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An Outline on the Appraisal of Indian Banking: Non-Performing Assets Perspective

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Abstract

The Indian financial system comprises an impressive network of banks and other financial and investment institutions offering a wide range of products and services which together function in a fairly developed capital and money market. The Indian banking industry is characterized by move towards liberalization of financial, money and capital market and its globalization by entering foreign trade as per the changes in global economy.

Keywords: NPA Management, Impacts of NPA, Efficiency in INDIAN Banking, Budget.

Introduction

It has seen many changes in the last decade on Greater competition among banks, entry of new private banks, mergers and increasing complexity in business has become its critical success factors. Also more emphasis is given to risk management. No wonder many structural reforms have taken place in the industry.Even though NPA is not a new phenomenon, for the past few years Indian banks have been weighed down by its enormous amounts. It has caused banking crises and sometimes even threatened the very health of the banking system.

NPA and Its Impact

In spite of the prudential norms framed by the RBI and continued focus of the various policy initiatives of the Government of India, a continuous increase in the NPA level has been experienced by all Indian banks with some variation. Banks have to cross many hurdles to earn profit in the face of low credit off –take by the industrial segment and the inability of the state/ central government to take up new projects. Apart from the internal and external complexities, increase in NPAs directly affects banks profitability sometimes even their existence. Our statistics reveal that bad debts are accounted for Rs. Two lakh crore in the banking sector and financial institution and banks have written off Rs seventy thousand crores as bad debts in the last 6 years.

The massive increase in the GNPAs of banks is largely due to a slow and inefficient legal system, policy reforms in the liberalized regime and the general slowdown of the lndian economy. Public sector banks recovered Rs12,860crore in 2011 as against Rs 9,883 a year before. Net NPAs as the percentage of net advances down to 6.7% on March 31, 2011 from 7.4 in the previous year. The impact of NPA is different financial parameters is stated below.

- NPAs reduce the earning capacity of assets and badly affect the ROA
- Nonetheless , higher provisioning requirement on mounting NPAs is adverse affecting capital adequacy and also bank’s profitability
- Since NPA is taken into consideration for total advances and average income assets, these show a lower figure than the actual.
- ROA , ROE, cost income ratio and capital adequacy ratio calculations connote NPA
- Cost of capital will increase due to NPAs and require economic value added

Identification of NPA

A non-performing asset is a credit facility in respect of which interest or the principal has remained unpaid after a stipulated period. Term loan: interest or instalment of the principal remains due for two quarters or more. Cash credit &Overdraft : Remains out of order for a period of two quarters. Bills purchased and discounted :If the bill remains overdue and unpaid for a period of two quarters. Agricultural advances: Interest instalment of the principal remains unpaid for two harvest seasons. (Rabi crop – 15 July and Kharif crop-15 Jan). Advances against term deposits &NSCS : Advances against securities such as national savings and term deposits certificates like Indira VikasPatra, KissanVikasPatra and LIC policies. Until the outstanding debt is covered by the realizable value of the securities, the account may continue to be treated as a standard asset even if overdue for quarters.

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Classification of Assets

Advances given by banks can be classified into four broad groups.

1. Standard asset : It doesn't create any problem while paying interest/ installment of the principal. It usually carries more than normal risk attached to the business.
2. Substandard asset : It is treated as NPA for a period not exceeding 2 years. However , this period was reduced to 18 months with effect from 31.3.2001
3. Doubtful asset : A doubtful asset is one which has remained NPA for a period exceeding 2 years. The period has now been reduced to 18 months with effect from 31.3.2001.
4. Loss asset : 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.

Even though accounts are classified as standard, substandard, doubtful and loss assets these are not realizable to the extent, advances taken can be straightaway classified as NPA irrespective of the stipulated period mentioned by the bank.

New Norms For Private Banks

The RBI has recently come up with new norms for granting licenses to new private sector banks. Non – bank financial intermediaries (NBFCS) and corporate houses that intend to promote banks now have to fulfill the following guidelines. The entry capital level has been revised from Rs.100 core to Rs.200 core. Promoters should hike the capital to Rs.300 core in three years. NBFCs can convert themselves into banks if their NPA are below 5% and the capital adequacy ratio (CAR) above 12% . The RBI is very particular about clearing the applications of new private banks. It has cleared two applications out of ten for new private banks namely, Kodak Mahindra Limited and Repo bank.

