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Bad loan in Indian banks: Hustle in bank growth

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Abstract
Banking sector being the pillar of the nation's growth is facing the serious issue of Non-Performing Assets (NPA) which will adversely affect the profitability and goodwill of the banks. NPA is not a single economy's problem as many countries in the world face the same but the level of severity differs. However, India's NPA chart shows an increasing trend in NPA levels for past few years which need an attention. The Public Sector Banks (PSBs) continue to be under stress, on account of aggressive lending in the past. India's bad loans are fifth highest in the world and surged dramatically after March 2015. The study shows the reasons behind the increase of NPA levels and some measures to reduce the same.

Keywords: Indian economy, policy reviews, credit appraisal, DRTS, Lok Adalat, Sarfaesi act

Introduction

The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management came into picture. The primary function of a bank is to lend funds as loans to various sectors such as agriculture, industry, personal and housing etc. and to receive deposits. Receiving deposit involves no risk, since it is the banker who owes a duty to repay the deposit, whenever it is demanded. On the other hand lending always involves much risk because there is no certainty of repayment. In recent times the banks have become very cautious in extending loans, the reason being mounting non-performing assets. Non-performing assets had been the single largest cause of irritation of the banking sector of India. Earlier the Narasimha committee-I had broadly concluded that the main reason for the reduced profitability of the commercial banks in India was given importance to priority sector lending. The committee had highlighted that priority sector lending was leading to the building up of non-performing assets of the banks and thus it recommended it to be phased out. Therefore while sanctioning credit the banker should appraise the project reasonably or else it leads to the non-repayment of loans and advances. Most of the banks today in India are facing the default risk wherein some part of the profit is reserved for covering the non-performing assets. The causes of NPA mainly depend on internal bank management, credit policy, business management problems and other external factors. NPA has its major impacts on Profitability, liquidity and credit loss of the bank. The study on causes and remedies of Non-Performing Assets also gives knowledge about the causes of NPA and various remedies to overcome the problems of NPA.

Review of Literature

Dr. Raj Kumar Mittal and Ms. Deeksha Suneja (2017) [1] examined "The Problem of Rising Non-performing Assets in Banking Sector in India" and also made a comparative analysis of public and private sector banks" using the secondary data collected from RBI publications, journals, reports and websites of public and private sector banks in India which was analyzed using graphs and figures. The study revealed that extent of NPA was more in public sector compared to private sector which can be recovered by government policies. The suggestion given was to consider ROI before lending loans and credit worthiness is to be considered.
Chetan Dudhe (2017) analyzed "Impact of Non-Performing Assets on the profitability of Banks" using secondary data such as RBI Bulletins, statistical tables relating to banks in India. The data collected was analysed using correlation and regression techniques. The study concluded that public sector banks are more prone to NPA problems that have adverse effect on their profitability growth.

The suggestion to get rid of this trouble is to have a proper credit management which includes activities such as preparation of credit planning, proper credit appraisal, post sanction follow up and need based credit.

Dr. Ujjwal M. Mishra and Jayant R Pawaskar (2017) [2] made a "A Study of Non-Performing Assets and its Impact on Banking Sector" that analyzed sector wise NPA, recovery channel and impact of NPA on Indian Banking Sector using secondary data which mainly constitute information from annual reports of banks. The data analysis tools used were ratio analysis, tables and pie diagrams which revealed that bank need to maintain proper credit appraisal system to reduce NPA.

Vivek Rajbahadur Singh (2016) [3] in "A Study of Non-performing Assets of Commercial Banks and it's recovery in India" aimed to understand the impact of NPA on banks, their recovery channels and suggested some ideas to avoid NPAs in future. The source for the study was secondary data collected from published data of Indian Bank, RBI, various magazines, Journals and books related to banking scenario. The study showed that there was increase in NPA and decrease in profit. The recovery measures for this problem as per the author were the RBI should revise the credit appraisal and monitoring policies.

Sowmya (2019) [4] in ''A study of banks' non-performing assets and problems associated with its recovery in India'' aimed to understand the objective to know the NPA levels of Public and Private sector of Indian Banking Sector and to understand the reasons for increase of NPA in Indian Banking Sector and also to provide suggestions to reduce Bank's NPA levels in India.

Objectives of the Study

1. To bring forward the reasons for mounting NPAs in Indian banking sector or to study the position of NPA and its causes.
2. To analyze the impact of NPAs on Indian economy.
3. To suggest ways and measures to reduce the level of NPAs in banks in India or to measure the importance of recovery channels in terms of recovery.

