges to go into the changing scenario of efficient assets management on one hand fulfilment of capital adequacy on the other hand.

**Prudential Norms**

1. Income recognition
2. Assets Classification
3. Provisioning norms for bad debts

**Performing Asset**

Performing assets are advances which generates income to the Bank by way of interest and other charges.

**Non- performing Asset**

Non- performing Asset is that deployment of the Bank's funds which is not earning any income / return for Bank and funds deployed also become illiquid.

**Income Recognition**

A Bank's advances are to be classified into performing and non performing assets (NPA). The international practice is not to consider interest income from NPA on accrual basis but to consider such income as and when it is actually received. The RBI issued a detailed guideline to Banks regarding classification of advances between performing and non performing assets which have been revised from time to time. The latest guideline for determining the status of credit facilities are discussed below:

1. Interest and or instalment of principal remains overdue for a period of more than 90 days in respect of the term loan,
2. The account remains out of order for a period of more than 90 days, in respect of an overdraft / cash credits (OD/CC),

3. The bills remain overdue for a period of more than 90 days in the case of bills purchased and discounted,

In case of direct agricultural advances, the following guidelines are applicable for classifying an account as a NPA.

1. A loan granted for short duration crop will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons.
2. A loan granted for long duration crop will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.
3. Any amount to be received that remains overdue for a period of more than 90 days in respect of any other account will lead to classifying that account as NPA

As a facilitating measure for smooth transition to 90 days norm, Banks have been advised to move over to charging rate of interest at monthly rates, by April 1, 2002. However, the date of classification of an advance as NPA should not be changed on account of charging of interest at monthly rests. Banks should, therefore continued to classify an account as NPA only if the interest charged during any quarter is not serviced fully within 180 days from the end of the quarter with effect from April 1, 2002 and 90 days from the end of the quarter with effect from March 31, 2004.

**Out of Order**

An account should be treated as 'Out of Order' if the outstanding balance remain continuously in excess of the sanctioned limit/ drawing limit. In cases where the outstanding balances in the principal operating account are less than the sanctioned limit/ drawing limit , but there are no credits continuously for 90 days as on the date of balance sheet or credits are not enough to cover interest debiting during the same period, these accounts should be treated as 'out of order'.

**Overdue**

Any amount due to Bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the Bank.

**Assets Classification**

As per the present guideline of RBI the assets classification and the requisite provisions for doubtful debts is as under.

Banks require classifying the loan assets (advances) into four categories

(1) Standard Assets
(2) Sub- standard Assets
(3) Doubtful Assets and
(4) Loss Assets

**Standard Assets**

Standard assets are which does not disclose any problem and which does not carry more than normal risk attached to the business. Such assets are considered as performing assets.

**Sub-standard Assets**

With effect from 31st March 2005, a Sub-standard asset would be one, which has remained NPA for a period less than or equal to 12 months. In such a case, the current net worth of the borrower / guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the Banks in full. In other words, such an assets will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the Banks will sustain some loss, if deficiencies are not corrected.

**Doubtful Assets**

With effect from 31st March 2005 an assets would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently known facts, conditions and values- highly questionable and improbable.

**Loss Assets**

A loss asset is one which 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.

**Provisions for Doubtful Debts**

Strict provisioning norms have been specified in the case of various categories of NPA, via sub- standard assets, doubtful assets and loss assets. In addition to nominal value 0.25% for direct advances to agricultural and SME sector and all other loans and advances at 0.40%. Further, a conservative policy was put in place in respect of loans, which have been either rescheduled or renegotiated. The provision has been extended from credit risk to market risk as well.

The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the Bank management and statutory auditors. The assessment made by the inspecting officer of the RBI is furnished to the Bank to assist the Bank management and statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines.

In conformity with the prudential norms, provisions should be made on the Non performing assets on the basis of classifications of assets into prescribed categories mentioned above. Taking into account the time lag between an accounts becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the Bank, the Banks should make provision against different categories of the assets as under.

