'DIMENSIONS OF SPURT IN NON- PERFORMING ASSETS OF PUBLIC SECTOR BANKS IN INDIA'

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INTRODUCTION:

"For every rupee that banks in India have lent in the nine months period between Aprilto December 2013, 13 Paise has turned sour and has been classified asNon-Performing Assets(NPAs). For United Bank of India, 60 paise is bad for every rupee lent. In the same period, 42 banks have lent Rs 5.02 lakh Crores and their gross NPAs for the same period stood at Rs 67,394 Crores. Most of the NPAs were, however, added by the Public Sector Banks (PSBs). In these nine months, PSBs added Rs 63,782 Crores of bad loans to their books and accounted for 94 per cent of the total NPAs. An analyst said PSBs are burdened by bad loans from the mid-corporate and SME sectors. On the contrary, private banks focus on retail customers who account for lower NPAs. "PSBs have loans like Air India, Kingfisher etc. that have cost them dear. Overall, gross NPAs for public plus private banks increased from 4.0% as on September 30, 2013, to 4.1 per cent as on December 31,2013 ".(Source: Financial Express dated 13.03.2014).Reserve Bank of India (RBI) Governor Dr. RaghuramRajan also has recently expressed concerns about the growing NPAs of banks, especially those of PSBs. "There is a problem of NPAs. I hope these will stabilize," he said. (Business Standard dated 29.03.2014) The overall gross NPAs in the banking sector stood at 4.1 per cent at the end of December 2013, according to ICRA. Gross NPAs of PSBs stood at 5.17% i.e., up from 4.82% as of end-September 2013.Out of the total 40 listed banks in India,14 banks have reported more than 50% jump in net NPAs during these six months ending September 2013. According to NPAsource.com, surveys also show that net NPAs of seven banks was higher than 3.5 per cent as on September 30, 2013 whereas all banks Net NPAs percentage was below 3.5 per cent as of March 31, 2013. Gross NPAs as on September 30, 2013 stood at Rs 2,29,007 crore, 27 percent higher when compared to Rs 1,79,891 crore as of March 31, 2013 for these 40 listed banks ,I.e. over Rs. 50,000 crores of NPAs have been added in 6monthsonly.

The issue of NPAs has been drawing the attention of the Regulators, Bankers, policy makers and academicians alike. When a loan becomes non-performing, it affects recycling of credit and credit creation…. "The higher levels of over dues (NPAs) create problem in recycling of funds in the lending institutions and also in raising more resources in the form of refinance from the apex financial agencies, leading ultimately to sizeable reductions in quantum of new credit and in some cases total stoppage. Moreover, it leads to operational inefficiencies, lowering of morale of bank staff and above all tarnishes the public image of banks. Hence, for the lending system, the problem of overdue cuts at the roots and creates an unhealthy environment" (Rural Banking System; Promises and Performance Evaluation by Dr. Dilip K. Chellani, Published by BhartiyakalaPrakashan, New-Delhi, 1998). Apart from this, NPAs affect profitability as well, since higher NPAs require higher provisioning, which means a large part of the profits needs to be kept aside as provision against bad loans. Therefore, the problem of NPAs is not the concern of the lenders alone but is, indeed, a concern for policy makers as well who are involved in putting economic growth on the fast track. In this paper we examine the trends in bank NPAs in India from various dimensions and explain how mere recognition of the problem and self-monitoring has been able to reduce it to a great extent in last decade. It also shows that PSBs in India, which function to some extent with welfare motives, have as good a record in reducing NPAs as their counterparts in the private sector.

Conceptual Framework of NPAs:

In simple words, NPAs means "Bad Loans". It is called "non-performing" as it stops earning income for the Bank. In technical terms, NPAs means loan assets in a bank account which is no longer "standard " and which has been categorized by a bank or financial institution as "sub-standard" or "doubtful" or "loss" assets in accordance with the directions relating to asset classification issued by RBI. When the bank loans and advances becomes the NPAs?:Effective from 1-4-2004, there are different norms for categorizing the bad bank loans and advances as NPAs depending upon the different types/forms of credit facilities provided by banks to their borrower customers. Viz; Forall Term Loan Accounts:"an NPAs shall be a loan or an advance in which the Interest and /or installment of principal remain overdue for a period of more than 90 days. For cash credit / Overdraft: "an NPA Cash Credit / Overdraft Account is the account which remains 'out of order' for a period of more than 90 days". For Bills purchased (BPs) / Bills Discounted (BDs): " An NPAs BPs/BDs account is one where the bill remains 'overdue' for a period of more than 90 days in the case of bills purchased and discounted", For Agricultural Loans: "where the Interest and/ or installment of principal remains overdue "for two harvest seasons" but for a period not exceeding two half years, and any amount to be received remains overdue for a period of more than 90 days in respect of all other types of lent accounts of banks."

