Non Performing Assets: A Challenge before Banking Sector in India

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Abstract: Management of nonperforming assets poses a great challenge for banks world over. Banking sector forms the backbone of many developing economies .If the banks fail to manage their non performing assets effectively then it leads to draining profitability and decreasing market goodwill not only for the banks but for the country as a whole. In this paper we try to assess the daunting problem of NPA management and the remedial measures taken by the banks. Also we try to compare the performance of public and private sector banks in effectively managing the NPAs over the years. For the purpose of the study secondary data published on the official website of RBI is used for analysis. The period of the data under the study is 6 years ie; from 2008 to 2013. The statistical analysis is done by measuring the mean & standard deviation and then applying the students T –test .The major finding of the study was the significant difference between the performance of private sector banks and public sector banks with respect to management of NPAs.

Keywords: Non Performing assets (NPAs), Public Sector banks, Scheduled Commercial Banks, Private sector banks.

Introduction

The structure of our Indian banking system is very complex and it has evolved under the influence of many factors including political considerations**.**

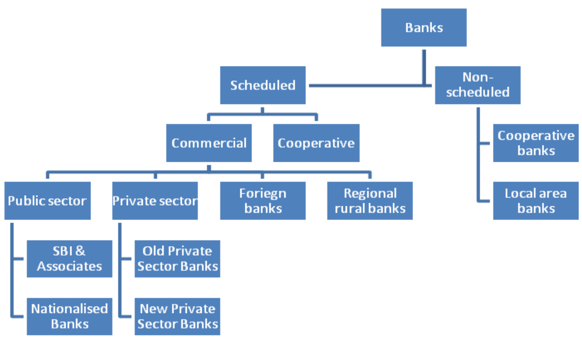


Fig .1 Structure of Banking in India

The public sector banks and the private sector banks are the majority contributors to the total Net NPAs of the scheduled commercial banks. As the banks are primarily into the business of accepting deposits and lending money, the NPAs become the natural fall out of the business. It is impossible completely avoid them but efforts can be taken in the direction of minimising the losses.

Non Performing assets or NPAs as we usually call them are nothing but the loans and advances given by the banks which turn into bad debts due to various reasons. In other words it can be said that when a bank gives a loan and is unable to recover the principal and the interest amount on time the loan is said to have turned into a NPA.

According to definition of NPAs the time period of 90 days is taken as the base and if the principal or interest payment is not received during this period the asset is turned into an NPA. As interest on loan is one of the major source of income for the banks, its collection becomes one of the priority tasks.

RBI serves as the regulatory body over all the banks and according to guidelines issued by it the banks have to classify their assets into 4 categories:

1. **Standard Assets**: These are the performing assets for which the payments of interest and the principal are received on time. Occasional defaults of less than 90 days due to various reasons like temporary unavailability of funds, forgetting the due date of payment etc are acceptable by banks. These assets yield regular interest to the banks.

2. **Substandard Assets**: These are the assets which have remained NPAs for a period of 1 year. This means that the borrower has not paid instalments for 90 days and up to 12 months. To make up for the losses from substandard assets banks usually make 10% provision of funds from their net profits.

3. **Doubtful Assets**: As the name suggests these are the assets for which the recovery of banks dues is in doubtful state. According to definition these are the assets which have remained substandard for a period of 1 year.

4. **Loss Assets**: The assets are categorized as loss assets when there is loss recognized by the bank or RBI. This is a permanent default and the assets are uncollectible. So the banks usually write off such assets from their balance sheet.

The major reasons identified behind the increase in NPAs are listed as under:

1. Will full default on the grounds of borrower.

2. Political interferences in the working of banks.

3. Loopholes in scrutinizing the applications before sanctioning the loans.

4. Death of the borrower.

5. Natural calamities.

6. Non performance of the business for which loan was take

7. Corruption.

The above mentioned list definitely not exhaustive in nature and many efforts are being taken in this regards to find maximum possible reasons behind the problem. This leaves grounds for researchers to explore the area in detail and come up with findings and solutions to help the banking sector face the challenge of rising NPAs.

