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A STRATEGY TO MANAGE THE NPAs OF PUBLIC SECTOR BANKS

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ABSTRACT

The global rating agency, MOODY's recently in its report of 2013 as rated that the Indian Public Sector Banks from 'Stable' to 'negative'. The RBI is also observed that in 2012-13 the NPAs of public Sector Banks were significantly increasing due to the poor asset quality and ineffective information systems. The study was taken with an objective of analyzing the impact and effect of NPAs of public sector banks and to suggest the suitable strategies to control and manage NPAs. The sample size taken for the study was 120 and the data was collected by way of questionnaire. The risk matrix for NPAs explains that the cause for NPAs are the internal and external factors among which the willful default by the borrower(external) and inefficient credit appraisal system(internal) are the key determinants. The findings of the study were to suggest the steps to minimize the credit risk and control the NPAs. The various factors determining the NPAs of Public Sector banks at higher degree are identified and various suggestions are given to minimize the NPAs.

Index terms – BASEL norms, Credit risk, Non Performing Assets, Rating agency, RBI policy Willful defaulters.

INTRODUCTION

Indian banking system is rated as an efficient and viable system globally, its operations focus in response to the changing economic environment. The policies and the framework of Reserve Bank of India always revolve around the development of the processes of the banks contributing in shaping the country's economic policies.

In Indian banking system the major role is displayed by the Public Sector Banks (PSBs). They are the oldest form of banks having large volume of operations and worldwide network of branches with their traditional business of accepting and lending money and also diversified business activities like venture capital, etc.

A healthy and financially sound banking system is required for a developing economy like India. The failure of the Indian Public Sector Banks will have negative impact on the various sectors of the economy contributing towards the GDP. The key cause for the failure of banks in Indian economy is accumulating Non Performing Assets (NPAs). NPAs reflect the performance of the banks. The high level of NPA explains that the probability of a large number of defaults that affects the credit worthiness and reputation of the banks, which means the capacity of the public sector banks to recover the loan outstanding, will have an adverse effect on the repayment capacity of the banks to the borrowers. The public sector banks are bleeding. More than Rs.83000 Crores of corporate loans have turned into bad debts within a time period of a year-and-a-half, according to a report of the parliamentary standing committee on finance which express that the remarkable hike in non performing assets of the public sector banks.

The report says that between March'2011 and December'2012. NPAs on corporate loans has gone up by 190% (Rs.83,490 Crores) comparing to priority sector and agriculture lending. In such situations to clean up their balance sheets most of the public sector banks are writing off a part of the bad debts. In 2012 the PSBs are accumulated Rs.1.56 lakhs Crores as bad debts. As per the Reserve Bank Of India norms the Public Sector banks are allowed to write off the bad debts, where the bank fails to ensure enough collateral against loans when the mortgaged assets are not sufficient to compensate the outstanding unrecoverable loans, banks have to go in for write offs when such loans turns bad.

The public sector banks are the mediators through whom the government routes all the developments and business schemes. Complete eradication of non-performing assets in public sector banks is not possible but, banks can aim at managing and reducing the losses arising due to high non-performing assets.

The global rating agency, MOODY's, in its latest report of 2013 has downgraded Indian banking system's rating from 'stable' to 'negative'. The Reserve Bank of India has also observed that in 2012-1 the Non performing Assets are increasing significantly and the reason for such increase is due to the poor asset quality and ineffective information system of the public sector banks. The NPAs in State Bank of India have grown 24% constituting one third of gross NPAs of all listed public sector banks put together Reserve bank of India has insisting the banks to make use of various actions and procedures for the recovery of bad loans and strengthen the recovery systems, credit appraisal and post sanction loan monitoring system to reduce/control non-performing assets.

REVIEW OF LITERATURE

Non-Performing Assets are popularly known as NPA. Commercial Banks assets are of various types. All those assets which generate periodical income are called as Performing Assets (PA).

The assets which do not generate periodical income are called as Non-Performing Assets (NPA). If the customers do not repay principal amount and interest for a certain period of time then such loans become non-performing assets (NPA). Thus non-performing assets

are basically non-performing loans. In India, the time frame given for classifying the asset as NPA is 180 days as compared to 45 days to 90 days of international norms.

Early in February this year, Pratip Chaudhuri, the chief of State Bank of India, was bold enough to say that the worst was over for India's top lender, while unveiling his bank's third-quarter results. The worst is over. Non-performing assets have plateaued and we do not see any acceleration. The NPA storm that had hit us in 2011 is now hitting other banks," Chaudhuri had told the media. The CEOs of quite a few banks had echoed similar views, saying that bad loans had peaked.