**Loss Assets**

The entire amount should be written off or full provision should be made for the amount outstanding

**Doubtful Assets**

1. Full provision to the extent of the unsecured portion should be made. In doing so, the realisable value of the security available to the Bank should be determined on a realistic basis. Deposit Insurance and Credit Guarantee Corporation/ Export Credit Guarantee Corporation of India (DICGC/ECGC) cover is also taken into account. In case of the advance covered by Credit Guarantee Fund Trust for Small Industries (CGTSI) guarantee becomes non- performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extent guidelines on provisioning for NPA.
2. Additionally, 20% - 100% of the secured portion should be provided for depending upon the period for which the advances has been considered as doubtful assets, as follow-Up to one year 20% provision but one year to three years 30% provision and more than three years 100% provision should be made.

**Sub- Standard Assets**

A general provision of 10% on total outstanding should be made without making any allowances for DICGC/ECGC cover and securities available. An additional provision of 10% (i.e. total 20% of the total outstanding) is required to be made on 'unsecured exposure' of loan. Generally such a situation may arise in case of personal and education loans etc. Unsecured exposure is defined as an exposure where the realisable value of the security is not more than 10% of the outstanding exposure. Security should not include guarantees, comfort letters etc.

**Standard Assets**

With effect from 15- November -2008, the provisioning norms for standard assets amended. It has been clarified that the provision should be made on global portfolio basis and not on domestic advances alone. So direct advances to agricultural and SME sector at 0.25% and all other loans and advances at 0.40%.

**Reasons for Mounting Npa's**

The various causes that make an asset NPA can be classified into two categories like internal causes and external causes.

**(a) External Causes**

1. Natural calamity leading to destruction of assets
2. Recession in the industry
3. Closure of factory due to strikes, court orders
4. Adverse Government policy guideline affecting the production, marketing sales of the product (Ex Import duties)
5. Adverse change in the projected demand due to factors like environmental regulation, change of fashion, change in consumer needs etc.

**(b) Internal Causes**

**1 Management**

1. Fraudulence of partners, directors, proprietor etc.
2. Will full default
3. Lack of proper organizational set up and control
4. Dispute among partners and directors.

**2 Marketing**

1. Scarce product base
2. Lack of distribution channels
3. Irregular delivery
4. Unsuitable pricing

**3 Financing**

1. Lack of resources
2. Costly outside borrowing
3. Diversion of funds for unproductive expenditure
4. Faulty costing and pricing
5. Increased cost of production

**4 Production**

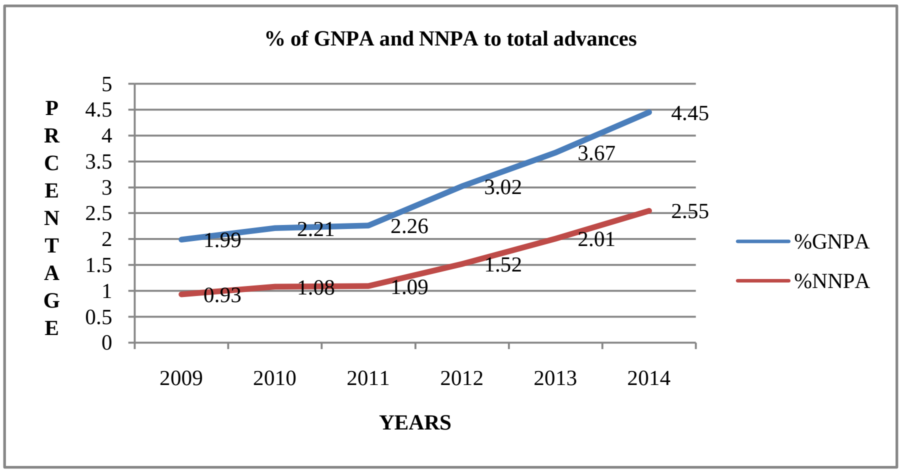
1. Inappropriate technology
2. Poor labour productivity
3. Poor quality control
4. Lack of production planning and control
5. Inferior quality of finished goods
6. Frequent machine breakdowns

