Study of Non Performing Assets of Indian Banks (Period 2001-2014)

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Abstract:

The main function of bank is to raise resources in the form of fresh deposits and to provide credit for economic activities. Reserve Bank of India (RBI), acts as an instrument of Government of India, provides mandates to Banks for providing banking services to the unbanked. RBI has set targets in terms of percentage (of total Adjusted Net Bank Credit) to be lent to certain sectors. Sectors like Agriculture, Micro and Small Enterprises, Education, Housing, Export Credit which have negligible access to organize lending market are called Priority Sectors. This type of lending which is at lower commercial lending rate is called Priority Sector Lending. As per the set targets of RBI, Banks have to juggle between the non priority sector (higher commercial lending rate) and priority sector. Because of the various factors involved like slowing down of economy, insufficient rains, policy paralysis etc the borrowers find difficulty in repaying their borrowings, this give rise to increase in Non Performing Assets (NPA) in the books of Banks. Non Performing Assets are loans or an advance where interest and/ or installment of principal remain overdue for a period of more than 90 days. The high level of NPA affects operations of banks as it reduces profitability and also major part of bank's fund is kept aside as provision for bad loans. This Paper examines NPA in Priority Sector/Non Priority Sector and analysis of its components. Comparative study is conducted between NPA of Public & Private sector banks. The result showed that Non Priority Sector has higher level of NPA as compared to the Priority Sector Lending. The result showed significant difference between the NPA of Public Sector banks and Private Sector banks.

Keywords:

NPAs, Priority Sector, Nationalization, Agriculture, Small Scale Industries (SSI), Non Priority Sector.

Introduction

Banks play an important role in society; they not only encourage saving habits but also lend credit for generation of livelihood. Its operation involves utilizing the deposits for lending purpose and to further generate funds by collecting interest on the credit amount. Reserve Bank of India (RBI), the apex institution in banking industry, has specified norms for credit lending so as to make this facility available for all strata of society. It has specified lending targets for banks which includes sectors, where large population works and contributes towards the economic development of the country. Hence sectors such as Agriculture, Small Scale Industries (SSI), Weaker Section, etc fall under Priority Sector Lending while others are called Non Priority Sector.

The borrower has to confront with several internal and external factors which result into default in repayment of funds. The internal factors such as diversion of funds for expansion, time/cost overruns, inefficient management, strained labor relations, inappropriate technology/technical problems, product obsolescence, etc., while external factors are recession, non-payment in other countries, inputs/power shortage, price escalation, accidents and natural calamities. If the borrower defaults in repayment of borrowed funds, banks lose money. This negatively affects banks profitability as it is has to set aside some portion of profit to make provisions for bad loans. So it is very important for Banks to lend credit diligently and to keep the Non Performing Asset (NPA) level low. The credit amount given to borrowers is an asset for bank and when it ceases to generate income through interest payment it is called Non Performing Assets.

According to the RBI, 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', in respect of an Overdraft/Cash Credit (OD/CC),
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 of 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 undertaken in terms of guidelines on securitization dated February 1, 2006.
vii. in respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

NPA levels are classified depending upon the Priority/ Non Priority Sector, this assist banks to comprehend factors for increase in NPA and to strategize controlling measures.

Literature Review

The Working Group of RBI on the Modalities of Implementation of the Priority Sector Lending recommended that out of the advances to priority sector, at least 40 per cent should be extended to agriculture sector by each bank. The Group suggested a target of 14 per cent of total bank credit for direct finance to agriculture and allied activities against the existing target of 16 per cent for both direct and indirect finance. Rangarajan (1991) for improving the efficiency of banking system there needs to be improvement in the quality of loan assets. The Narasimham committee (1991) proposed to include the small and marginal farmer, the tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans and other weaker sections under priority sector and it should be 10 per cent of aggregate credit. It also recommended that there is need for gradual phasing out of the directed credit programme, i.e. the target of 40 percent of all credit to priority sector should be stopped. Rajagopal (1994) suggested that only poor and underprivileged should be given concessional credit or low rate of interest credit. Department of Banking supervision (1999) studied the impact of priority sector advances on NPAs & found that NPAs in priority Sector is much higher. Dr. Y.V. Reddy (February 3, 2001), Deputy Governor of RBI, remarked that the flow of credit to priority Sector/rural areas has not been up to the mark due to accumulation of losses in public Sector Banks on account of high NPAs. Bhati (2006) in his study suggested that the financial institutions should have the financial capacity to accept the lending risks

