

# The investigation of the effects of increasing non-performing assets on the Indian economy prior to COVID-19.

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Strong banking sector is one of the most significant prerequisite of strong economy because it channels the savings into the investment. The economy of a country depends upon sound banking system in the country. Any crisis in the banking sector it directly affect the economy of the country. For economic development of a country we need a sound banking system but now a days banking industry are negatively affecting to the society because of the rising of Non- Performing Asset (NPAs) .Non Performing Asset means any asset which stops giving returns to its investors for a specified period of time.This bad performance is not a good sign and can result in crashing of banks as happened in the sub-prime crisis of 2008 in the United States of America. Also the NPA problem in India is worst when comparing other emerging BRICS Economics. For the last a few years the NPA of banks is increasing tremendously. NPAs in public sector banks increased by about Rs 10.2 lakh crore between March 2015-2018 from Rs 3,23,464 crore, as on March 31, 2015, to Rs 10,35,528 crore, as on March 31, 2018. Several steps have been undertaken by the RBI and the government of India to curb the increasing NPA of Indian banks, but these steps have not been proved to be successful.

Now a day the increasing NPA has become the burning issue in banking sector. If we are not controlled this situation it impact on Banks, Industries and Economy of the country. Higher NPA ratio trembles the confidence of investors, depositors, lenders etc. It also causes poor recycling of funds, which in turn will have deleterious effect on the deployment of credit. The non-recovery of loans effects not only further availability of credit but also financial soundness of the banks this situation causes for the economic recession in the country. To overcome this problem RBI and Banks should coordinate each other and develop the rules and regulation for lending and recovering of loans should be improved. Then only the NPAs would reduce in the country.

**Keywords:** Bank, Non performing asset , Economic recession

## INTRODUCTION:

Banking sector plays a important role in the economic development of the country by restructuring the banking industry any country can control the economic activity in the country. Reforms in India has progressed promptly on aspects like reduction in statutory reserve requirements, interest rate deregulation, asset classification, income recognition and prudential norms for interest rates. But it could not match the pace with which it was expected to. The accomplishment of these norms at the execution stages without restructuring the banking sector as such is creating havoc, The major problem which banking industry are facing is increase of non-performing assets and difficult to find the reasons for mounting of non-performing assets.

During pre-nationalization period and after independence, the banking sector remained in private control Large industries who had their control in the management of the banks were utilizing major portion of financial resources of the banking system and as a result low priority was accorded to priority sectors. Government of India nationalized the banks to make them as an instrument of economic and social change and the mandate given to the banks was to expand their networks in rural areas and to give loans to priority sectors such as small scale industries, self-employed groups, agriculture and schemes involving women. To a certain extent the banking sector has achieved this mandate. Lead Bank Scheme enabled the banking system to expand its network in a planned way and make available banking services to the large number of population and touch every strata of society by extending credit to their productive Endeavour's. This is evident from the fact that population per office of commercial bank has come down from 66,000 in the year 1969 to 11,000 in 2004. Similarly, share of advances of public sector banks to priority sector increased from 14.6% in 1969 to 44% of the net bank credit. The number of deposit accounts of the banking system increased from over 3 crores in 1969 to over 30 crores. Borrowed accounts increased from 2.50 lakhs to over 2.68 crores.

## LITERATURE REVIEW

**According to a study by Brownbridge** (1998), most of the bank failures were caused by non-performing loans. Arrears affecting more than half the loan portfolios were typical of the failed banks. Many of the bad debts were attributable to moral hazard: the adverse incentives on bank owners to adopt imprudent lending strategies, in particular insider lending and lending at high interest rates to borrowers in the most risky segments of the credit markets

**Roma Mitra et.al (2008)**, A stable and efficient banking sector is an essential precondition to increase the economic level of a country. This paper tries to model and evaluate the efficiency of 50 Indian banks. The Inefficiency can be analyzed and quantified for every evaluated unit. The aim of this paper is to estimate and compare efficiency of the banking sector in India. The analysis is supposed to verify or reject the hypothesis whether the banking sector fulfills its intermediation function

sufficiently to compete with the global players. The results are insightful to the financial policy planner as it identifies priority areas for different banks, which can improve the performance. This paper evaluates the performance of Banking Sectors in India.