Research methodology

The study utilizes secondary data available in the form of RBI annual reports, World Bank data related to the topic, Magazines, Journals and other web sources. The collected data was analyzed using tables, Chart, figures and graphs.

Major causes for increase in non-performing (NPAs) of banks

The banking sector has been facing the severe problems of the rising NPAs. But the problem of NPAs is more in public sector banks when compared to private sector banks and foreign banks.

a. **Willful Defaulters:** we have seen an upsurge in mal-administration by the corporate in the country in terms of wilful defaults by showing lack of morale to repay loans. There are borrowers who are competent to pay back loans but are intentionally or unintentionally refrain from repayment.
b. **Bad lending practices:** A non-transparent way of providing loans has led to increase in NPAs of the banks. The diversification of funds to business frauds, due to poor credit appraisal system, the bank gives advances to those who are not able to repay it back. Thus, unplanned expansion of credit during the boom period led to enormous rise in NPAs.
c. **Over-expectation of economic growth:** Due to over-expectation of economic growth in future, made the Indian banking sector to disburse more credit during the boom period of the business cycle. But the economy is unable to achieve its specified targets because of implementation of demonetization and GST. The high expectation of growth does not materialise and bad loans accumulate as borrowers are unable to repay.
d. **Natural hazards:** Every year India is hit by major natural calamities in one or other part of the country. Thus, making the borrowers unable to pay back there loans. Irregularities of rain fall and other event reduces production, the farmers are not able to repay the loans. The bank has to make large amount of provisions in order to pay damages to those loans, hence they end up with a reduced profit. e. Severe Competition: Severe competition in any particular market segment leads to rise in NPAs. In the anxiety to attain business targets the rules and procedures for prudent banking were conveniently forgotten. For example the Indian Telecom sector is facing this situation.
e. **Misgovernance:** Misgovernance and policy paralysis hampers the timeline and working of the banks. Political interference in the functioning of the public sector banks and providing huge loans to their known has major impact on rising NPAs. Political pressure in selection of Chairman and heads of the banks by the Government is also a cause of concern.
f. **General slowdown of Industrial sector:** After 2011 there was a slowdown in the Indian economy which resulted in faster growth of NPAs. The banks that finance those industries ultimately end up with a low recovery of their loans reducing their profit and liquidity.
g. **Ineffective recovery tribunal:** Although vigilance mechanisms exist, but lack of penalties enforcement means that wrongdoing is neglected. The Govt. has set recovery tribunals, which works for recovery of loans and advances, due to their carelessness and ineffectiveness in their work and the perception of „wait and watch‟ makes the bank suffers the consequence of non-recovery, their by reducing profitability.
h. **Financial Burden:** The execution of any governments scheme fall over public sector banks. Banks continued to be the primary source of long-term big-ticket investment projects in India, from roads and ports to power and steel. This increases the financial burden on banks. The Infrastructure sector is facing this problem.
i. **Lack of Management information system:** There seems to be lack of Management information system (MIS), which makes the decisions on real time basis poor. Proper MIS and financial accounting system is not implemented in the banks, which leads to poor credit collection and allocation.

Public Sector banks provide around 80% of the credit to industries and it is this part of the credit distribution that forms a great chunk of NPA. The Industry accounts for highest NPA, RS. 6.09 trillion Or 20.41% of the gross advances given by scheduled commercial banks. The situation became serious with the substantial delay in environmental permits, volatility in prices of raw materials and a shortage of supply, affecting the infrastructure sector- power, iron, and steel.

Table 1: NPAs in various sectors of the economy.

Si. No.	Sectors	NPA	% of Gross Advances
1	Industry	6.09 trillion	20.41
2	Service sector	696 billion	6.53
3	Agriculture sector	149 billion	-

From 2000-2008, the Indian economy was in a boom phase and banks, especially public sector banks, started lending extensively to companies. Indiscriminate lending by banks during the high growth period is one of the main reasons for the deterioration in asset quality. Another reason is the relaxed lending norms adapted by banks, especially to the big corporate houses, foregoing analysis of their financials and their credit ratings.