Sooden & Kumar (2007) pointed out that that although the lending targets were fixed, direct and indirect finance were clubbed, interest rates were deregulated and lending procedures in the credit delivery system were simplified, banks could not achieve the targets set for agriculture lending. The analysis also shows that banks preferred medium and large farmers which were against the core principle of equity. It leads to adverse selection and diversion of funds. This in turn adversely affects the quality of assets. Uppal's (2009) study concludes that priority sector advances of all the banking groups are increasing. Lending to priority sector creates many problems for the Indian banks like low profitability, high NPAs, transaction cost etc. Jaynal Ud-din Ahmed's (2010) study observes that with the increase of priority sector lending, there has been corresponding increase in the volume of NPAs. However, it cannot be said that PSL is the only factor in enhancing

the volume of NPAs in the area under study; other factors like credit deposit ratio, ratio of NPA to advances, capital adequacy ratio are equally responsible of increased NPAs. Gourav Vallabh, Anoop Bhatia, and Saurabh Mishra, (2004) studied the movement of non-performing assets of public and private banks along with foreign banks operating in India during the 1994-95 to 2003-04. The summarized that there was decrease in NPA levels with increase in the in Priority Sector Loans to Total Loans and this was due to macro-economic factors.

A. S. Ramasastri and N. K.Unnikrishnan (2005) mentioned that NPAs are result of banks activities with regard to credit appraisal system and monitoring of end-usage of funds. According to them, NPA also depend on business cycle and recovery procedures in case of defaulted loans

Objective

1. To study the NPA levels in Indian Banks
2. To compare the NPA levels of Priority/ Non Priority Sector Lending
3. To perform comparative study of NPA due to Priority/ Non Priority Sector Lending in Public and Private Banks

Hypothesis

1. There is significant difference in NPAs of Public and Private banks
2. The level of NPA is high for Priority Sector Lending as compared to Non Priority Sector Lending
3. There is significant difference between the NPA of Priority Sector and Non Priority Sector in Public Sector Banks
4. There is significant difference between the NPA of Priority Sector and Non Priority Sector in Private Sector Banks

Data Source and Methodology

The study is based on the secondary source of data. Data is collected from publications by Reserve Bank of India and Commercial Banks. Indian Banking related articles, journals, case studies and reports are used for drawing inferences.

Tools used to analyze the data of banks are ratios, tables and charts.

Indian Banking System

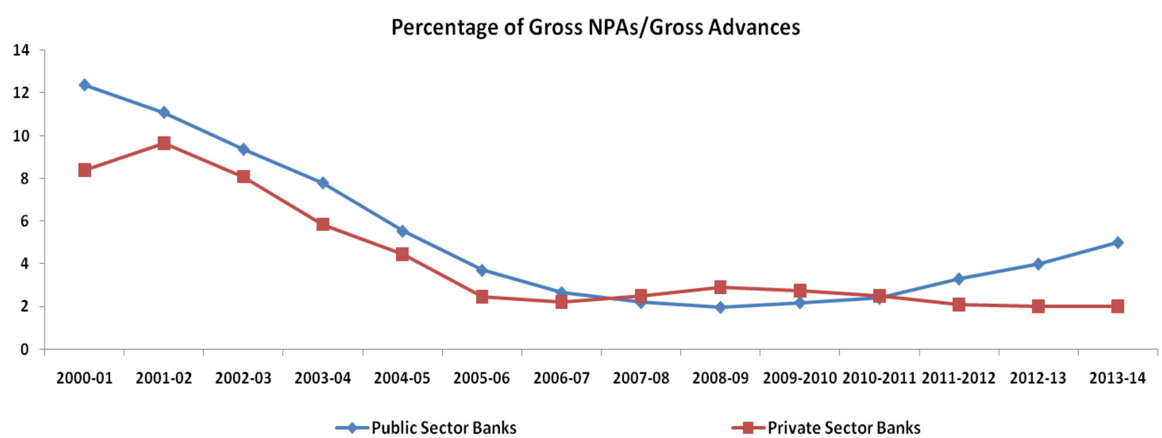
A very important role is played by Indian Banking System for providing financial strength to the country's economy. Indian Banks not only provide credit to the productive sector of the economy but also act as a facilitator for financial inclusion. As per the targets set by RBI, every bank has to lend 40 percent of Adjusted Net Bank Credit to the Priority Sector. The Priority Sector includes Agriculture, Small Scale Industries, Advances to Weaker section, Export Credit etc. These sectors mostly operate on small scale and engage large population for generation of livelihood. In order to encourage contribution of Priority Sector towards economy, the credit facilities availed to such sector is at lower interest rate as compared to the Non Priority Sector. These measures by Banking System ensure that both Priority and Non Priority Sectors grow and contribute towards economy of India.

