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Non performing assets of NBFI'S in India

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Abstract

This paper focuses on the non-Performing assets of NBFI's in India. The reasons, problems and impact of NPAs have been given due importance. An asset is classified as Non-performing Asset (NPA) if dues in the form of principal and interests are not paid by the borrower for a period of 90 days. Non-performing asset is a term very frequently used by lending institutions. The reasons for NPAs may be wrong selection of borrower, non scrutiny of units, delay in sanction of loans etc. Due to several steps taken by the RBI, NPAs have reduced considerably. Foreign experiences must also be used along with a clear understanding of the local conditions to create a tailor- made solution which is transparent and fair to all stakeholders. Though NPAs have been reduced to some extent, it should be kept in mind that it will not raise further in the future.

Keywords: Asset; Impact; Loans; NBFIs; Non-performing assets; Recovery.

Introduction

Financial institutions have conventionally been the major source of long-term funds for the economy in line with the development objective of the state. Financial institutions can be broadly categorized as all- India or state-level institutions depending on the geographical coverage of their operations. Based on their functions, all-India financial institutions (AIFIs) can be classified as [i] Term-lending institutions which extend long-term finance to different industrial sectors e.g.: IFCI Ltd., Industrial Investment Bank of India (IIBI) Ltd., Infrastructure Development Finance Company (IDFC) Ltd., Export-Import Bank of India (EXIM Bank) and Tourism Finance Corporation of India (TFCI) Ltd.; [ii] Refinance institutions which extend refinance to banking as well as nonbanking financial intermediaries for lending to agriculture, small scale industries (SSIs) and housing sectors, respectively; e.g. National Bank for Agriculture and Rural development (NABARD), Small Industries Development Bank of India (SIDBI) and National Housing Bank (NHB)] [iii] Investment institutions which deploy their assets largely in marketable securities. State/ regional level institutions are a distinct group and comprise various State Financial Corporation's (SFCs), State Industrial and Development Corporations (SIDCs) and North Eastern Development Finance Corporation (NEDFi) Ltd., Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC) and its erstwhile subsidiaries.

Non-performing asset is the term very frequently used by lending institutions. Lend – Lease companies and others for the defaulter's assets, Which were originally pledged to lenders at the time of grant of loans. The borrowers who continue to pay their interests and installments have also pledged some property, machines, etc to lenders, but their assets are performing assets, in as much as that they continue to honour the commitments to lenders. On the other hand, the borrowers whose loans have gone sore and

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have become defaulters, their assets are non performing. Lenders may solicit valuer's services to ascertain what price or value these assets will fetch if sold in the open markets.

Meaning of NPAS

An asset was earlier classified as Non-performing Asset (NPA) if dues in the form of principal and interests not paid by the borrower for a period of 180 days. However, with effect from March 2004, default status would be given to a borrower if dues are not paid for 90 days. If any advance or credit facilities granted by banks to a borrower become non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status.

Term loan

Interest or installment of the principal remains due for two quarters or more.

Cash credit or OD

It remains out of order for a period of two quarters.

Bills purchased and discounted

If the bill remains overdue for a period of two quarters it will be considered as NPA.

Agricultural advances

Interest installment of the principal remains unpaid for a period of two quarters.

Advances against term deposit & NSFCS Advances

Advance against securities such as national savings and term deposits. Until the outstanding debt is covered by the realizable value of the securities, the account may continue to be treated as standard assets even if overdue for quarters.

Computation of NPAS

It is generally expressed in the percentage form as

NPAs = Gross or Net NPAs / Total or Net advances X 100

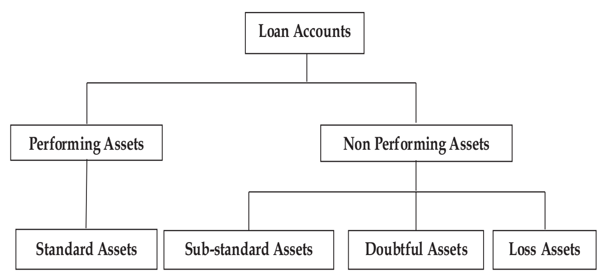
Where, net NPAs = Gross NPAs less provision for NPAs.

Objectives

1. To study the non-performing assets or NPAs in NBFIs

2. To find out the reasons for the NPAs and its impact on the economy

Classification of Loan Assets



Advances given by banks can be classified into four groups.

1. Standard Assets

It does not create any problem while paying interest/installments of the principal. It usually carries more than normal risk attached to the business.

2. Sub-standard Assets

It is treated as NPA for a period exceeding two years. However, this period was reduced to 18 months with effect from 31.03.2001.