Asset Classification and Provisioning Norms:

Although the issue of assets-contamination was given importance ever since bank nationalization in July 1969 yet it was only after the Narasimham Committee Report (1991) that highlighted its impact on the financial health of the commercial banks. Health Code System; 1985-91: The RBI advised banks in 1985, to introduce the Health Code System (HCS) indicating the quality (or health) of individual loan assets under the following eight categories: **1.** Satisfactory, **2**. Irregular, **3.** Sick: viable, **4**.Sick: non-viable/sticky, **5.** Advances recalled, **6**. Suit filed accounts, **7**. Decreed debts and **8**.Bad and doubtful debts. Banks were asked to disclose health of their loan portfolio in these eight categories. The prudential norms of Income Recognition, Assets Classification and Provisioning were introduced in India to follow international best practices. The Narasimham Committee (1991) felt that the classification of assets according to the HCS was not in accordance with international standards. The Committee believed that a policy of income recognition should be objective and based on the actual recovery of income rather than on accrual/ subjective considerations. Initially, it introduced 180 days' time norms for realization/servicing of interest as well as installments. With effect from 1-4-2004 the norms were made on par with International norms of 90 days. Accordingly, now all bank loans and advances are classified into following four categories; viz.:1) Standard Assets– These are those assets which do not create any problem while paying interest/ installments of the principal. It usually carries more than normal risk attached to the business. Banks are required to keep 0.25% of advances as a provision under this category of asset. 2. Sub-Standard Assets – Those assets which has remained non- performing for a period less than or equal to 12 months. Generally, banks are required to make 10 per cent on total outstanding balance and 10 percent on unsecured exposures as provisions.3. Doubtful Assets – Assets remained in the sub-standard category for a period of 12 months. 100% to the extent advance not covered by realizable value of security. In case of secured portion, banks are maintaining the provision in the range of 20% to 100% depending on the period of asset remaining sub-standard and 4.

Loss Assets– These assets are those where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. Generally 100% of the outstanding balance is kept as a provision. The Categories 2, 3 and 4 collectively are called as NPAs.
Gross and Net NPAs: Gross NPA: Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on Balance Sheet date. Gross NPA reflects the quality of the loans made by banks. It consists of all the nonstandard assets viz: sub-standard, doubtful, and loss assets. It is calculated with the help of following ratio: Gross NPAs Ratio = Gross NPAs / Gross Advances.Net NPA: Net NPA shows the actual burden of banks. It is defined as NPAs net of provisions held for the same.i.e., Net NPA = Gross amount of NPAs –total provisions held for such NPAs

NPAs at Global Level:

Banks' lending anywhere in the world has inherent risk of borrowers default/non-repayment. NPAs are therefore global phenomenon varying in degrees from country to country and also from year to year. NPAs or NPL (Non-Performing Loans: as they are called in many nations) presented in the following table-1 shows that in 2003 the aggregate sum of all NPAs at the global level was US$ 1,300 billion. India ranked fourth with NPAs of around US$ 30 billion (2.3 per cent of the global NPAs) while Japan had the highest NPAs of US$ 330 billion (25.4 per cent of the global NPAs) and Turkey had the lowest NPAs of US$ 8 billion (0.7 percent of global NPAs).It may be noted that the absolute level of NPAs depends on total advances. A country with a large population or GDP may have large advances and, in turn, larger NPAs as well.

Table 1
Global NPAs in billion $and percentage to total global NPAs: 2003 and 2013.

Country	Japan	China	Taiwan	Thailand	Turkey	Indonesia	India	Korea	Germany
NPAs Amount ($billion)	330	307	19	18.8	8	16.9	30	15	283
NPAs as % total (global) NPAs in 2003	25.4	23.6	1.5	1.5	0.7	1.3	2.3	1.2	21.8
NPAs as % total (global) NPAs in 2013	1.5	2.5	NA	-	-	-	2.3	3.5	2.7

Source: Global NPL/NPAs Report 2004 and 2013, Ernst and Young.