Table 2: Total Gross NPAs of Schedule Commercial Banks (SCBs)

Si. No.	Year	Gross NPAs	Growth in Gross NPAs (in %)
1	2009	68,216 crore	22.5
2	2010	81,808 crore	19.9
3	2011	94,121 crore	15.1
4	2012	1.37 lakh crore	45.7
5	2014	2.16 lakh crore	4.72
6	2015	3. 23 lakh crore	5.43
7	2016	6.37 lakh crore	11.8
8	2017	8.86 lakh crore	12.5
9	2018	10.35 lakh crore	12.9

Impact of Rising NPA

The accumulation of bad loans happened over an extended period of time, and today it threatens to hamper both the banking sector and Indian economy.

a. Lower growth rates: All of this will lead to a situation of low off-take of funds from the security market. This will hurt the overall demand in the Indian economy. Finally, it will lead to lower growth rates and of course higher inflation because of the higher cost of capital. This trend may continue in a vicious circle and deepen the crisis.

b. Impact the Profitability of the Bank: Non-Performing Assets not reduces the profit of the Bank and also increases the loss due to the presence of NPAs; the banks follow low interest policy on deposits and high interest policy on advances provided. Thus, this act puts a pressure on recycling of funds and directly impacts the Profitability of the Bank.

c. Interest rates will rise: The price of loans, i.e. the interest rates will shoot up. The shooting of interest rates will directly impact the investors who wish to take loans for setting up infrastructural, industrial projects etc. It will also impact the retail consumers like us, who will have to shell out a higher interest rate for a loan.

d. Increase in Current account deficit: NPA plays an important role in every economic condition and also the main cause of the increase in the current account deficit. Interest rates, Loan, Housing Loans, CRR, and SLR all are directly affected by the system. e. Scarcity of funds: As the NPA of the banks rises; it will bring a scarcity of funds in the Indian security markets. Few banks will be willing to lend. The shareholders of the banks will lose a lot of money as banks themselves will find it tough to survive in the market. This will lead to a crisis of confidence in the market.

e. Fall in Public Confidence: The poor performance of the Bank due to increases in Non-Performing Assets not only lower the sentiments of the investor but the bank also lose the faith of public, this directly affects the deposits into the bank. Higher NPA impact the revenue strength of the banks. The banks will recover their losses by levies charges on those operations which were free of cost like-

- Withdrawal limit from ATM
- Withdrawal number of times
- Cash deposits in other branches
- Internet transaction charges

f. Liability Management: Shareholders are interested in the enhancement of investment and market capitalization. But due to high Non-Performing Assets, bank for forced to lower the interest rates of the deposit and likely to pay Higher interest rates on advances. This is a difficult situation and hampers the banking business.

g. Reduces the confidence level of the investor: High Non-Performing Assets reduces the confidence level of the investor which significantly impacts the Share price of the Bank in this situation, banks stop payout of dividend to the shareholders, which was not in the interest of the investor.

Table 3: Details of Gross Non-Performing Assets (NPAs) of major banks in India

	S1.No. planks	Net Loss (FY 2017-18)	Gross NPAs (In %)
1.	Punjab National Bank	12,283 crores	18.4
2.	IDBI Bank	8,238 crores	28
3.	State Bank of India	7,718 crores	10.9
4.	Bank of India	6,043.7 crores	16.6
5.	Indian Overseas Bank	6,300 crores	25.3
6.	United Bank of India	1,454 crores	24.1
7.	Central Bank of India	5104.9, crores	21.5
8.	Syndicate Bank	3,223 crores	11.5
9.	Canara Bank	4,222 crores	11.8

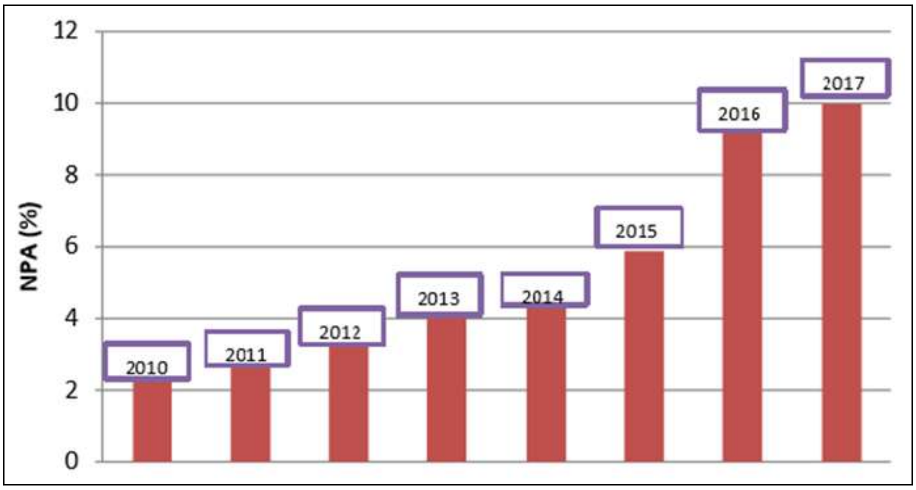
The public sector banks (banks owned by Central/State govt.) are facing huge NPAs. The Nirav Modi scam-hit Punjab National Bank (PNB) has reported the maximum rise of Rs 29,100 crore in gross NPAs to Rs 86,620 crore in the March quarter. Most PSBs also recorded a rise in bad loans. Among private banks, the gross NPAs of ICICI Bank and Axis Bank have risen significantly. The lowest NPA ratio was reported by the Karnataka-based Vijaya Bank at 6.3%, followed by Indian Bank at 7.4%. The only good news of the latest quarter is that six public sector banks have reported profits i.e. Bank of Baroda, Canara Bank, Indian Bank, Vijaya Bank, and Union Bank. Private sector banks to have NPAs but they are fairly low when compared to public sector banks.

