

Non-Performing Assets in Indian Banking System – A Study With Reference to SBH (Before the Merger)

S. Narasimha Chary*, Mohd Fasi**

Abstract

The Indian banking system is granting the loans to the agricultural, industrial, and service sectors for the economic progress but in return not getting its return in time. Therefore, the loans are being converted into the form of bad loans or nonperforming assets (NPAs). Issuing the loans to their customers is the primary duty of the banks; but, the recovery option is becoming the major hurdle for most of the Indian banks. The banks are facing many problems at the time of recovering the loan; thereby, the loan is becoming bad loans and banks are unable to pursue these loans. The banking sector in India is in a crisis with the increasing burden of bad loans provisioning and the decline in profitability of commercial sector banks, particularly public sector banks. Bankers are the heart and soul of any business. The economy of the country also mostly depends on the functioning of banking institutions. According to the Reserve Bank of India information, the annual growth of Indian bank credit is declining from time to time. It was nearly 30% during the period of 2007. But it reduced to 9.7% in the year 2014–2015. Further, it decreased to 9.4% during the beginning of the financial year 2015–2016. This decline in the credit growth is indicating that the performance of the banks is not smooth. It is being affected by the NPAs.

Keywords: NPA, Banking System, Public Sector Banks

Introduction

A strong banking sector is important for flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. Therefore, the banking system requires the smooth workflow in its financial operations. Though, this system is delivering the strong

base by providing finance to almost all the sectors, it is suffering from a major problem which is known as nonperforming asset (NPA). It is the major concern of Indian banking system because it is affecting the financial performance of banks. It is effecting to the whole banking system in general and public sector banks in particular. The increase in NPAs is directly creating its impact on the financial performance of the banks. The high level of NPAs indicates that defaults are increasing in a large number and affecting the profitability and net worth of the banks. The growth of NPAs is not only the problem of Indian banking system, but it is also one of the major factors in the international market.

The Indian banking system is granting the loans to the agricultural, industrial, and service sectors for the economic progress but in return is not getting its return in time. Therefore, the loans are being converted into the form of bad loans or NPAs. Issuing the loans to their customers is the primary duty of the banks; but, the recovery option is becoming the major hurdle for most of the Indian banks. The banks are facing many problems at the time of recovering the loan; thereby, the loan is getting bad loan and banks are unable to pursue these loans further. The banking sector in India is in a crisis with the increase in the burden of bad loans provisioning and the decline in profitability of commercial sector banks, particularly public sector banks. Bankers are the heart and soul of any business. The economy of the country also mostly depends on the functioning of banking institutions. According to the Reserve Bank of India information, the annual growth of Indian bank credit is declining from time to time. It was nearly 30% during the period of 2007. But it reduced to 9.7% in the year 2014–2015. Further, it decreased to 9.4% during the beginning of the financial year 2015–2016. This decline in the credit growth is indicating that

* Kakatiya University, Telangana, India. Email: snchary@gmail.com

** Assistant Professor, The Crescents College of Business Management, Warangal, Telangana, India.
Email: mohdfasi34892@gmail.com

the performance of the banks is not smooth. It is being affected by the NPAs.

Non-Performing Assets

NPAs are the bad loans of the banking system. These are an asset of the bank that ceased to generate principal and interest amount of the loan. Every bank gives the loans and advances to its customers. If customers or borrowers do not pay the principal or interest amount for a specific period of time, the loan becomes the bad loan. This bad loan in the banking sector is termed as NPAs. The Reserve Bank of India (RBI) has defined the NPAs as the term loans on which interest or instalment of principal amount or both remain overdue for a period of more than 90 days from the end of a particular quarter. Further, the RBI has issued the guidelines on NPAs in the master circular on Income Recognition, Asset Classification, Provisioning, and Other Related Matters. According to it, an account can be declared as the NPAs on the following circumstances.

