Non-performing Assets impact on Banking sector

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Abstract

The level of Nonperforming assets is the most significant way to measure the overall performance of banking sector. Definitely, banks in modern scenario of industrialization and emerging of crony capitalism play a vital significant role to provide financial assistance to all the sectors; primary, secondary and tertiary, from giant industries to small and middle entrepreneurs in every corner of the world. The banking sector, which is anxiously viewing the rising Covid graph in the country, doesn't expect a repeat of 2020 but bankers are bracing for a rise in non-performing assets (NPAs). On the other hand, they expect the Reserve Bank of India (RBI) to delay normalisation of the accommodative monetary policy and any possible hike in interest rates, with focus remaining on growth

Similarly, the Banking sector of India is a fundamental monetary help area that supports improvement through channelizing assets for useful reason, intermediating stream of assets from surplus to deficiency units and supporting monetary and economics strategies of the public authority. In fact, Banks act as a social goal through need area loaning, mass branch organizations and business age. Keeping up resource quality and productivity are basic thrust for banks endurance and development. During the time spent accomplishing such targets, a significant issue to banking area is commonness of Non-Performing Assets (NPA). Reserve bank of India characterized NPA as "An Asset, including a lending resource, becomes Non-Performing Asset when it stops to create pay for the bank". The significant foundations for NPAs are unshakable default, miss usage of acquired assets, absence of appropriate pre-enquiry prior to giving advance. The Gross NPA of Indian Banks was 10.03 lakh crores as on 30 June 2018. Public Sector Banks represents 88.74% of all out Gross NPAs. In this, the accompanying top five public area banks represents 46.67% the five banks are SBI, PNB, IDBI, BOI and BOB. Private Sector Banks represent 11.26% of complete Gross NPAs; among the top Private Sector banks are ICICI, AXIS and HDFC. The fundamental goal of this paper is to contemplate the circumstances and end results of NPAs in Banking Sector.

Key Words: -*NPA, types of NPA, reason for NPA, causes for NPA, effects of raising NPA*

Introduction

To begin with one can, express that the Banking sector is the key foundation of any financial system. The prosperous condition of an entire economy is overall depended upon the effective function of the banking sector. Banks create credits by the process of accepting the deposits from the customers and lending the loans to the needy ones. Amounts received by the interest on loan and from principal are used for further credit creation in the economy. However, the increase of `non-performing assets ensures disturbance on the smooth running of credit creation. Therefore, if one wants to determine the overall performance of the banking sector, NPAs is the prime indicator to judge. A solid financial area is significant for thriving economy. With the presentation of monetary area changes in 1991 the essences of Indian Banking area have also changed. The financial area additionally has a vital part in the recuperation cycle of the country's economy in general. The financial business has moved bit by bit from a synchronized climate to a decontrolled market-based economy. There has been huge transformation taking place in the momentary part of banks in India, especially with the start of advancement and globalization in market improvement. The disappointment of the financial area may antagonistically affect different areas. Today, Banks are not only meant to make a decision about just based on number of branches and volume of stores but additionally based on norm of resources. Non-performing assets are one of the significant worries for banks in India especially in the present context. Perhaps, NPAs are not limited to credit imbalance but in fact contrarily influences the productivity, liquidity and dissolvability of the banks.

Objective of the study:

The primary goal of this paper is to examine the circumstances and end results of NPAs in Banking Sector. So entire focus is given to accumulate the resources to understand and thrive the impact and further cause of NPAs on the banking system.

Meaning of NPA:

Cash or Assets given by banks to organizations as advances now and again stay neglected by borrowers. This late or non-installment of credits is characterized as Non-Performing Assets (NPA). They are additionally named as awful resources.

In India, the RBI screens the whole financial framework and, as characterized by the country's national bank, if for a time of over 90 days, the premium or portion sum is late then that advance record can be named as a Non-Performing Asset.

The issue of Non-Performing Assets has been examined finally for monetary framework everywhere on the world. The issue of NPAs isn't just influencing the banks yet additionally the entire economy. Truth be told significant degree of NPAs in Indian banks is only an impression of the condition of strength of the business and exchange.

Types of NPA’s

Non-performing assets refers to those kinds of loans or advances which can be in arrears or in defaults. We can say that, non-performing assets are those types of loan or advances whose principle or interest are either late from due date or have not been paid. It can be described in other way that the borrower has broken the loan agreement with the bank and receiver of the loan is not in the position to pay the loan amount of the bank i.e., insolvent.

