

Non-performing Assets in Public Sector Commercial Banks- A Retrospect

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Abstract

The present study emphasizes on the management of non-performing assets in public sector commercial banks in India by covering asset classification norms, identification of non-performing assets, provisioning against advances etc. Public sector commercial banks provide finance to needy covering various sectors including priority, no-priority and public sectors. In this juncture, the study is intended to trace the movements and recovery of non-performing assets in public sector commercial banks during 2006-2011 with the backdrop of financial crisis happened during 2008.

Keywords: Non-performing Assets, Commercial Banks, Priority and Non-priority Sector, Debt Recovery System

1. Introduction

As per the balance sheet perspective, every organisation comprises of Assets and Liabilities. As per the language of accounting, the amount of assets held by an organisation equals to that of liabilities of the organisation. As long as an asset performs its best to the benefit of the organisation, it creates positive cash flows whereas if it fails to do so, it will be useless and have the negative impact. The yield of a bank will be the difference between interests received from borrows and paid depositors. All loans/ advances do not yield income due to several factors. If any bank fails to collect the loan/ advance given to borrower it is said to be non-performing asset (NPA). The concept of NPAs coined by the banking experts in light of financial sector reforms took place during 1990s. Since then, it become a buzz word in banking literature and attracted the attention of most of policy makers. After the first financial sector reforms, Indian banking system saw rapid changes in terms of regulative and prudential norms, trading volume, scope of business operations, usage of

technology, reaching of customers, product diversity, availability of funds, etc. Along with these, there is an increase in NPAs. Particularly this trend can be traced out in public sector commercial banks. Against this backdrop, an earnest attempt is made here to analyze the NPAs in terms of intensity, magnitude, recovery, trend and causes for occurrence in public sector commercial banks.

2. Literature Review

Huge volume of research has been conducted on public sector commercial banks. A brief review of these studies is highlighted in the following paragraphs in order to sketch the importance of the present study. Reserve Bank of India (RBI) (2010) expressed its views on NPA in an occasional paper that an asset including a leased asset, becomes non-performing when it ceases to generate income for the bank. Jaynal Ud-din Ahmed (2010) opined that the level of NPAs of banks is an important criterion to assess the financial health of banking sector. Khan and Bishnoi (2001) worried that banking crisis exists in the country if the level of NPAs touches 10 percent of GDP. In view of Jain and Balachandran (1997) the loss of income from NPAs caused to low profitability of the banks. Rooma Mitra and Sankaraavi (2008) made a study on the performance of banking sector in India and opined that the financial policy planners as it identify priority areas for different banks, which can improve the performance. Satish B Kumar (2008), in his article studied the performance of Indian private sector banks. He stated that there was a significant influence of the usage of information technology on the performance of banking sector. Brijesh K. Sahoo and Anandeeep Singh (2007) examined the performance trends of Indian commercial banks during 1997-2005. Prasanth K Reddy (2002) made a study on NPAs in India and global context-similarities

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and dissimilarities, remedial measures and concluded the importance of a sound understanding of the micro economic variables and systematic issues relating to banks in order to curb the problems of NPAs. He Dong (2004) investigated the procedure of resolving NPAs of Indian banking system and the role of Asset Reconstruction Company (ARC). Bhavani Prasad, G.V. and Veena, D (2011) studied NPAs in Indian banking sector, trends and issues and concluded that PSB, which currently account for more than 78 percent of industry assets are saddled with NPAs. Further, they claimed that there was a sharp fall of revenue from traditional sources, lack of modern technology and massive workforce while the new private sector banks are far ahead in this regard.

3. Need of the Study

On the basis of existing available literature in the field of study it is understood that there are many studies on non-performing assets in the recent past. These studies have extensively covered causes, management, prudential norms, and guidelines of NPAs. Further, most of the researchers have focused on analysis of sectoral-wise, bank-wise, priority-wise etc. Hardly, there were a few works, which analyse NPAs in the public sector commercial banks (PSCB). Further, it is felt that PSCB are very crucial for economic development in the country. Furthermore, the good performance of PSCBs is considered positive sign of economic development in the country. Therefore, the study on non-performing assets in PSCB is believed to be worth full in the light of the aforementioned reasons.

4. Objectives of the Study

The main objective of the study is to review the intensity of NPAs in PSCBs. The specific objectives are to: (i) assess the reasons of occurrence of NPAs in PSCBs (ii) evaluate the quantum and trend of NPAs in PSCBs and (iii) analyze the recovery pattern of NPAs during the study period.

