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NON-PERFORMING ASSETS: ROTS INDIAN BANKING SYSTEM

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ABSTRACT

Asset quality is one of the vital areas in determining the soundness of a bank. The rise in NPAs will directly have an impact on the major functioning of the banks. The credit distribution of the Scheduled Commercial Banks (SCBs henceforth) binds the working capital needs of the different sectors in the economy like Agriculture, Industry, Infrastructure, Power and Transport, Personal Loans and Household credits. Addressing the SCBs asset quality concerns and strengthening its balance sheets to reinvigorate credit growth is clearly the highest priority of RBI and the Government. The analysis revealed that the gross NPAs of public sector banks increased by 311.22% from 2013 to 2017. Likewise, the gross NPAs of private banks witness an increase of 269.47% from 2013 to 2017. The correlation analysis revealed that there exists a linear relationship between the Gross advances and GNPAs of all Bank groups.

Keywords: NPA; banks; advances; asset quality; borrowers.

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1. INTRODUCTION

Asset quality is one of the vital areas in determining the soundness of a bank. The prerequisite for sustainable asset quality is the quality of loan portfolio and the credit administration in the banks. Asset quality expressed in terms of NPA of a bank is the true reflection of its sound and efficient management of credit portfolio. The rise in NPAs will directly have an impact on the major functioning of the banks. The credit distribution of the Scheduled Commercial Banks (SCBs henceforth) binds the working capital needs of the different sectors in the economy like Agriculture, Industry, Infrastructure, Power and Transport, Personal Loans and

Household credits. Banks hold the capacity of primary credit providers for commercial and industry needs. Addressing the SCBs asset quality concerns and strengthening its balance sheets to reinvigorate credit growth is clearly the highest priority of RBI and the Government.

The nature of asset quality is described as contagious and insidious, according to the transcripts of fed partnership under the topic bank-life cycle; the contagious nature of loan losses emanates from the fact that their downside impact can be quickly transmitted to earnings, capital, and liquidity. They are insidious in the sense that it is often difficult to know that there is a problem until it's too late. Moreover, these problems prey on the weak banks, which are vulnerable and have a relatively small amount of capital to absorb unanticipated losses. The burgeoning stress in the balance sheets of most banks and the consequent deterioration in the capital becomes the major areas of concern. The public sector banks have lower profitability and productivity ratios than their private-sector competitors; they have lost significant market share, and their asset quality is much weaker. The big picture of NPA deliberately comes out from the continuous loss reports of commercial banks in the last three years since 2014. RBI believed that the asset classification practices in the banks are not proper and they were postponing the bad-loan classification and deferring the inevitable. In 2015, the execution of the Asset Quality Review (AQR) by the former governor Dr.Raghuram Rajan has thrown light on the NPA accounts in the banks and its exposure to the total assets of the Banks. Almost all public sector banks were impacted, while the impact on the private sector was limited to the ICICI Bank and Axis Bank. HDFC Bank – the second-largest private sector lender – emerged unscathed from the crisis as its exposure to big-ticket infrastructure projects was relatively small. Bad loans in the Indian banking system jumped to 80 percent in FY16, according to RBI data, mainly on account of the Asset Quality Report. The AQR helps the banks to take proactive steps to clean up their balance sheets. The IMF had conducted stress tests on India's fifteen largest banks—12 public sector banks and three private banks during 2017. In its report, the IMF observed that the overall system seems quite resilient and 64% of the assets of the top 15 banks are with the 'resilient' ones. But the other banks, the remaining 36%, will find themselves in a precarious position even under baseline assumptions. All of these banks in the 36% are state-owned, the report noted, without revealing the names of the banks examined. Under an adverse stress scenario, nine out of 12 state-owned banks will breach "hurdle rates", i.e. the rates prescribed by Reserve Bank of India for various capital adequacy ratios, according to the stress test report. The higher proportion of stressed assets in the bank balance sheet is disappointing the bankers and discourages them to expand the credit. The slower credit growth in the banks and the indiscriminate lending practices will bode the banks for future slippages. Cleaning up of their balance sheet is considered a primary factor to continue the supply of credit.