NPA in India

The following chart shows NPA levels in India for the past 8 years i.e. from 2010-2017.

The chart clearly depicts an increasing trend in NPA levels. Moreover, the annual reports 2018 of RBI shows that NPA levels as a percentage of gross NPAs on total loans reached 12.2 percent in March 2018. The estimations related to

NPAs levels too are not positive as it is expected that there will be further increase in gross NPA percentage. This situation shows the necessity to review the framework and policies of Indian banking sector. Indian Banking Sector can be divided into public sector and private sector. To have a clear cut view on banking sector of India both public and private sector NPA levels and management needed to be understood.



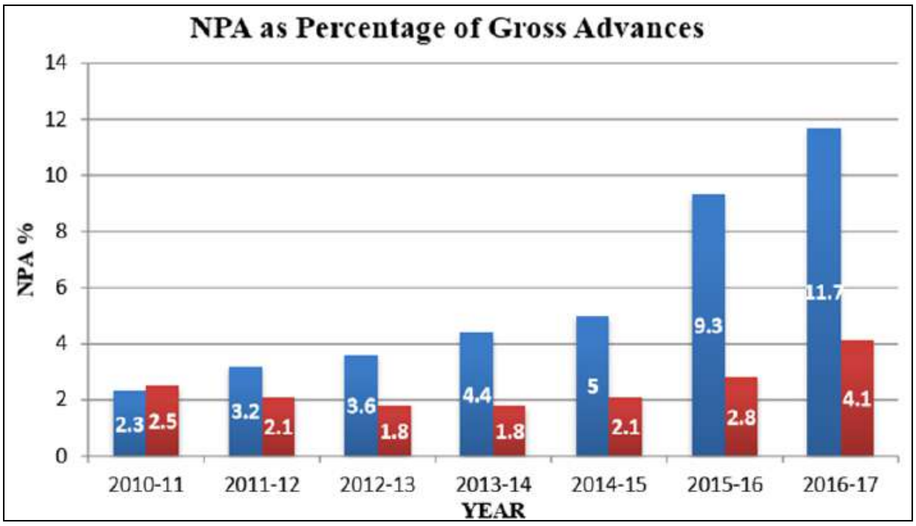
***Source*:** World Bank Report

Chart 1: NPA levels in India

Public and Private Sector Banks in India

In India, public sector banks came into scenario in 1955 and it's the period during which the banks got nationalized. The public sector banks are one in which the government hold more than 50% of the stack. Whereas, in case of private sector more than 50% of the stack are held by the private stakeholders holds. First private bank named IndusInd Bank was established in the year 1994 in Mumbai. At present there are totally 41 private sector banks and 21 public sector banks functioning in India. The efficiency of banks is measured by its profitability which is adversely affected by Non-Performing Assets (NPAs). Managing NPAs is becoming a great challenge for banks. However in comparison with public sector, private sector is efficient in managing NPAs which is evident from the following chart based on RBI's data.

From the above chart it's clear that as compared to private sector, the public sector is more prone to NPA risks. Revising NPA management policies and techniques by public sector will help to get rid of NPA risks.



***Source*:** RBI

Chart 2: Gross NPAs of public and private sector

Measures and prevention

1. Lok Adalats 2001: Lok Adalats is a mechanism to settle matters relating to recovery of dues, out of court. These are convened by Debt Recovery Tribunals/Debt Recovery Appellate Tribunals. Lok Adalats have no judicial powers. It is a mutual forum for the bank and the borrower to meet and arrive at a mutual settlement. Once the settlement is signed by both the parties, the same is placed before the court. The court would then pass a suitable decrees / orders as per the terms of settlement. Such decrees cannot be challenged in the next higher courts. At present, accounts in doubtful and loss category with outstanding above Rs. 5.00 lacs can be referred to Lok Adalats. Lok Adalats Proved to be quite effective for speedy justice and recovery of small loans.