A sound health of the banking system is a key pre-requisite for economic development and financial stability. The NPA is an essential parameter to evaluate the financial health of banks. As compared to Asset Quality, NPA defines the credit management quality and efficiency in the allocation of resource. NPAs affect the operational efficiency, which in turn affects profitability, liquidity and solvency position of banks. It so generates a vicious cycle of effects on the sustainability and growth of the banking system, and if not managed properly could lead to bank failures.

It is often observed that during the economic slowdown, banks performances deteriorate as the asset qualities declines and results in poor recoveries. During the pre-crisis period i.e. 2003-2008 there was an impressive increase in GDP which also resulted into reduction of NPA levels. GDP during that period was on an average 8.9 per-cent per annum which resulted into reduction of NPA for Indian banks. NPA of Public sector banks decreased from 7.7% at the end of March 2003 to 2.2 % at the end of March 2008. And NPA of Private sector banks decreased from 8.07% at the end of March 2003 to 2.5% at the end of March 2008. Post crisis GDP slowed down because of global and domestic factors, resulting into increase in NPA levels.

An analysis of Gross NPA in proportion to Gross Advances for Public and Private sector banks in India for period 2000- 2014 determines the movement in NPA as percentage of Advances (Chart 1). It is observed that there was steep reduction in NPA levels pre-crisis period because of the economic growth. Post crisis period, economic deceleration resulted into increase in NPA levels.

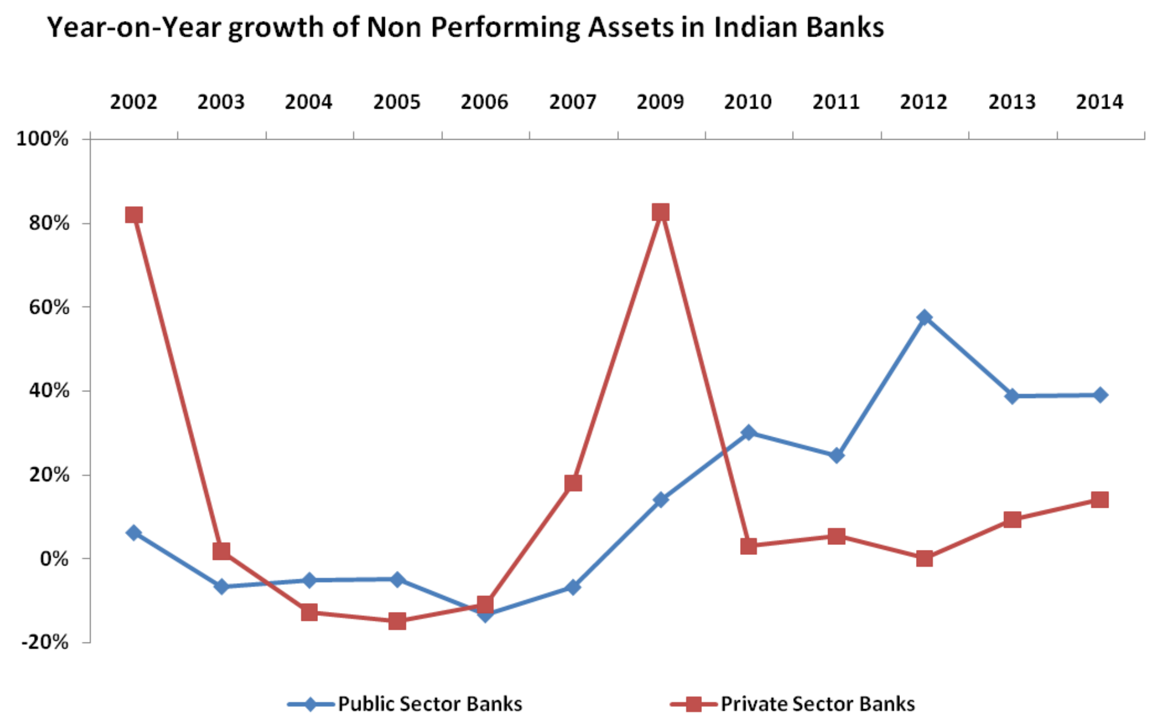
Chart 1: Percentage of Gross NPAs/ Gross Advances