1.1. Statement of the Problem

Banks play an important role in the financial system and the economy of a country. As a key component of the financial system, banks allocate funds mobilized from depositors to borrowers in an efficient manner. These financial services help to make the overall economy very efficient. The banking sector in India consists of 27 public sector banks, 26 private sector banks, 46 foreign banks, 56 regional rural banks, as on 31st March 2018. The sound health of the banking system is imperative for efficient financial intermediation to achieve overall development and financial stability. The health of the banking system is worsening during the recent past, especially after the global economic crisis. In this backdrop, this article highlights the trend in the NPA and aims to measure the relationship between gross advances and gross NPAs.

1.2. Objectives of the Study

- To study the level of NPAs in Indian Banks.
- To analyse the Bank group-wise trend in the level of Gross NPAs.
- To measure the relationship between gross advances and gross NPAs.

1.3. Methodology

The study used secondary data, it consists of historical data of Gross advances and Gross NPA. The data were collected from the Reserve Bank of India websites. The Secondary data were collected for a period of 13 years from 2005 - 06 to 2016 – 17 for the purpose of the study. Year on year trend was calculated and correlation analysis has been used to study the relationship between gross advances and gross NPA.

2. THE LEVEL OF NPAS IN INDIAN BANKS

According to the RBI's Financial Stability Report, 2017, India's gross NPAs stood at 9.6% in the Nationalised banks, Private sector banks in addition to co-operatives and small banks. In the world economies, India is in second place with a huge amount of NPAs next to Italy which holds 16.4% NPAs. Before 2008, the asset quality of SCBs was improving on a secular basis, following the implementation of Prudential Guidelines since the mid-1990s. The GNPA ratio had declined sharply from 12.0 percent as at the end of March 2001 to 3.5 percent as at the end of March 2006 and thereafter this ratio was flat till March 2011. However, since then, the NPA of the banks has been increasing; As at the end of December 2013, the Gross NPAs of these domestic banking system was 4.40 percent of Gross Advances of the total stressed assets in the banking system (which includes NPAs and restructured standard assets) as at Dec 2013 it was 10.13 percent of the gross advances of the banks, which is a cause of concern for the Reserve Bank. According to the response given by then Finance Minister Arun Jaitley in the Lok Sabha on August 11, 2017, the gross NPAs of public sector banks increased by 311.22% from Rs.1,55,890 crores in 2013 to Rs.6,41,057 crores in 2017. The gross NPA ratio as a percentage of total assets rose from 3.84% to 12.47%. Likewise, the gross NPAs of private banks witness an increase of 269.47% from Rs.19, 986 crores in 2013 to Rs.73, 842 crores in 2017. The Trend in the Gross NPAs of Indian Commercial banks is shown in chart 1