### OBJECTIVES OF THE STUDY

- To study the trend of Non-Performing Assets during last 10 years
- To determine the factor affecting Non-Performing Assets
- To find out the impact on economy by the Non-Performing Assets
- To find the effectiveness of recovery techniques adopted by the Banks for NPAs
- To suggest measure to reduce Non-Performing Assets in banks.

### RESEARCH METHODOLOGY:

The present study is an attempt to examine the impact of Non-Performing Assets on economy of the country. The present study mainly relies on the secondary data collected from various published articles, RBI websites, Government sites, annual reports of commercial bank, other banking sector related articles and books.

### BANK:

The term bank has originated from the term 'Banchi'. In olden days, the traders of Italy who performed the job of exchanging money were known as Banchi or Bancheri because the table which they used for making payment was called a Banchi. A bank deals in money in the same way as a businessman deals in goods. Banks are business enterprises which deal in money, financial instruments and provide financial services for a price called interest, discount, commission etc.

### HISTORY:

In India, the banking system is as old as early Vedic period. The book of Manu contains reference regarding deposits, advances, pledge, policy of loan, and rate of interest. From the beginning of 20th century banking has been so developed that in fact, it has come to be called "LIFE BLOOD" of trade and commerce. With the dawn of independence, changes of vast magnitude have taken place in India. After independence India launched a process of planned economic activity in order to overcome the multitude of problems it faced as an underdeveloped nation. The increasing tempo of economic activity leads to tremendous increase in the volume and complexity

of banking activity. Therefore, the role of banks has had to expand at a fast pace. The banking system, the most dominant segment of financial sector, accounts for over 80% of the funds flowing through the financial sector. A banking sector performs three Primary functions in an economy: The operation of the payment system, the mobilization of savings and the allocation of savings to investment projects. By allocating capital to the highest value use while limiting the risk and cost involved, the banking sector can exert a positive influence on the overall economy, and thus of broad macro-economic importance. The origin of the Indian banking industry may be traced to the establishment of bank of Bengal in Calcutta (now Kolkata) in 1786. The growth of banking industry in India may be studied in terms of two broad phases.

Pre-independence (1786-1947) and Post-independence (1947 till date). The Post-independence phase may be

further divided into three sub phases such as pre-nationalization period (1947-1969). Post nationalization period (1969 to 1991) and Post-liberalization period (1991 till date).

Types of Banks:

### **PUBLIC SECTOR BANKS**

Public sector banks are the ones in which the government has a major holding. Public Sector Banks dominate 75% of deposits and 71% of advances in the banking industry. Public Sector Banks control

Commercial banking India, these can be further classified into:

Nationalized banks<sup>2</sup>) State Bank of India and its associates<sup>3</sup>) Regional Rural Banks

### **PRIVATE SECTOR BANKS:**

Private sector banks came into existence to supplement the performance of public sector banks and serve the needs of the economy better. As the public sector banks were merely in the hands of the government, banks had no incentive to make profits and improve their financial capability. The main difference between public and private sector banks is only that public sector banks follow the RBI interest rules strictly but private banks can make some changes in them but only after the approval from the RBI. Private sector banks are the banks which are controlled by the private lenders with the approval from the RBI. Their interest rates are slightly costly as compared to public sector banks.

### **NON PERFORMING ASSETS :**

NPAs play an important role in the development of a country. If any country fails to control this it leads to economic crises in the country. As per RBI NPAs means An

asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A ‘non-performing asset’ (NPA) was defined as a credit facility in respect of which the interest and/ or installment of principal has remained ‘past due’ for a specified period of time.

Type of loan and its features

Sl.no.	Name of facility	specification
1	Term loan	interest and/or installment of principal remain overdue for a period of more than 180 days
2	Overdraft/Cash Credit	account remains ‘out of order’ for a period of more than 180 days
3	bills purchased and discounted,	bill remains overdue for a period of more than 180 days
4	Agricultural loan	interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years
5	Any loan	Any amount to be received remains overdue for a period of more than 90 days

#### Definition by RBI:

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

A Non-performing Asset (NPA) is a loan or an advance where:

Interest and/or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan,

The account remains ‘out of order’ for a period of more than 180 days, in respect of an Overdraft/Cash Credit (OD/CC),