Source: RBI website

A study of Year-on-Year growth of NPA in Indian Banks determines the increase in NPA levels for both Public and Private sector banks during 2009. (Chart 2) The Private sector bank's NPA increased by 83% in 2009 which was similar to its increase in NPA during 2002. The NPA levels of Public sector banks have also increased from 2009 and had peaked to 57% in 2012. For both the years when NPA levels where highest for Public and Private sector banks, India was facing issues related to weak external demand, inflation and policy paralysis.

Chart 2: Year-on-Year growth of Non Performing Assets in Indian Banks



Source: RBI website

Source: RBI website

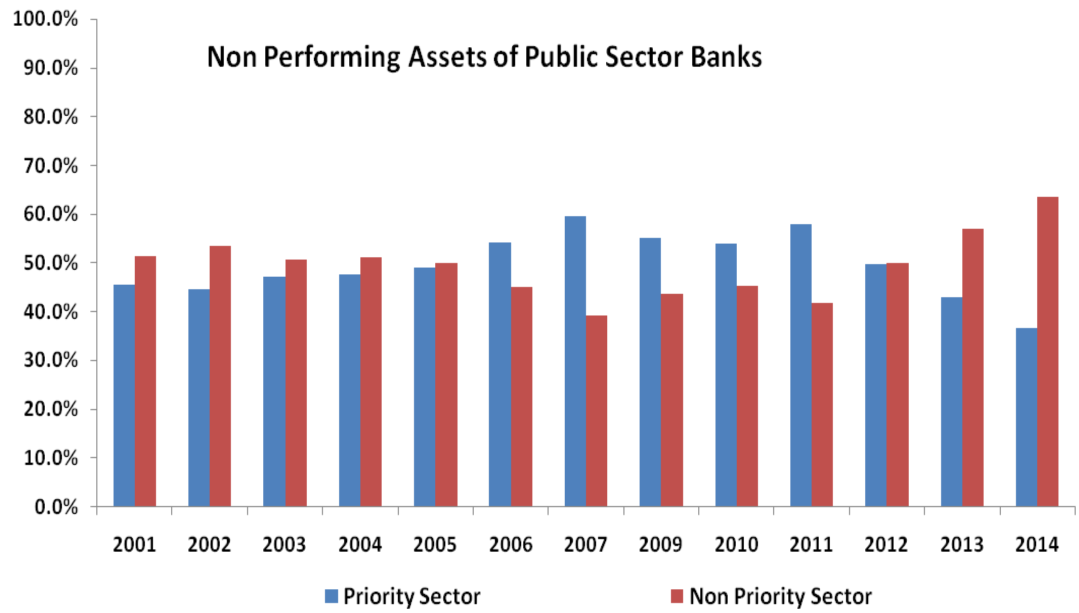
Public Sector Banks

Public Sector Banks in India are the ones where Government holds majority of stakes. They have branches spread across India and carry operations on massive scale. They are also called Nationalized Banks and are total 22 in number. Because of these characteristics, Public sector banks have been successfully achieving their Priority Sector Lending target and also lending funds to Non Priority Sector.