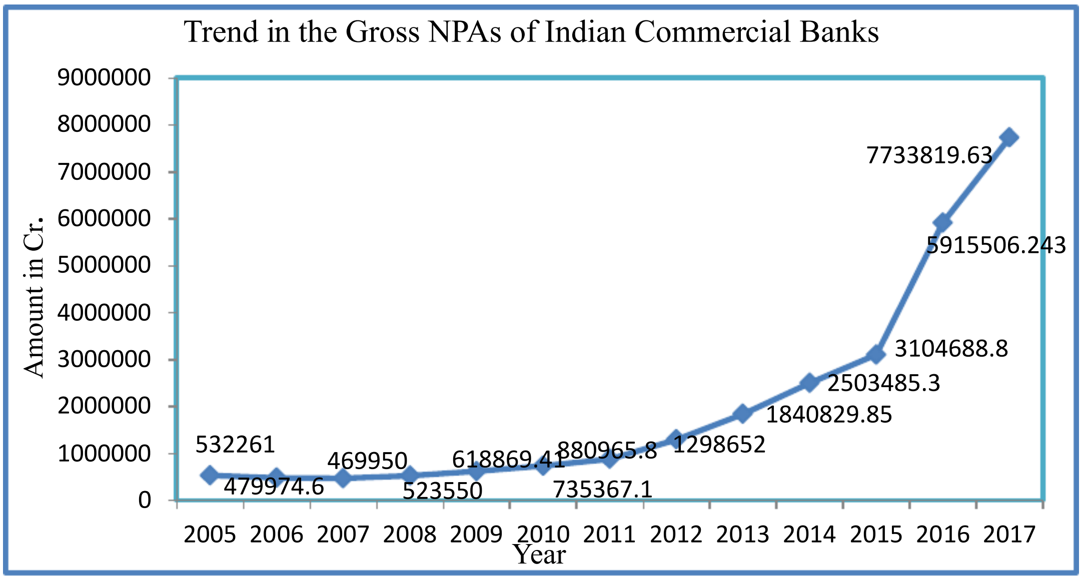

Chart 1

Source: *Compiled from the RBI's Statistical Returns Relating to Banks in India, 2005 - 2017.*

In Chart 1, the Gross NPA of Indian banks which includes SBI and its associates, nationalized banks and private sector banks during the period from 2005 to 2017 is shown and it reveals that the amount of Gross NPA has reached the peak of Rs.77.33 lakh crores in 2017 from 5.32 lakh crores in 2005 the share of Gross NPAs of the individual bank groups to the total Gross NPAs is shown in the Chart 2.

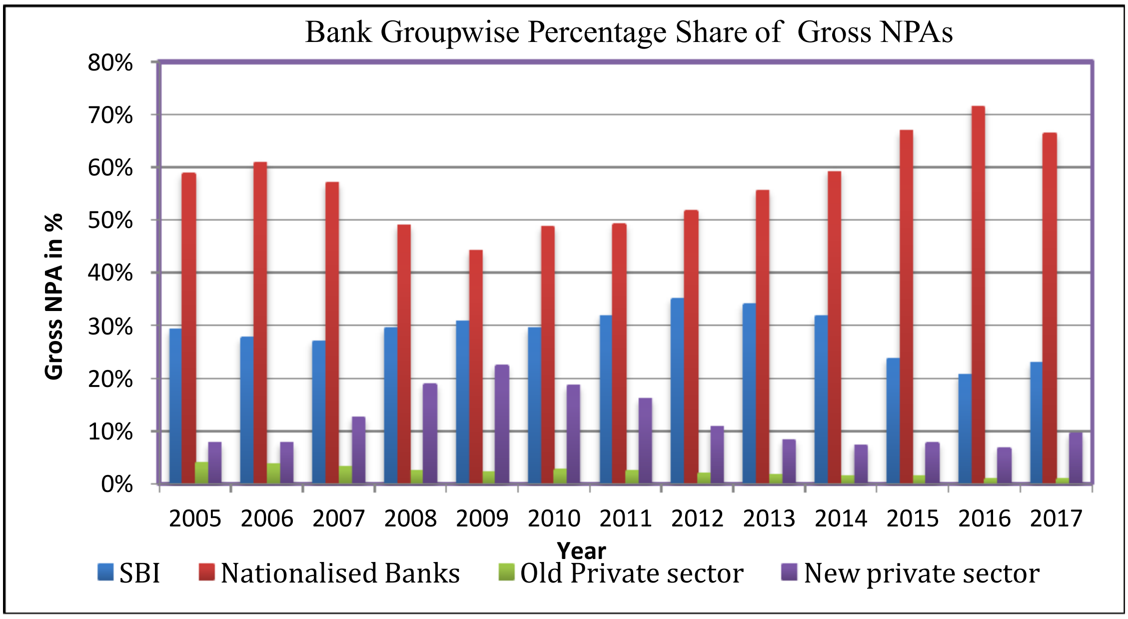

Chart 2

Source: *Compiled from the RBI's Statistical Returns Relating to Banks in India, 2005 - 2017.*

Chart 2 shows that the share of the nationalized banks is higher than the other bank groups. The spread of the NPAs in the Indian Banks has significantly increased from 2011 - 2017. To understand the depth of the problem, the position of the top 10 banks with higher NPAs during 2011 - 2017 is described.