**Gross Npa's and Net Npa's of Public Sector Banks in India**

**Table :1**

| Year (As on 31st March) | Total Advances (Amt in Rs.Crore) | Gross Npa (Amt in Rs.Crore) | % of Gnpa to Total Advances | Net Npa (Amt in Rs.Crore) | % of Nnpa to Total Advaces |
|---|---|---|---|---|---|
| 2009 | 2260155 | 45156 | 1.99 | 21033 | 0.93 |
| 2010 | 2701300 | 59926 | 2.21 | 29375 | 1.08 |
| 2011 | 3305632 | 74600 | 2.26 | 36000 | 1.09 |
| 2012 | 3877307 | 117262 | 3.02 | 59162 | 1.52 |
| 2013 | 4472845 | 164462 | 3.67 | 89950 | 2.01 |
| 2014 | 5101054 | 227264 | 4.45 | 130360 | 2.55 |

**(Source: RBI Report on Trends and Progress of Banking in India, Various Issues)**




It is noticed from the above table and diagram, in absolute terms the amount of gross NPA's continued to increase for the period under study. On march 31st 2009, the total amount of gross NPA's increased from Rs.45156 crore that is 1.99% of total advances to Rs. 227264 crore in the year 2014 which is 4.45% of total advances. The amount of gross NPA's increased by nearly five times from 2009 to 2014.

The above table also shows the trend in the ratio of gross NPA and net NPA. Constantly growing in the ratio indicates that mounting the quality of bad assets in the public sector banks. The ratio of gross NPA's to total advances placed at 1.99% in the year 2009 to 4.45% in the year 2014 which shows an increasing trend. A same trend was observed in case of a net NPA ratio, which increase from 0.93% in the year 2009 to 2.55% in the year 2014.

**Pearson's correlation**

**H1: Alternative hypothesis**

There is significant relationship between total advances and gross non-performing assets and net non-performing assets of public sector banks in India

**Correlation between total advances with gross NPA's and net NPA's of public sector banks in India**

| Correlation | Total Advances | Gross NPA's | Net NPA's |
|---|---|---|---|
| Pearson Correlation | r = | 0.97 | 0.95 |

**Result**

There is a high positive correlation between total advances and Gross NPA's of public sector banks in India.

There is a high positive correlation between total advances and Net NPA's of public sector banks in India.

**Findings**

There is a high positive correlation between Total Advances and Gross NPA's of public sector banks in India. Therefore, 0.97.

There is a high positive correlation between Total Advances and Net NPA's of public sector banks in India. Therefore, 0.95.

From the data given in above table, it is observed that the amount of Gross NPA's and Net NPA's of public sector banks in India constantly increasing.

Increasing in ratio of Total Advances to Gross NPA's and Net NPA's of public sector banks in India.

**Suggestions**

1. Emphasis on continuous process of assessing performance of deployed money in form of all type of assets and not only take myopia view to assess performance of only that money which is deployed by way of credit that is loans and advances.
2. PSB's are expected to take various steps including procedural changes, different types of book keeping, transparent system in which clear cut accountability can be fixed.
3. Bank must evolve a system established that funds realised by way of loans and advances is utilised for the purpose creating assets stated in the sanctioned proposal and the same have been verified by Banks responsible officials immediately on creation of such assets.
4. Above referred assets verification report will established endues of funds has also the age of assets and economic life of assets will help Bank in deciding the course of action to be taken or monitoring performance of this assets vis. a vis. conduct of borrower account and financial transaction in the account.
5. Irrespective of good or bad conduct of the borrower account, whether or not such account remains performing or non- performing, Bank must evolve a table of year wise provision to be made on such account.

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