Data: The main source of the data used for the study is secondary in nature. Basically, the information is collected from books, periodicals, journals, magazines, reports, websites etc.

Tools of analysis: The present study is analyzed with the help of accounting and statistical tools including mainly

percentages. Wherever possible and feasible, charts are drawn to illuminate the facts and figures.

Period of the study: The present study covers a six years period from 2006-2011. During 2008, India has undergone financial crisis along with the world economy in which Indian financial system severely affected. The study will have a look on the performance PSCBs in connection to NPAs during pre-economic crisis and post-economic crisis.

Scope and limitations of the study: The scope of the present study is confined to PSCB leaving other sectors of banks, namely, private banks and foreign banks. The researcher felt that the inclusion of private banks and foreign banks in the study may deviate from the objectives of the study, otherwise these banks also might have included in the study. This may be one of the limitations of the study.

5. Organisation of the Study

The entire study has divided into three sections. The first section deals with introduction of the study, objectives and methodology of the study. The second section is devoted to discuss the objectives of the study, while the last section concludes with summary and conclusion.

NPAs and causes: Non-performing asset or NPA, it is called such as while it is an 'Asset', it does not bring substantial income to its owner or is just dormant. Gross NPA is an advance considered as irrecoverable, for bank has made provisions, and which is still held in bank accounts. Net NPA is obtained by deducting items like interest due but not received; part payment received and kept in suspense account from Gross NPA. NPAs are threatening to the stability and cause to banks' low profitability through the loss of interest income and chance of losing the principal amount too. RBI has issued the guidelines in 1993 based on the recommendations made by Narsimhan committee. The committee strongly recommended that there is great need of proper identification and reduction of NPAs and it to be treated as a national priority as because NPA directs toward credit risk that bank face and its efficiency in allocating resources.

PSCBs are facing more problems than the private sector banks and foreign banks. The NPAs in PSCBs are growing rapidly in comparison to other banks due to internal and external factors. One of the major causes of NPAs in the

PSCBs is the directed loan system under which commercial banks are required to supply 40 percent of their credit to priority sector. Amongst all the sectors, micro sector has become a villain towards PSCBs. This sector is very prone to become sick or weak. Various poverty alleviation programmes, promoted by the government, have failed miserably in meeting the objectives which in turn has left a great influence on the performance of PSCBs. Political interference, manipulation, misuse of funds, unreliable customers are said to be some severe causes of rising of NPAs. Further, the following were identified as other causes of NPAs: (i) improper selection of borrowers business activities; (ii) adoption of unscientific and weak credit appraisal system; (iii) industrial sickness on account of bad economic environment in the country; (iv) inefficiency in the management of borrower; (v) lack proper follow-up by banks; and (vi) recession in the market.

Prudential norms: In order to facilitate the banks in classification of assets, recognition of NPAs, provisioning for bad debts, sale/ purchase of NPAs, write off of NPAs and guidelines on restricting of advances of NPAs, RBI has issued prudential norms. These norms issued by the RBI acted as necessary guidelines for commercial banks in connection to aforementioned aspects of NPAs. These have been discussed in the following paragraphs.

Income recognition: The income recognition guidelines are: (i) the policy of income recognition is to be objective and must be based on the record of recovery; (ii) interest on advances against term deposits, National Savings Certificates, Indira Vikas Patras, Kisan Vikas Patras and Life policies may be taken to income account on the due date, if adequate margin is available in the accounts; (iii) fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit; and (iv) in case of Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest has been realised.

Asset classification: The RBI has issued guidelines to banks for classification of assets into four categories. These are: (i) standard assets are the loans which do not have any problem and are of less risk; (ii) substandard assets are those which come under the category of NPA for a period less than 12 months; (iii) doubtful assets are

those NPAs that exceed period of 12 months; and (iv) loss assets are those whose loss has been identified by the bank or internal auditors or the RBI inspection but the amount has not been written off wholly.

