An Analysis of Non-Performing Assets in Indian Banking Industry: The Tide is Shifting?

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ABSTRACT
The crest of Non-Performing Assets sweeping the Indian Banking sector posed a crisis of sorts. Though the banking sector is no stranger to NPAs but the ensuing globalization coupled with the Damocles sword of Basel Norms made it more severe than it looked especially with the onset of new millennium. The acceptance of a new robust mechanism to make the banking sector less prone to the cruel twist and turns of a market driven economy made it inevitable for the sector to first prune the weak links. The stakeholders took the challenge in tandem with the regulators as well as the Government to check the downturn of assets. However, the immediate outcome was not encouraging. Insolvency and Bankruptcy Code (2016) and Bad Bank with a different nomenclature were introduced through legislative efforts. Though they were new concept for India, it will be too early to predict about success or failure of these new initiatives. The research paper focuses on the concept of the bad debts, its origin and remedies in the context of Indian banking system. The paper co-relates the resolution of bad debts with the growth of Indian economy.

Keywords: NPAs, Resolution of Bad debts, Indian Banking Industry, Indian Economy

1. INTRODUCTION:

In recent times, Indian banking industry has faced torrid times owing to soaring Non Performing Assets (NPA). The quantum of NPA jumped from industry average of 3% -4% of advances to almost 20% - 25% thus triggering an eventual panic.

The accumulation of huge Non Performing Assets in banks has severely dented the capital base of the banks. The severity of bad debts was first realized only in early 90s when post liberalization reforms were initiated. The magnitude of gross NPAs in banks and financial institutions is presently over Rs.7.43 lakh Crores(Mar, 2022) which comes to around 5.8% of gross advances. It has also become evident that the major defaulters are the big ticket borrowers. The banks and financial institutions have continuously resorted to reduce NPAs in a time bound strategic approach.

2. OBJECTIVE:

1. To study about Non Performing Assets and relevant regulations
2. To evaluate the impact of the various measure on resolution of bad debts of banks.

3. RESEARCH METHODOLOGY:

1. Usage of Scientific method and descriptive method for analysis
2. Usage of Secondary data.

4. AN INTRODUCTION TO NON PERFORMING ASSETS(NPA)

In line with international practices, RBI introduced a system of income recognition, asset classification (IRAC) and provisioning norms from 1993 onwards based on the findings / recommendations of Narasimhan Committee. The IRAC norms and provision requirement on various categories of advances have undergone periodic changes since then. The gist of the said norms is reproduced below:

4.1 Definition of an NPA:-

An asset becomes non-performing when it ceases to generate income to the Bank. A nonperforming asset (NPA) is defined as a credit facility in respect of which the interest and / or instalments of principal has remained ‘overdue’ for a ‘specified period’ of time.

The concept of ‘specified period’ is reduced in a phased manner. The shortening of the period is from 4 quarters in 1993 when the concept of IRAC norms was first introduced in India to **present level of 90 days**.

4.2 Asset Classification-

Substandard Asset: Substandard asset is one which has remained NPA for a period less than or equal to 12 months. Its Asset Code is 20.

Doubtful Asset: It consists of 3 stages - Doubtful I, Doubtful II and Doubtful III. The provision requirement in each stage of Doubtful asset will be as under:

1. **Doubtful I (Code 31)** – Assets remaining for a period of 12 months in Doubtful category – provision requirement shall be 50% of RVS + 100% of shortfall in security (i.e. NPAs over 12 months upto 24 months)
2. **Doubtful II (Code 32)** – Assets remaining for a period of further 24 months in Doubtful category – provision requirement shall be 60% of RVS + 100% of shortfall in security (i.e. NPAs over 24 months upto 48 months)
3. **Doubtful III (Code 33)** – Assets remaining for more than 3 years in Doubtful category and require a provision of 100%.

Loss Assets – Code 40

A loss asset is one where loss has been identified by Bank or internal or external creditors or RBI inspectors but the amount has not been fully written off.