Apart from the absolute value, it is also important to look at what proportion of the total loans & advances has become bad/non-performing. It may be noted that in 2003, NPAs amount was highest for Japan in absolute terms whereas in percentage terms it was on much lower than that of many countries including China, Thailand etc. So the ratio of NPAs amount as percentage to total loans, which is now called as "NPAs in percentage or gross NPAs is a better indicator of NPAs (Ernst and Young Report, 2004**).**

NPAs of Developing and Developed Economies:

It may be interesting to study the status of NPAs inselect developing economies vis-a-vis developed economies. In this regards according to Global Financial Stability Report -2009 which compares the level of Net NPAs and also Provisions for bad loans made for the period between 2002 to 2008 is presented in the following table 2 here as under. The table 2below indicates that there is progressive declining trend in Gross NPA% for both the developing economies as well as developed economies. The provisions made for NPAs also shows progressively declining trend commensurate with declining trend of Gross NPA %. Only China and Indonesia's made higher provisions than previous year in 2008 whereas amongst developed countries Australia and USA showed sudden spurt in 2006 – may be due to financial crisis periods. It may also be noted that in 2008 NPAs percentage of most of developed countries is hovering around 1% whereas the same is about 3% for developing countries for obvious reasons.

Table 2

Global NPAs/NPL of select countries as percentage to their total loans & the provisions for NPAs

Developing Nations	2002	2006	2007	2008	Provision →	2002	2006	2007	2008
China	26 %	7.5%	6.7%	2.5%	In $million	X	x	39.2	115.3
India	10.4%	3.5%	2.5%	2.3%		X	58.9	56.1	52.6
Indonesia	24%	13.1%	4.1%	3.5%		130	99.7	87.7	98.5
S. Africa	2.8%	1.2%	1.4%	2.6%		46	x	X	X
Advanced Nations									
Australia	0.4 %	0.2%	0.2%	0.5%		106.2	204.5	183.7	87.2
France	4.25	3.2%	2.7%	nglgble		58.4	58.7	42.1	34.1
GERMANY	5.0%	4.0%	2.7%	nglgble		X	x	77.3	X
ITALY	6.5%	5.3%	4.6%	nglgble		X	46	49.5	X
JAPAN	6.5%	5.3%	4.6%	nglgble		X	30.3	26.4	24.9
UK	2.6%	0.9%	0.9%	nglgble		75	x	X	X
USA	1.4%	0.8%	1.4%	2.3%		123.7	137.2	93.1	84.1

(N. B.: "nglgble" = Negligible = less than 0.1 per cent)

Source: Global Financial Stability Report, April -2009, IMF

The second (right) side of table gives an idea of country wise provisions for NPAs made by banks. No specific or distinct trend is indicated; this is truism as depending upon gross level of NPAs and depending upon regulatory provision requirement banks make provision for NPAs. One interesting feature is to be noted in the above table that the NPAs/NPL as a percentage of the total loans has been consistently declining for almost all countries (except S Africa and USA in 2008) over the years. This shows that the quality of bank assets has been improving across countries over the years. This could also be the result of the stringent regulations prescribed by the BASEL Norms.

Bank NPAs in India

In India, Scheduled Commercial Banks (SCBs) gross NPAs as percentage to total advance has come down from 11.4% in 2001to 5.2% in 2005 and presently it is hovering around3 to 3.5%.

Table 3
Net and Gross NPAs of Scheduled Commercial Banks: 2008-2012
(Amt. in Rs. Crores)

YEAR	Gross loans	Gross NPAs	Net Loans	Net NPAs
2008	25,079	564 (2.3)	24,770	247 (1.0)
2009	30,383	682 (2.3)	30,009	314 (1.1)
2010	35,449	847 (2.4)	35,013	391 (1.12)
2011	43,511	979 (2.5)	43,106	418 (0.97)
2012	51,589	1423 (3.1)	50,842	649 (1.4)

Figures in the bracket indicates in percentage terms
Source: RBI data.

