MANAGEMENT OF NON PERFORMING ASSETS (NPAs) IN PUBLIC SECTOR BANKS

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ABSTRACT

The non-performing assets of the banks and financial institutions have acquired the status of dangerous and calamitous problem all over the world. The survival of these institutions has been endangered as their viability and solvency are influenced by the NPAs. The main activity of such financial institutions i.e. lending activity gets adversely impacted due to the non recovery of the loan assets and interest on such assets influence the credit dispension process. As a consequence the profitability of such financial institutions also gets affected. This all results into greater need for funds by way of capital and extra provisions. Thus, the management of bad loans and keeping them at the lowest level is of paramount significance for the financial institutions as they are based upon public confidence.

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NON PERFORMING ASSETS (NPAS):

The health of a vibrant economy largely depends upon a healthy banking system which, in turn, depends upon a sound asset structure. The public sector banks (PSBs) in India have made significant contributions to almost all the sectors of the Indian economy such as agriculture, industries of various categories, trade, employment and infrastructure. The ever increasing trends in deposits and credits speak volumes for the performance of Indian banks. However, the non-performing assets (NPAs) in the credit portfolios of the PSBs have become a thorn in the flesh during the last one decade or so. NPAs have not only affected the productivity and the profitability of the banks, but also sullied the image of Indian banking and drain on the very value system of the society. The concept of NPAs for the first time was introduced during the year 1992-93 to the Indian banking industry. Since the launch of economic liberalisation and financial sector reforms, banks and financial institutions are under pressure to bring down their NPAs on par with international standards and also to improve their profitability. A rise in NPAs results in higher operational costs and erosion of capital forcing the institutions to keep their lending rates high.

The most calamitous problem being faced by commercial banks all over the world in recent times is spiraling non-performing assets (NPAs). They are affecting their viability and solvency. NPAs adversely influence lending activity of banks as non recovery of loan installments and interest on the loan portfolio negates the effectiveness of credit dispensation process. Non recovery of loans also hurt the profitability of banks. Besides, banks with high level of NPAs have to carry more own funds by way of capital and create reserves and provisions and to provide cushion for the loan losses. NPAs, thus, make two pronged attack on the bottom lines of commercial banks: one, interest applied on such assets is not taken into account because such interest is to be taken into account only on its realisation, two, banks have to make provisions for NPAs from the income earned by them on performing assets. Persistently high level of NPAs make banks and financial institutions fragile leading ultimately to their failure. This shakes confidence both of domestic and global investors in the banking system.

Thus, managing bad loans and keeping them at the lowest possible level is critical and need of the hour for banks. An NPA level of over five percent is indicator of poor quality of loan portfolio. With growing competition and shrinking spreads, banks should strive to keep NPAs much below the level of ten percent to make net earnings necessary for their survival and growth. Under the new RBI monitoring system a bank’s performance has become crucially

dependent on the recognition of income and non performing assets[1]. Before discussing how to manage loans in commercial banks, it would be pertinent to comprehend the concept of NPAs and examine factors contributing to the emergence of NPAs in the loan portfolio of banks

The principal objectives of commercial banking operations are to generate profits and contribute to growth process of the country. The technique that commercial banks adopt to fulfil these objectives has a direct bearing on their assets and liabilities. Banks always strive to adopt an appropriate operational approach with a view to maintain liquidity and profitability of their assets. But there are many assets in the banking system, where there is an imbalance between the liquidity and profitability. Such assets are known as non performing assets, for instance, term loan, overdraft, cash credit account, government securities, etc. The amount to be received from these assets remains unpaid or remains overdue. The government securities, bonds and debentures of corporations can also be included in non performing assets, if interest is not received regularly from them and if still there are some recoverable arrears. In other words, an asset will become non-performing asset, if it does not generate income to the bank.

An asset is classified as non-performing asset if dues in the form of principal and interest are not paid by the borrower for a period of 180 days. However, with effect from March 2004, default status would be given to a borrower if dues are not paid for 90 days. If any advance or credit facilities granted by banks to a borrower becomes non-performing, then the banks will have to treat all the credit facilities granted to that borrower as non performing without having any regard to the fact that there may still exist certain credit advances having performing status.

MANAGEMENT OF NPAS:

Since the adoption of liberalisation, privatization, globalisation and financial sector reforms, banks and financial institutions are under tremendous pressure to reduce and bring down their NPAs at par with international standards. The reduced NPAs will improve the profitability of such institutions. The concept of NPAs introduced during the year 1992-93 in Indian banking industry forced the financial institutions to keep their lending rates high because NPAs results in higher operational cost and erode the capital. The NPAs also have a double effect on the profit and loss account, firstly the income arising on accrual basis is not recognised and secondly the sufficient provision is to be made in the balance sheet. This is definitely going to

strain the profit and loss account which, in turn, jeopardises the solvency of the financial institutions. The guidelines issued by the Reserve Bank of India on income recognition, assets classification and provisioning norms have compelled banks in India not only to show the true financial picture in the balance sheet but also to take corrective steps for improving their loan portfolio[2].