In other words, if the borrower is not able to pay their loan amount as well as interest on it within allotted time period then we can consider that amount of loan as non-performing assets. In India, the time line given for classifying the loan as NPA is 180 days.

NPA’s are of four types:

Standard Assets: These type of assets bears only normal risk and are not considered as NPA in normal sense of the word. Hence there is no requirement of special provision for standard assets.

Sub- standard Assets: Those loans and advances which are not performing assets for a period of 12 months falls under the category of sub-standard assets

Doubtful assets: The assets not performing for a period of more than 12 months are known as doubtful assets.

Loss assets: All those assets banks which are unable to recovered by the financial institution are falling under the category of loss assets.

Percentage of provision to be created

	Secured Loan	Unsecured loan
Substandard Assets	15 %	25 %
Doubtful Assets	25-100 %	100 %
Loss Assets	Written off or 100 %	Written off

Covid 19 and its impacts on non-performing assets

The banking sector, which is anxiously viewing the rising Covid graph in the country, doesn't expect a repeat of 2020 but bankers are bracing for a rise in non-performing assets (NPAs). On the other hand, they expect the Reserve Bank of India (RBI) to delay normalisation of the accommodative monetary policy and any possible hike in interest rates, with focus remaining on growth.We don't expect any significant decline in credit offtake but there could be some slippages in loans if states impose stringent lockdown to tackle the pandemic," said an official of a nationalised bank. Credit offtake growth has already declined to 0.4 per cent (Rs 43,484 crore) in December from 1.1 per cent (Rs 1,18,951 crore) in November.

Bankers note that prolonged curbs on economic activity such as closing time of malls, weekend curfew, restrictions on cinemas, gyms and restaurants could affect repayment capacity of borrowers. While bankers say it's too early to make an assessment on the likelihood of a hit on EMIs, the situation could deteriorate if the pandemic lingers for a prolonged period and lay-offs happen in various sectors like travel, tourism, retail and hospitality. Banks have already cut down the number of employees in branches across the country to tackle the spread of the virus.
Rating agency Icra said a third Covid wave poses high risks to performance of borrowers who were already impacted by the earlier waves. Icra estimates that the overall standard restructured loan book for banks increased to 2.9 per cent of standard advances, or Rs 2.85 lakh, crore as on September 30, 2021, up from 2 per cent as on June 30, 2021. "Economic impact is expected to be shallower than the second wave, drawing on past/ international experience. Slower policy normalisation is likely to be accompanied by gradual reduction in fiscal deficits," said Radhika Rao, senior economist, DBS Bank.
"With the increased spread of the new Covid-19 variant, i.e. Omicron, there is a high possibility of the occurrence of a third wave. As banks restructured most of these loans with a moratorium of up to 12 months, this book is likely to start exiting the moratorium from Q4 FY2022 and Q1 FY2023. Therefore, a third wave poses high risk to the performance of the borrowers that were impacted by the previous waves and hence poses a risk to the improving trend of asset quality, profitability, and solvency," said Anil Gupta, vice president, financial sector ratings, ICRA Ratings.