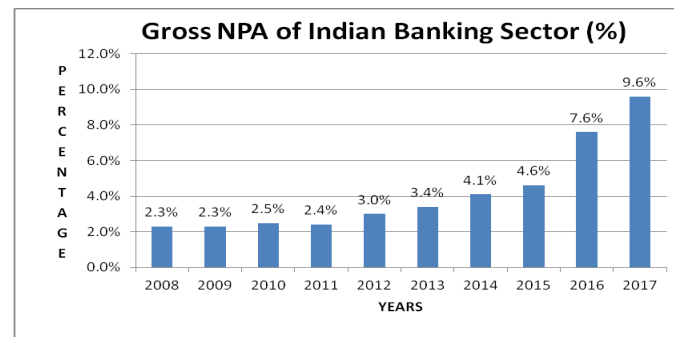
- When an account ceases to generate income or interest for the bank.
- Bank overdraft or cash credit remains overdue continuously for 90 days.
- The bill purchased and/or discounted remains overdue for 90 days.
- The securitization bill remains outstanding for 90 days.
- The derivative transaction remains unpaid for 90 days.
- For agricultural loans, the principal or interest amount remains overdue.
 - For two crops seasons in case of short duration crop loans.
 - For one crop season in case of long duration crop loans.

In all the above situations, the account of the borrower can be considered as NPAs based on the asset classification. In order to learn more about the NPAs, it is important to study the classification of the assets.

Non-Performing Assets in India

In recent years, the gross NPAs of banks have increased from 2.3% of total loans in 2008 to 4.3% in 2015; in

the year 2016, it has increased to 7.6%. Further, in the year 2017, it has jumped to 9.6%. This increase in NPAs may be due to various reasons, including slow growth in domestic market and drop in prices of commodities in the global markets. In addition, exports of products such as steel, textiles, leather, and gems have slowed down.



Source: Press note given by RBI Governor, Raghuram Rajan, *The Hindu* Newspaper

Fig. 1: Gross NPA of Indian Banking Sector¹

The increase in NPAs is affecting the credit market in the country. This is due to the impact that the non-repayment of loans has on the cash flow of banks and the availability of funds with them. Additionally, a rising trend in NPAs may also make banks unwilling to lend. This could be because there are lesser chances of debt recovery due to prevailing market conditions. For example, banks may be unwilling to lend to the steel sector if companies in this sector are making losses and defaulting on current loans. Therefore, the banking sector has to bring some strong reforms in order to recover the bad loans issued in the market.

There are various legislative mechanisms available in India with banks for debt recovery. The first mechanism was created after the economic reforms in India in the year 1993 and given the name as DRT Act, 1993 (Recovery of Debt Due to Banks and Financial Institutions Act). One more mechanism called SARFAESI Act (Securitisation and Reconstruction of Financial Assets and Security Interest Act) was created in the year 2002 to resolve the issues related to NPAs. This mechanism has given some resistance to the banking system; however, it is not sufficient to curb the bad loans. Thereafter, few more mechanisms were established like Debt Recovery

¹ Press note given by RBI Governor, Raghuram Rajan on 28 June, 2016, *The Hindu* Newspaper

Tribunals, Corporate Debt Restructuring and Strategic Debt Restructuring; however, the NPAs are growing all the time. The RBI has to take this up as seriously as possible; otherwise, the banking system has to fetch the consequences related to it.

Review of Literature

An attempt is made to collect the information from the previous researches and relevant studies conducted in the area of influence of NPAs in banking sectors. The review of literature has been presented in a summarized and precise manner.

RBI's Study Team has conducted the research on identifying the percentage to willful defaults of the banks. They have identified that more than 75% of the NPAs are only because of willful defaulters. This is mainly due to the inappropriate lending policies, no power to the branch managers to take strong action against willful defaulters, etc.

The Working Committee (1999) of the central government has concluded that the NPAs are affecting the banking system so adversely. They have suggested that a strong mechanism is required to handle the issue in the serious manner. They have also recommended that the compromising model for the NPAs recovery is the most effective mechanism.