NPA management is a matter of concern to entire banking industry. Before drawing up a proper plan for the recovery of NPAs what one has to see is the background of an NPA and the reasons for its origin. A lot of NPAs result from lack of proper monitoring and control. There are NPAs which occur due to the factors beyond the control of the borrowers. Sometimes, NPAs occur due to diversion of funds by the borrower. But, effective monitoring and control will definitely restrict NPAs.

The eagerness shown by the banks to reduce NPAs is definitely a welcome step in a right direction. But, it should be ensured that NPAs are being reduced by taking stringent measures at the time of loans sanctioning, regular monitoring, systematic evaluation and legalised recovery and not through excessive provisioning to mislead the competitors, stakeholders and public at large.

METHODS OF NPAS MANAGEMENT IN PUBLIC SECTOR BANKS:

NPA is not just a problem for banks, they are bad for the economy. The money locked up in NPAs is not available for productive use purpose and to that extent the banks seek to make provisions for NPAs or write them off. It adversely affects their profitability over a long period of time and results in higher rate of interest to their diligent credit customers. Steps taken at the appropriate time may help in avoiding NPAs. Qualitative appraisblical, supervision and follow up should be taken up for the present advances to avoid further NPAs. Things have reached a stage where a hard look at some of the basic issues will have to be taken to improve bank general capabilities and to meet the prudential requirements. Reduction of NPAs should be treated as a national priority item to make the Indian banking system more strong, resilient and geared to meet the challenges of globalization[3]. The following are the some measures for reduction of NPAs:-

Rephasement of the Loan - It is necessary to fix repayment schedule for term loan according to the income generating capacity of the unit. If repayment schedule is not fixed properly or a unit is not able to generate expected profit, possibility may be explored in consultation with the borrowers for rephasement of the loan installment. Rephasement of the

loan installment should be done only when it is expected to get payment after the rephasement.

Rehabilitation of Potentially Viable Units - It may be encouraged where units are potentially viable and management is reliable. If the rehabilitation programme runs smoothly, it may not be necessary to make provisions even after one year for additional facility provided.

Compromise Proposal - A compromise may be called where borrower agrees to pay a certain amount to the banker with some concession. A large number of compromise proposals are being approved by banks with a view to reduce their NPAs and recycling of funds instead of resorting to legal procedures.

Filing of Civil Suits or Legal Action for Recovery - Where compromise proposal is not acceptable to banks, it is better to recall the advances at an early stage instead of waiting for a long time. Civil suit may be filed against borrowers.

Debt Recovery Tribunals - On the suggestion of the Narasimham Committee, Government had formed Debt Recovery Tribunals (DRTs). In respect of public and private sector banks, the number of cases disposed off by the DRTs as on March 31, 2002 were 13520 involving recovery of Rs. 2,864 crore.

Assets Recovery Branches - Some banks have opened Assets Recovery Branches at critical centres for undertaking bad and doubtful debts. Such assets will be transferred to these recovery branches which have special trained staff with necessary background for recovery.

Revenue Recovery Act - The Talwar Committee had recommended a simplified procedure for recovery of commercial banks' dues financed under State Government sponsored schemes. These recommendations have been accepted by most of the major States. However, results in terms of recovery have not been encouraging.

Staff Training - The success of a bank depends on staff competence in performing certain jobs. The credit officer and the clerk attached shall be trained effectively for the successful implementation of reforms. They will train the other staff members and avoid failures and keep the bank away from committing mistakes.

Staff Incentives for Recovery - Banks are supposed to keep their NPAs at a low level to maintain profitability. Banks should try recovery from hardcore NPAs. This is possible through staff only. With the incentives provided, staff will work with zeal and take special interest to recover the dues by the appropriate method in consultation with their higher authorities.

Identification of Borrower - Normally processing of a loan application and disbursement of loan by the manager is taken up in consultation with credit department. While disbursing any loan to anyone it will be better to introduce the borrower to all the staff about his activity and the quantum of loan disbursed to him. Conducting of staff meetings and obtaining suggestions for effective supervision and reduction of NPAs are essential. The Narasimham Committee suggested the establishment of Credit Monitoring Cell at Regional /Zonal levels to monitor the advances of branches. It will be better, if staff meetings at branch level are conducted to discuss their credit portfolios and for seeking suggestions for effective reduction of the NPAs. As the local staff are well versed with the borrower, they can suggest appropriate method to recover the dues from him.