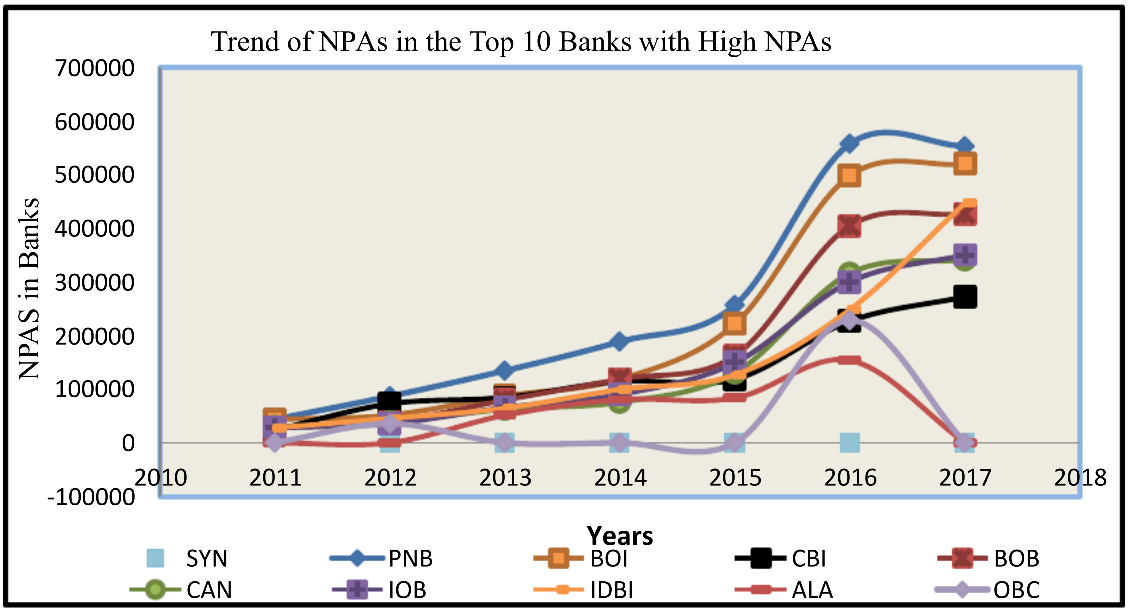

Chart 3

Source: *Compiled from the RBI's Statistical Returns Relating to Banks in India, 2005 - 2017.*

From Chart 3, it is clear that during 2011 - 2017, among the top 10 banks with excessive NPAs, the nationalized banks are the major contributors to the accretion of NPAs in the Indian banks. The amount of total Gross NPA has increased by 9%. Deliberately one can find that Punjab National bank's NPA has increased abnormally and it is followed by the Bank of India and Bank of Baroda; also the higher NPAs are observed in other public sector banks, which include the Canara Bank, Indian Overseas Bank, IDBI Bank, Central Bank of India, Allahabad Bank and Oriental Bank of Commerce. Notably, these banks are the largest lending institutions with thousands of branches and are operated throughout India. With this worsening asset quality, the domestically important lenders have been affected in enlarging the credit to the needy segment. In the country with the annual GDP growth of 7%, the brimming MSME enterprises are pushing the high requirement of credit.

2.1. Trend in Gross Advances

The trend in gross advances of all four bank groups is analysed using line chart which are shown in Chart 4 and Chart 5