The RBI conducted the study on the NPAs. They stated that the banks have to closely monitor the operations of the bank loans. They have also concluded that the banks have to take severe steps to recover the overdues. It is the responsibility of the bank staff to examine the defaulters and pursue them accordingly. Finally, they have emphasised on the monitoring of large NPA accounts and viewed that it can be reduce through the up-gradation of technology and compromise the settlement option of recovery.

S. Sambasiva Rao (2002) conducted the study on recovery of loans and its mechanism. He suggested that the defaults of bank loans should be treated as criminal offence. Further, the defaulters should be punished severely so that others cannot commit the same error. Finally, he concluded that financial recovery should be made from the possible source in order to recover the loan value.

Avinash V. Raikar (2006) has studied on the issues and problems of co-operative credit institutions. He identified that the major problem of co-operative credit institutions is the high overdues or bad loans as well as low resources of collecting the funds. He concluded that in order to survive the CCIs have to use the modern technologies and try to reduce the burden of overdues.

Lakshmanan, C. and Dharmendran, A. (2007) studied the impact of NPAs on performance variables in Chennai Central Co-operative Bank. They examined performance variables, namely, net profit, investment, legal expenses, and spread. They observed that the results of NPAs on all the above performance variables were negative and insignificant at 5% level in all the equation. They concluded that the effective management of NPAs is essential to strengthen the financial position of the bank.

Jayalakshmi, G. and Sumathy, M. (2009) conducted the study on NPA in Indian co-operative banks. They opined that the NPA can be controlled with the strong management policies and pro-active actions against the defaulters. Further, they have concluded that the bank officials can make the legal procedure at the time of granting the loans to its customers.

Mayilsamy, R. and Revathi Bala, M. (2009) conducted the study on management of NPAs in District Central Co-operative Banks in India. They have emphasised that the report given by the Narasimham Committee, 1998, is rightly highlighting the issue of NPAs. It is one of the economic causes to the nation and it is affecting the nation in terms of decrease in capital and insufficient credit financing.

Pacha Malyadri and S. Sirisha (2011) have conducted the study related to the regulations of the NPAs. They have observed that the banking system in India is recovering some NPAs due to the implementations of CAMEL (Capital Adequacy, Asset Quality, Management Soundness, Earning Capacity, and Liquidity). They have suggested that the government should formulate bank-specific policies to curb the NPAs. Further, the government should implement these policies through the RBI for upliftment of public sector banks.

From the above literature review, it is found that earlier researchers have covered many aspects of impact of NPAs in public sector banks but they have not covered

the statistical information of gross NPA & Net NPAs. Keeping this in view, we have taken up this study.

Need and Importance of the Study

The Indian banking system is working under the four different sectors. They are public sector banks, private sector banks, co-operative banks, and foreign banks. Among these banks, public sector banks are more dominating banks in the Indian economy. They hold nearly 82% of the market share in the form of deposit, loans, and advances. They are contributing directly to the generation of GDP by mobilizing savings and channelizing investments. But after managing every challenge successfully and by giving standard services to the customers, NPAs became the biggest of all challenges to the banking sector and managing NPA is one of the hardest tasks for the banks.

Objectives of the Study

The main objective of the study is to analyse the impact of NPAs on the performance of State Bank of Hyderabad (SBH). The other objectives are as follows:

- To understand the cause and factors responsible for lower profitability and operational efficiency in the public sector banks.

- To assess the standard advances and gross advances of SBH.
- To analyse the Gross NPA and Net NPA's of SBH.

Research Methodology

The present study is done on the financial performance of the SBH before its merger with State Bank of India. The data are collected from RBI publications, annual reports of bank, journals, official records, and other published sources. The collected data are edited, classified, tabulated, analysed, and interpreted. Finally, conclusion is drawn based on the study, and suggestions are offered.

Limitations of the Study

The following are the limitations of the study:

- The study is limited to the SBH of Telangana state.
- The data are related to last 5 years only.
- As the sample is insignificant to the banking sector; therefore, findings cannot be generalised.