Provisioning norms: These norms include: (i) commercial banks are held responsible for making of adequate provisions for any diminution in the value of loan assets; (ii) in conformity with the prudential norms, provisions should be made on the non-performing assets on the basis of classification of assets; (iii) loss assets to be written off. If loss assets are permitted to appear in the books for any reason, 100 percent of the outstanding should be provided; (iv) the requirements of the provisions are made on the basis of period for which the advances has remained in doubtful category. Up to 1 year it is 25 percent, for 1 to 3 years it is 40 percent and for more than 3 years it is 100 percent; (v) on substandard assets, a general provision of 15 percent on total outstanding should be made without making any allowances; and (vi) on standard assets, banks should make a general provision as 0.25 percent in case of direct advances to agricultural and Small and Micro Enterprises, 1.00 percent to commercial real estate, housing loans extended at teaser rates and restructured advances, 0.40 percent to all other loans and advances not included in above three cases.

Table 1: Non-performing assets in PSCBs during 2006-11

(Rs. crores)

Year	NPAs	
	Gross	Net
2006	11,347.24	11,062.88
2007	14,644.93	14,401.46
2008	18,190.74	17,974.01
2009	22,834.73	22,592.12
2010	27,334.58	27,013.00
2011	30,798.04	33,056.32
Mean	20,858.38	21,016.63
CGR %	18.11	20.01
t' cal	6.82*	6.29*

Note: *Indicates significant at one percent level

Source: Compiled from various issues of RBI bulletins on Trend and Progress of Banking in India in 2011.

In addition to the above said prudential norms, RBI has issued prudential norms on: (a) creation and utilization

of floating assets; (b) accounting and disclosures; (c) leased assets; (d) loss assets; (e) provisions under special circumstances; (f) coverage ratio; (g) banks/financial institutions for the sale of transactions; (h) purchase/sale of non-performing financial assets; (i) reconstructing of advances by banks etc.

6. Discussion

Trend in NPAs: A glance at Table 1 reveals the trend in gross and net non-performing assets in PSCBs during 2006-11. The lowest gross NPAs were at Rs.11, 347.24 crores in 2006 whereas the highest was at Rs. 30,798.04 crores

The mean gross NPAs were at 20,858.38 crores. The compound growth rate (CGR) is 18.11 percent, which is significant at one percent level as 't' calculated value is greater than that of critical value. As per gross NPAs, on an average, 18.11 percent growth was registered during the period. The net NPAs in 2001 were 11,062 crores against

to 33,056.63 crores in 2011. The mean NPAs during the period were 21,016.63 crores with 20.01 percent of CGR. This is significant at one percent level. On an average, per year there is 20.01 percent of growth rate in NPAs. It may be identified that there is continues growth in both gross and net NPAs throughout the study period. It may be summed up that in spite of a number of measures taken and induced by the RBI to tackle the problem of NPAs, they became vain.

Trends in NPAs: The trend in NPAs of PSCBs during 2006-11 is shown in Table 2. A look at the table hints that the gross NPAs have increased from Rs. 41,378 crores in 2006 to Rs. 71,047 crores in 2011 with relative ups and downs.

Then percentage in total advances has decreased till 2009 and has raised in the last two years. The financial crisis might be the caused for upward trend. A similar trend can be observed with loss assets and gross NPAs in absolute terms. The loss assets in the gross NPAs constituted

Table 2: Trend in NPAs of PSCBs during 2006-11

(Rs. crores)

Year	Loss as-sets	Gross NPAs	Total advances	% of loss assets to gross NPAs	% of loss assets to total advances	% of gross NPAs to total advances
2006	5,180	41,378	10,70,872	12.52	0.48	3.86
2007	4,510	38,602	13,73,777	11.68	0.33	2.81
2008	3,712	39,749	16,96,333	9.34	0.22	2.34
2009	3,803	44,039	21,03,763	8.64	0.18	2.09
2010	4,928	57,301	25,19,331	8.60	0.20	2.27
2011	5,514	71,047	30,79,804	7.76	0.18	2.31