Literature Review

There is a high degree of negative correlation between the NPA ratios and profitability and there can be an enhancement in the profitability of the banks if NPAs have decreasing trend continuously (Rajput N., Gupta M., Chauhan A.K., 2013). In the context of India the lending policy and the credit policy are the crucial influencing factors for non performing loans (Reddy, 2002 and Karunakar et al., 2008).The problem of NPAs is related to several factors which are internal to the banks as well as external (Gupta S.,Kumar S.,2004).Some studies have revealed contradictory relationship between efficiency and NPAs among various bank groups, like, Indira R. & Vasishtha G.,2002,Gujral N., 2003 Das & Gosh, 2006,Debaprosanna Nandy,2010 & Rajput N. & Gupta M.,2011.

Rajiv Agarwal (1991) in his study titled "Designing Effective Credit Recovery Management and Control System" suggested the organization of credit recovery seminars to change the attitude, beliefs and perception of officers at various levels .He also suggested that in change in organizational culture and public image of the banks may lead to effective management of credits.

Dr J.B Kulkarni (2003),in "Management of Non Performing Assets" emphasised on the non legal recovery measures like personal contacts, reminder visits, loan compromise, recovery camps and rehabilitation/replacements of sick units to be used for effective management of NPAs.

Significance of the study: The importance of financial sector in any economy can be easily understood by imagining it as blood stream flowing in human body. Just as a healthy blood stream ensures the sound health of human body, a healthy financial system ensures the stability of the economy. A healthy economy easily attracts foreign investment which further boosts up the development processes in the country.

Banks form an integral part of the financial system and especially in India where there is dominance of bank driven growth model, this sector requires utmost attention.

As on 31st march 2013 the net NPAs of 26 nationalised banks were Rs 90,036.9 crores and that of the private sector banks were Rs 5994.4 crores as compared to Rs 59391.2 crores and Rs 4,401.2 crores respectively as on 31st March 2012.

Also in the first half of the financial year 2013-14 the non performing assets of 40 listed banks of our country stood at Rs 1,23,533crores, recording 38% hike in their values from the previous financial year. It is further being predicted that the value would reach Rs 1, 50,000 crores by the end of the financial year.

This alarming situation calls for an in-depth inspection of the policies adopted by our banks to fight against the problem and analyze the differences in approach of the public and private sector banks.

Objectives of the Study

Considering the vast nature of the topic and keeping in view the efforts taken by researchers in this field the following objectives been addressed in this research:

1. To study the various categories of loan assets of public sector banks and private sector banks.

2. To study the relationship between gross advance and NPAs of the public sector banks and private sector banks.

3. To study the difference between the NPAs of public sector banks and private sector banks.

Hypotheses Formulation:

Part I: *Comparison between public and private sector banks with respect to proportion of various categories of loan assets to total advances of public sector banks and private sector banks.*

H_0: There is significant difference between the proportion of various categories of loan assets of public sector banks and private sector banks.

H_1 (Alternate Hypothesis): There is no significant difference between the proportion of various categories of assets of public sector banks and private sector banks.

Part II: *Comparison of Gross NPAs of public sector banks with Gross NPAs of private sector banks*.

H_0: There is significant difference between the percentage of NPAs of public and private sector banks.

H_1 (Alternative Hypothesis): There is no significant difference between the percentage of NPAs of public and private sector banks

Research Methodology:

Source of data: For the purpose of the study secondary data available on the official website of RBI has been used.

Sample Size: For the purpose of study sample has been taken as all 26 public sector banks and all 20 private sector banks.

Time period for study: The data from 2008 to 2013 (six years) have been analysed for the study.

Statistical Tools: To analyze the data statistically mean and standard deviation have been calculated. Further students T-Test is applied to make choice between null hypothesis and alternative hypothesis.

Analysis of data:

Part I Banks Group wise classification of Loan Assets

Table 1. *Standard Advances to Total Advances ratio of Public Sector banks and Private sector banks (in %)*

Year → / Bank Group ↓	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**Mean**	**Std Dev**	**T- Value Calculated**	**T- Value Tabulated**

Public Sector	97.67	97.90	97.72	97.68	96.83	96.16	97.33	0.68	-0.2241	2.570582
Private Sector	97.25	96.75	97.03	97.55	97.92	98.09	97.43	0.52		

Findings: The mean for public sector banks is 97.33 and for private sector banks is 97.43.The value of standard deviation for public sector banks is 0.68 and for the private sector banks is 0.52.The T-value is calculated at 5% significance level (α = 0.05) and with 5 degrees of freedom. The T-value calculated is -0.2241.