Data Analysis and Interpretation

Statement Showing the Balance Sheet of State Bank of Hyderabad from 31st March to 2012 to 31st March 2016

Table 1

(Rupees in Crores)

Particulars	March 2012	March 2013	March 2014	March 2015	March 2016
Equities and Liabilities					
Shareholders Fund					
Equity Share Capital	20.75	20.75	20.75	20.75	20.75
Reserve and Surplus	6476.92	7610.92	8348.68	9575.80	10378.88
A. Total Shareholders Fund	6497.67	7631.67	8369.43	9596.55	10399.63
Other Liabilities					
Deposits	98731.92	113324.26	119509.70	130166.19	137174.06
Borrowings	5978.40	5448.42	6336.39	8502.45	8874.53
Other Liabilities and Provisions	7107.46	9673.71	7273.53	6237.58	8148.55
B. Total Other Liabilities	111817.88	128446.39	133119.62	144906.23	154197.14
Total Capital and Liabilities (A+B)	118315.45	136078.06	141489.05	154502.78	164596.78
ASSETS					
Total Fixed Assets	437.44	472.47	519.90	638.17	685.96
Current Assets					
Cash and Balance with RBI	5737.34	6375.97	6637.59	5791.68	6517.35
Balances with Banks Money	3270.85	1419.60	247.27	1622.50	1307.74
Investment	29241.80	33967.98	34266.96	36491.15	38007.59
Advances	77052.31	89856.51	95653.80	105053.13	111065.35
Other Assets	2575.71	3985.53	4163.53	4906.15	7012.79
D. Total Current Assets	117878.01	135605.59	140969.15	153864.61	163910.82
Total Assets (C+D)	118315.45	136078.06	141489.05	154502.78	164596.78

Source: Compiled from secondary data

Interpretation

As per the above balance sheet of SBH (From March 2012 to March 2016), it is evident that the bank’s borrowings are increasing from time to time. It has increased from 5978.40 crores (in the year 2012) to 8874.53 crores (in

the year 2016). Further, it shows that the provisions of the bank are also increasing. These two aspects have the direct connection with the NPAs. Due to the increase in borrowings and provisions, the public sector banks’ NPAs are growing significantly, which is not the good sign for the banking system in general and Indian economy in particular.

GROSS NPAS

Gross NPA (In Percentage)	=				
$\frac{\text{Gross NPA}}{\text{Gross Advances}} \times 100$					
Gross NPA (In Rupees) = Sub-Standard Assets + Doubtful Assets + Loss Assets					
Gross Advances = Gross NPA + Standard Advances					

Table 2: Statement Showing the Gross NPAs (in figure & percentage) of State Bank of Hyderabad from 31st March 2012 to 31st March 2016

Financial Year	Gross NPA (Rs. in Crores)	Standard Advances (Rs. in Crores)	Gross Advances (Rs. in Crores)	Gross NPA %
2011–2012	2007.36	76405.14	78412.50	2.56
2012–2013	3186.04	66075.70	69261.74	4.60
2013–2014	5824.20	93058.65	98882.85	5.89
2014–2015	4984.77	10,615.88	108600.65	4.59
2015–2016	6590.91	108033.61	114624.52	5.75

