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Degradation in asset quality: A Sectoral study of non-performing assets in public sector banks in India

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Abstract

Banking system is the most crucial sector of the economy. A robust and sound banking sector is very indispensable for overall economic development of a nation. Asset quality is the most important parameter to evaluate the financial health of the banking system. Non-Performing Assets is a serious ailment associated with the banking system of India. It negatively affects the profitability and renders adverse impact on the operational efficiency of the banks and consequently leads to deterioration in asset quality. Because of the hazardous impact of economic slowdown, plenty of projects/Industries are under stress and as an outcome banking system of India has seen significant rise in the level of Gross and Net NPA in the recent past. The major portion of NPA (about 85%) belongs to Public sector banks which account about 76 percent of banking business in India. PSBs comprise SBI & its associates and nationalized banks. An attempt has been made in this paper to analyze the trends of NPA in Public sector Banks during 2009-2016. With the help of Statistical tools viz. trend analysis and average annual growth rate, level of Gross and Net NPA in SBI & Associates and Nationalized banks has been analyzed. Study found that during the 8 years of study period, level of Gross and Net NPA has shown significant increase particularly in non-priority sector. It is an alarming signal to the PSBs in India and requiring serious attention.

Keywords: gross NPA, net NPA, asset quality, non-priority sector, public sector banks

Introduction

Lending is one of the most important functions of the banks. Extending loans/advances carries risk, generally known as credit risk. When borrower of the loan is not able to make repayment of the loan, the loan account turns as Non Performing assets. NPA in the broader sense is a loan/advance which ceases to generate income for the bank. It is an important criterion to evaluate the financial performance and asset quality of the banks. The problem of bad loan is associated with entire banking system of India but the magnitude of the problem is more significant in Public sector banks.

Non Performing assets renders negative impact on the profitability of the banks and it badly affects the overall financial fitness and operational efficiency of the banking system. Loan portfolio of the PSU banks is under stress and has shown momentous increase in Gross and Net NPA. Aggressive lending in recent past particularly in non priority sector lending highlighted steep rise in level of NPA. Infrastructure sector, iron and steel industries, aviation sector, mining business has undergone through serious stress due to several macro and microeconomic conditions. Provisions for stressed assets increases financial burden on the banks and adversely affect the profitability of banks. Emerging stress in asset quality leads to rising trends in Non Performing Assets in banks.

Non Performing Assets

According to Reserve Bank of India an asset (loans or advances) turns into Non-performing asset when it ceases to create earnings for the bank. In other words we can say that an asset should be considered as NPA if interest or installments of principal leftovers overdue and not paid for a time period of more than 90 days. The NPAs may be further divided into two types; (i) Gross NPAs and (ii) Net NPAs.

Gross NPA

Gross Non Performing assets are the total outstanding of all the borrowers classified as substandard, doubtful and loss asset. Gross NPA is an advance/loan which is considered Non recoverable and bank has made provisions for the same which is at rest held in banks' books of account. Gross NPAs are the summation of all loan assets that are recorded as Non-Performing Assets as per RBI Guidelines. Gross NPA determines quality of loan/advances given by banks.

Net NPA

Net Non Performing assets are calculated by subtracting the provisions from Gross Non Performing Assets. Net NPAs are computed as; Gross NPA-(Balance in interest suspense account+ claims received from DICGC/ECGC and pending for adjustment + Part payment received and kept in suspense account + Total provisions held).

Review of literature

Jain Vibha (2007) [1] examined that the problem of NPA is a serious concern for the banking Industry of India. The research has been conducted to understand the movement of NPA during 1997-2003. The root cause of the problem is inadequate credit appraisal mechanism. Early recognition may reduce the problem of bad loan up to certain extent, alertness of the bank in invariably related with the profitability.

Rajini Saluja and Roshan Lal (2010) [2] observed that the growing NPAs in baking industry is an issue of deep concern. It is just not a problem for banks but also proves fatal to the economic growth of the country. The study concludes that there is huge difference in NPAs of public and foreign banks. Public sector banks are highly pressurized by the NPAs. Gross and Net NPAs of PSBs have improved over the years because of rigorous policy initiatives and enforcement of various legal and non-legal measures.

Debarsh and Sukanya (2012) [3] emphasized that NPA is most important parameter to evaluate the financial performance of banking sector. Problem of bad loan is affecting badly the profitability of PSU banks. Authors suggested that for effective management of NPA accounts Public Sector Banks must strictly follow asset classification norms, recovery procedures and use to technological platform at its optimum level.

