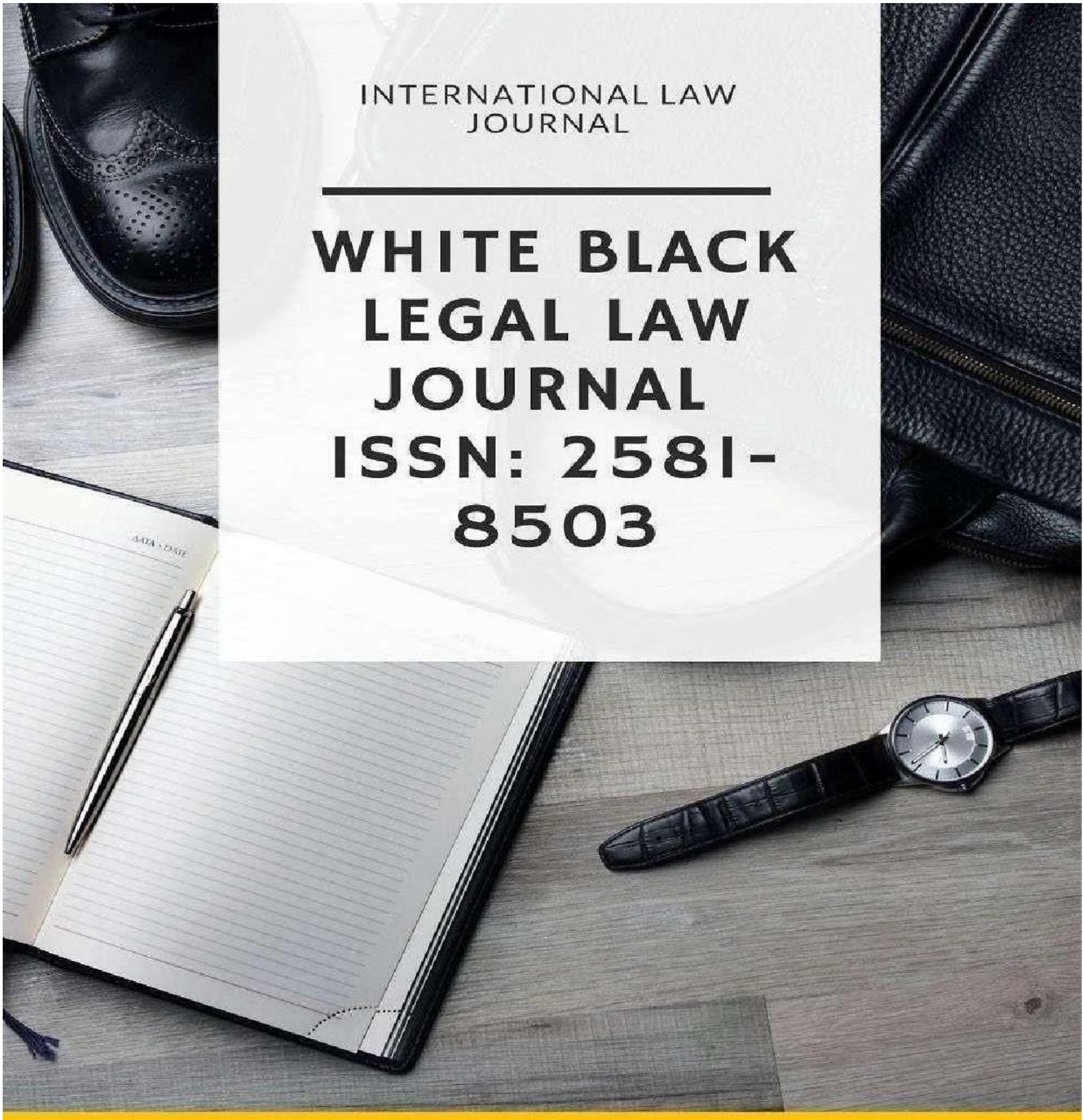

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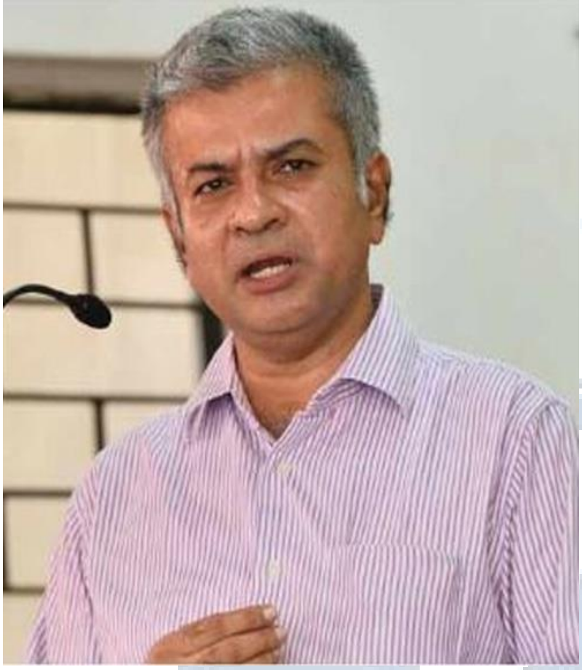

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With this thought, we hereby present to you

Critical Analysis of Problem of Non- Performing Assets in the Indian Banking Industry

AUTHORED BY - SHREYA RAJ &
UJJWAL KUMAR SINGH

ABSTRACT

This paper aims to investigate the most recent trends in Non-Performing Assets (NPAs) within the Indian Banking Industry. However the Non- Performing Assets show the health and the performance of the banks. Analyzing data from the previous ten to fifteen years, the study provides an in-depth interpretation of the growth of NPAs and the resulting financial crisis in the country. The study will also explore the factors contributing to the increase in NPAs and the efforts taken by the Government to mitigate the issue through various legislation, programs and policies.

KEYWORDS

NPA (Non Performing Assets), Health Code System, Poor Credit Appraisal System, Asset Reconstruction Company, Scheduled Commercial Banks (SCBs),

INTRODUCTION

All countries are competing to become the most developed in the world. The stability and growth of the countries economy and finances are key indicators of its progress which is based on the banking system and management of the country but on the other hand the problem of increase in the non performing assets (NPA) is making these indicators less attainable. Reserve Bank of India summarily defines[i] the NPA as credit in respect of which interest and/ or installment of principal has remained 'past due' for a specific period of time and the asset which becomes non performing when it ceases to generate income for the bank. NPA prima facie can be defined as those assets of which interest becomes due for the period more than 90 days which was 180 days prior to March 1995. NPA is a crucial matric in the evaluation of a banks financial performance since it