5. FACTORS RESPONSIBLE FOR NPAs:

Though the factors which contribute towards piling of NPAs are many, some major factors are as follows:

1. Diversion of funds for expansion/modernization/setting up new projects/helping promoting sister concerns.
2. Time/cost overrun while implementing projects.
3. External factors like raw-material shortage, raw-material/Input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accident etc.
4. Business failure like product failing to capture market, inefficient management, strike/strained labour relations, wrong technology, technical problem, etc.
5. Failure, non-payment/over dues in other countries, recession in other countries, externalization problems, adverse exchange rate, etc.
6. Abrupt change in Government policies like excise, import duty changes, deregulation, pollution control orders, etc.

7. Wilful default, siphoning of funds, fraud, misappropriation, promoters/management disputes etc.

Besides these, factors like deficiencies in credit appraisal, monitoring and follow-up; operational delay in release of limits; delay in settlement of payments/subsidies by Government bodies, etc. also contribute towards incidence of NPAs.

6. REASONS FOR GROWING NPAs IN THE CURRENT PERSPECTIVE

The soaring NPAs in recent times can be attributed to the affects of the global recession coupled with internal factors like the slowdown in the domestic economy which had adversely affected the performance of corporate as well as small and medium enterprises leading to a negative impact on credit quality.

Another reason for sudden rise in NPAs was reported to be on account of a shift to system based recognition of NPAs from a manual one. The RBI in its Financial Stability Report, December 2013 has indentified five sectors - Infrastructure, Iron and Steel, Textiles, Aviation, and Mining - as the stressed sectors. PSBs have high exposures to the 'industry' sector in general and to such 'stressed' sectors in particular. Increase in NPAs of banks is mainly accounted for by switchover to system-based identification of NPAs by PSBs, slowdown of economic growth, and aggressive lending by banks in the past, especially during good times. As PSBs dominate the Indian Banking Sector and increase in the NPAs of PSBs is matter of concerns, steps were taken to improve the situation.

7. IMPLICATIONS OF NPAs

For an Economy: The stability of financial system of a nation is wholly dependent on healthy development of financial institutions especially banks. The incredibly high level of NPAs in financial institutions has been a matter of grave concern as bank credit is the catalyst to the economic growth of the nation and any bottleneck in its smooth flow , one cause for which is the mounting NPAs, is bound to have adverse repercussions on the economy. It disturbs the cycle of lending-repaying-borrowing thus driving the fund out of the financial system and leads to a situation where banks are reluctant to lend fresh funds to new projects or the on-going projects thus choking the system. Once the credit to various sectors of the economy trickles down, the economy is deeply hurt. The growth in GDP, Industrial output etc along with fall in profit margins instigates depression in the market.

For Banking: The malaise of NPAs put other important functions of banking in the backburner. Recovery mechanism takes priority over other aspects and most important , business expansion is halted. High level of provisioning, lower interest income put burden on profitability as well as capital adequacy. NPAs, in short, throws a spanner in the regular functioning of banks and open a vicious cycle on the sustainability and growth of the banking system, which if ill managed may lead to failure of financial system.

8.1 BRIEF HISTORY OF DEBT RECOVERY MECHANISM

In 60's and 70s, the soaring NPAs led to passage of Sick Industrial Companies Act, 1985(SICA). With the establishment of Board for Industrial and Financial Reconstruction (BIFR), the insolvency and bankruptcy matters were relocated away from High Courts. The 90's pushed both, the Government as well as the RBI into action. While the government passed the Recovery of Debts due to Banks and Financial Institutions Act. 1993 (RDDBFI) wherein, Debt Recovery Tribunals (DRTs) were set up. Though it started fine, but soon got blogged up by pending cases which led to government legislating

Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002(SARFAESI) to ease the pressure.