Banambar sahoo (2015) [4] observed that Lack of cohesive regulatory framework, Political pronouncements like debt relief and Socio-political pressures on commercial credit decisions are the key reasons for augmented level of NPA in banking industry particularly in PSU banks. Author also examined the root cause of NPA from the borrower side like improper choice of project/activity, Adoption of obsolete technology and inefficient management etc.

S Poornima, M Theivanayaki (2015) [5] examined in their study that level of NPA is increasing in Public sector banks with an alarming rate, it is not a good indicator for the financial health of PSU banks in India. Authors concluded that PSU banks of India must take on methodical framework with a clear objective, flexibility and sufficient financial support in order to resolve the problem of stressed assets.

Jayasree, M. and Radhika, R (2011) [6] examined that level of NPA has been increased in new private sector banks and foreign banks during the study period 2005 to 2009. Study focused on sector wise comparison of lending in private and foreign banks during the study period. Authors found that NPA renders negative impact on the profitability of banks.

Meenakshi Rajeev (2008) [7] observed in her study which was conducted on NPA of banks due to SSI lending. She found that SSI entrepreneurs are unable to make repayment of loan due to business failure. Competition from Chinese products of lower price and failure in power supply remained the reasons behind business failure. On the other hand personal loans accounts possesses high probability to turning into NPA because these loans are usually given by banks to the borrower without any collateral so probability of becoming NPA is more because of willful default.

Dr Sonia narula and monika (2014) [8] analyzed in their study that decline of NPA is essential to improve profitability. Research was conducted to find out relationship between Net profit and NPA of Punjab national bank for the period 2007-2012. Study examined that mismanagement by bank lead to higher NPA. Authors concluded that there is positive relation between Net profit and NPA of PNB due to wrong selection of borrower. Further, it was suggested that banks should be very careful in selection of the borrower, close pre sanction evaluation and post disbursement control should be done by banks to constraint rising Non Performing Assets in Indian banking Industry.

Objectives

1. To study the trends in Gross and Net Non-Performing Assets in Public Sector Banks in India during 2009-2016.
2. To analyze the level of Non-Performing Assets in Non-priority sector lending by PSBs in India.

Methodology

Research is exploratory and analytical. Secondary data related to Non Performing assets of PSBs during 2009 to 2016 has been obtained through annual publication of RBI- report on trend and progress of banking in India and RBI monthly bulletins. In order to meet the objective of study trend of PSBs has been analyzed with trend analysis and average annual growth rate (AAGR).

Data collection and analysis

Table 1: Gross and Net NPA of Public Sector banks (End of March) (Amount in Billion)

Year	Advances		Non-Performing Assets					
			Gross NPA			Net NPA		
	Gross	Net	Amount	As % of Gross Advances	As % of Total Assets	Amount	As % of Net Advances	As % of Total Assets
2008-09	22835	22592	450	2	1.2	212	0.9	0.6
2009-10	27335	27013	599	2.2	1.3	294	1.1	0.7
2010-11	30798	33056	746	2.4	1.4	360	1.2	0.7
2011-12	35504	38773	1178	3.3	2	594	1.5	1
2012-13	45602	44728	1656	3.6	2.4	900	2	1.3
2013-14	52159	51011	2273	4.4	2.9	1306	2.6	1.6
2014-15	56167	54763	2785	5.0	3.2	1602	2.9	1.8
2015-16	58414	56954	5608	9.6	6.1	3474	6.1	3.8

***Source*:** Handbook of statistics on Indian economy

Gross and Net NPA of Public sector banks during 2009-2016 has been tabulated in the above table. There is a record increase 9.6% of Gross NPA in the year 2016 in the Public sector banks. On the other hand net NPA has also shown a steep rise in the year 2016 and stood at 6.1 % which was 2.9 % in the previous year. This is alarming signal to Public sector banks in India.

Public sector bank holds about 75 % of banking business of Schedule commercial banks in India. During the study period the aggregate Net Advance of all Public Sector Banks remained 328890 billion which is 74.89 % of the total net advance of Schedule commercial banks during 2009-2016. Further, the total Gross NPA of PSU banks during the study period were 15295 billion which is 83.58 % of the Total Gross NPA of SCBs in India. On the other hand Net NPA of PSBs during the study period remained 8742 billion which is 90.64 % of Total Net NPA of SCBs during the same period.