causes the margin to decline and provisioning requirements to rise. Nowadays with recent trends in the mounting level of NPA, it can be seen that economy can be devastatingly affected by whole banking sector whether it's public or private. In the process of granting loans, there is chance of bad loans but matter becomes serious when NPAs start going beyond certain level which causes problem in management of loans and its recovery. NPA highly affects the profitability and economic growth. Earlier, due to social banking structure NPA was not paid much attention but Report of the Committee on the Financial System (Narsimham) 1991 introduced the recommendations for the reforms regarding Non Performing Assets in India.

CHANGE IN CLASSIFICATION OF ASSETS

The nationalization of banks in 1969 was one of the most significant changes to the Indian banking sector that has occurred over the years thereafter banks are controlled and regulated by government. There has been steady increase in borrowings by the private sector from the commercial banks. However, the corporate sector's average net annual borrowings from the commercial banks increase steadily over the course of the period, a little rising from Rs. 5 Crore in 1951-55 which further increased roughly to Rs. 900 crore in 1985-86 to 1987-88 and more than Rs. 2045 crore in 1988-89 to 1990-91[ii]. The government's attention was drawn to the rise in borrowings, leading to the implementation of the Health Code system to monitor and check the loan and asset transactions and manage them effectively. In 1985-86 the Reserve Bank India has introduced a deep analysis for a comprehensive and uniform credit monitoring system through the Health Code System in banks. This system provided information about the health of individual loans, the quality of the credit portfolio, and the extent of loans causing concern in relation to total loans. The Health Code System did assets classification into eight categories viz-a-viz