Table 2. *Sub Standard Advances to Total Advances ratio of Public Sector banks and Private sector banks (in %)*

Year→ Bank Group↓	2008	2009	2010	2011	2012	2013	Mean	Std Dev	T- Value Calculated	T- Value Tabulated
Public Sector	0.99	0.93	1.10	1.10	1.70	1.89	1.29	0.40	0.386011	2.570582
Private Sector	1.54	2.02	1.48	0.60	0.58	0.56	1.13	0.63		

Findings: The value of mean for public sector banks is 1.29 and for private sector banks is 1.13.The value of standard deviation for public sector banks is 0.40 and for the private sector banks is 0.63. The T-value is calculated at 5% significance level (α = 0.05) and with 5 degrees of freedom. The T-value calculated is 0.386011.

Table 3. *Doubtful Advances to Total Advances ratio of Public Sector banks and Private sector banks (in %)*

Year→ Bank Group↓	2008	2009	2010	2011	2012	2013	Mean	Std Dev	T- Value Calculated	T- Value Tabulated
Public Sector	1.13	0.99	0.98	1.04	1.33	1.81	1.21	0.32	0.580483	2.570582
Private Sector	0.94	0.96	1.12	1.46	1.17	1.06	1.12	0.19		

Findings: The mean for public sector banks is 1.21 and for private sector banks is 1.12.The value of standard deviation for public sector banks is 0.32 and for the private sector banks is 0.19. The T-value is calculated at 5% significance level (α = 0.05) and with 5 degrees of freedom. The T-value calculated is 0.580483.

Table 4. *Loss Advances to Total Advances ratio of Public Sector banks and Private sector banks (in %)*

Year→ Bank Group↓	2008	2009	2010	2011	2012	2013	Mean	Std Dev	T- Value	T- Value

									Calculated	Tabulated
Public Sector	0.22	0.18	0.20	0.18	0.14	0.14	0.18	0.03	- 5.21817	2.570582
Private Sector	0.26	0.26	0.37	0.39	0.32	0.29	0.31	0.06		

Findings: The mean for public sector banks is 0.18 and for private sector banks is 0.31.The value of standard deviation for public sector banks is 0.03 and for the private sector banks is 0.06. The T-value is calculated at 5% significance level (α = 0.05) and with 5 degrees of freedom. The T-value calculated is -5.21817.

Summarized results

	T-value Calculated	T-Value Tabulated	H_0/H_1
Standard Advances to Total Advances	-0.2241	2.570582	H_0
Sub Standard Advances to Total Advances	0.386011	2.570582	H_0
Doubtful Advances to Total Advances	0.580483	2.570582	H_0
Loss Advances to Total Advances	- 5.21817	2.570582	H_0

Results & Discussions:

The summarized results show that H_0 is accepted for all categories of loan assets of public and private sector banks H_0 is accepted which means that there is significant difference between proportion of various loan assets to total advances of public and private sector banks.

Part II: Comparison between Public Sector banks & Private Sector Banks's w.r.t NPAs

Table 5. *Proportion of Gross NPAs to Total Advances of Public Sector banks and Private sector banks (in %)*

Year→ Bank Group ↓	2008	2009	2010	2011	2012	2013	Mean	Std Dev	T- Value Calculated	T- Value Tabulated	H_0 / H_1
Public Sector	2.33	2.10	2.28	2.32	3.16	3.84	2.67	0.681	0.299	2.262	H_0
Private Sector	2.75	3.25	2.97	2.45	2.07	1.91	2.57	0.520			