Table 2: Gross and Net NPA of Schedule commercial banks (End of March) (Amount in Billion)

Year	Advances		Non-Performing Assets					
			Gross NPA			Net NPA		
	Gross	Net	Amount	As % of Gross Advances	As % of Total Assets	Amount	As % of Net Advances	As % of Total Assets
2008-09	30383	29999	683	2.3	1.3	316	1.1	0.6
2009-10	35450	34971	847	2.4	1.4	387	1.1	0.6
2010-11	40121	42987	979	2.5	1.4	417	1.1	0.6
2011-12	46488	50736	1429	3.1	1.7	652	1.3	0.8
2012-13	59718	58798	1941	3.2	2	987	1.7	1
2013-14	68757	67352	2634	3.8	2.4	1427	2.1	1.3
2014-15	75607	73882	3233	4.3	2.7	1761	2.4	1.5
2015-16	82260	80384	6552	7.6	4.8	3698	4.6	2.9

***Source*:** Handbook of statistics on Indian economy

Schedule commercial banks had significant growth in the Gross and Net Non-Performing assets. During the study period. The above table shows that Gross NPA has become 7.6 % as on 31 March 2016 which was at 4.3% in the previous year. Further Net NPA has also rose significantly and stood at 4.6% in the march 2016.

Table 3: Movement of GNPA and Net NPA in PSBs (Billions)

Year	Gross NPA	Annual Growth Rate	Net NPA	Annual Growth Rate
2008-09	450	11	212	19
2009-10	599	33	294	39
2010-11	746	24	360	23
2011-12	1178	58	594	65
2012-13	1656	41	900	52
2013-14	2273	37	1306	45
2014-15	2785	23	1602	23
2015-16	5608	101	3474	117

***Source*:** Department of Banking supervision, RBI

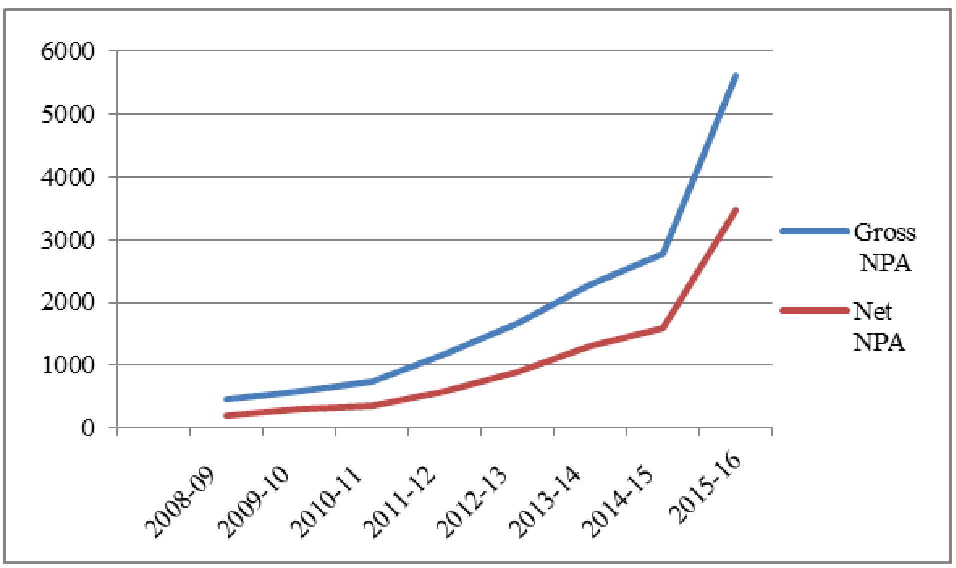

Fig 1

Table 4: Composition of NPA of PSBs as on 31 March (Amount in Billions)

Years	Priority Sector		Non Priority Sector		Public Sector		Total
	Amount	%	Amount	%	Amount	%	Amount
2009	242	53.75	205	45.59	3	0.66	450
2010	305	50.89	291	48.58	3	0.52	599
2011	401	53.82	342	45.85	2	0.32	746
2012	561	47.57	591	50.17	27	2.27	1178
2013	677	40.91	967	58.39	12	0.70	1656
2014	799	35.16	1472	64.79	1	0.06	2273
2015	966	34.69	1816	65.21	3	0.09	2785
2016	1307	23.30	4301	76.70	36	0.64	5608