The above table-3 indicates that during the review period 2008-2012, the absolute amount of Gross NPAs has been growing with sudden spurt in 2011 and 2012. The decline in the Net NPAs is sharper than Gross NPAs in 2011, mainly because of the increasing level of provisions made by banks. While Net NPAs may give true idea of burden on bank and indirectly the strength of particular bank to with stand the onslaught of NPAs. However, it is Gross NPAs % which is true measure of growth in NPAs. According to RBI data, net NPAs of the 26 public sector banks (i.e., excluding Private Sector and foreign Banks in India) rose to 2.02 per cent during 2012-13 as compared to 1.53 in the previous fiscal. Net NPAs of new private sector banks rose marginally to 0.45 per cent as compared to 0.42 per cent for the same period.

NPAs of Private Sector Banks vs. Public Sector Banks:

There is also general perception that PSBs have higher NPAs than Private sector or Foreign Banks. Following table 4 presents the classification of Bank-groups assets as on 31-3-2013.The table indicates that SBI group has the highest NPAs of 4.42 percent. Old as well as new private sector banks have performed the best in keeping the NPAs at less than 2 percent. Within the group, new generation private sector bank group consisting of HDFC, ICICI, AXIS, Yes Bank etc have performed the best amongst all banks groups in India. Surprisingly, the foreign banks as group have performed better than nationalized banks as their NPAs level was 2.94 percent i.e., better than nationalized banks but worse than private sector banks in India and this may be due to few big ticket size loans contaminated their loan books.

Table 4
Assets Classification in different bank-groups in India: as on 31-3-2013
(Amount in Rs. Crores)

Bank Group 1	Standard Assets 2	Sub-Standard 3	Doubtful 4	Loss 5	Total Assets 6	Total NPAs 7(3+4+5)
Nationalized Banks	30,39,600 (96.76)	55800 (1.78)	42400 (1.35)	3500 (0.11)	3141300	101700 (3.24)
SBI group	13,56,100 (95.57)	25800 (1.82)	33700 (2.38)	3300 (0.23)	1418900	62800 (4.42)
Total PSBs**(A)**	43,95,700 (96.39)	81600 (1.79)	76100 (1.67)	6800 (0.15)	4560200	164500 (3.61)
Old Private Sector Banks	2,67,900 (98.10)	2300 (0.84)	2300 (0.84)	600 (0.22)	273100	5200 (1.90)
New Private sector Banks	8,70,500 (98.25)	4100 (0.47)	8900 (1.00)	2500 (0.28)	886000	15500 (1.75)
Total Private Sector Banks**(B)**	11,38,400 (98.21)	6400 (0.55)	11200 (0.97)	3100 (0.27)	11,59,100	20,700 (1.79)
Foreign Banks**(C)**	2,61,000 (97.06)	2900 (1.08)	2700 (1.00)	2300 (0.86)	268900	7900 (2.94)
Total SCBs (A+B+C)	57,95,100 (96.78)	90900 (1.52)	90000 (1.50)	12200 (0.20)	5988200	193100 (3.22)

Source: RBI data.
Note: figures in bracket indicate percent to total assets.

RBI's past data also indicate that despite the NPAs bug biting the banking industry on the whole, private sector banks seem to have done a better job of wriggling out of the stress arising from the slowdown in the economy. Between March 2011 and September 2013, the ratio of gross NPAs to gross advances of public sector, old private sector and new private sector banks put together, rose rather sharply from 2.4 percent to 4.3 percent. While the share of the PSBs in incremental advances between end-March 2011 and end-September 2013 was 76 percent their share in the increase in absolute NPAs was 96 percent.

<u>Sector wise Analysis of NPAs in Banks in India:</u>

Often, the high percentage of NPAs of Indian commercial banks is attributed to the credit Policy followed by the RBI under the social banking motto of the Government of India (GOI).To examine this we first look at the NPAs of the domestic banks under the directed credit called "Priority sector" vis-à-vis "Non-Priority" sector popularly called C & I loans and advances. Following table5 reveals that the NPAs of the domestic banks under priority sector are indeed lower and considerably fallen than the NPAs under the non-priority sector during both the years-end 2012 and 2013 (March-end). Table 5 clearly indicates that the NPAs ratio in Priority sector was consistently lower than the NPAs ratio in non-priority sector. Thus, the deterioration in total assets quality in 2012-13 was primarily due to under total non-Priority sector. Thus the real banking/better banking is directed/targeted bank advances. Further, it is worth taking a note that under C & I advances the bank managements often take the help of professionals like Chartered Accountants, Cost Accountants and Chartered Financial Analysists etc. to evaluate/examine the viability of the loan proposals received and take the final decision of financing the proposals yet it is under the priority sector advances although are large in number and per account amount is also less, the NPAs are also lower. However, while it has been often highlighted in many studies that NPAs in the priority sector is less than that of the non-priority sector, a point often missed is that the priority sector advances constitutes about 40Per cent of total lending. Therefore, it is important to examine NPAs figures in proportion to the advances made in that particular sector.