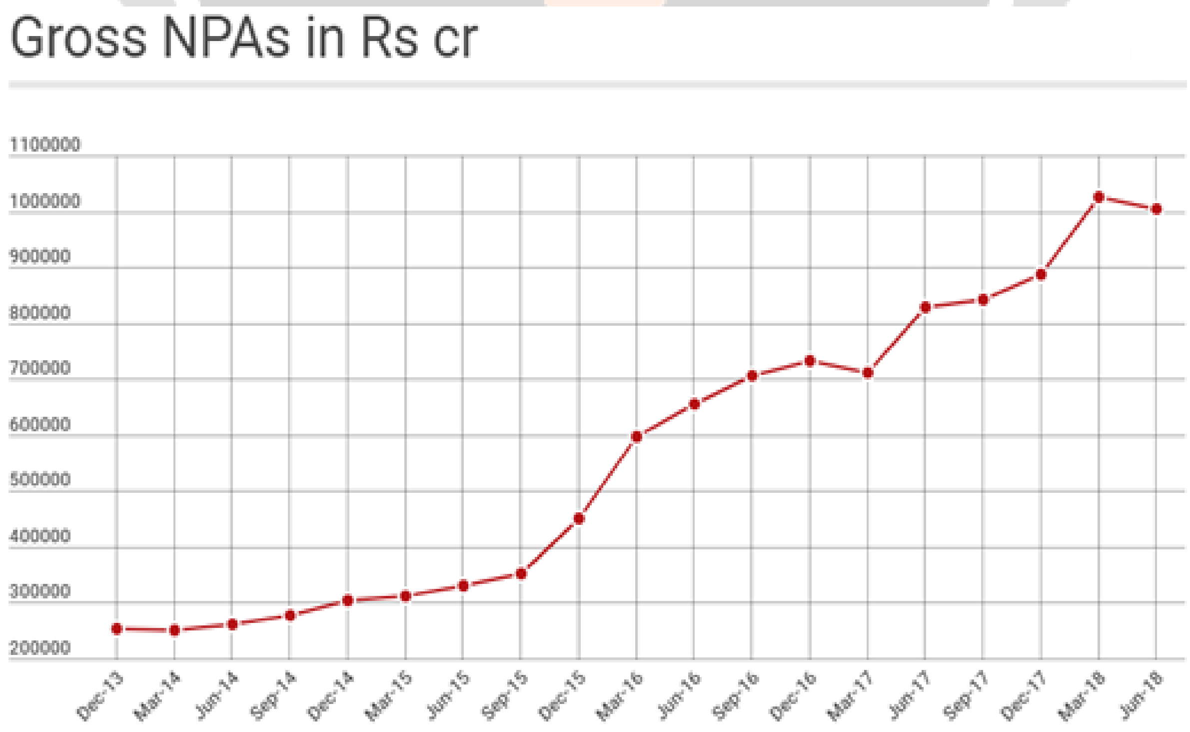
Macro stress tests for credit risk indicate that the gross non-performing asset (GNPA) ratio of banks may increase from 6.9 per cent in September 2021 to 8.1 per cent by September 2022 under the baseline scenario, and to 9.5 per cent under a severe stress scenario, according to the Financial Stability Report of the RBI. NPAs to advances ratio declined from 8.2 per cent at end-March 2020 to 7.3 per cent at end-March 2021 and further to 6.9 per cent at end-September 2021.With states imposing Covid-related restrictions (night curfew on movement of people, restaurants allowed at 50 per cent capacity, offices to operate at 50 per cent capacity in various states), economic activity is likely to get impacted in Q4FY22, according to Abheek Barua, chief economist, HDFC Bank.
"There is a downside risk to our growth forecast to the tune of 20-30 bps. The current forecast is 6.1 per cent for Q4 of FY22.

Downside risks emanate from additional states imposing restrictions, restrictions extending beyond January 2022 and a slowdown in global recovery to weigh on exports," Barua said.The RBI's liquidity normalization to continue while rate hike expectations could moderate as Omicron risk looms. The reverse repo rate hike in February is now uncertain.

The economy expanded by 8.4 per cent year-on-year in July-September 2021, with the level of GDP exceeding pre-pandemic levels (July-September 2019) for the first time since Covid struck. More recent high-frequency indicators of economic activity suggest some loss of momentum in the third quarter of 2021-22. The pace of the recovery remains uneven across sectors, inflation formation is being subjected to repetitive supply shocks and the outlook is overcast with global risks. Omicron haunts near-term prospects, the RBI said in the report.

Non-Performing Assets and India's Scenario-

"Bad Loans crossed Rs. 10 lakh crores", a headline that gleamed in almost all the daily newspapers on 31 March 2018 of India. Did it happen suddenly or in a day or a year! No, not at all, over the last decade, Indian banks in igeneral and the government-owned ones in particular felt the heat of credit in form of non-performing asset; transferring of loans into bad loans. This figure mounts to approximately seven times the value of farm loan waivers given by all the state government of India. This eventually leads to several questions like- does the corporates have any intention returning the loans? Or did the Union Government seriously indulge itself to bring back the defaulters as well the 'lost money'? etc. are questions that needed to be dealt. But let's start with the showcase that begins with the New Economic Reform or Globalization or Liberalization or Privatization; name differ but act remain the one. One thing is definitely certain, that over the decades since New Economic Reform in 1991, the banking industry has undergone a sea of changes and hence credit management. Earlier, say before 1991, asset quality wasn't been the prime concern in Indian banking sector, but was mainly focused on performance objectives such as opening wide networks/branches, development of rural areas, priority sector lending, higher employment generation, etc. thus establishment of the Nationalized Banks under the savior of the then Nationalization Policy emphasized on the need of the weaker section, artisan and self-employed.ii Besides, the country witnessed rapid expansion in bank branches into the rural area led to mobilization of saving. But as the coin have two sides, alike bank nationalization also figured the blink side in the form bureaucratization, red-tapism, and disruptive tactics of opportunist trade unions and bank employees, absence of proper accounting, transparency and prudential norms resulted in building-up of non-performing assets in the banking system of then.