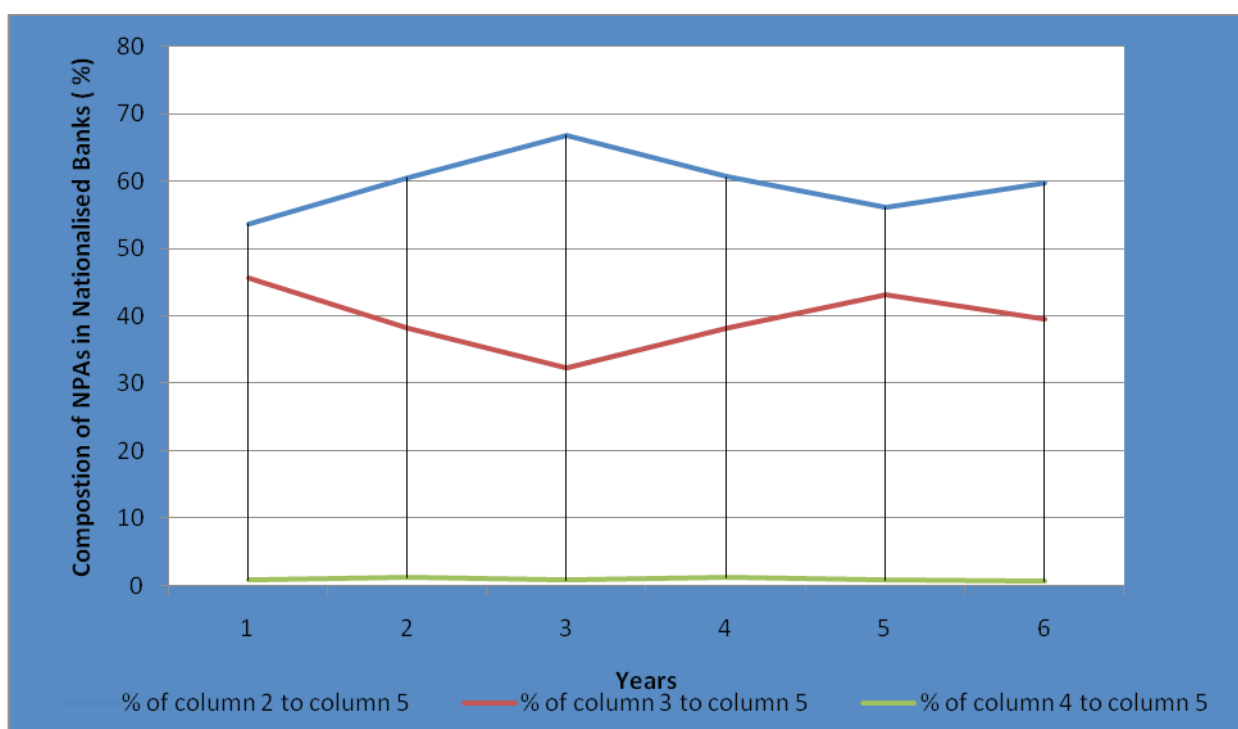
Source: As in Table 1

Table 3: Sectoral Distribution of NPAs of Nationalized Commercial Banks during 2006-11

(Rs. crores)

Year	Priority sector	Non-priority sector	Public sector	Total	% of col. 2 to col. 5	% of col. 3 to col.5	% of col. 4 to col.5
1	2	3	4	5	6	7	8
2006	15,124	12,845	216	28,185	53.66	45.57	0.77
2007	15,779	9,965	302	26,046	60.58	38.26	1.16
2008	16,385	7,941	202	24,528	66.80	32.38	0.82
2009	15,871	10,001	297	26,169	60.65	38.22	1.13
2010	19,908	15,283	280	35,470	56.13	43.09	0.79
2011	25,678	16,957	273	42,907	59.85	39.52	0.64

Source: Compiled from various issues of RBI bulletins on Trend and Progress of Banking in India

Chart 1: Composition of NPAs of Nationalized Commercial Banks

Source: Table 3

Table 4: Composition of NPAs of SBI Group of Banks for the period 2006-11

(Rs. crores)

Year	Priority sector	Non-priority sector	Public sector	Total	% of col. 2 to col.5	% of col.3 to col. 5	% of col. 4 to col. 5
1	2	3	4	5	6	7	8
2006	7,250	5,819	125	13,193	54.95	44.11	0.95
2007	7,175	5,193	188	12,556	57.14	41.36	1.50
2008	8,902	6,222	97	15,220	58.49	40.88	0.64
2009	8,447	9,250	177	17,874	47.26	51.75	0.99
2010	10,940	10,646	244	21,831	50.11	48.77	1.12
2011	15,567	12,567	6	28,140	55.32	44.66	0.02