Encouraging of Loans to Small Borrowers - With the liberalisation of Industrial policy, there was mushroom growth in industrial sector. Many entrepreneurs created industries on paper and deceived the banks. To avoid such incidents, better to go for small advances, where it will be easy to watch the end use of the funds and through proper follow-up, keep the unit viable.

Special Incentives for Prompt Repayers - Special Incentive Scheme should be launched for the borrowers who pay installment regularly. This type of scheme will be essential in rural areas where everybody tries to derive some benefit from banks.

Credit Investigation - Better management information system and credit investigation set up by banks would go a long way in preventing the defaulters of one bank from moving to another bank in the same area. Further, effective and speedy approach shall be adopted for compromise wherever necessary and the settlement should be transparent.

More Powers to Debt Recovery Tribunal - Loans which are above Rs 10 lakhs and became NPA as per prudential norms will be referred to DRT for recovery. They are not in a position to dispose off the cases quickly and many cases are pending with DRTs. In order to avoid delay in the process, DRTs shall be given special powers to dispose off the security of NPA accounts and realise the advances.

Legislative Reforms - The law of Incidence, The Transfer of Property Act, The Sick Industrial Companies Act, The Banking Regulation Act and the Reserve Bank of India Act are the examples of legislation, which are in urgent need of redrafting. Enactment of Securitisation Act 2002 is the latest legislation for reducing the NPAs of banks.

RESEARCH DESIGN

The present study was undertaken for knowing the impact of Securitisation Legislation in the management of NPAs in selected financial institutions. To attain this target following banking institutions operating at their local, regional and zonal levels have been approached to provide the requisite data and information. Banks operating at all the three levels include State Bank of India, Oriental Bank of Commerce, Union Bank of India, Allahabad Bank Bank of Baroda, Canara Bank and Punjab National Bank. Banks operating at two levels include Bank of India, Central Bank of India, Dena Bank, Punjab & Sind Bank, State Bank of Patiala, Syndicate Bank and Vijaya Bank. Banks operating at only one level include Andhra Bank, Bank of Maharastra, Corporation Bank , Indian Bank, Indian Overseas Bank,United Bank of India and UCO Bank. In all 54 bank branches of 21 public sector banks have been included in the study. The performance at national level of the banks under study has been already discussed in previous chapter while various aspects of NPAs and Securitisation Legislation have been enquired from the respondent banks situated in Haryana, Punjab, Delhi, U.P. and Chandigarh.

Methods to Reduce NPAs in Public Sector Banks - After knowing about compliance of the RBI guidelines for managing NPAs, an attempt was undertaken to look into the various methods employed by the banks to reduce NPAs.

TABLE 1.1

Methods to Reduce NPAs in public sector banks

Methods Used by Banks	Respondents
(a) Recovery	08 (14.82)
(b) Compromise with Borrower	—
(c) Writing off Loans	—
(d) All of the Above	46 (85.18)
Total	54 (100)

Source: Sample Survey

Figures given in parentheses represent percentages

The summarised responses presented in Table 1.1 shows that 85.18 percent respondent banks were making the use of all the methods like ‘recovery’, ‘compromise with borrowers’ and ‘writing off loans’, where as rest of the respondents only depended on ‘recovery’ method to reduce NPAs.

On the basis of above examination it can be concluded that banks are not only adhering to RBI guidelines to manage NPAs but also making the best use of various prescribed means to deal with the menace of NPAs.

Machinery for Managing NPAs In Public Sector Banks - The banking industry has devised and implemented different mechanisms to deal with the problem of NPAs under the purview of existing laws. The mechanism may be called by different names such as asset recovery branch, settlement advisory committee, recovery cell, NPA management department, NPA cell, credit investigation and information agency, etc. They all are meant for effective management of NPAs. Certain banks are using same terminology at all the levels of their operations while others are using different terminology at different levels of their operations.

TABLE 1.2

Machinery for Management of NPAs

Existence of Machinery	Respondents
(a) Asset Recovery Branches	34 (62.96)
(b) Settlement Advisory Committee	23 (42.59)
(c) Recovery Cell	47 (87.04)
(d) NPA Management Department	36 (66.67)
(e) NPA Cell	29 (53.70)
(f) Credit Investigation & Information Agency	12 (22.22)

Source: Sample Survey

Figures given in parentheses represent percentages

The Table 1.2 prepared for this purpose shows that highest percentage of respondents use the term 'recovery cell' for the effective management of NPAs and lowest percentage of respondent banks use 'credit investigation and information agency' for the same purpose.

To us the term recovery cell is not that much refined and sophisticated as credit investigation and information agency because the term recovery cell make us to believe that banks may be using coercive measures for realising their dues.

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