The NPA analysis of Public Sector bank determines that NPA level in Priority Sector lending was less as compared to NPA level in Non Priority Sector for period 2001-2005 (Chart 3). During the high economic growth period the NPA level of Non Priority Sector declined as compared to NPA level of Priority Sector.

But Post 2012, the NPA level of Non Priority Sector has raised and was recorded 63% the highest ever in the year 2014.

Chart 3: Non Performing Assets of Public Sector Banks



Source: RBI website

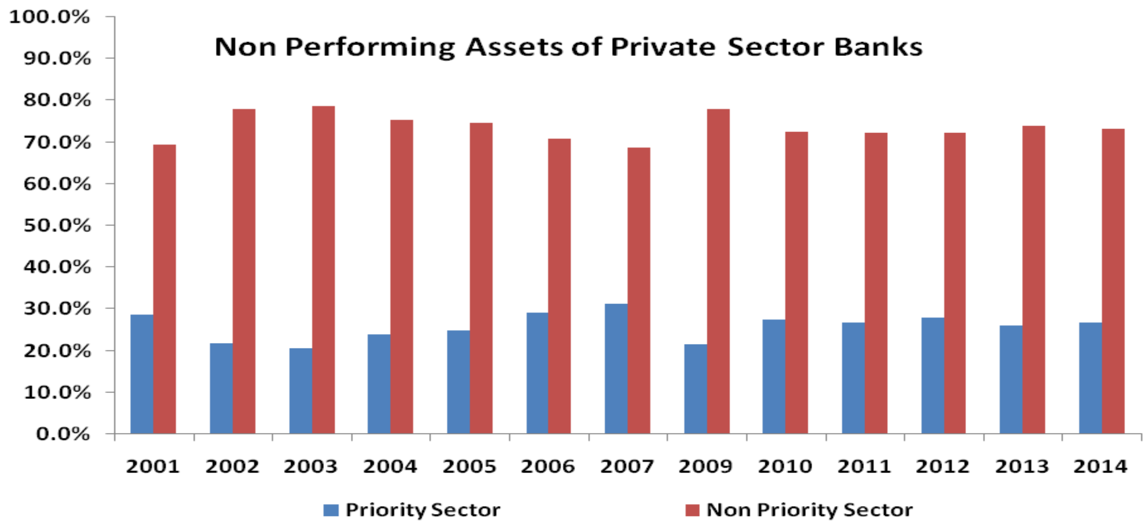
One of the reasons for high NPA in priority sector is the national level operations of sponsored program, loan waiver schemes, lack of effective follow up and recovery measures of Public Sector Banks.

Private Sector Banks

Private sector banks are the banks where majority of the stake is held by private party and not Government. These are professionally managed and highly organized in their operations. Currently, there are 23 banks which are growing with rapid pace. It is generally believed that Non Priority Sector prefers lending from Private Banks because of their fast lending operations.

The NPA analysis in Private sector banks determines that the NPA levels of Priority sector are way below the NPA levels of Non Priority sector (Chart 4). The NPA level of Priority Sector on an average has been 25.9% and NPA level of Non Priority Sector on an average has been 73.6% for period 2001-2014.

