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NON PERFORMING ASSETS FROM INDIAN PERSPECTIVE

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Abstract

The present study deliberates on the various issues, perspectives and future directions of non-performing assets (NPAs) in Indian Banks. The important aspect of norms and guidelines for making the whole sector vibrant and competitive. The problem of losses and lower profitability of Non-Performing Assets (NPA) and liability mismatch in banks and financial sector depend on how various risks are managed in their business. An attempt is made in the paper that what is NPA? The factors contributing to NPA, the magnitude of NPA, reasons for high NPA and their impact on Indian banking operations. The lasting solution to the problem of NPAs can be achieved only with proper credit assessment and risk management mechanism. It is better to avoid NPAs at the market stage of credit consolidation by putting in place of rigorous and appropriate credit appraisal mechanisms.

Key Words: NPA, Factor Contributing NPA, Magnitude and Consequences, Banking Risks, Indian Banking Industry.

Introduction

The Indian Banking sector underwent significant and radical changes since liberalization movement in 1990's. From a regulated banking system with social and national objectives integrated into operations, banking sector moved to a deregulated regime with increased competitive pressure.

Banking unlike other industries is considered as indispensable element for social and economic development. Research on banking stressed the role of banks in social and development. In India, the objective of banking in post-independence period mainly focused on supporting government to achieve the social and economic agenda. The nationalization of banks in 1969 and regulated banking environment was primarily focused to achieving social and economic development objectives of the government. This was achieved through spreading bank branches, providing employment opportunities, directed lending, regulated interest, etc. Even though banking contributed significantly to support government in achieving its performance objectives, bank's performance was not satisfactory in terms of profitability and quality of assets.

The Narasimham committee report (First report) recommendations are the basis for initiation of the process, which is still continuing, though many of the sick banks are able to come out of the red after repeated doses of fund infusion. But a few of the banks are still in the red and efforts are on to resuscitate them. The bigger challenge at the moment is to deal with the worsening financial health of the banking sector. The important financial institutions like Industrial Finance Corporation of India (IFCI) and Industrial Development Bank of India (IDBI) are also not in the pink of health, which require government support for revitalizing themselves. The important aspect of the banking sector reforms is relating to liberalization of norms and guidelines for making the whole sector vibrant and competitive. This was a gradual process undertaken with utmost care and least it should disrupt the banking sector. Slowly the Reserve Bank of India (RBI) has freed the interest rate, but marginally increased now, both on the d ep o sit and lend ing spectrums a t pre sent. Simultaneously it has relaxed the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) and also unlocking more and more funds in the financial markets. On the deposit side, the bank is free to offer any rate of interest depending upon their asset – liability position. But the RBI regulates the savings rate. Similarly the banks can charge the flexible rate on lending operations depending upon their risk perception. It is futile to say that there are no controls but they are much lesser as compared to the controls that was existed before the initiation of banking reforms. The other vibrant dimension of the banking sector is to reduce the Non – performing assets (NPA). During 1980 to 1996, there was a crisis in the banking sector World over. According to a study 73 percent of the member countries of the International Monetary Fund (IMF) have experienced serious banking problems but most of these member countries are developing nations only. One of the prominent reasons for the crisis is building up of Non - Performing Assets in the banking and financial sector. India has also experienced the problem of raising NPA. Apart from compromise on object credit assessment of borrowers due to political economy considerations.

Banking Risks

The problem of losses or lower profitability of NPAs, assets and liability mismatch in banks and financial sector depend on how the following risks are managed in their businesses. (a) Credit risk (b) Interest rate risk (c) Exchange rate risk (d) Liquidity risk (e) Transfer risk (f) Operational risk (g) Market risk (h) Settlement risk (i) Counter party risk and (j) Country risks.

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According to SARFAESI 2002. NPA is an asset or account of a borrower, which is classified by a bank or financial institution as sub-standard asset, doubtful asset and loss asset .

Indian Banking Industry Saddled with High NPAS

The Reasons: The liberalization policies launched in 1991 opened the doors to the entrepreneurs to setup industries and business, which are largely financed by loans from the Indian banking systems. There is a shakeout with many businesses are failing and loans have become bad. In the global economy prevailing today, the vulnerability of Indian businesses has increased. A culture change is crept in where repayment of bank loans is no longer assured. A constant follow up action and vigil are to be exercised by the operating staff. Diversion of funds and willful default has become more common. As per a study published in the RBI bulletin in July 1999, diversion of funds and willful default are found to be the major contributing factors for NPAs in public and private sector banks. Today, the situation looks optimistic with the industry succeeding in overcoming the hurdles faced earlier. The timely restructuring and rehabilitation measures have helped to overcome setbacks and hiccups without seriously jeopardizing their future. The greater transparency and stricter corporate governance methods have significantly raise the credibility of the corporate sector. The attrition rate in corporate sector has come down. The challenges before the banks in India today are the raising NPAs in the retail sector, propelled by high consumerism and lowering of moral standards.

Objectives

1. To study the trends in Non Performing Assets.
2. To study Non Performing assets from Indian perspective.

Impact of NPAs on Banking Operations

The efficiency of a bank is not reflected only by the size of its balance sheet but also the level of return on its assets. The NPAs do not generate interest income for banks but at the same time banks are required to provide provisions for NPAs from their current profits. The NPAs have deleterious impact on the return on assets in the following way,

1. The interest income of banks will fall and it is to be accounted only on receipt basis.
2. Banks profitability is affected adversely because of the providing of doubtful debts and consequent to writing it off as bad debts.
3. Return on investments (ROI) is reduced.
4. The capital adequacy ratio is disturbed as NPAs are entering into its calculation. C The cost of capital will go up.
5. The assets and liability mismatch will widen.
6. The economic value addition (EVA) by banks gets upset because EVA is equal to the net operating profit minus cost of capital and
7. It limits recycling of the funds.

It is due is due to above factors the public sector banks are faced with bulging NPAs which results in lower income and higher provisioning for doubtful debts and it will make a dent in their profit margin. In this context of crippling effect on banks operation the slew asset quality is placed as one of the most important parameters in the measurement of banks performance under the Camel's supervisory rating system of RBI.

Conclusion

It is needless to mention, that a lasting solution to the problem of NPAs can be achieved only with proper credit assessment and risk management mechanism. In a situation of liquidity overhang, the enthusiasm of the banking system to increase lending may compromise on asset quality, raising concern about their adverse selection and potential danger of addition to the stock of NPAs. It is necessary that the banking system is to be equipped with prudential norms to minimize if not completely to avoid the problem of NPAs. The factors leading to NPAs rests with banks themselves. This will necessitates organizational restructuring, improvement in the managerial efficiency and skill up gradation for proper assessment of credit worthiness It is better to avoid NPAs at the nascent stage of credit consideration by putting in place of rigorous and appropriate credit appraisal mechanisms. Having regard to strong possibilities of NPAs assuming high proportion of total assets, unless the authorities for preventing mounting NPAs thereby eroding the profitability and liquidity of the banks initiate serious corrective action. At the outset NPAs are considered to be gloomy as well as greedy to the Indian economy.

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