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Impact of NPAs on Financial Performance of IFCI Ltd.

Abstract

Nowadays growing NPAs is one of the biggest problems for any concern. It reflects the picture of overall performance of any organization. An asset becomes non performing when it ceases to generates income for the organization. The main objective of study is to know the impact of NPAs on financial performance of IFCI Ltd. A secondary data based descriptive analytical research methodology is being applied. The study concludes that during the study period NPAs of IFCI ltd. shows an increasing trend which multitudes various financial diseases. Though IFCI Ltd is very much serious about this problem and strong steps have also been taken to reduce NPAs but still it requires lots of attention and actions.

Keywords: Non Performing Assets (NPAs), Financial Institutions, Capital Adequacy, Risk Management, Financial Sector Reforms, Financial Diseases.

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Introduction

Reform in financial sector is a necessary concomitant of trade and industrial policy liberalization, so competitive spirit and efficiency that we are seeking to bring about in the real economy would cove the critically important financial sector and be further sustained by it. The reform in financial sector can be affected by improving the financial health of banks and development financial institutions, so that they may become viable, efficient and serve the emerging needs of the real economy in a better way in which the spirit of competitive efficiency is being ignited. When the reform process was started in 1992, there was a massive problem of cleaning the balance sheets of banks, which had deteriorated over the years. Successive reform initiatives in this area have been aimed at prescribing certain prudential standards for the financial system and addressing certain structural weaknesses, which could minimize asset classification, meeting minimum capital adequacy standards through recapitalization and devising a supervisory framework are steps in the direction of ensuring the safety of financial system.

Objectives of Study

1. To study the general concept of NPA
2. To study the need of IFCI Ltd in India.
3. To study the position of NPA in IFCI Ltd.
4. To study the Impact of NPAs on financial performance of IFCI Ltd.
5. To study the Management of NPA by IFCI Ltd.

Review of Literature

Review of literature helps a researcher to be familiar with the emerging trends on the one hand and start some mental thinking on the other. It helps in finding fertile theoretical background, clear concepts, an idea of developing trends in research methodology, data processing, reporting pattern. Besides answering many a 'what','when',' why' and 'how', these are helpful in distilling worthwhile results.

Desai Maulesh (1992)[3] stated that increasing amount of NPAs breaks the backbone of any financial sector as it multitudes the various type of financial problem in any financial sector. The study suggested that credit monitoring system, recovery system; warning signals can avoid or reduced the alarming situation of NPAs.

Pradhan, Pradip Kumar (2014)[9] revealed that nowadays efficiency of any financial institutions is not judged through profitability but also the level of NPAs.This study investigates the correlation between selected NPA variables and performance indicators of the financial institutions with special reference to Orissa State Financial Corporation. The finding of this study is that NPA has a negative impact on profitability, liquidity, sanction and disbursement of loan and the overall performance of the OSFC.

Das Sulanga and Dutta Abhijit (2014)[2] revealed that NPAs are a burning issue for the public sector banks and controlling and managing NPAs is very important. This study is a analytical study of NPAs of 26 public sector banks with the objective to find out the differences in the mean variation of the concerned banks. This study also point out the reason behind the increasing in NPAs in public sector banks and also provided some suggestion to reduce NPAs.

Gopi. E and Paulraj Joseph (2015)[4] stated that growing NPAs is one of the biggest problems that the Indian banks are facing nowadays. NPAs reflect the overall performance of any banks. This study focused on the causes and impact of NPAs with special reference to public sector banks and concluded that NPAs destroy the current profit and interest income and affect the smooth functioning of the recycling of the funds.

Srivastava R M (2001)[10] first published in 1984 and revised in 2001 is an indispensable reference and has already undergone several editions. It is a mammoth work comprising 42 chapters and three sections, the last one dealing with management of development banks in India including an in-depth study of IFCI Ltd.

Bhole, L.M. (2000)[1] is a commendable contribution towards financial institutions literature. Apart from a history of Indian financial system in the post 1950 period, this book discusses systematically the regulatory and promotional institutions, banking institutions, non-bank financial intermediaries and statutory financial organizations market etc. It also makes a survey of the financial system in India as well as financial sector reforms affected from time to time.