Union Budget 2007-2012

Many financial analysts feel that it is a good budget for the present environment as it focus in infrastructure development apart from second generation banking reforms and capital account liberalization. It lays emphasis on NPA management since source of income are getting thinner and profits are under strain due to rising NPAs and lower lending rates. In spite of cutting the interest rates by a half percent on the small saving rates, it has taken progressive steps in favour of bank deposits by introducing dividend tax on mutual funds and reducing tax incentives on long- term investments. The foliations of interest rates could be minimized by passing the fiscal responsibility and budget management bill in parliament

Twenty nine debt recovery tribunals (DRTs) and five appellate tribunals have been set up . As on sept.30,2011 DRTs recovered Rs 14,026 crore from 18709 accounts. The work of the recovery was Rs3,527crore. A pilot asset reconstruction company would be set up in this year with the participation of public and private sector banks, financial institutions and multilateral agencies.

NPA Management in the IOB

The banks NPA management policy emphasizes early identification of doubtful loans prompt responses to early warning signals and corrective norms as per time norms. As per the RBI guidelines it is encouraging one-time settlement scheme. It approved one –time settlement for Rs718 crore in respect of 1.95 lakh accounts with NPAs uptoRs 5 rore and made a cash recovery of Rs384 crore. The banks gross and net NPAs, as at end March 2001, stood at 12.93% and 6.03% respectively as against 14.25% and 6.41 respectively in the previous fiscal year.

The bank extended financial assistance under its rehabilitation scheme of the units having a caliber for turnarounds approved by the BIFR. The BIFR identified 512 units financed by the bank as sick. Among these 59 PSUs are included. It agreed to the rehabilitation of 96 units with an amount of Rs 763 crore. Out of these, 58 packages involving Rs 472 crore, were accepted for rehabilitation. An integrated management apex committee was set up for the overall control of the management functions.

Table I. IOB NPA Ratio

Month &Year	Dec 2012	Sep 2012	Dec 2011
Gross NPA	4.13%	3.87%	3%
Net NPA	2.33%	2.25%	1.23%

Source: IOB Annual Report

Indian Overseas bank lost 2.13% to Rs.80.55 at 13:49 IST on BSE as the state – run bank's ratio of gross non – performing assets to gross advances edged higher at 4.13% as on December 2012 , from 3.87% as on 30 September 2012

Guidelines for Effective NPA Management

To quote from the Narasimham committee report, 1998, ‘ NPAs constitute a real economic loss to the nation in that they reflect the application of scarce capital and credit funds to unproductive uses. The money locked up in NPAs is not available for productive uses and to the extent that banks seek to make provisions for

NPAs on to write them off it is a charge on their profits. NPAs, in short, are not just a problem \for the banks. They are bad for the economy.' Here are therefore some guidelines for the effective management of NPAs

- Early warning signals for incipient sickeness have to be identified and proactive remedial action initiated.
- Attention has to be paid to high value NPAs.
- Close monitoring is to be made of substandard and doubtful assets to prevent the transformation of these accounts into loss assets.
- Banks have to take up the rehabilitation of deserving units only.
- To deal with chronic NPAs, the RBI has recently introduced the formation of settlement advisory committees (SACs) for encourageing amicable settlements.
- The success of SACs depends to a large extent on the attitudes of bankers and borrowers.
- Classification of assets is to be made on income recognition assets classification (IRCA) norms , introduced by the RBI in 1992-93.

Checklist for Increasing Efficiency in Indian Banking

In India investment are around 24% and there is a need to increase them to 30% .we have to take the initiative to encourage savings to extend their credit to potential investors.

- A detailed appraisal must be made of the promoter's attitude. Corruption at registration offices has to be stopped to prevent promoters from indulging in mischievous activities.
- Dynamic people are to be recruited to collect doubtful debts and for better asset liability management.
- Political pressures are to be resisted in the operation of banks.
- Banks must operate in a democratic environment.
- Banks have to adopt professionalism and accountability in their functioning.
- New technologies should be introduced to reduce administrative costs and increase profit margins.
- Economic value added (EVA) and market value added (MVA) are the two parameters that tell us how investors' hard earned money is going to be utilized by banks, which must find ways to keep their funds safely and ensure adequate return.
- Banks must be transparent in their functioning and accountable to shareholders and public to maintain international standards of corporate governance.

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