I. Satisfactory
II. Irregular
III. Sick/ Viable
IV. Sick: Nonviable/ Sticky
V. Advance Recall
VI. Suit filed accounts
VII. Decreed Debt
VIII. Bad & Doubtful Debts

Subsequently, in an order to increase transparency in the loan accounts and to find the actual financial health of the banks on their balance sheets, the Reserve Bank of India introduced practical regulations relating to income recognition, asset classification and provisioning, as recommended by Narsimhan Committee (1991). These regulations were implemented in phased manner over a three year period starting from 1992-93, with certain modifications and amendments. The new regulations provided objective criteria for asset classification, provisioning, and income recognition, which was previously lacking. This change has resulted in a more quantifiable and objective approach to assess non performing assets. Thereafter Narsimhan Committee suggested new assets classification by compressing existing Health Code System into extensive four groups which are as follows:

I. Standard Assets
II. Sub- Standard Assets
III. Doubtful Assets
IV. Loss Assets

The classification system helps to categorized NPA into different stages based on which appropriate actions and measures can be taken. However, no assets are directly labelled as Non Performing Assets, but they are classified based on fulfilling certain criteria which results in them being designated as Non Performing Assets. In the case of *State Bank of India v. Rajesh Agarwa*[iii] Hon'ble Supreme court held that an opportunity of hearing is required to be given to the borrowers before classifying their account as NPA along with that it is statutory mandate under section 13(2) of the SARFAESI Act[iv]to give notice in writing to the borrower to discharge in full his liabilities to the secured creditor within 60 days from the date of notice.

CAUSES OF NPA

The Bank search as a source of capital, and individuals obtain loans from the bank for a variety of purposes. NPA is caused by number of factors which are as follows:

1. Credit Bloom - During the phase of globalization that began post 1991, businesses in every sector were attempting to establish their positions and secure funding. During this time, bulk loans were granted. From 1996 to 2005[v], both priority and non priority sectors received substantial loans, which ultimately lead to wide spread Non Performing Assets issues.
2. Tightened Monetary Policy – At that time, reserve Bank of India implemented strict monetary policies in the country by raising the repo rate and reverse repo rates. Despite of all these measures taken, the number of non performing assets continued to rise .
3. Poor monitoring of borrowing – After sanctioning the loan, Bank doesn't monitor the borrowers' account, and due poor follow up and supervision[vi]also lead to contribution in raising of NPAs. Additionally the slow and insufficient allocation of finances and their distribution have resulted in borrowing units being deprived of necessary funds
4. Intentional Defaults - It has been noticed that borders have sufficient ability to repay the loans but abstain themselves from repaying intentionally. It is crucial to identify these individuals and implement effective strategies to recover the loan amounts which have been lent to them.
5. Poor Credit Appraisal System – A lot of time due to the carelessness, bank gives the loan to those people who can't pay back to the bank. So one of the reasons for increase in NPAs is the insufficient credit appraisal process.

6. Accumulation of NPAs in the banking sector can be attributed to several key factors, including recession- induced price escalation, changes in government policies, power shortages and the lack of strict enforcement of laws for willful defaulters. This factors play a significant role in the growth of NPAs is in banking sector[vii].
7. Weak Legal System – A robust legal framework is an essential component of effective governance of individuals and societies. It is widely regarded as cornerstone of functioning country's legal and organised system, safeguarding individual rights and resolving conflicts. And due to the weak Legal System for recovery of NPA contributed huge accumulation of NPAs in banking sector.

RECOVERY MECHANISM

Prior to 1993, recovery of loan amount was done by issuing notice, filing recovery suit before court of law and so on and as we all know Indian Judiciary had been overburdening with the pendency of cases, meanwhile civil suits and recovery suits were among them, due to which recovery was very tiresome and cumbersome process as well as time taken. Somehow banks were failing to recover it's principal as well as interest and it was leading to contribution in rising of the NPAs. Subsequently Government felt this issue as a burning problem and constituted the committee under the chairmanship of the Late Shri Tiwari in the year 1981 for recommending the solutions for the same. Thereafter the committee studies the whole system and situation regarding the loan and its recovery problem. The committee recommended the some legal reforms like establishment of Special Tribunal to deal with the problem of recovery process.