Need of Study

A strong and efficient financial system is crucial to the attainment of the objective of creating a market driven, productive and competitive economy and to support higher investment levels and accentuate growth. The creation of such a system has been the objective that has inspired the process of financial sector reform since 1992 as part of the broader programmed of structural economic reforms. In 1990 the Government of India appointed a Committee on Financial Sector (CFS) under the chairmanship of Shri M Narasimham to examine all aspects relating to the structure, organization, functions and procedures of the financial system. Financial Sector consists of the Central Bank, Commercial banks, financial institutions, saving institutions (post office saving banks), investment institutions (LIC, GIC, Mutual Funds, PFS, Money market mutual funds etc). The committee submitted its first report in November 1991 and the second one 7 years later. The committee made several recommendations which are inter-allia – Reduction in Statutory Liquidity Ratio, Directed Credit, Phasing out of concessional rate of interest, Adoption of Capital adequacy norms, Deregulation of Interest Rates, Banks having consistent record of profitability be allowed to tap capital market, Greater transparency in the financial statement of banks, Setting up of Assets Reconstruction Fund and Interest on Non-performing assets not to be booked.

Research Methodology

The research methodology of the proposed study is secondary data based descriptive- analytical research methodology. The major portion of the secondary data is extracted from annual reports of IFCI Ltd 2010-11 to 2015-1016. Secondary data is also collected from annual reports of other financial institutions, RBI circulars, various books, journals and websites.

Non Performing Assets (NPAs)

In order to ensure greater transparency in the borrowed accounts and to reflect actual health of banks in their balance sheets, RBI introduced prudential regulations pertaining to income recognition, asset classification and provisioning recommended by Narasimhan Committee with certain modifications in a phased manner. Though in 1985-86 RBI had already introduced the Health Code system for commercial banks advising them to recognize income only on realization basis. An asset, including leased assets, becomes non performing when it ceases to generate income for the bank. A non performing asset (NPA) is a loan or an advance where; (i) interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan (ii) the account remains 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power for 90 days. (iii) the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted (iv) the installment of principal or interest thereon remains overdue for two crop seasons for short duration crops (v) the installment to principal or interest thereon remains overdue for one crop season for long duration crops (vi) the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction (vii) in respect of derivative transactions, the overdue receivables representing positive mark-to –mark value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

Categories of NPAs

Banks/financial institutions are required to classify non-performing assets further into the following three categories based on the period for which the assets has remained non performing and the reliability of the dues: Substandard Assets, Doubtful Assets and Loss Assets. A substandard asset is one which has remained NPA for a period less than or equal to 12 months. An asset is classified as Doubtful Assets if it has remained in the substandard category for a period of 12 months. 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.

Gross NPAs and Net NPAs

There are two concepts related to non-performing assets — Gross NPAs and Net NPAs. Gross NPA refers to all NPAs on a bank's balance sheet irrespective of the provisions made. It consists of all the non-standard assets, viz. sub-standard, doubtful, and loss assets. Net NPA is gross NPA less provisions. Since in India, bank balance sheets

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contain a huge amount of NPAs and the process of recovery and write-off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the central bank guidelines, are quite significant. That is why the difference between gross and net NPA is quite high. Thus gross NPA reflects the quality of the loans made by banks, net NPA shows the actual burden of banks.

Credit Risk Management V/S Management of NPA

Quite often credit risk management (CRM) is confused with managing non-performing assets (NPAs). However there is an appreciable difference between the two. NPAs are a result of past action whose effects are realized in the present i.e they represent credit risk that has already materialized and default has already taken place. On the other hand managing credit risk is a much more forward-looking approach and is mainly concerned with managing the quality of credit portfolio before default takes place. In other words, an attempt is made to avoid possible default by properly managing credit risk.

Genesis and Establishment of IFCI Ltd.

1948, the year of IFCI's birth, was a seminal year in development banking, not only in India but also all over the world. The World Bank was just three years old, while Kreditanstalt-fur-weideraufau (KFW) of Germany was born the same year. The first finance minister of independent India (Hon'able Shri Shanmukham Chetty), while moving the Industrial Finance Corporation Bill in the Constituent Assembly on November 20, 1947, gave an indication of the role IFCI was expected to play. He said "With…… our anxiety to go ahead at full speed with the industrial development of the country, the setting up of an industrial finance Corporation has acquired a new significance and urgency….the objective of this Bill is to set up a finance Corporation for the purpose of financing large-scale industries in this country".[12]

Sir Shri Ram, the first Chairman of IFCI, aptly defined the objectives and importance of the Corporation in 1949; "The importance of the role which IFCI's called upon to fill at the present time is emphasised by the apathy of the money and stock market and the prevailing dearth of capital to meet the requirement of the industry. It is in many ways, a fortunate circumstance that IFCI has been brought into being as in the absence of the assistance rendered by us, many industrial concerns could have experienced difficulties. The facilities granted by IFCI have been calculated to further the expansion of industrial production, maintenance of employment and attainment of a more balanced economy". [13]