***Source*:** Department of Banking supervision, RBI

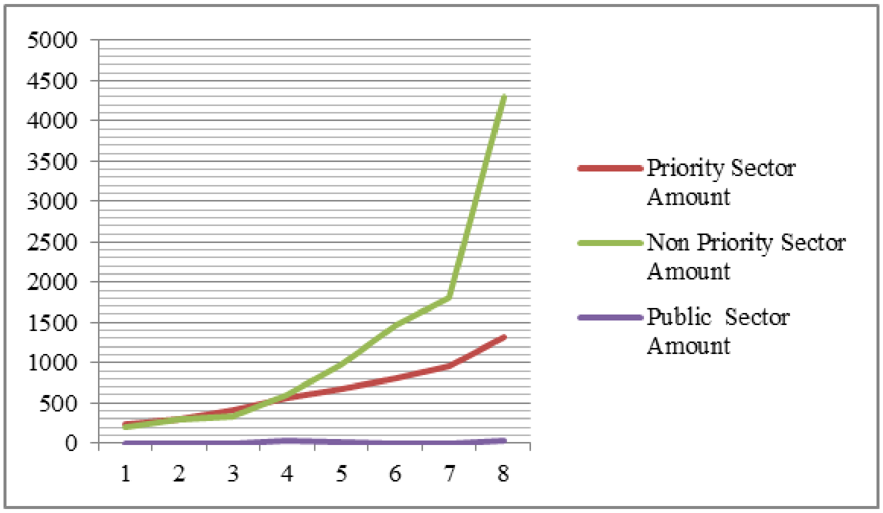

Fig 2

Table 5: Composition of NPA-Nationalized Banks as on 31 March (Billions)

Years	Priority Sector		Non Priority Sector		Public Sector		Total
	Amount	%	Amount	%	Amount	%	Amount
2009	158	59.35	107	40.19	1	0.46	265
2010	196	53.76	165	45.40	3	0.84	364
2011	246	55.61	194	43.84	2	0.55	442
2012	324	46.96	357	51.49	11	1.55	696
2013	411	40.16	606	58.91	9	0.93	1028
2014	538	36.45	936	63.46	1	0.09	1474
2015	709	34.61	1338	65.26	3	0.13	2050
2016	1006	23.18	3321	76.82	19	0.42	4310

***Source*:** Department of Banking supervision, RBI

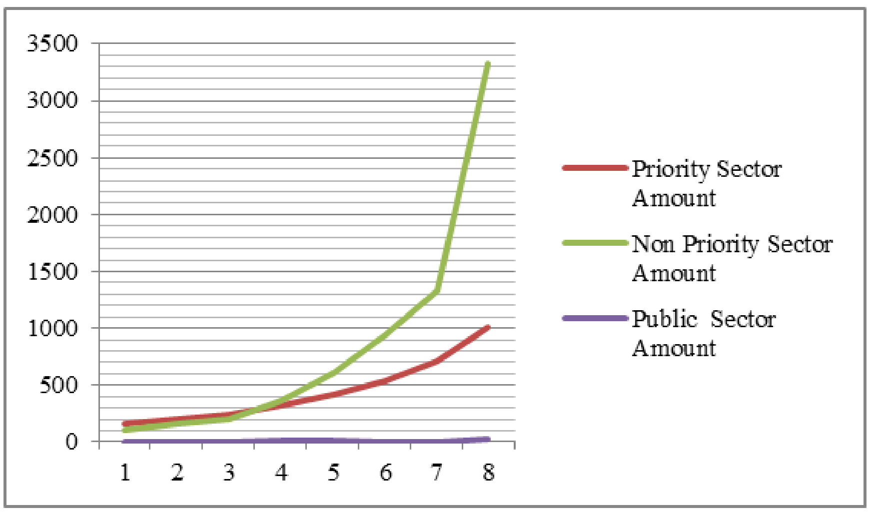

Fig 3

Table 6: Composition of-NPA-SBI & Associates as on 31 March (Billions)

Years	Priority Sector		Non Priority Sector		Public Sector		Total
	Amount	%	Amount	%	Amount	%	Amount
2009	84	45.70	99	53.35	2	0.95	185
2010	109	46.45	126	53.51	0	0.04	235
2011	155	51.22	149	48.78	0	0.00	304
2012	234	48.44	232	48.27	16	3.29	482
2013	264	42.12	361	57.55	3	0.33	628
2014	261	32.76	537	67.24	0	0.00	798
2015	257	34.93	478	65.07	0	0.00	735
2016	301	23.70	980	76.30	17	1.41	1298