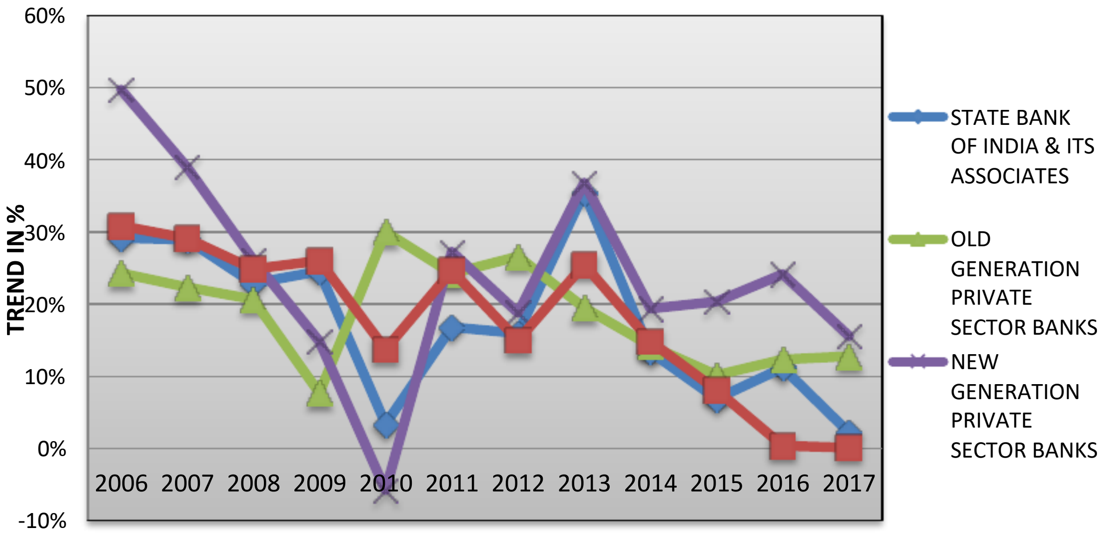

Chart 4 Trend in Gross Advances in Different Bank Groups

Source: *Computed from RBI's Statistical Tables relating to Banks in India, 2005-2017*

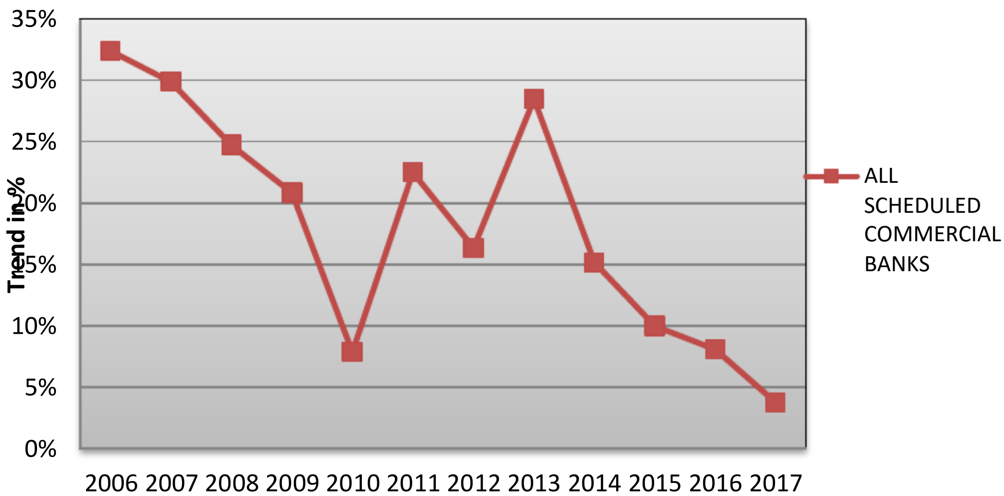

Chart 5 Trend in Gross Advances of All Scheduled Commercial Banks

Source: *Computed from RBI's Statistical Tables relating to Banks in India, 2005-2017*

From Chart 4, it is clear that the trend in gross advances in all the four bank groups has marginally decreased between 2005 and 2017. A sharp decrease was noted in Nationalised banks, State bank groups and New generation private sector banks during 2009-2010 and it was followed by a slight increasing trend in 2012. From 2013 onwards, there was a continuous falling trend in the gross advances of all the bank groups.

The trend of gross advances in ASCBs is exhibited in Chart 5. It shows a sharp decrease in the gross advances of ASCBs during 2010, followed by a sharp increase till 2012. The linear trend line in Chart 5 clearly explains that there is a sharp decreasing trend in the gross advances of ASCBs between 2005 and 2017.