Later on, in the year 1991 another committee was constituted by Government of India that was Narasimham Committee under chairmanship of Sri. M. Narasimham former Governor of Reserve Bank of India, which suggested the setting up of the Asset Reconstruction Fund for taking the NPAs from the banks and financial institutions and sell them out and satisfy the loan money. Therefore many Debt Recovery Tribunals and Asset Reconstruction Companies were established in various part of countries. Debts Recovery Tribunals (DRTs) and Debt Recovery Appellate Tribunals (DRATs) are established under the provisions of Recovery of Debts and Bankruptcy Act, 1993 which aims to expedite the adjudication and recovery process of Debts due to Borrowers. But speedy adjudication of matters were not able to be achieved as it was expected because process was time consuming. And DRTs had to face various obstacles while discharging its performance by the virtue of provisions like sections 22 and 4 of Sick Industrial Companies (Special Provisions) Act (SICA) 1985[viii], however speedy recovery of debt remains the major problem of banking sector.

Therefore, Umerjee committee under the chairmanship of Former Retired Executive Director of RBI framed the law and parliament enacted the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) 2002 where banks and financial institutions are empowered with inherent power to take action against default borrower without intervention of court. It's the strengthening legislation for the banks and financial institutions for debt recovery. Under this Act, if borrower fails in repay the secured debt or any instalment, secured creditor shall serve the notice regarding failing to repay the instalment. The borrower would communicate with secured creditor about discharging its liabilities within 60 days from the date of notice otherwise secured creditor may exercise all its rights under SARFAESI Act for recovering its debt. As per section 4 of the SARFAESI Act 2002, after 60 days from the date of notice, if borrower fails to discharge its liabilities, secured creditor may take one or more of the following actions[ix]:

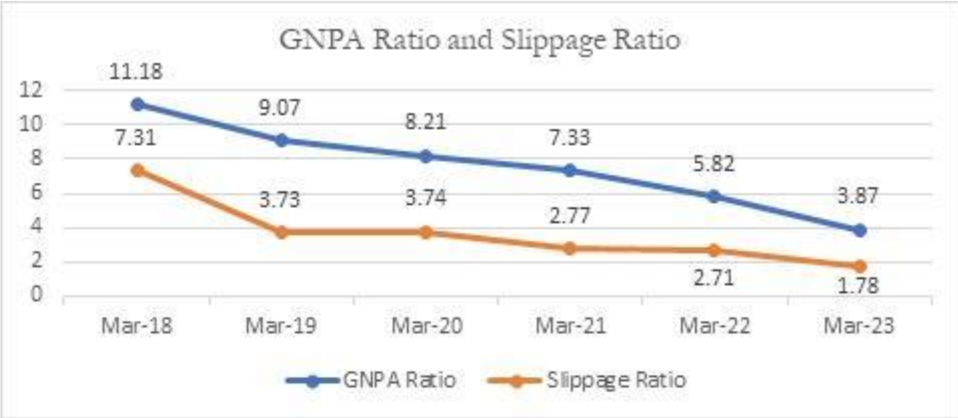
- Possession of the secured assets can be taken by the secured creditors;
- The management of the business can be taken by the secured creditors;
- Any person can be appointed to manage the secured assets;
- A person, from whom any money is due or may become due to the borrower, may be required to pay the debt to the creditor.

Through this way , currently banks and financial institutions are recovering the debt from the borrowers. Additionally, there are various criticism against this Act regarding violation of rights of borrowers. It is considered to be stringent law by some scholars too.

TRENDS IN NON PERFORMING ASSETS AND ITS INTERPRETATION

The problem of NPA has been the constant challenge before the government and banks. There has been many legislations enacted for tackling the problem recovery of bad debts. Because of social banking motto, Indian Commercial Banks have been getting into the issue of increase in NPA. In the year 2018, the Government of India and Public Sector Banks jointly took the reformative step by launching Agenda for Enhanced Access & Service Excellence (EASE) to check the efficiency and performance of public sector banks. It aims to focus on risk assessment, NPA management, financial inclusions, customer service etc. . Through this paper recent trend of NPAs in last five years from 2018-2024 would be analyzed and interpreted in context of performance and efficiency of initiative launched in 2018 Agenda EASE.