***Source*:** Department of Banking supervision, RBI

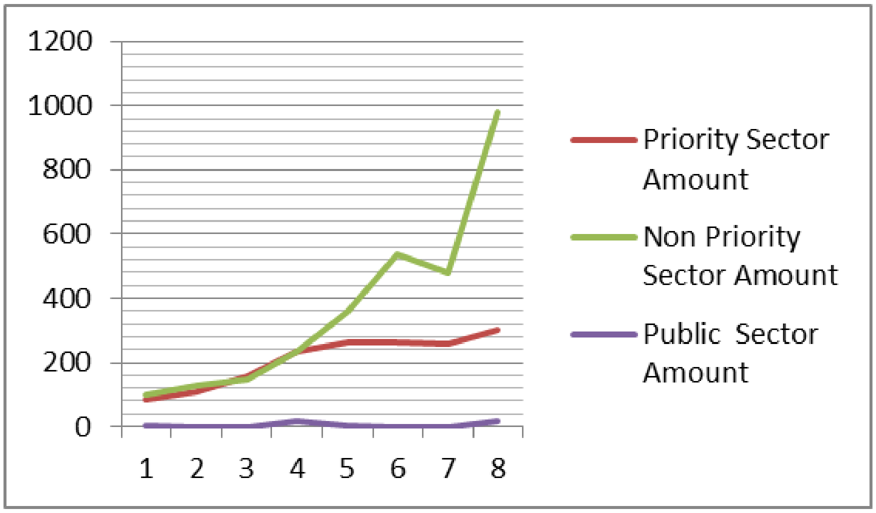

Fig 4

Findings

Gross and Net NPA of Public sector banks has shown a steep rise during the study period. The average annual growth rate of Gross NPA in Public sector banks during the study period (2009-2016) remained 41 % which is alarming. On the other hand the rate was 47.87% in Net NPA during the same period (Table-III). Trend lines showed the noteworthy rise in the level of Gross and Net NPA of Public sector Banks (Trend lines-Table III). The movement of NPA is more significant during 2015 to 2016; the amount of Gross NPA on March 2016 was 5608 billion as compare to 2785 billion on March 2015 i.e. about 101 % increase in the level of Gross NPA within one year. On the other hand amount of Net NPA stood 3474 billion on March 2016 as compare to 1602 billion on March 2015 with 117% increase within one year.

Aggressive lending in Non priority sector in recent past is one of the key reasons behind mounting NPA in PSBs. Non priority sector lending has shown a noteworthy rise during the study period. 76.70 % of total gross NPA belongs to Non priority sector as on March 2016 (Table-IV) in Public sector banks in India. In Nationalized banks 76.82% of Gross NPA comes from Non priority sector on 31 March 2016 (Table-V) and SBI and associates banks showed 76.30 % of Total gross NPA from the Non priority sector (Table-VI) which is highest during the study period. Further, the growth of Gross NPA in priority sector is less than the growth of Gross NPA in Non priority sector (Trend lines: Table IV, V and VI). The above trend lines showed that aggressive lending in Non priority sector has resulted in huge level of NPAs in Public sector banks in India.

Suggestions

- Public sector banks needs to strengthen the existing credit appraisal system and they must emphasize to develop a cohesive lending policy framework with standard practice of close pre-sanction approval and post sanction follow-ups.
- Public sector banks in India should follow a selective approach for the extension of credit particularly in Non priority sector. Loans/advances must be granted on the basis of the credit worthiness of the borrower instead of Name and fame of the borrower. And banks must utilize their market intelligence to collect the information about the borrower before extension of credit.
- PSU Banks should also employ technical staff at periodical intervals to visit factory sites for on the spot study to obtain first hand information on the progress of the project for which bank has extended credit.
- Credit management should be viewed as part of a co-ordination group efforts made by all departments involved with customers to minimize bad debts and maximize profit instead of leaving it in the hands of the credit risk management department.

Conclusion

The increase in NPAs shows the inefficiency of banking system to maintain their asset quality and it renders negative impact on the operational efficiency of the banks. During Financial Year 2013, both Indian and global economies faced excessive challenges putting additional stress on asset quality finally resulting in increase in GNPAs, Net NPAs and restructured assets. PSBs faced larger asset quality implications owing to the fact that they were the prime lender to crucial and slowing sectors like power, iron, infrastructure and mining, and agriculture which got affected extensively during the global economic slowdown in 2008.

However Private sector banks (Including new and old private banks) functioning in the same macro economic conditions but they are able to control their bad loan problems because of watchful approach in credit appraisal, management of risk and recovery of loan. They focused on retail banking and extended less credit to big corporate houses and more to middle class citizens who are far more candid and customary in repayment of their financial obligations. Further, if the credit facility has been extended to the corporate houses from the private bank, it was more to meet the working capital needs for short term.

The level of Gross and Net NPA is increasing with an alarming rate particularly in Public sector banks in India. It is requiring serious attention; there should be a joint effort from the government and banking sector to cope up with the problem before it become out of control. Further the management of PSBs in India must pay singular attention towards the problem of bad loans and take appropriate action to arrest the creation of new NPAs, besides putting efforts on the recovery fronts of existing NPAs. Effective and timely action is essential to ensure future growth of the Banking system of India.

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