Supporting government gestures, RBI also stepped up its efforts to cleanse the system of bad debts. The Corporate Debt Restructuring (CDR) mechanism was placed in august 2001 establishing a Framework for a resolution which was normally reserved for an insolvency and bankruptcy law. Like other laws/regulations, this scheme was also misused mainly for recognition of NPAs rather than using it for their resolution. Sensing it had enough; RBI withdrew the forbearance on asset classification w.e.f 1 April 2015. However, it allowed asset classification b0enefits for certain types of restructuring schemes. Consequently, the lenders have primarily been exercising the following options:

1. Resolution through various re-structuring mechanisms like Framework for Revitalizing Distressed Assets - January 2014, 5:25 Scheme for Infrastructure Projects - July 2014, Framework on Fraud Detection and Reporting - May 2015, Strategic Debt Restructuring (SDR) Scheme – June 2015, Scheme for Sustainable Structuring of Stressed Assets (S4A) – June 2016 which can be undertaken as per defined RBI guidelines
2. Initiate recovery proceedings in the case of NPAs under the extant legal framework, primarily through Lok Adalats, Debt Recovery Tribunals \(DRTs) and enforcing security interest under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)
3. Assignment of debt to asset reconstruction companies (ARCs).

8.2 RECENT INITIATIVES TAKEN BY THE GOVERNMENT

Apart from routine initiative like bolstering the extant debt recovery management systems in the financial Institutions, Some recent initiatives taken by the government to address the rising NPAs include:-

1. Insolvency and Bankruptcy Code (2016): When compared with the different measures taken in the past to rejuvenate stressed assets, IBC truly stands out as the trumpeted King for its wide-ranging influence on the lending and borrowing practices in India. It is also proving to remarkable way forward in ensuring the confidence of investors in the Indian capital markets. Since the inception of IBC, a total of 5258 cases (termed as Corporate Insolvency Resolution Process – CIRPs) have been commenced by the end of June, 2022, as highlighted by the data from IBC Quarterly Newsletters.

Year / Quarter	**CIRPs at the beginning of the Period**	**Admitted**	**Closure by**				**CIRPs at the end of the Period**
			Appeal/Review / Settled	***Withdrawal under Section 12A***	***Approval of Resolution Plan***	***Commencement of Liquidation***	
016 - 17	0	37	1	0	0	0	36
2017 - 18	36	707	94	0	19	91	539
2018 - 19	539	1157	154	97	77	305	1063

2019 - 20	1063	1989	345	217	136	541	1813
2020 - 21	1813	536	87	160	122	350	1630
2021-22	1630	878	69	143	140	333	1823
Apr-Jun, 2022	1823	332	24	26	23	83	1999
Total	**NA**	**5258**	**731**	**586**	**480**	**1609**	**1852**

Out of 5258, 731 have been closed; 586 have been withdrawn; 1609 have ended in orders for liquidation and 480 have ended in approval of resolution plans as of June, 2022.

2. National Asset Reconstruction Company Limited (NARCL) – India's Bad Bank, or India's first, one-of-its kind bank for managing NPAs was introduced in the wake of the financial challenges created by COVID-19. The National Asset Reconstruction Company Limited (NARCL), a unique strategic initiative backed by the Government of India, was proposed as a solution for bad debt management. The NARCL will work on ARC-AMC structure to resolve legacy NPAs through aggregation of debt in ARC coupled with a resolution strategy. The structure provides a very promising proposition for the entire Indian banking system, which would benefit in two ways – first, by selling their stressed assets and second, by investing in NARCL and potentially earning returns through better recoveries from aggregation and turnaround of assets.