The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,

Interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes,

Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

Out of Order' status

An account should be treated as '**out of order**' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for six months as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as '**out of order**'

### Categories of NPAs

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the realisability of the dues:

#### Sub-standard Assets:

A sub-standard asset was one, which was classified as NPA for a period not exceeding two years. With effect from 31 March 2001, a sub-standard asset is one, which has remained **NPA for a period less than or equal to 18 months**. In such cases, the current net worth of the borrower/ guarantor or the current marketvalue of the security charged is not enough to ensure recovery of the dues to the banks in full. In other words, such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

#### Doubtful Assets:

A doubtful asset was one, which remained NPA for a period exceeding two years. With effect from 31 March 2001, an asset is to be classified as doubtful, if it has remained **NPA for a period exceeding 18 months**. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.

#### Loss Assets:

A loss asset is one 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. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

#### PUBLIC SECTOR BANKS NPAsRs in cr's

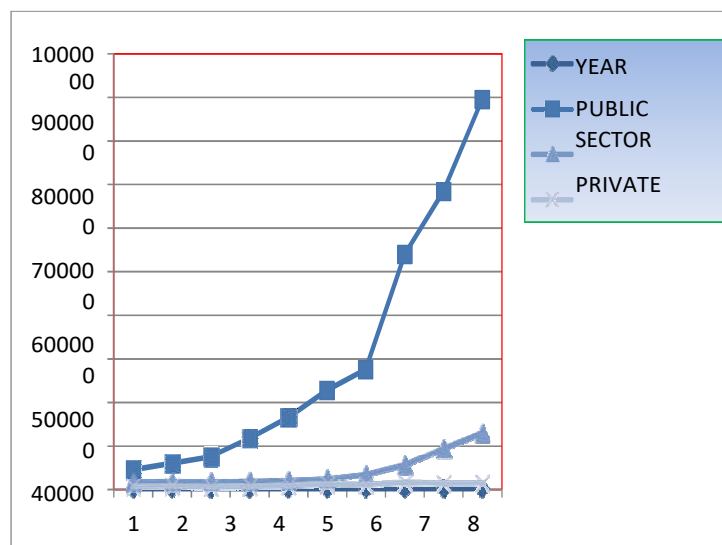
	Name of the public sector bank	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
1	ALLAHABAD BANK	1078.25	1221.8	1647.92	2058.98	5136.99	8068.04	8357.96	15384.57	20687.83	26562.79
2	ANDHRA BANK	368.14	487.87	995.64	1798.01	3714.49	5857.6	6876.54	11443.63	17669.98	28124.36
3	BANK OF BARODA	1842.92	2400.69	3152.5	4464.75	7982.58	11875.9	16261.44	40521.04	42718.7	56480.38
4	BANK OF INDIA	2470.88	4882.65	4811.55	6470.87	9309.53	12878.4	22193.24	49879.13	52044.52	62328.46
5	BANK OF MAHARASHTRA	798.41	1209.79	1173.7	1297.03	1137.55	2859.85	6402.06	10385.85	17188.71	18433.23