Source: As in Table 1

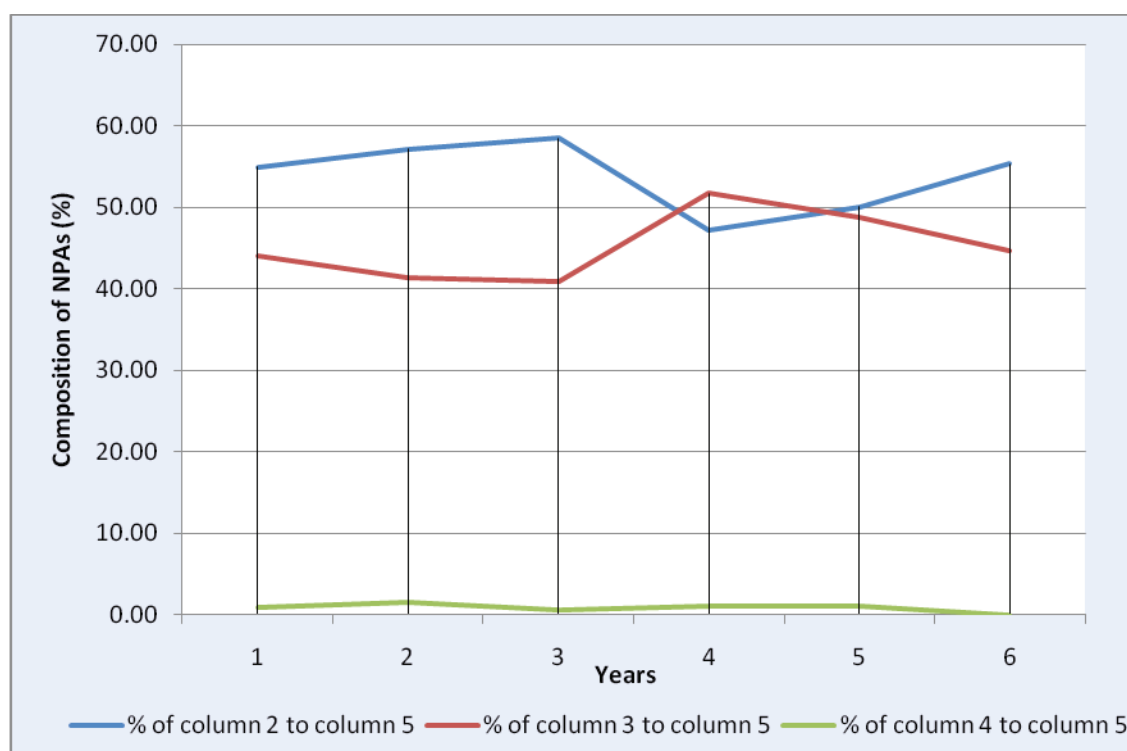
12.52 percent in 2006 vis-à-vis 7.76 percent in 2011. An identical situation prevails in the relative share of loss assets to total advances.

Sector-wise: The composition of NPA of PSCB in different sectors, namely, priority sector, non-priority sector and public sector, can be examined through Table 3 and Table 4.

A look at the Table 3 explains that there is a raise in NPAs of nationalized commercial banks with regard to

the proportion of priority sector. In total NPAs was 53.66 percent in 2006 as against 59.85 per cent in 2011. It even registered 66.80 percent in 2008. The share of non-priority sector was 45.57 percent in 2006 while 39.52 percent in 2011. There is an increasing trend in priority sector whereas declining trend in non-priority sector. The account of public sector was less than one percent except in 2007 and 2009. The pictorial presentation of composition of NPAs in nationalized commercial banks is exhibited in Chart 1.

Chart 2: Composition of NPAs of SBI Group of Banks



Source: Table 4

The composition of the NPAs in SBI group of banks during 2006-11 is presented in Table 4. The NPAs in SBI group of banks stood at Rs. 13,193 crores in 2006 vis-à-vis Rs. 28,140 crores in 2011. The trend of nationalized commercial banks can be observed in the case of SBI group of banks.

The priority sector banks were followed by non-priority sector and public sector banks. The following chart portrays the composition of NPAs of SBI group of Banks during the period.

Table 5 reveals sub-sector-wise NPAs in priority sector and non-priority sectors of PSCBs during 2006-2011. There are three sub-sectors in priority sectors viz., agriculture, micro, and small enterprises. The NPAs of agriculture sector in 2006 were at Rs. 6,506 crores or 16.86 percent while it rose to Rs. 14,487 crores or 20.39 percent in 2011. There were relative ups and downs during the period. The least NPAs in agriculture sector were at 12.96 percent each of 2008 and 2009 against to 20.80 percent in 2007. Micro and small enterprises mounted up Rs. 5,843 crores or 15.14 percent of NPAs in 2006 against to Rs.14,340 crores or 20.18 percent in 2011 with continuous increment during the period except in 2007.