The Bill was passed and became an Act on 27th March 1948. It was on Ist July1948 that IFCI opened its doors for business. It began initially with an authorised capital of Rs 100 million. IFCI was established with the specific objective to make medium and long-term credits more readily available to eligible industrial concerns in India, particularly where normal banking channels were unavailable, or where recourse to capital issue methods were impracticable. Now IFCI Ltd. is not only a term lending institution, but also an active financial intermediary and a provider of a wide range of services to industry. IFCI's services principally cover — project financing, financial services including merchant banking and allied services and promotional services. Apart from these IFCI is also providing other services like — corporate advisory services, project advisory services and finance, infrastructure advisory, corporate finance and investment banking, corporate restructuring advisory etc.

Initially IFCI was authorized to assist only those public limited companies and co-operative societies organized in the private sector and incorporated by an Act of Legislature or registered in India, which were engaged in the manufacture or processing of goods, or in shipping, or in mining, or in the hotel industry, or in the generation or distribution of electricity, or any other form of power. The IFCI Act was amended in 1960 to widen the scope of its activities by including, in the definition of industrial concerns; those engaged or to be engaged in the preservation of goods. Public sector and proprietary and partnership concerns were, therefore, outside the ambit of the business of IFCI.

In 1970 a far-reaching decision was taken by the Government of India, whereby IFCI's business was broadened to assist such public sector undertakings as were organized as per public limited companies under the Companies Act 1956 or had declared at least a maiden dividend, built up sufficient internal resources to undertake expansion programmes, and had not approached, or did not approach, the Government for budgetary support for their expansion programmes. Since, most of the public sector projects are organised as 'private limited', they could not avail themselves of the assistance of IFCI. Accordingly the IFCI Act was further amended in 1973 to authorize IFCI to finance private limited companies in the public sector. Again the IFCI (Amendment) Act, 1986 has made it possible for IFCI to provide assistance, inter alia medical, health or other allied services. Before its conversion into a company IFCI was eligible to assist any limited company in the public, joint or private sector or a co-operative society incorporated and registered in India which was engaged or proposed to engage itself in the manufacture, preservation or processing of goods or in the shipping, mining or hotel industry or in the generation of distribution of electricity or any other form of power, transport, setting up or development of industrial estates, fishing, maintenance, repair, testing or servicing of machinery, equipment, vehicles etc. providing medical, health, or allied services, providing services relating to information technology telecommunications or electronics, leasing or sub-leasing, providing engineering, technical, financial, managerial, marketing and allied services, research and development activities. It may be noted that IFCI does not provide financial support to financial institutions. Further, it can extend assistance only for productive purpose such as purchase of new machinery, construction of factory building and purchase of land. Its finance is not available for purchase of raw materials or for the repayment of existence facilities, save in exceptional circumstances. Financial assistance is available for setting up of new industrial projects as also for the expansion, diversification, and renovation or modernisation of existing ones.

For ensuring greater flexibility and an ability to IFCI to respond to the needs of the changing financial system, an enactment called the Industrial Finance Corporation (Transfer of Undertaking and Repeal) Act, 1993 was passed on the 2nd April 1993. Pursuant thereto, the Industrial Finance Corporation of India Ltd. was incorporated as a company under the Companies Act, 1956 on 21st May, 1993 and the Certificate for commencement of business was issued on the 24th June, 1993. As per the notification issued by the Government of India on the 7th June 1993, the undertaking of IFCI under IFC Act, 1948 stands transferred to and vests in the aforesaid company w.e.f. 1st July, 1993. Every shareholder of IFCI under IFC Act, 1948, has become the shareholder of the company with effect from the same date. Thus, after 45 years of a rich and varied history as the pioneer industrial finance organisation in the country, IFCI has taken a major step towards future growth by converting itself into a company. It is the first institution in the financial sectors in India to be converted form a statutory corporation into a company. Subsequently, the name of Industrial Finance Corporation of India was also changed to "IFCI Ltd" w.e.f. October 1999. After becoming a company IFCI Ltd. made a public issue of new equity share aggregating Rs 525 crore (including premium).