6	CANARA BANK	2167.97	2590.31	3137.36	4031.75	6260.16	7570.21	13039.96	31637.83	34202.04	47468.47	
7	CENTRAL BANK OF INDIA	2316	2458	2394	7273	8456	11500	11873	22721	27251.33	38130.7	
8	CORPORATION BANK	559.22	650.94	790.23	1274.21	2048.23	4736.79	7106.67	14544.25	17045.22	22213.44	
9	DENA BANK	620.77	641.99	842.24	956.5	1452.45	2616.03	4393.04	8560.49	12618.73	16361.44	
10	IDBI BANK LIMITED	1435.69	2129.38	2784.73	4551.37	6449.98	9960.16	12684.98	24875.06	44752.59	55588.25	
11	INDIAN BANK	459.18	510.1	740.31	1850.78	3565.48	4562.2	5670.44	8827.04	9865.14	11990.14	
12	INDIAN OVERSEAS BANK	1923.41	3611.08	3089.59	3920.07	6607.96	9020.48	14922.45	30048.63	35098.26	38180.15	
13	ORIENTAL BANK OF COMMERCE	1058.12		1468.75	1920.54	3580.49	4183.96	5617.86	7666.22	14701.68	22859.27	26133.64
14	PUNJAB AND SIND BANK	161.04		206.15	424.28	763.44	1536.9	2553.52	3082.19	4229.05	6297.59	7801.65
15	PUNJAB NATIONAL BANK	2506.91		3214.41	4379.39	8719.62	13465.79	18880.06	25694.86	55818.33	55370.45	86620.05
16	STATE BANK OF INDIA*	18413.91		25532.46	30392.79	48214.41	62778.47	79816.49	73508.45	12968.56	177810.6	223427.5
17	SYNDICATE BANK	1594.54		2006.82	2598.97	3182.7	2978.5	4611.13	6442.38	13832.16	17609.31	25758.6
18	UCO BANK	1539.51		1666.43	3150.36	4086.2	7130.09	6621.37	10265.05	20907.73	22540.95	30549.92
19	UNION BANK OF INDIA	1923.35		2670.89	3622.82	5449.86	6313.83	9563.74	13030.87	24170.89	33712.28	49369.93
20	UNITED BANK OF INDIA	1020		1372.3	1355.78	2176.42	2963.82	7118.01	6552.91	9471.01	10951.99	16552.11
21	VIJAYA BANK	698.82		994.45	1259.19	1718.46	1532.94	1985.86	2443.21	6027.07	6381.78	7526.09

**PRIVATE SECTOR BANKs NPAsRs in crore**

	Name of the private sector bank	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
1	AXIS BANK	897.77	1318	1599.42	1806.3	2393.42	3146.14	4110.19	6087.51	21280.48	34248.64
2	HDFC BANK	1988.07	1816.76	1694.34	1999.39	2334.64	2989.28	3438.38	4392.83	5885.66	8606.97
3	ICICI BANK	9649.31	9480.65	10034.26	9475.33	9607.75	10505.84	15094.69	26221.25	42159	53240.2
4	FEDERAL BANK	589.54	820.97	1148.33	1300.83	1554.01	1087.41	1057.73	1667.77	1727.05	2795.62
5	KARNATAKA BANK LTD	443.2	549.64	702.17	684.72	638.86	835.94	944.21	1180.4	1581.59	2376.07

**COMPARISON CHART AMONG PUBLIC SECTOR PRIVATE SECTOR AND FORIGN BANK**



Source Rbi.org.in

#### NON PERFORMING ASSETS AS A MAJOR ISSUE AND CHALLENGE FOR BANKING INDUSTRY:

The banking system plays a vital role in the finance sector. Without the sound and efficient system of the bank will lead to a healthy economy. The Narasimhan committee introduced the concept of non-performing assets. And it is the best way for judging the status of the bank. The burden will lie on the bank for the non-payment of loans. When the loans are not repaid there will be a huge loss to the bank and there will be money to transact between the customers. It is a risk arising from the customers to the bank. The bank needs to bear all the risks. Nowadays non-performing asset is kept on increasing in both public sector banks and private sector banks. They face ultimate survival in the market. As compared to public sector-private sector banks have less non-performing assets, and their net worth is slightly increasing. NPA hurts funds over banks in capital markets. The government of India propounds many policy and rules to decrease and control over non-performing assets. Non-performing assets are the only reasons to fall on revenue. The causes for increasing the NPAs are the following

GDP slowdown -Between early 2000's and 2008 Indian economy were in the boom phase. During this period Banks especially Public sector banks lent extensively to corporate. However, the profits of most of the corporate dwindled due to slowdown in the global economy (Lehman Crisis).



Relaxed lending norms especially for Corporates when their financial status and credit rating is not analysed properly.

Funds borrowed for a particular purpose but not use for the said purpose

Project not completed in time

In-ability of the corporate to raise capital through the issue of equity or other debt instrument from capital markets.

Business failures

Willful defaults, siphoning of funds, fraud, disputes, management disputes, mis-appropriation etc. Deficiencies on the part of the banks viz. in credit appraisal, monitoring and follow-ups, delaying settlement of payments\subsidiaries by government bodies etc. Five sectors Textile, aviation, mining, Infrastructure contributes to most of the NPA, since most of the loan given in these sector are by PSB's. NPAs in the corporate sector are far higher than those in the priority or agriculture sector. However, even the PSL sector has contributed substantially to the NPAs. Banks did not conduct adequate contingency planning, especially for mitigating project risk. Policy Paralysis and key economic decisions were delayed which affected the macroeconomic stability. Companies with dwindling debt repayment capacity were raising more & more debt from the system.