3. Doubtful Assets

These assets are those which have remained NPA for a period exceeding two years. This period of two years was reduced to 18 months by March 31, 2001. These assets are so weak that their collection or liquidation in full is considered highly improbable in order to arrive at the amount of provision to be made against doubtful assets, unsecured portions and the secured portions of these assets.

4. Loss Assets

A loss asset is one which has been identified by the bank or internal or external auditors or the RBI inspectors, but the amount has been written off wholly or partly. Non-performing assets play an important role in financial sector, where the NPAs assume a large portion if an asset is classified as a loss of recoverability.

Reasons for Growing NPAS

1. Expansion of business and Diversification of funds.

2. Time overruns during implementation.

3. Improper selection of the borrowers, inadequacy of capacity and capital of the borrowers.

4. Deficiencies in approval, processing, sanction and disbursements.

5. Inadequate sanction of the limit of economic size of the unit.

6. Unrealistic condition of sanctions and fixing unrealistic repayment settlement.

7. Political interference.

8. Lack of infrastructural facilities of units like raw material, power, transportation, marketing and technical support.

9. Lack of inter bank co-ordination as well as co-operation with financial institution in exchanging information.

10. Changes in Government policies like import duties.

Basis For An Account Becoming NPA

From the borrower part

- Failure to bring in requisite capital.
- Too ambitious project.
- Longer gestation period.
- Unnecessary expenses.
- Over trading.
- Imbalances of inventories.
- Lack of proper planning.
- Reliance on single customers.
- Lack of expertise.

From the bank part

- Incorrect selection of borrower.
- Poor credit evaluation.
- Unhelpful in supervision.
- Tough stand on issues.
- Too rigid attitude.
- Systems congested.
- Non scrutiny of units.
- Lack of motivation.
- Delay in sanction.

Other causes

- Lack of infrastructure.
- Increase in material cost.
- Fast changing technology.
- Government policies and taxation
- Unhelpful attitude of the government.
- Laws.
- Changes in consumer preferences.
- Credit policies.
- Civil commotion.
- Legal obstruction and time consuming nature of asset disposal process.
- Manipulation by the debtors using political influence has been cause for industrial bad debt being so high.
- Political tool – directed credit to SSI and rural sectors.

Impact of NPAS

NPAs reduce the earning capacity of assets and badly affect the return on assets. Creating higher provisions adversely affect the capital adequacy and affect the profitability of banks. If NPAS are considered for computing total advances, an average income asset shows lower balance than actual balances. While calculating the return on total assets, return on equity and capital adequacy ratios the NPAS are considered. The cost of capital will be increased due to NPAs and require economic value to be added. It decreases the value of shares some times even below their book value in the capital market.

Problems due to NPAs

1. Recession in the economy.

2. Downturn in most of the segments.

3. Fresh addition of NPAs every year.

4. Tightening of income recognition and asset classification norms by RBI.

5. Slow progress in legal course of action for recovery through civil & other legal forum/ machineries.

NBFI's non -performing assets

Non-Banking Financial Institutions (NBFIs) supplement the efforts of scheduled commercial banks in credit delivery and financial intermediation. Given their growing inter-linkages with the banking sector, financial soundness of NBFIs assumes considerable importance to ensure overall financial stability.

Apart from commercial banks and cooperative credit institutions (urban and rural), the financial system in India consists of a wide variety of NBFIs, such as Non-Bank Financial Companies (NBFCs), financial institutions and primary dealers. NBFIs form a diverse group not only in terms of size and nature of incorporation, but also in terms of their functioning. In addition to enhancing competition in the financial system, these institutions play a crucial role in broadening the access of financial services to the population at large. With the growing importance assigned to the objectives of financial penetration and financial inclusion, NBFIs are being regarded as important financial intermediaries, particularly for the small scale and retail sectors. Table 1 shows the amount of NPAs during 2005-06 to 2009-10.