From the trend analysis, it is clear that the Public sector banks and New generation private sector banks have witnessed a sharp decline in their growth of gross advances and the trend in ASCBs has also declined sharply. The major reason behind the sharp decrease in gross advances during the period of 2010 might be the impact of the global crisis in 2008. During the crisis period and post-crisis in 2009, the liquidity crunch of foreign investors has been equated by the contribution of both public and private sector banks with high risk. During 2012-2013, the level of NPAs has increased abnormally and due to the high provisioning and lower profit, the levels of advances continue to decrease which leads to further deterioration in the asset quality of banks.

3. RELATIONSHIP BETWEEN GROSS ADVANCES AND GNPAS

To examine the relationship between the Gross advances and GNPA of the different Bank Groups in India, correlation analysis was used.

Null Hypothesis, H_0: There is no linear relationship (when one variable increases another increases) between Gross advances and GNPAs among different bank groups.

Alternate Hypothesis, H_1: There is a linear relationship between Gross advances and GNPAs of different bank groups of ASCBs.

The results of correlation analysis is shown in Table 1

Table 1 Correlation Analysis

BANK GROUP	MEAN OF GROSS ADVANCES (Rs. In cr)	MEAN OF GROSS NPAs (Rs. In cr)	CORRELATION VALUE (TWO TAILED AT 0.01)
SBI and its Associates	10647527	529031	0.90
Nationalized Banks	23376240	1293124	0.78
Old Generation Private Sector Banks	1266218	31520	0.94
New Generation Private Sector Banks	7527849	195394	0.90

Source: *Computed from RBI's Statistical Tables relating to Banks in India, 2005-2017*

From Table 1, it can be inferred that with regard to the relationship between Gross Advance and GNPA, Old generation private sector banks group tops the list with the correlation value r = 0.94 and it is followed by SBI and its associates and new generation private sector r = 0.90 and nationalized banks with correlation value r=0.78. The higher correlation value of 0.90, 0.78, 0.94 and 0.90 clearly indicates a strong linear association between Gross advances and GNPAs of the banks. The positive value of correlation clearly indicates the positive linear association between the Gross Advances and GNPAs in all Bank groups (i.e.,) when the Gross Advances increases the GNPA also increases in all bank groups. Hence, the Null hypotheses get rejected and result that there is a linear relationship between the Gross advances and GNPAs of all Bank groups.

4. CONCLUSION

The nationalized banks are the major contributors to the accretion of NPAs in the Indian banks. The amount of total Gross NPA has increased by 9%. NPA of Punjab National bank's has increased abnormally during the study period, 2005 to 2017 and it is followed by the Bank of India and Bank of Baroda; also the higher NPAs are observed in other public sector banks, which include the Canara Bank, Indian Overseas Bank, IDBI Bank, Central Bank of India, Allahabad Bank and Oriental Bank of Commerce. Notably, these banks are the largest lending institutions with thousands of branches and are operated throughout India. The higher correlation value of 0.90, 0.78, 0.94 and 0.90 clearly indicates a strong linear association between Gross advances and GNPAs of the banks. The positive value of correlation clearly indicates the positive linear association between the Gross Advances and GNPAs in all Bank groups (i.e.,) when the Gross Advances increases the GNPA also increases in all bank groups.

The analysis revealed that there is a significant increase in the gross NPAs to total advances in the Public sector banks and a few private sector banks have impaired the entire banking industry. In order to achieve the objective "clean and fully provisioned bank balance sheets", the banks need to maintain adequate provisioning for the NPA. If the level of NPA increases year on year basis, then the provisioning also increases and it affects the bank's profitability and liquidity. The economic survey recommends 4 R's to fix the NPA problem of the Indian Banking Industry. Recognition, banks are advised to value their assets on a true value basis. Recapitalization, infusion of equity capital to safeguard the capital base, Resolution, timely action on stressed assets should be taken, and finally Reform, setting a strong norm to avoid the repetition of the NPA problem. Based on their NPA level banks are advised to follow the 4 R's techniques to solve the NPA problem.

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