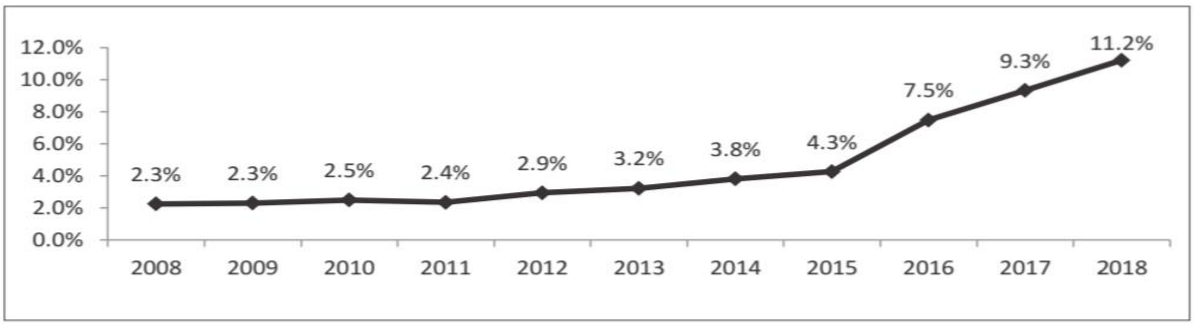
Fig 1: Non Performing Assets in Scheduled Commercial Banks (SCBs)



Source: published by Press Information Bureau (PIB)[x]

As from the above chart, we can analyse that the ratio of gross non performing assets has been declining from 11.8 in 2018 to 9.07 in 2019, similarly this declining trend has been followed in the year 2020 , 2021, 2022 and 2023 to 8.21, 7.33, 5.82 and 3.87 respectively. As per the report by Press Information Bureau (PIB) nodal agency of Govt of India, Gross NPAs of Schedule Commercial Banks (SCBs) have decreased from Rs. 9,33,779 crore and a gross NPA ratio of 9.07% as of March 31st, 2019 to Rs. 5,71,515 crores and a gross NPA ratio of 3.87% as of March 31st, 2023. Moreover, the fresh slippage for SCBs has decreased from Rs. 3,01,795 crores and a slippage ratio of 3.73% during the financial year 2018-19 to Rs. 2,13,368 crores and a slippage ratio of 1.78% during the FY 2022-23. As we can say that GNPA and NNPA have decreased from 11.5% and 6.1% in March 2018 to 3.9% and 1.0% in March 2023 respectively. Through different comprehensive measures have been taken for recovering the bad debts like in last five financial years 2018-23, Rs. 1,51,428 crores have been recovered by SCBs through SARFAESI Act, 2002 and an amount of Rs. 72,708 crores have been recovered by SCBs through Debt Recovery Tribunal. It has been possible because of initiation of Agenda EASE which helps in NPAs management, stressed assets reduction.

Fig 2: GNPA Ratio of all Scheduled Commercial Bank[xi]



Source: dbie.rbi.org.in

If we see the trend of last ten years of the. We find the two bifurcation in the phase of NPA, first before March 2018 and post 2018. From the above chart, it is reported that the accumulation of NPA had been increasing continuous for the last years 2008-2018 from 2.3% to 11.2% in 2018, it shows how bad situation was prevailing, efficiency and performance of SCBs was highly disappointed.

CONCLUSION

It can be concluded from this paper that prior to 2018, the issue of Non Performing Assets (NPAs) was a major contributor to financial crises and even today it is the problem. However, the government of India took a significant and noteworthy step with the introduction of Agenda EASE, which has proven to be drastic game changer in reducing NPAs. The EASE initiative was designed to improve risk management, better manage NPAs, deepen financial inclusion, enhance customer service, initiate digital transformation, increase retail and MSME Credit off -take, develop analytical capabilities, transform human resources and strengthen governance. Additionally enactment of Insolvency & Bankruptcy Code 2016 has also provided comprehensive and time bound framework for resolution of NPAs in the banking sector. The banks would have to be very vigilant in granting the loans to the customer on the basis of then repayment capabilities. India banks need to upgrade its assets management, technology up gradation.

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