

## Manoeuvring Growing NPA in Indian Public Sector Banks

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### Abstract

Banking sector is an important attribute of a flourishing economy. The efficiency and stability of banking sector affects the growth of economy. The non performing assets have direct impact on the profitability of the banks. It expresses the efficiency with which bank can utilize its total resources. Growth in NPA involves necessity of provisions which decreases the profit of bank and thus shareholder value. It also reflects state of health of industry and trade in economy. This paper deals with understanding the concept of NPA, its present status in public sector banks along with reasons. Recommendations are made in the end focusing that public sector banks need to effectively control their rising NPA levels in order to induce profitability in their balance sheets by appropriately analyzing the credit worthiness of borrowers, recognizing the critical accounts at early stage and using legal course of action preemptively.

**Keywords:** NPA; Indian Economy; Public Sector Banks; Profitability; Credit Monitoring.

### Introduction

*Present status and reasons of NPA in public sector banks*

A non performing asset is a loan or an advance for which the principal or interest remained overdue for a period of 90 days. Banks classify NPAs into substandard, doubtful and loss assets. When an asset remains NPA for period less than or equal to 12 months, it is termed as substandard. An asset is classified as doubtful if it has remained in substandard category for period of 12 months. When an asset is considered uncollectible and of little value such that its continuance as bankable asset is not warranted, although there may be some salvage or recovery value, then it is called as loss asset (RBI, 2017).

As per financial stability report of RBI, the gross non performing advances of all scheduled commercial banks stood at 11.6% of gross advances in March 2018 (RBI, 2018). The gross NPA of Indian public and private banks is 10.03 trillion rupees in June 2018. The public sector banks contributed 87% of bad loans. The PSBs have recorded loss of approximately 1.7 trillion INR from December 2015 to June 2018. This figure is more than 80% of the capital infusion of 2.11 trillion INR announced by government of India in October 2017.

The maximum loss in this period is recorded by IDBI bank which is around Rs.20,000 crore. Punjab National Bank, State Bank of India and Bank of India follow this lead consecutively. This loss is also because of higher provisions made by PSU banks to curb the bad debts. Cumulative provisions of Rs.6.09 trillion have been made between Dec 2015 to June 2018. The other important reason for such huge losses by PSU banks in falling credit growth and decline in net interest income. UCO bank and Indian overseas banks have contracted their advances by more than one-fifth of their total loan portfolio. The PSU banks are also facing tough competition from private players resulting in decrease in net interest income as they have to offer credit products at competitive rates comparable to the private players (Bandopadhyay, 2018).

The prime reason attributed to these dreadful

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levels of NPAs in public sector banks is relaxed lending to giant corporates. During the booming period of economy in 2008, these banks lent extensively to the corporate sector. But the subsequent years, the corporates were not able to pay back the loan and their ability was hindered by plethora of internal and external factors. Few amongst such factors are slowdown in global economy, volatility in price of raw material especially in mining and steel sector, delay in getting environmental clearance for starting new projects etc. The banks also did not perform appropriate financial analysis of the projections submitted by the large customers. Banks also failed in conducting a contingency planning to mitigate the prospective financial risk. Those companies which were highly leveraged and had inadequate profitability were given extended credit facility by banks in name of restructuring which further worsen the problem. Thus companies with waning debt paying capacity raised more and more debt (Gopi and Paluraj, 2018)

### Literature Review

Mittal (2017) propounded that non-performing assets have direct impact on the profitability of banks. NPA negatively affect the efficiency with which bank is utilizing its assets, managerial effectiveness and resource optimization of banks. Increase in NPA raises the cost of capital, affect the liquidity position of banks. Dudhe (2017) said that NPA is the vital factor for examining the financial performance of bank. They not only affect that particular bank but also the total financial system in economy. Banks have started paying more attention towards recovery of pending loans to improve their solvency conditions. Devi and Reddy (2017) postulated that it is not possible to competently eliminate non performing assets from banking industry because of various systematic non diversifiable external factors. But the risks arising from such incidents need to be assessed and steps should be taken to mitigate risks arising from these factors. The avoidance of nonperforming assets can be achieved by following proper appraisal policy, supervision and regular follow up of accounts. Durafe and Singh (2016) suggested that banks should consider return on investment on proposed project and provide loan to customers who have better credit worthiness. Bodla.B (2015) proffered that in order to sustain and grow in competitive environment, the public sector banks need to do credit appraisals in fair manner and judiciously monitoring of outstanding dues is

out rightly required. Joseph and Prakash (2014) proposed that wielding debt recovery tribunals, compromise settlement schemes, securitization act and asset reconstruction companies may help in recovering dues from NPA accounts. Strong credit risk management and assessment system can act as a precautionary tool in prevention of further non performing assets.

### Recommendations

The accountability of chairpersons and other top management should be well defined and established. Their terms should also be elongated so that they can be hold accountable for decisions they are making and also they can bring meaningful changes in making the system more efficient. The incentives given to the employee to public sector bank should be improved. Better incentive scheme will attract better talent which could be retained (Prasad and Veena, 2016). Despite credit monitoring system and vigilance department, there is negligent attitude of enforcement authorities to penalize any culprit. The concurrent audit system must be shored up more so as to red flag the real time risks. There is a need of development of secondary market for non performing assets. The pricing of assets should be made more transparent and greater autonomy should be given to PSBs to dispose pending loss making assets. More appropriate diagnostic measures should be adopted to know actual cash flow of the firm. Artificial intelligence techniques can be used to monitor transactions to prevent financial fraud. This technique can also be used to recognize the stressed assets early by observing the account transaction pattern. Financial information should be gathered from suppliers, customers and people in particular industry before lending. (Guleria, 2016) Although the new Insolvency and Bankruptcy code has been designed to facilitate quick resolution of stressed accounts in prescribed time, but this platform should be more coherently used by banks to recover their debt from insolvent firms.

### Conclusion

Banks are vital conduit for channelizing flow of capital in Indian economy. Prolonged NPA jeopardize the lending activity of banks which adversely affects the supply of funds to genuine borrowers. All the stake holders of lending activity like banks, RBI as regulator and government are needed to take collective preventive steps to

restore the health of public sector banking which constitutes major chunk of Indian banking (Dutta, 2014). This requires building a prudent monitoring policy, regulatory mechanism and strong legal framework to ensure quick resolution of cases.

Giving public sector banks are major source of credit, they are invariably affected by any cyclical fluctuation in economy. There is but obvious indiscriminate lending during boom period and when economy faces downturn, banks face deterioration in asset quality leading to potential NPA. This affects the efficiency, profitability and liquidity of banks unfavourably leading to inefficient allocation of resources (Verma 2018).

Early recognition of probable non performing assets mitigates its detrimental impact on balance sheet. Leniency of banks to defer from NPA recognition should not be facilitated. For expediting this, strong governance and adoption of proactive approach is required. This will escort to minimal negative effect on bank's capital. The legal framework provided for resolution should be quicker and efficient. There is a need to simplify the insolvency laws as well.

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