Source: Compiled from secondary data

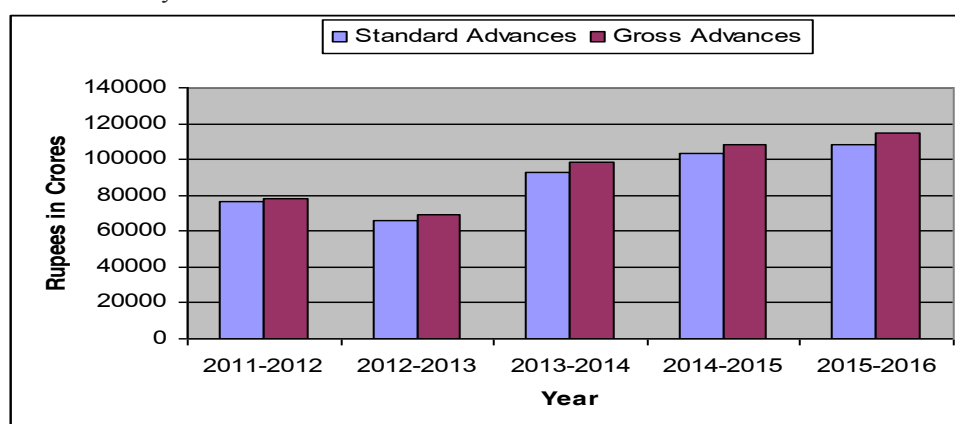


Fig. 2: Showing Standard Advances and Gross Advances of SBH (in Crores)

Interpretation

According to the available data of the table, the standard advances of the SBH have increased from 76405.14 (in the year 2012) to 108033.61 crores (in the year 2016). Further, the gross advances of the SBH have increased

from 78412.50 crores (in the year 2012) to 114624.52 crores (in the year 2016). Due to the increase in the advances, the gross NPA has raised to 2.56% (in the year 2012) to 5.75% (in the year 2016). Within the 5 years, the percentage of gross NPA got doubled.

NET NPAS

	Gross NPA (In Percentage)	=				
$\frac{\text{Gross NPA}}{\text{Gross Advances}} \times 100$						
Net NPA (In Rupees) = Gross NPA – Provisions						
Net Advances = Gross Advances – Provisions						

Table 3: Statement Showing the Gross NPAs & Net NPAs (in figure & percentage) of State Bank of Hyderabad from 31st March 2012 to 31st March 2016

Financial Year	Gross NPA (Rs. in Crores)	Gross Advances	Gross NPA %	Provisions (Rs. in Crores)	Net NPA (Rs. in Crores)	Net Advances (Rs. in Crores)	Net NPA %
2011–2012	2007.36	78412.50	2.56	1005.41	1001.95	77073.08	1.30
2012–2013	3186.04	69261.74	4.6	1737.39	1448.65	89978.26	1.61
2013–2014	5824.2	98882.85	5.89	2839.31	2984.89	95669.55	3.12
2014–2015	4984.77	108600.65	4.59	2636.26	2348.51	104844.20	2.24
2015–2016	6590.91	114624.52	5.75	2847.75	3743.16	111073.00	3.37

Source: Compiled from secondary data

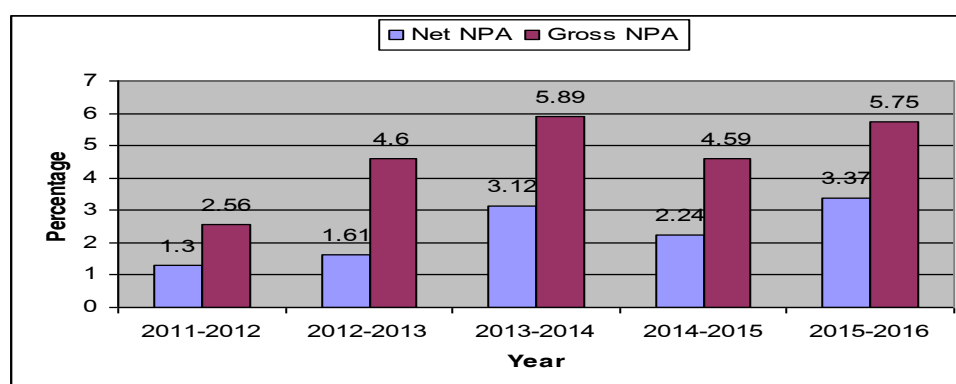


Fig. 3: Showing Net NPAs & Gross NPAs of SBH (in Percentage)

Interpretation

According to the data of the table, the gross NPAs of the SBH have increased from 2.56 to 5.75%. Further, the net NPAs of the bank have increased from 1.30 to 3.37%. Even though both the gross NPAs and net NPAs have decreased in the year 2014–2015, they again came back to the previous place by increasing more than 1% significantly. This analysis is the indication for the public sector banks which are suffering with the drawback of NPAs to take initiative for reducing it.