#### Impacts of NPAs

The efficiency of a bank is not reflected only by the size of its balance sheet but also the level of return on its assets. The NPAs do not generate interest income for banks but at the same time banks are required to provide provisions for NPAs from their current profits

The NPAs have deleterious impact on the return on assets in the following ways

The higher NPA's, the weaker will be the bank's revenue stream.

Indian Banking sector has been facing the NPA issue due to the mismanagement in the loan distribution carried by the Public sector banks.

As the NPAs of the banks will rise, it will bring a scarcity of funds in the Indian markets. Few banks will be willing to lend if they are not sure of the recovery of their money.

The shareholders of the banks will lose of money as banks themselves will find it tough to survive in the market.

The price of loans, interest rates will shoot up badly.

It will impact the retail consumers, who will have to shell out a higher interest rate for loan.

Finally, it will lead to lower growth and higher inflation because of the higher cost of capital.

It is due to above factors the public sector banks are faced with bulging NPAs which results in lower income and higher provisioning for doubtful debts and it will make a dent in their profit margin.

Steps taken by RBI and Government in last few years to address NPA's

'Mission Indradhanush' was launched to make the working of public sector bank more transparent and professional in order to curb the menace of NPA.

Introduction of Insolvency and Bankruptcy code. Also, SARFAESI Act and DRT Act have been amended to make the recovery process more efficient and expedient.

RBI introduced Corporate Debt Restructuring (CDR) mechanism, setting up a Joint Lenders' Forum, 5:25 scheme, Strategic Debt Restructuring (SDR) scheme.

Prompt corrective action (PCA) of the RBI helps to mitigate financial stability risks by arresting the deterioration in the banking sector, so that further capital erosion is restricted and banks are strengthened to resume their normal operations.

'Project Sashakt' – the five-pronged strategy to deal with NPAs recommended by the Sunil Mehta-led committee has been a positive move.

Recognition of Bad loans is the first step in the direction of dealing with NPAs. Economic Survey 2016-17 proposed setting of PARA- The Public Sector Asset Rehabilitation Agency colloquially called "Bad Bank" to assume the NPA of public sector banks in India. There has been a proposal to create Public Credit Registry.

FINDINGS:

NPA plays a very important role in the development of economy as well as performance of the bank

All the banks are suffering from increases of NPAs

Comparatively private banks are better than public banks

RBI continuously working towards controlling the NPAs in the country

#### SUGGESTIONS TO CONTROL NPAs:

The Bank should adopt the following general strategies to control NPAs. The suggestions are as follows:

Projects with old technology should not be considered for finance and Large exposure on big corporate or single project should be avoided.

Bank should prevent diversion of funds by the promoters. And The Credit section should carefully watch the warning signals viz. non-payment of quarterly interest, dishonor of check etc.

Identifying reasons for turning of each account of a branch into NPA is the most important factor for upgrading the asset quality, as that would help initiate suitable steps to upgrade the accounts.

The bank must focus on recovery from those borrowers who have the capacity to repay but are not repaying initiation of coercive action a few such borrowers may help.

Effective inspection system should be implemented.

#### CONCLUSION:

Growing NPAs is one of the biggest problems that the Indian banks are facing today. If proper management of the NPAs is not undertaken it would hamper the efficiency of the banks. If the concept of NPAs is taken very lightly it would be dangerous for the banking sector. The NPAs destroy the current profit and interest income and affect the smooth functioning of the recycling of the funds. Banks also redistribute losses to other borrowers by charging higher interest rates. Lower deposit rates and higher lending rates repress savings and financial markets, which in turn hampers the economic growth of the country. Thus, it is highly essential for the banks to focus their attention on

growth of NPAs and take appropriate measures to regulate their growth.

**Reference:**

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Non-Performing Assets of Indian Banks Phases and Dimensions by SHRUTI J PAN DEY, VISHAKHA G TILAK,  
BIPIN DEOKAR

Non-Performing Assets of Banks Have They Really Declined? And on Whose Account? K M Shajahan