2. Debt Recovery Tribunals (DRT 1993): Under the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993 banks approach the Debts Recovery

Tribunal (DRT) whereas, under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002 borrowers, guarantors, and other any other person aggrieved by any action of the bank can approach the Debts Recovery Tribunal (DRT). Debts Recovery Tribunal is located across the country. Some cities have more than one Debts Recovery Tribunals. New Delhi, Chennai, Kolkata and Mumbai have three Debts Recovery Tribunals. Ahmadabad and Chandigarh have two Debts Recovery Tribunal (DRT) each. One Debts Recovery Tribunal has been constituted at Allahabad, Aurangabad, Bangalore, Coimbatore, Cuttack, Ernakulum, Guwahati, Hyderabad, Jabalpur, Jaipur, Lucknow, Madurai, Nagpur, Patna, Pune, Vishakhapatnam and Ranchi.

3. Sarfaesi Act, 2002: The full form of SARFAESI Act as we know is Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. Banks utilize this act as an effective tool for bad loans (NPA) recovery. It is possible where non-performing assets are backed by securities charged to the Bank by way of hypothecation or mortgage or assignment. SARFAESI is effective only for secured loans where bank can enforce the underlying security e.g. hypothecation, pledge and mortgages.

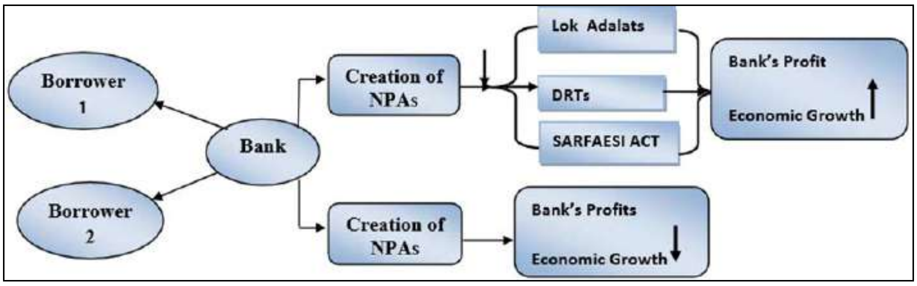


Fig 1: The banking process to loan to two borrowers

The above figure defines that the bank has provide loan to two borrowers. They have not paid their instalment which creates NPAs. In case of borrower 1 the bank has recovered their loan which not only increases the profit of the bank but also help in economic growth. In case of borrower 2 non recovery of loan reduces the profit of the bank and economic growth.

4. Asset Recovery Construction Industry Limited (ARCIL): The word asset reconstruction company is a typical used in India. Globally the equivalent phrase used is "asset management companies". The word "asset reconstruction" in India was used in Narsimham I report where it was envisaged for the setting up of a central Asset Reconstruction Fund with money contributed by the Central Government, which was to be used by banks to shore up their balance sheets to clean up their non-performing loans. ARC has been set up to provide a focused approach to Non-Performing Loans resolution issue by:-

1. Isolating Non-Performing Loans (NPLs) from the Financial System (FS),
2. Freeing the financial system to focus on their core activities and
3. Facilitating development of market for distressed assets.

5. Corporate Debt Restructuring (CDR 2005): Corporate debt restructuring is the reorganization of a company's outstanding obligations, often achieved by reducing the burden of the debts on the company by decreasing the rates paid and increasing the time the company has to pay the obligation back.

6. Credit Information Bureau-2000: A good information system is required to prevent loan falling into bad hands and therefore prevention of NPAs. It helps banks by maintaining and sharing data of individual defaulters and wilful defaulters.

7. Joint Lenders Forum-2014: It was created by the inclusion of all PSBs whose loans have become stressed. It is present so as to avoid loan to same individual or company from different banks. It is formulated to prevent the instances where one person takes a loan from one bank to give a loan of the other bank.

8. Bad Banks-2017: Economic survey 16-17, also talks about the formation of a bad bank which will take all the stressed loans and it will tackle it according to flexible rules and mechanism. It will ease the balance sheet of PSBs giving them the space to fund new projects and continue the funding of development projects.

Conclusion

Indian Banking sector once strength of the nation is facing a downfall due to lack of care in lending activities. The bank's lending systems and recovery mechanisms need to be revised and improved which is a step by step process. Though immediate recovery of banking sector is not possible, it is expected to recover from increasing NPA levels in the long run.

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