IFCI Ltd. has various subsidiaries namely Stock Holding Corporation of India Ltd (SHCIL), IFCI Infrastructure Development Ltd (IIDL), IFCI Venture Capital Funds Ltd (IFCI Venture), IFCI Financial Services Ltd. (IFIN), IFCI Factors Ltd (IFL), and MPCON Ltd. Apart from the other activities IFCI Ltd also has various associates i.e Tourism Finance Corporation of India Ltd (TFCI Ltd.), HARDICON Ltd. (HARDICON), Himachal Consultancy Organization Ltd (HIMCON), North India Technical Consultancy Organization Ltd (NITCON), KITCO Ltd (KITCO), and Joint venture IFCI Sycamore Capital Advisors Pvt. Ltd (ISCAPL). Apart from this IFCI Ltd also promoted various societies i.e. Institute of Leadership Development (ILD), Management Development Institute (MDI, Rashtriya Gramin Vikas Nidhi (RGVN).

Financial Position of IFCI Ltd.

The following table shows the financial position of IFCI Ltd. during 2010-11 to 2015-16.

Particulars	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Total Assets (Cr)	24268	28183	25884	28989	34968	36900
Loans and Advances (Cr)	10677	9695	10869	16881	22094	22063
Sanctions (Cr)	13209	6765	2192	9717	12230	10895
Disbursements (Cr)	8399	6054	1504	8683	8687	7488
Gross NPA (Cr)	2644	2608	3661	3451	2617	3545
Net NPA (Cr)	156	327	1454	2123	1758	2466
*% of Gross NPA	24.76	26.90	33.68	20.44	11.84	16.07
N.P. After Tax (Cr)	706	664	451	508	522	337
Capital Adeq. Ratio (%)	16.4	21.3	23.9	21.3	18.8	16.9
Earnings Per Share (Rs)	9.6	9.0	4.1	3.1	3.1	2.0
Dividend Per Share (Rs)	1	1	1	1	1	1
**MPS (BSE) (Rs) Low	19.65	20.15	17.85	21.80	17.55	19.50
**MPS (BSE) (Rs) High	68.5	49.4	40.2	44.9	41.55	30.85

Source: -Annual Report of IFCI Ltd (Various issues) and www.bseindia.com
* % of NPA on long term long and advances
** Annual data is based on calendar year.

The table envisages the dismal financial position of IFCI Ltd during study period. Amount sanctioned by IFCI Ltd which is the main cause of any financial institution has a decreasing trend except in last two years of study period where it increased slightly over previous years. The year 2012-13 need special mention here; in this year the sanctioned amount decreased dramatically i.e 68% over the previous year. NPA is like blood-pressure for any financial institution, if blood pressure is not under control it may create different type of diseases in human body. In IFCI Ltd. NPA shows an increasing trend during this period which is not a good sign for the health of IFCI Ltd., it multitudes the different type of financial diseases to IFCI Ltd like decrease in net profit, decrease in earning per share, low level of dividend per share, low market price of equity shares, increasing capital adequacy ratio etc. All these sign are clearly shown by the table given above which is self explanatory.

Management of NPAs

Management of NPA remained a focused area for IFCI Ltd to reduce the amount of NPAs in the years to come for which it continued to take aggressive approach through continuous monitoring by Committee of Executives and Committee of Directors, Strategies adopted for recovery of NPAs included hard measures like sale of mortgage assets through Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SRFA & ESI**)**, prompt sale of shares pledged by the promoters, attachment of properties of borrowers/ guarantors, filing of criminal complaint against borrower, arrest of borrowers/guarantors and other legal measures like filing of recovery application before Debt Recovery Tribunals (DRT), Complaints under Negotiable Instruments Act, etc. wherever possible, One Time Settlements (OTS) were entered into or loans were assigned to Assets Reconstruction Companies to realize blocked funds in NPAs. In respect of sick but viable NPAs, measures were also taken through Joint Lending Forums for revival of such cases for possible up gradation in future.

Conclusion

Nowadays growing NPAs in any concern is one of the biggest problems. It reflects the picture of overall performance of any organization. A high level of NPAs suggests high level of probability of a large number of credit defaults that affects the profitability and liquidity of any organization. If proper management of NPAs is not undertaken it may multitude different type of problems in any organization. In IFCI Ltd. NPAs adversely affected the financial position. Rapid and strict changes in norms relating to NPAs by RBI worsened this situation. It is not fair if we put all blames on NPA for this pitiable financial position of IFCI Ltd. Others factors like- appraisal system, monitoring system, criteria for loan sanctioned, management of NPA, favourism to big houses etc are also responsible for poor financial position of IFCI Ltd during this period, but this truth cannot be ignored that NPA remained the main cause for this sorry state of affairs which need special attention. Though IFCI Ltd is very much serious about this problem and strong steps have also been taken to reduce NPAs but still it requires lots of attention and actions.

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