They blamed the rise in bad loans to a newly-introduced system where bad loans were flagged off in customized software, without any manual intervention as was done in the past. This resulted in reversal of interest income. Bankers justified that once migrated fully to this new system, the pain would cease. However, holes have been blown into that argument after SBI shocked the market with its numbers for the quarter to June 2012.

The bank's slippages, fresh bad loans, stood at Rs 10,844 crore. Many other banks, too, have seen significant rise in slippages. Indian Overseas Bank's fresh bad loans almost doubled to Rs 865 crore and it almost tripled for the Central Bank of India to Rs 1,448 crore. In the June quarter, most state-run banks, barring a few, showed moderate growth in their earnings. Analysts said that the unprecedented growth in profit for Bank of India in the June quarter was hardly a surprise, considering that was the last quarterly result for its current chairman.

The top three private banks, ICICI Bank, HDFC Bank and Axis Bank, too, maintained consistency in their earnings. What is troubling many is whether banks, especially the PSU banks, took a realistic call in the past, while assessing their performance and outlook. "Few big-ticket troubled accounts, like Kingfisher Airlines, are classified as bad loans. A number of troubled accounts are either restructured before they turn bad or the borrowers are knocking at the doors of the corporate debt restructuring cell.

Thus, we expect stress on asset quality to continue in the second quarter," said Hemindra Hazari, head of research institutional equities at Nirmal Bang Equities. But it is not just the pressure of more bad loans that is a challenge to banks. They will have to channelise their energy towards mobilising low-cost deposits and growing their balance sheets. Ironically, demand for loans from better-rated customers has almost dried as most of them prefer to dip into internal accruals or to keep on hold their expansion plans, given the bleak macroeconomic scenario. Deposits are growing at a much slower pace, something which has caught the attention of even the banking regulator. Further, low cost deposits are slowly moving out of large banks to smaller private banks that are offering higher rates on savings bank accounts. This is an indication that some of the long-established practices of basic banking — raising deposits, lending and recovery — are being altered.

BA Prabhakar, CMD of Andhra Bank, said: "Banks will have to brace for a slower growth in balance sheet this year. Demand for advances will be low due to a slowdown in the economy.

So, there may not be a big chase for deposits." But the SBI chief still holds out hope. "The current NPA of 5% is a bit of an aberration... it has peaked." The markets will test him on that.

The accumulated and enormous level of NPA in post-liberalization period forced policy makers to reform banking sector. A Committee on Banking Sector Reforms known as Narasimham Committee was set up by RBI to study the problems faced by Indian banking sector and to suggest measures revitalize the sector. The committee identified NPA as a

major threat and recommended prudential measures for income recognition, asset classification and provisioning requirements. These measures embarked on transformation of the Indian banking sector into a viable, competitive and vibrant sector. The committee recommended measures to improve “operational flexibility” and “functional autonomy” so as to enhance “efficiency, productivity and profitability” (Chaudhary and Singh, 2012).

In India, NPA were very high in the beginning of 90's. Over a period of time there is considerable decline in the NPA's of all banks. In the case of public sector banks, gross non-performing assets were 9.4% in 2002-03 and it declined to 7.8% in 2003-04. The net NPA during the same period declined from 4.5% to 3%.

OBJECTIVE OF THE STUDY

The research focuses on the following objectives.

- ❖ To analyze the cause and impact of the Non Performing Assets (NPAs) of Public Sector banks and to give suitable suggestions.

RESEARCH METHODOLOGY

The regulatory measures and the norms introduced from time to time by the various bodies like BIS, RBI, BASEL always focus on the profitability , growth and a strategies to control and minimize the credit risk exposed to the banks which arises due to the nonpayment of the outstanding loan. The systematic implementation of the BASEL norms helps the bank in synchronizing the inter-departmental activities of the bank concentrating much on the credit and the operational department.

The study was conducted during February '2013 to April'2013. The primary data was collected through a structured questionnaire from the various public sector bank branches located in and around Chennai. The sample size is 120.

Research design proposed for the study is “descriptive” type of research deals with the quality of responses from the respondents, attitudes, interest, technical skills, experience, behavioral, beliefs and values, emotions, self concept, etc.

Primary data was collected by questionnaire survey method. Secondary data was collected from various journals & research articles to support the research. The statistical tools used to analyze the cause and impact of the NPAs of Public Sector Banks are multiple regression, T test, Factor analysis, frequency table and the reliability test.