The proportion of NPAs in other sectors is gradually decreased over the period of time from 27.47 percent to 17.48 percent even though there was an augmentation in absolute terms. In case of non-priority sector, the proportion of NPAs in public sector amounted to Rs. 490 crores or 1.27 percent in 2006 vis-à-vis 278 crores or 0.39 percent in 2011 with relative fluctuations. It can be noted that there is a decrease in absolute terms and relative terms of NPAs throughout the study period. It may be summed up that NPAs in agriculture and micro and small enterprises sectors are relatively increasing over the period against to other sub-sectors of priority sector. The NPAs in priority sector have seized more than 55 percent of total NPAs throughout the study period where as a stagnated trend could be identified in non-priority sector with relative swings.

Recovery of NPAs: To solve the problem of NPAs, a combination of channels was introduced.

The percentage of recovery of NPAs through Lok Adalaths was 1.55 percent and 2.87 percent during 2010 and 2011 respectively. The debt recovery tribunals (DRTs) showed a recovery performance of 32 percent and 27.89 percent in the former and later respectively. Under the SARFAESI

Table 5: Composition of NPAs in Sub-sectors of Priority and Non-priority Sectors of PSCBS during 2006-2011

(Rs. crores)

Year	Priority Sector		Of which						Non-priority sector		Of which		Total NPAs
			Agriculture		Micro and small enterprises		Others				Public sector		
	Amount	% to total	Amount	% to total	Amount	% to Total	Amount	% to total	Amount	% to total	Amount		
2006	22,953	59.46	6,506	16.86	5,843	15.14	10,604	27.47	15,648	40.54	490	1.27	38,601
2007	25,287	63.62	8,268	20.80	5,805	14.60	11,214	28.21	14,462	36.38	299	0.75	39,749
2008	24,318	55.21	5,708	12.96	6,984	15.86	11,626	26.40	19,725	44.79	474	1.08	44,043
2009	24,318	55.21	5,708	12.96	6,984	15.86	11,626	26.40	19,725	44.79	474	1.08	44,043
2010	30,848	53.84	8,330	14.54	11,537	20.13	10,981	19.16	26,453	46.16	524	0.91	57,301
2011	41,244	58.05	14,487	20.39	14,340	20.18	12,417	17.48	29,802	41.95	278	0.39	71,046

Source: As in Table 1

Table 6: Channel wise Recovery of NPAs of Public Sector Commercial Banks during 2009-10 and 2010-11

(Rs. crores)

Recovery channel	2009-10				2010-11			
	No. of cases referred	Amount involved	Amount recovered	% of col.4 to col.3	No. of cases referred	Amount involved	Amount recovered	% of col.8 to col.7
1	2	3	4	5	6	7	8	9
Lok Adalaths	7,78,833	7,235	112	1.55	6,16,018	5,254	151	2.87
DRTs	6,019	9,797	3,133	32	12,872	14,092	3,930	27.89
SARFAESI Act	78,366	14,249	4,269	30	11,8642	30,604	11,561	37.78

Source: RBI, Report on Trend and Progress of Banking in India, 2010-11, 2011, Mumbai, p146

Act the percentage of recovery was 30 in 2010 while 37.78 in 2011. The numbers of cases referred to Lok Adalaths have declined remarkably due to their poor performance in the recovery front.

7. Summary and Conclusions

It is observed from that above discussion that there is a decline in the percentage of NPAs to total advances till 2009. The vulnerability of NPAs is highest in priority sector in nationalized banks as well as SBI group followed by non-priority sector and public sector. It may be said that the policy makers should take the due care while sanctioning loans and advances under priority sector. As a public sector commercial bank there is no scope to escape from the social banking in terms of sanctioning loans and advances to the downtrodden and poor in order to uplift

their economic condition. However, bankers should take enough care while sanctioning loans to priority section. Proper awareness to be created among borrows about norms and conditions of loans, repayment terms, rebate or reduction in interest payments for quick repayment of loans etc. The Lok Adalaths and DRTs should function to recover NPAs. The firm commitment, abiding of prudential norms, consciousness of authorities, feeling responsibility etc. at every level of loan process may bring NPAs to minimum level.

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