Chart 4: Non Performing Assets of Private Sector Banks

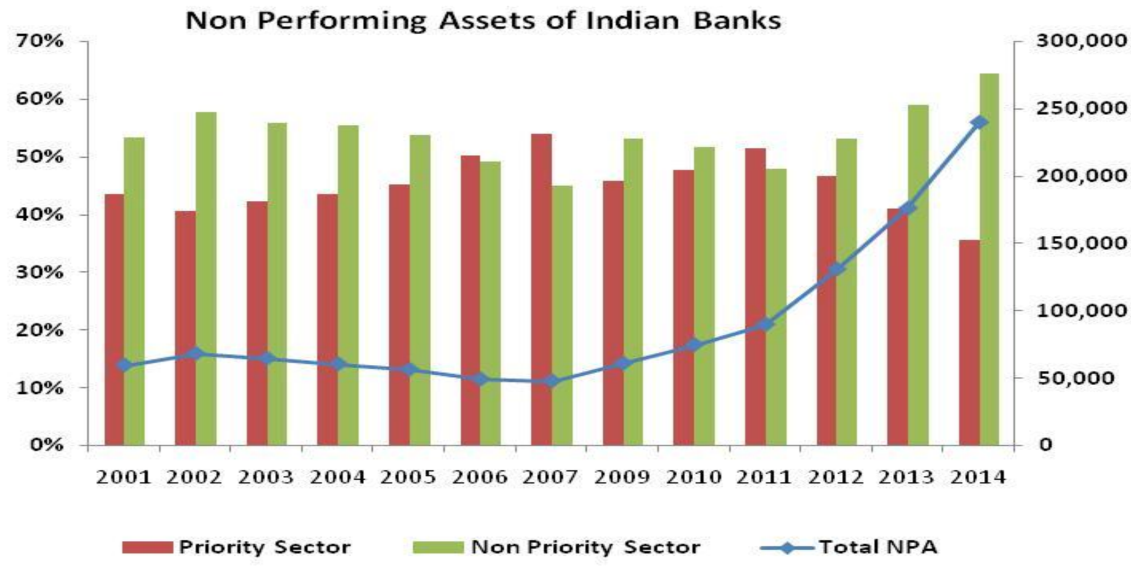


Source: RBI website

The sharp rise in NPAs of non-priority sector was reflective of the slowdown in the economy and stressed financial conditions of corporate that followed after the global financial crisis. It is noteworthy that the Reserve Bank issued guidelines regarding restructuring of loans, as a one-time measure in view of the extraordinary external factors during the crisis period, for preserving the economic and productive value of assets, which were otherwise viable.

The total NPA level in the Indian Banks inclusive of Public and Private Banks with respect to Priority Sector and Non Priority Sector is depicted below in Chart 5. It is observed that with an exception of couple years the Non Priority Sector lending has generated higher NPA as compared to the Priority Sector Lending. During the period 2001-14, Priority Sector Lending has generated NPA of 45% on an average and Non Priority Sector Lending has generated NPA of 54% on an average. The NPA levels in Priority Sector decrease in 2008-09 because of the implementation of the Agriculture Debt Waiver and Relief Scheme.

Chart 5: Non Performing Assets of Indian Banks



Source: RBI website

Indian banks, during pre-financial crisis period i.e. 2003-2007 the NPA levels showed declining trend as India had favorable economic conditions. Year 2006-07 showed an increase in NPA of Priority sector as there was increase in the credit flow to Agriculture and allied activities. A steep decrease in NPA of Priority Sector is been observed in the year 2009 as Government implanted debt waiver scheme.

Post financial crisis the NPA levels of non priority sector didn't had major change, but it started to increase from 2012. The reasons for such increase in NPA of Non Priority Sector were policy paralysis and inflation

Conclusion

Indian Banking Sector is monitored under the resilient regulations and has been able to sustain positive growth. It is been observed that during buoyant economic conditions banks lend heavily as they are optimistic about borrowers repaying capacity. Hence NPA are inversely proportional to GDP growth.

In accordance with NPA and its share in total gross advances, public sector banks, account for high NPA as compared to private sector banks. However, the share pattern in NPAs is distinct when viewed separately in the pre and post-crisis period. The share of public sector banks in total NPAs has declined during the post-crisis period, as compared to the pre-crisis period. However, the share of private sector banks has gone up significantly in the post-crisis period

The bank group-wise and sector-wise gross NPAs reveal that, public sector banks have recorded higher increase in their NPAs in the priority sector than in the case of non priority sector in the recent period. Conversely, private sector banks have witnessed greater increase in non-priority sector NPAs as compared to the priority sector.

The NPA levels in Indian Banks are not at distressed levels as some cushion is provided by the sound capital adequacy of banks, which ensure that the banking system remains resilient even in the unlikely contingency of having to absorb the entire existing NPAs. Nevertheless, it is worth to recognize the problem in its early stages and initiate corrective measures in the right earnest.

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