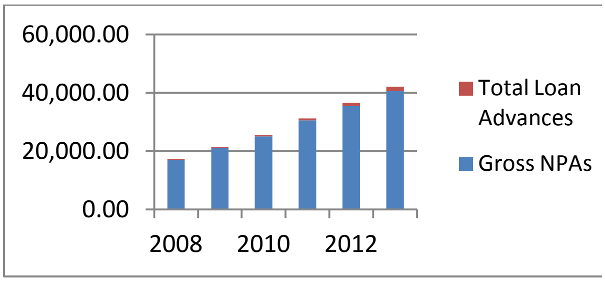
Findings: The mean for public sector banks is 2.67 and for private sector banks is 2.57.The value of standard deviation for public sector banks is 0.681 and for the private sector banks is 0.520. The T-value is calculated at 5% significance level (α = 0.05) and with 5 degrees of freedom. The T-value calculated is 0.299.

Results & Discussions: H_0 is accepted as T calculated is less than T tabulated which means that there is significant difference between the NPAs of public sector banks and private sector banks.

Part III: ***Studying the relationship between gross advances and gross NPAs with in a sector (Intra-sector Study).***

Table 5. *Gross NPAs and Total Advances of Public Sector banks (Rs in billions)*

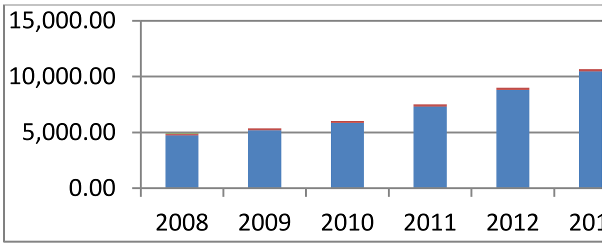
Year➔	2008	2009	2010	2011	2012	2013	Mean	Std Dev
Gross NPAs	396.00	440.32	572.93	710.80	1,124.89	1,558.90	800.64	454.66
Total Loan Advances	16,960.51	20,986.33	25,124.39	30,599.53	35,503.89	40,558.74	28,288.9	8940.00



Results & Discussions: From the bar diagram it is evident that public sector banks have not been able to efficiently managed their NPAs over the years. Their total gross advances have increased but the NPAs have increased in greater proportion. Hence overall ratio has increases over the years.

Table 6. *Gross NPAs and Total Advances of Private Sector banks (Rs in billions)*

Year➔	2008	2009	2010	2011	2012	2013	Mean	Std Dev
Gross NPAs	129.78	168.90	173.87	179.75	183.21	199.92	172.57	23.49
Total Loan Advances	4,727.00	5,200.77	5,851.10	7,329.53	8,812.16	10,466.65	7,064.54	2240.93



Results & Discussions: From the bar diagram it is evident that private sector banks have very efficiently managed their NPAs over the years. Their total gross advances have increased but the NPAs have not increased proportionally. Hence overall ratio has declined over the years.

Findings & Conclusions:

1. The analysis of data revealed that for all categories of loan assets there is significant difference between the values for public and private sector banks. There seems only small difference in the ratios in percentage values but when these values are expressed in rupees the difference is clearly noticeable.

2. The analysis of Gross NPAs to the total advances made by banks of both public and private sector banks reveals that there is clear visible relationship between the NPAs and the total advances. As the business size of banks increases their total advances also increase which in turn increases the probability of NPAs. Hence it can be concluded that the increasing size of the business has direct impact on probability of increasing NPAs.

3. On comparison of NPAs of public and private sector banks the researcher found that over the period of time from year 2008 to 2013 the private sector banks have been more efficient in managing their NPAs which is proved by the declining proportion of gross NPAs to total advances. On the other hand public sector banks have not been so efficient in management of NPAs which has resulted in increasing percentage over the period. The difference between the values of NPA percentages for public and private banks is highly significant.

4. As the total gross advances increase in value the probability of increase in NPAs also increases. But private sector banks have proved that if the proper management strategies are adopted by banks, the NPAs could be very efficiently managed.

Recommendations

1. It is true that with increase in the size of business the chances of loan assets becoming non performing also increases but this cannot be taken as excuse for the poor performance of public sector banks. Loan accounts should be more professionally managed to combat the situation.

2. The effective practices of private banks in managing NPAs should be adopted and modified to suit the environment of public sector banks.

3. The management of NPAs can be outsourced to professional service providers.

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