List of 2,426 Who Together Owe Rs1.47 Lakh Crore to Public Sector Banks

As part of its nationwide campaign to celebrate bank nationalisation day, AIBEA had released list of wilful defaulters of PSBs. Among the listed tycoons, Mehul Choksi-owned Gitanjali Gems Ltd with its default of Rs4,644 crore to Punjab National Bank (PNB) topped the list. It is followed by ABG Shipyard Ltd (Rs1,875 crore, State Bank of India-SBI), REI Agro Ltd (Rs1,745 crore, UCO Bank), Ruchi Soya Industries Ltd (Rs1,618 crore, SBI), Gili India Ltd (Rs1,447 core, PNB), Winsome Diamonds & Jewellery Ltd (Rs1,390 crore, Central Bank of India-CBI), Kudos Chemie Ltd (Rs1,301 crore, PNB), Nakshatra Brands Ltd (Rs1,109 crore, PNB), Coastal Projects Ltd (Rs984 crore, SBI) and Winsome Diamonds & Jewellery Ltd (Rs892 crore, PNB). These top 10 defaulters together owe Rs17,005 crore to state-run lenders.

WILFUL DEFAULTERS – RS. 200 CRORE & ABOVE
(147 ACCOUNTS) RS. 67,609 CRORES

		Amount technically/ prudentially written-off	Funded-amount outstanding	TOTAL RS. IN CR
Punjab National Bank	Gitanjali Gems Limited		4644	4644
SBI	Abg Shipyard Ltd	1,875		1,875
UCO Bank	Rei Agro Limited	895	850	1,745
SBI	Ruchi Soya Industries Limited		1,618	1,618
Punjab National Bank	Gili India Limited		1447	1447
Central Bank of India	Winsome Diamonds And Jewellery Limited	695	695	1390
Punjab National Bank	Kudos Chemie Ltd	1301		1301
Punjab National Bank	Nakshatra Brands Limited		1109	1109
SBI	Coastal Projects Limited	979	5	984
Punjab National Bank	Winsome Diamonds AndJewellery Limited	892		892

<u>Causes for Non-performing assets</u>

A strong banking sector is significant for a thriving economy. The disappointment of the banking sector may unfavorably affect different areas. The Indian financial framework, which was working in a shut economy, presently faces the difficulties of an open economy. One of the fundamental drivers of NPAs into banking area is the coordinated advances framework under which business banks are required a recommended level of their credit (40%) to priority areas. Starting today almost 7% of Gross NPAs are secured up in hard core, risky and misfortune resources, aggregated throughout the long term. There are several causes that together resultant for non-performing assets, of which few follows below-

1. **Imperfect loaning measure**: In this causes banking sector should satisfy himself in all aspects that borrower is in the position to pay back the bank loan. There is various method available to the bank to satisfy himself about the borrower i.e., client balance sheet, current ratio etc.

2. **Improper innovation**: Due to inappropriate technology and management information system banks are not able to take decision on real time basis because used of old technique and measure adopted by all branches of the banks. So, banks are in need to upgraded their system and measure as per the current scenario to meet out requirement.

3. **Inappropriate SWOT examination**: The unseemly strength, shortcoming, opportunity and threat investigation is another justification expansion in NPA's. so, the bank ought to analyze the productivity, suitability, long haul worthiness of the venture while financing.

4. **Weak credit examination framework**: Due to the poor credit show the banking sector need to offer advances to those individuals who can't reimburse it back. As a result, the NPA's of the bank continuously increases. So, the bank ought to keep up legitimate credit examination framework.

5. **Administrative lacks**: The Banks should consistently choose the borrower carefully and should accept substantial resources as security to protect its tendency. The bank ought to follow the standard of expansion of risk which implies that the banker ought not concede advances to a couple of huge firms just or to move them in couple of ventures or in couple of urban communities.

6. **Absence of regular follow up**: There is also very significant loophole from the side of the banks that they do not pay attention to the borrower on the regular basis, due to this always there is chance in default in the payment of interest amount as well as principal amount.

7. **Inadequate and flawed documentation**: it is equally important that the banks should check each and every document of borrower very carefully and verify it by cross examination before going ahead to finalizing the loan.