RESULTS AND DISCUSSIONS

Reliability Test: The reliability test was carried out to identify the reliability and viability of the variables both independent and dependent, selected to meet the set of objectives for the study in the form of structured questionnaire circulated to the various respondents from the banks. The test was conducted to test statistically, the impact and cause of NPA and suggest measures to help the Public Sector banks to handle their Non-Performing Assets in a safer zone.

The statistical analysis explains that the variations in the default risk and loss is clearly explained by the various independent variables chosen for the research at a level of 92% (0.921)

Reliability Statistics

Cronbach's Alpha	N of Items
.921	43

Multiple regressions: The multiple regression models were used to identify the impact and cause of NPA in Public Sector Banks and strategy to control and manage the Non-Performing Assets cause for default risk and loss. The dependent variable selected was the default rate which was converted into the index and the other 15 variables were selected as independent variables to identify the effect and cause of such loss on control of default payment, the multiple regression method was adopted to analyze the multiple factors. As per the regulatory measures and norms, it's a practice followed in Public Sector Banks to maintain the provisions as per provisioning norms suggested by Reserve Bank of India and BASEL norms. Provisioning is nothing but allocation of money at a certain percentage every year to meet the unexpected future losses arising due to default by borrowers. RBI guidelines based on BASEL II norms for Non Performing Assets provisions are as follows.

Sl. No.	Type of Asset	Provision
1	Standard Assets	0.25% for all type of standard advances
2	Sub Standard Assets	10% for all type of standard advances
3	Doubted Assets - Up to 1 year - 1 – 3 years - More than 3 years	100% for un secured advances and 20% for secured advances 100% for un secured advances and 30% for secured advances 100% for un secured advances and 50% for secured advances
4	Loss Assets	100% for un secured advances and secured advances

The NPA growth involves the necessity of provision which reduces the lending capacity of Public Sector Banks and also impacts the profitability and market value of the banks as NPA reflect the performance status of the Public Sector Banks in India.

The regression analysis fitted indicated R^2 value implying that more than 91% of variation in the dependent variable is explained by the independent factors included for the analysis. The F (256.7) value implied that R^2 (0.914) a statistically significant and so the analysis is fit for interpretation.

The analysis explains that the willful default by the borrowers is a significant factor influencing the default risk, which is managed and controlled by way of provisioning and the strategies dictated as per BASEL norms for every unit increase in the willful default the risk of increase in NPA would go up by 96%. The fraudulent practices like advancing loans to ineligible persons, advances without security or to the inefficient project/businesses is a significant factors remarkably influencing the default loss at a level of 78%. When the borrowers are not regular and prompt in their payment of interest and loan amount, the risk of NPA was significantly high at 1.781 for every unit of delay.

Further the analysis is revealed that many internal factors like inefficient management, inappropriate technology, labour problems, etc. resulting in poor performance of the companies are the other important factors influencing the default rate at 83% giving rise to high credit/default risk in turn increasing the level of NPAs of the Public Sector Banks in India.

Thus it is evident from the study that the Public Sector Banks are exposed to higher level of credit risk due to the growing level of NPAs which if not controlled and managed will lead to the other type of risk which will end up with remarkable loss assets, which will curb the credit worthiness of the public sector banks in repaying their depositors. The regulations like RBI's norms as framed with the base of BASEL supervisory norms explain the importance of the credit risk can be managed by reducing and controlling the factors determining the NPAs of the Public Sector Banks in India.

SUGGESTIONS

- ❖ The banks must be careful while scrutinizing the financial statements and audited reports submitted by the borrower. If the statements reveal sharp decline in production and sales, diversification of funds, high level of stock of inventories is a sign to the banker stating that everything is not well with the unit.
- ❖ It is suggested that the personal visit and face-to-face discussion and inspection of the borrower business will help the banker to know about the problems of the business and the financial status and also a chance to identify whether it is a case of willful default.
- ❖ Implementation of effective Management Information System on loan monitoring makes possible to identify the sickness and weakness of the borrower and the close monitoring of such loan accounts will help the banks to classify accounts based on warning signals.

CONCLUSION

Banking industry has undergone a major change after the first phase of economic liberalization;

Hence the importance of credit management has emerged. In recent time banks are very cautious in extending loan, because of mounting NPA. This article highlights the reasons for an asset turning bad and measures to be taken to manage NPAs. Due to various steps taken by the Government of India NPA levels were reduced to considerable level. So it is an indication for the bankers with bad loan in their portfolio to take appropriate actions immediately.

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