Table 5
Sector wise NPAs of Domestic Banks in India (March-end 2012 and 2013)
(Amount in Rs. Crores)

Bank Groups	Total Priority sector	Of which under Agriculture	MSE	Total Non-Priority Sector	Total NPAs
SBI Group 2012	23900 (52.3)	9800 (21.4)	4100 (9.0)	21800 (47.7)	45700
2013	26400 (44.1)	12400 (20.7)	10600 (17.6)	33500 (55.9)	59900
Natlonalised Bank Group 2012	32300 (48.4)	12900 (19.3)	13400 (20.0)	34500 (51.6)	66800
2013	40500 42.2	15600 (16.3)	17800 (18.6)	55400 (57.8)	95900
PSU Banks 2012	56200 **(50.0)**	**22700** (20.2)	**17400** (15.5)	56300 **(50.0)**	112500
2013	66900 **(42.9)**	**20800** (18.0)	**28400** (18.2)	89000 **(57.1)**	155900
Old Private sector banks 2012	1800 (42.9)	600 (13.4)	700 (16.8)	2400 (57.1)	4200
2013	1900 (36.8)	600 (12.2)	700 (13.9)	3300 (63.2)	5200
New Private sector banks 2012	3300 (23.4)	1600 (11.3)	1000 (7.2)	10800 (76.6)	14100
2013	3300 (22.2)	1500 (10.4)	1200 (8.5)	11500 (77.8)	14800
Private sector bank group 2012	5100 **(27.9)**	**2200** (11.8)	**1700** (9.4)	13200 **(72.1)**	18300
2013	5200 **(26.0)**	**2200** (10.9)	**2000** (9.9)	14800 **(74.0)**	20000
All domestic banks 2012	61300 **(46.9)**	**24900** (19.0)	**19100** (14.7)	69500 **(53.1)**	130800
2013	72100 **(41.0)**	**30200** (17.2)	**30400** (17.3)	103800 **(59.0)**	175900

Source: RBI – Trends and Progress of Banking in India, 2012-13

NB: Figures in bracket indicate percent to Total NPAs

Computation of sector-wise NPAs also indeed reveals that NPAs in the MSE sector is rising as well as higher than the Agriculture sector in the total NPAs for all domestic banks by March-end 2013 compared to a year end. An important question arises at this juncture is that, although it is essential to reduce NPAs to achieve the sustainability of banks and achieve the international norms, Will such an endeavor have an adverse effect on the poor, especially farmers and small entrepreneurs in rural India? The issue assumes importance as this group constitutes more than 60 per cent of the total population and is dependent upon agriculture as source of income and livelihood in India.

Table 6
Movement Chart of Gross NPAs of all bank groups in India: 2012-13
(Amountin Rs. Crores)

Banks	**Nationalized banks (i)**	**SBI Group (ii)**	**PSBs (i+ii)**	**Old Pvt sector (A)**	**New Pvt sector (B)**	**Total Pvt Sector (A+B)**	**Foreign Banks**	**Total of allSCBs**
O/B 1/4/12	69600	48200	117800	4200	14500	18700	6200	142900
+Addition	**77200**	**42500**	**119800**	**4100**	**8700**	**12800**	**4100**	**136800**
-recovery	42900	21900	64800	3000	3300	6300	2400	73600
-Write off	**1700**	**6000**	**7800**	**100**	**4000**	**4200**	**0**	**12000**
Closing Balance as on 31/3/13	102200	62700	165000	5200	15800	21000	7900	194000
% of NPAs	3.6%	5.0%	4.1%	1.9%	2.0%	2.0%	2.9%	3.6%
% of Write off	0.68%	9.56%	4.72%	1.92%	25.3%	20%	0%	6.18%

Source: RBI; Report on Trend and Progress of Banking in India in 2012-13

Heavy Write-Off by banks: It may also be reiterated that the NPAs position might have been worse but for the heavy write-off resorted to by all banks during the year 2012-13. As per row 3 of the above table 6, it is evident that all SCBs together have written off over RS 12,000 crores of Bad Loans during the year. This also means that the Gross NPAs of all banks which was shown as Balance sheet asRs.194, 000 cores would have risen to Rs 206,000 crores on 31/3/13.Write-off is a drain on profitability and also waste of public money.