9. Analysis of Data and Findings

Year	Gross NPA(Amt in Rs Crore)	Net NPA(amt in Rs. Crore)	NPA as percent of Gross advances	NPA as percent of Net advances
2011	97900	41700	2.5	1.1
2012	142300	64900	3.1	1.4
2013	194100	98700	3.2	1.7
2014	264400	142600	3.8	2.1
2015	323300	175400	4.3	2.4
2016	611900	349800	7.5	4.4
2017	791800	433100	9.3	5.3
2018	1039700	520700	11.2	6
2019	936474	355068	9.1	3.7
2020	899803	289531	8.2	2.8
2021	835138	258050	7.3	2.4
2022	743653	204226	5.8	1.7

Table 2.1.NPA of Scheduled Commercial Banks vis-à-vis total advances year wise

FY/CHANNELS	LokAdalat	DRT	SARFAESI	IBC
2010-11	3.70	27.60	37.90	NA
2011-12	11.80	17.00	28.60	NA
2012-13	6.10	14.00	27.10	NA
2013-14	6.20	9.51	26.59	NA
2014-15	3.18	6.97	16.33	NA
2015-16	4.40	9.20	16.50	NA
2016-17	6.30	10.20	18.30	NA
2017-18	4.00	5.40	32.00	49.60
2018-19	5.10	3.90	15.00	45.70
2019-20	6.20	4.90	17.40	46.30
2020-21	4.00	3.60	41.00	20.20
2021-22	2.30	25.70	22.50	23.80

Table 2.2

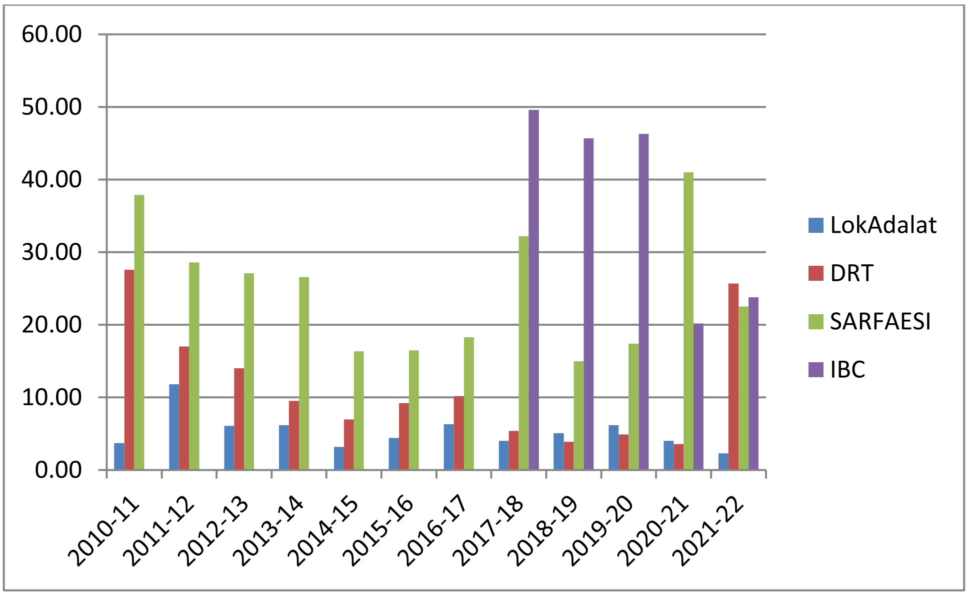

Table 2.3

findings of the study:

Year wise Recovery Percentage of SCBs through Various channels Major

The following are the major observations of this research:

1. The result of the table 2.1 & 2.2 revealed that percentage of NPAs recovered in SCBs through SARFAESI Act 2002 has maintained a steady streak in past 12 years and at the same time recovered more than any other channel.
2. IBC (2016) did perform well in patches but mainly concerned with big ticket NPAs.

10. CONCLUSION:

A strong and healthy banking sector is important for a developing economy. The failure to cure the financial system of the malaises like NPAs will doom other sectors too thus making it imperative that financial stress is identified early and through prompt corrective action , it is nipped in the bud. The ray of hope has emerged and a recent study points towards decline in NPAs putting it as low as sub 4% by FY 2024.

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