8. **Inadequate recovery tribunal**: The Indian government has set of many recovery tribunals. There work is to recover the loans and advances from the borrower, but due to their careless ness and inadequacy in their work the bank suffers lots of non-recovery, thereby reducing the profitability of the banks.

9. **Purposeful defaults**: The Indian Public Sector Banks are worst hit by these defaults. It is a default in repayment obligation. Ex: Kingfisher Airlines Ltd. is one among many of those willful defaulters. Others are Beta, Napthol, Winsome Diamonds & Jewellery Ltd., Rank Industries Ltd., XL Energy Ltd. etc.

Effects of NPA:

The following are the major effect of NPAs faced by the banks as well as Indian economy-

1. **Profitability of Banks**: Higher NPA’s ceases to generate income of the banks, due to this the interest income of the banking sector will continue to reduce, as NPA’s increasing day by day it will also reduce the net income of the banking sector.

2. **Regular increase in provisions of banks**: RBI has presented prudential standards for money acknowledgment and resource order for Indian banks and monetary establishments, to guarantee legitimate provisioning and straight forwardness in the distributed records. In understanding with the prudential standards of RBI, banks need to give arrangement on Non-Performing Assets. The arrangements are made by banks based on order of resources into Non-Performing Assets.

3. **Liquidity position**: - Higher NPA’s effects liquidity position of the banking system, due to higher NPA’s there is a discrepancy in their liquidity position and assets and force the banks to raise the resources at higher cost. Higher NPA’s may cause liquidity issues which is likely to lead run on banks by depositors.

4. **Effect on small scale industries**: -Generally banks provide the loans to the large scale sector, Banks are generally hesitant to issue loans to the small scale industries. Due to unwilling behavior of the banks MSME will suffers the lack of the funds from the banks and has to borrow the loan at a higher rate to the other financial institution.

5. **Shareholder's confidence**: - Normally shareholder invested their money in profitable share and expected return from their investment in the form of dividend but which is possible only when banks are able to make a significant profit and progress of their business. Due to continuous increase in the NPAs account banks are not able to generate profit as well as there is a negative impact bank business due to this the shareholder do not receive return on their capital invested in the banking share and sometime it may spoil invested value in share.

6. **Burden to Government:** - Government is the majority shareholder of banking sector, if there is any scuffle in banking system, government of India provide capital to the bank to overcome from this situation.

7. **Public confidence**: - Trustworthiness of banking sector is affected substantially because of continuously increasing NPA's, it shakes the confidence of general public in the banking sector.

8. **Conclusive burden on society:** - Rising NPA's will ultimately affects the consumer who will now pay more interest on their loan amount. It leads to lower growth and higher inflation because of the higher cost of capital.

Conclusion

The Non -performing assets is always been creator a big problem to the banking sector, in fact, it isn't limited to just the banking sector but reflection of it is seen in the economy of a country. Money locked in the account of NPA's will directly shades its impact on the profitability of the banking sector as it is confirmed that Indian banks are highly dependent on the interest income on the money lent to its customer. Due to this, the impacts are also foreseen on all the financial ratios of the banking sector i.e., Net Interest Margin, Return on Assets, Profitability, Dividend Pay-out, Provision coverage ratio, Credit contraction etc., which may likely to erode the value of all stakeholders including Shareholders, Depositors, Borrowers, Employees and public at large. Although various steps have been taken by government to reduce the NPAs but still to meet out the inroads lot needs to be done, so that the problem faced in regard to the insolvency could find its solution. Undoubtedly, the NPAs level of our banks is still high as compared to the foreign banks, and it is not at all possible to have zero NPAs. The bank needs to be proactive in the selection of clients and customers while sanctioning of loans. The bank management should speed up the recovery process. As it is clear crystal that the problem of recovery is not with small borrowers but more significantly with large borrowers, and therefore, a strict policy should be followed for solving this problem. The government should also make more provisions for faster settlement of pending cases and also it should reduce the mandatory lending to priority sector as this is the major problem creating area. So, the problem of NPA needs lots of serious efforts otherwise NPAs will keep killing the profitability of banks which is not a good sign for the growing Indian economy at all.

Thus, in the final words, one should stress on the potentiality in a country like India where one witnesses a trend of economy boost with tremendous capacity of resources (Natural and Human) as well as an upgrowing market. But it is equally true, the potentialities could only be harnessed when the we launch a pad of rectification where the government, administration and the banking sector need to come up with transparent policies, systematic approach and accomplish method of recovering the bad loans and bringing to minimum.

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