<u>Heavy spurt of NPAs in PSBs: Recent NPAs Trends in 2013-14:</u>

According to NPAsource.com, the Gross NPAs of listed banks have doubled since September 30, 2011; while net NPAs have risen by 2.4 times or 140percent, during the same period fourteen banks had reported more than 50% rise in net NPAs in first half of 2013-14 as under:

Bank	March 2013	September 2013	Change Amount Percentage	
ING Vysya Bank	9	52	53	584.8
Bank of Maharashtra	393	1535	1142	290.7
Syndicate Bank	1,125	2547	1422	126.4
United bank of India	1,970	4385	2415	122.6
Corporation Bank	1,411	2668	1257	89.1
South Indian Bank	250	440	190	76.3
Kotak Mahindra Bank	311	547	236	75.9
IDBI Bank	3,100	5174	2074	66.9
HDFC Bank	469	767	298	63.6
Total 40 banks	93,109	1,28,533	35,424	38.0

Source: NPAsource.com

CAUSES OF NPAs

We examine below the various methods adopted by banks in India, especially the PSBs to tackle the menace of NPAs. To evaluate that, let us first examine the main causes of assets turning into NPAs.

Causes of NPAs; The reasons for the bank loan accounts becoming NPA could be any or a combination of some of the following factors/reasons:

- Closure of the unit.
- Sickness of the unit.
- Death of the borrower.
- Destruction/Loss of the asset financed.
- Willful default by the borrower.
- Business losses.
- Sudden environmental change (demand/supply/consumer preferences/ market/product) etc.
- Non-realization from debtors / receivables.
- Inability of borrowers to repay the due amount, due to change in his repayment capacity/financial position etc.

Whatever might be reason as above, the fact that the asset is not generating income and / or principal remains overdue will make it NPAs, notwithstanding the integrity of the borrower, value of collaterals, assurance of borrower to repay, security available etc. Apart from business failure, there are many other causes which are also responsible for accumulation of NPAs like faulty credit management, lack of professionalism in the workforce, unscientific repayment schedule, mis-utilisation of loans by borrower, lack of timely legal solution to cases, political interference at local levels and waiver of loans by government. A recent study by ASSOCHAM has said: "There are a number of factors responsible for weak performance in respect of debt recovery and consequently banks' accounts turning into NPAs. NPAs occur due to the factors attributed to the borrowers, lenders and also due to external environment. Borrowers may divert their funds for expansion, modernization, diversification etc. (RBI, 1999). The borrowers' low priority to technology up gradation, inadequate attention to research and development, inefficient management etc. also lead to accounts in becoming non-performing. Loans may turn bad due to faulty policies of lenders also. Credit appraisal policies followed by the banks are old and ineffective. Sometimes delays in sanction/disbursement also make the project unviable." However, the majority of the bankers consider 'lack of entrepreneurship' as the most important reason for NPAs closely followed by 'willful defaults' as the main reasons for NPAs , while majority of the borrowers consider 'market failure' as the reason for their inability to service their loans. Banks need to have effective credit monitoring policy for follow up, but unfortunately banks are not able to follow up the loan accounts efficiently which leads to loans being difficult to recover. Legal system is also ineffective. It takes a number of years to recover the amount. It is evident from the analysis made here that the problem of NPAs in India has not yet reached in the critical stage that has reached in many European countries. Industry related loan accounts which are near about 42% of total loans, and 20% of the industry-related loan assets can be considered as problematic. However, the burden of NPAs does have a serious impact on the long-term viability of the Indian financial sector and the absence of efficient resolution mechanisms will affect the growth of credit to the banking industry.

Suggested Remedial Actions To Arrest NPAs

Credit appraisal has to be more efficient, effective and professional. Credit monitoring has to be more vigilant and alert from the date of disbursement itself. Deterrent punishment for intentional defaulters is the need of hour. Legal framework has to be more Bankers –friendly; Credit History system has to be more robust and wide-spread encompassing all transactions etc.