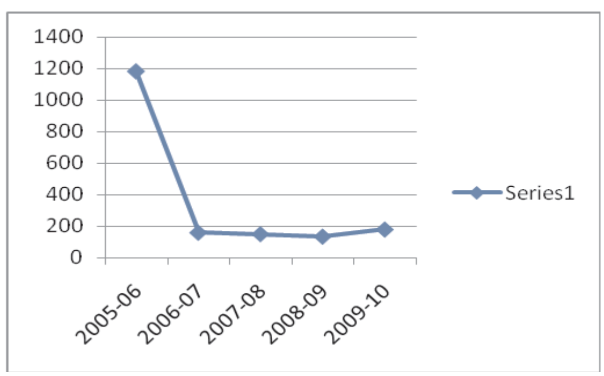
Table 1. Non performing assets of NBFIs from 2005-06 to 2009-10

(Rs. in crores)

Year	Amount of NPAs	Net NPA % (Net NPA/Net advances)
2005-06	1180	27.7
2006-07	160	0.68
2007-08	151	0.56
2008-09	135	nil
2009-10	180	nil
Total	**1806**	

Table 1 shows the amount of NPAs for five years from 2005-06 to 2009-10. It was very high during 2005-06 and it reduced to a great extent in the following years. The percentage of net NPA was very high in the year 2005-06. The following chart shows the amount of NPAs during the period of study.

Chart 1. NPA of NBFIs



Asset classification of NBFIs

The NPAs are classified into Standard Assets, Sub-standard Assets, Doubtful Assets and Loss Assets. Table 2 shows the details for the study period.

Table 2. Classification of assets of NBFIs from 2005-06 to 2009-10

(Rs. in crores)

Year	Standard assets	Sub-standard assets	Doubtful assets	Loss assets
2005-06	1,13,077	174	1006	0
2006-07	1,26,297	143	17	0
2007-08	1,50,425	67	84	0
2008-09	1,80,605	51	85	0
2009-10	2,16,583	120	56	0

From Table 2 it is clear that the NBFIs did not have any loss assets during the study period. In case of sub-standard assets and doubtful assets it was very high during 2005-06 when compared to other years. In 2007-08 and 2008-09 the doubtful assets are more than sub-standard assets. It was very low in the year 2006-07. Chart 2 reveals the asset classification for the study period.

Table 3 shows the NPA and recoveries during the study period. NPA was very high during the year 2005-06 but gradually it started to decline. This shows the efficiency of the financial institutions in recovery.

Chart 2. Assets classification of NBFIs

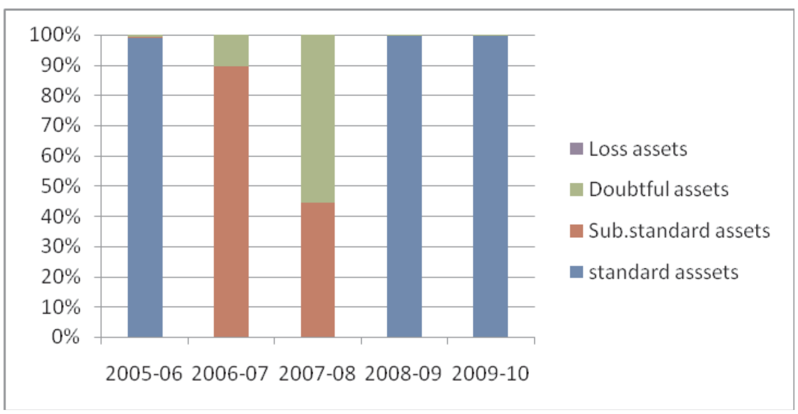


Table 3. Details of NPAs, amount recovered and the NPAs at the end of year

(Rs. in crores)

Particulars	2005-06	2006-07	2007-08	2008-09	2009-10
NPA in the beginning of the year	3678	1180	160	151	135
Recoveries / additions against NPA	2498	1020	9	16	+45
NPA at the end of the year	1180	160	151	135	180

Preventive Measures

RBI to prevent slippage of NPAs from substandard to doubtful/loss category, the following recommendations are suggested.

- Recognize the problem early.
- Early alert system.
- Prompt corrective action.
- Meeting with borrowers.
- Creation of proper database.
- Creating awareness among bank staffs.
- Suitable recovery measures.
- Compromise settlement scheme.
- One time settlement scheme.
- Debt recovery tribunals.
- Bringing attitudinal changes.
- Delayed payment by government undertakings.
- Writing – off bad debts.
- Involvement of staffs in recovery progress.

Conclusion

NPAs are posing a major threat not only to the financial institutions, But to the economy as a whole. Financial institutions should pay attention to various factors like ability of the borrower to repay the loan, usefulness of the project to which the loan is to be sanctioned and its profitability nature in future etc. NPAs adversely affect the profitability of banks and it leads to financial crisis, so care should be taken to prevent NPA. Though NPAs have been reduced to a considerable extent it is not possible to have zero NPAs in the balance sheet. Due to several steps taken by the RBI to reduce NPAs, it has reduced considerably. Foreign experiences must also be used along with a clear understanding of the local conditions to create a tailor- made solution which is transparent and fair to all stakeholders.

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