Conclusion

After analysing the SBH's financial performance in relation to NPAs, we can say that the public sector banks are suffering a lot with the performance barrier called "NPAs". They are unable to bring back the bad loans or the unproductive loans to the banks. The analysis also indicates that the banks allow the advances on a regular basis, but when it comes to the matter of recovering the loan, the banks unable to fulfil their duties. It may be due to the lower power in the hands of bank branches, or may be the transfer of higher authorities from one

branch to another from time to time, or may be due to the negligence, etc., but the overall concept says that NPAs are seriously effecting the banking system, which result in the lower profitability and inconsistency in financial performance of Indian banking system in general and public sector banks in particular.

Recommendations

The NPA is like termite, which eats the whole financial system. If this termite is not controlled, it will be dangerous for the financial system. The government has taken several policy decisions and prepared several strategies to control the high rate of NPAs in the banking sector. But these steps have not created desired effect on the rate of NPAs. Here are some suggestions for reducing NPAs. If these suggestions are implemented effectively, they will be helpful for reducing NPAs with the immediate effect.

- Proper selection of borrower is one of the primary duties of the bank in order to control the loans to turn into bad loans or NPAs.
- After the sanctioning of the loan, the bank should follow-up the borrower regularly.
- Every bank should create one recovery cell to collect the principal amount as well as the interest on loans.
- If the loan is converted into NPA, the bank should publish the name of the defaulter on the local newspaper.
- The bank should assign more power to the branch managers to recover the NPAs.

References

- Gopalakrishnan (1996). Credit and recovery performance of industrial finance under agricultural sector. *Agricultural Banker*, 20(1), 27–31.
- RBI (1999). Some aspects and Issues relating to NPAs in commercial banks. *Reserve Bank of India Bulletin*, 50(3), 913–936.
- Rao, S. S. (2002). A primer for NPA management. *IBA Bulletin*, 24, 623–626.
- Sinha, R. P. (2006). Capital adequacy of Indian commercial banks: Some empirical results. *The ICFAI Journal of Finance Economics*, 4(1), 26–44.
- Raikar, A. V. (2006). Co-operative credit institutions in India: An overview. *Indian Co-operative Review*, 44(1), 1–20.
- RBI Annual currency report. (March 31, 2010). Management of non-performing assets (NPAs).
- Malyadri, P., & Sirisha, S. (2011). A comparative study of non-performing assets in Indian banking industry. *International Journal of Economic Practices and Theories*, 1(2). (October), e-ISSN 2247 – 7225.
- Rajput, N., Kakkar, R., & Kaura, R. (2013). Profitability and credit culture of NPAs: An empirical analysis of PSB's. *Research Journal of Commerce & Behaviour Science*, 2(3). Retrieved from www.theinternational-journal.org
- Srinivas, K. T. (2013). A study on non-performing assets of commercial banks in India. *Abhinav International Monthly Refereed Journal of Research in Management & Technology*, 2. ISSN – 2320-0073.
- Swamy, V. (2013). Determinants of bank asset quality and profitability - An empirical assessment. Retrieved from <http://mpira.ub.uni-muenchen.de/47513>
- Singh, A. (2013). Performance of Non-Performing Assets (NPAs) in Indian commercial banks. *International Journal of Marketing, Financial Services & Management Research*, 2(9). ISSN 2277-3622.
- Gavad-Khompi, S. (2013). A comparative trend analysis of non-performing assets of commercial Banks in India. *Research Directions*, 1(5). ISSN: 2321-5488
- Das, T. (2013). An evaluation of performance of the West Bengal state co-operative bank Ltd. *International Journal of Research in Commerce & Management*, 4.