The asset quality of banks is an important indicator of their financial health; it also reflects the efficacy of their credit risk management and recovery environment. The asset quality of the banking system deteriorated significantly during the year and there was an increase in the total stressed assets in the banking system (that is, NPAs plus restructured assets). Banks need to not only follow the various measures put in place by the RBI and the GOI effectively for resolution and recovery of bad loans but also strengthen their due diligence, credit appraisal and post sanction loan monitoring systems to minimize and mitigate the problems of increasing NPAs. There is a need to improve the effectiveness of the recovery system. Recovery should be focused on efficiency and fairness -reserving the value of underlying assets and jobs where possible, even while redeploying unviable assets to new uses and compensating employees fairly. This should be done while ensuring that contractual priorities are met. In this regard, there is urgent need for accelerating the working of Debt Recovery Tribunals and Asset Reconstruction Companies. It is also necessary to collect credit data and examine large common exposures across banks. This will enable the creation of a central repository on large credits, which can be shared with the banks. This in turn will enable banks to be aware of building leverage and common exposures. This also underscores the need for expediting the setting up of an enhanced resolution structure for financial firms. Going forward, we are sure that these issues will engage priority attention of RBI/GOI.

NPAs show no signs of abating in 2014-15 also.

Indicating a tough year ahead for the country's banking system, bad loans are likely to rise further in 2014 as the lag effect on asset quality in relation to economic slowdown has not yet peaked, reveals a study by industry body ASSOCHAM. The study, which raises serious concerns on deteriorating asset quality of banks, found that slippages are on increase in 2014-15 also. . According to the ASSOCHAM study, restructured accounts have grown at a compounded annual growth rate of 47.86% in public sector banks. The corresponding figures for private sector banks are 8.12%, suggesting that private banks are less affected. One of the reasons why private banks have relatively less bad loans vis-à-vis public sector banks is that they don't face Government pressure to lend to the infrastructure sector. For these private banks, retail accounts constitute almost 30% of their total loans and advances, helping them maintain healthy growth in profitability and fewer bad loans.

A study by ICRA has also reported that:"The situation is further expected to deteriorate as NPAs are expected to further grow and reach Rs 1, 50,000marks by end of FY14 because there is a lag effect on asset quality in relation to the state of the economy," the study said. "Improvement unlikely on bad loan front; PSBs to blame": ICRA (FE 07.03.14) Another study by FITCH has also highlighted the grave dimensions of menace of growing NPAs in India as under: "Indian banks could be worst hit in the emerging markets due to the further weakening of asset quality because of economic slowdown and high interest rates, ratings firm Fitch has said. The downside risk is greatest in China and India, but has risen in Russia and Turkey, Fitch Ratings said in its latest report on emerging market banks. Indian banks asset quality is likely to weaken further. Stressed assets, including non-performing loans (NPLs) and restructured loans, are expected to rise from 10% of total loans as of mid-2013 to around 15% by March 2015.The ratings firm said government-owned banks are most affected and may need Rs 3.8 trillion or around $60 billion of new equity by 2019 to achieve full compliance with Basel rules". "Banks Asset Quality will weaken Further ": Fitch (Economic Times 19.04.14)

Conclusion:

On the basis of the foregoing discussion, certain broad observations, issues and perspectives on the performance of banking sector and financial stability of the economy on the eve of the introduction of Basel III norms by RBI to the banks, it would be appropriate to conclude that;

1. In retrospect, the Indian Banks have overall demonstrated a trend of continued good performance and profitability despite rising interest rates, increase in operating costs and the spillover effects of recent global financial crisis .This is reflected in higher credit growth deposit record, better return on assets, and return on equities. The capital position improved significantly as the banks were able to mobilize substantial deposits/ funds.
2. However, as observed from the above analysis, the level of NPAs is also high with all banks currently and the banks are expected to bring down their NPAs. This can be achieved by good credit appraisal procedures, effective internal control systems along with their efforts to improve asset quality in their balance sheets.
3. However, maintaining profitability is a challenge to commercial banks especially in a highly competitive era and opening up of banking business to NBFC and Foreign Banks. And last but not the least the, competition amongst banks including with license granted to two banks recently and with the rest of the financial sector will increase. Financial Inclusion campaign would further put stress in loan assets. There is a need for decisive changes in the banking structure to enable it to grow in size, resources, efficiency and inclusivity.

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