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# A Critical Review of NPA Management: Challenge for Public Sector Banks

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## Abstract

The economic liberalization and globalization policy of the government in the nineties have led to economic growth and financial stability of the country, but it also brought huge increment in bad loans in the banking sector, especially public sector banks. The coronavirus pandemic and the subsequent lockdown had a devastating impact on Indian banks which were already struggling with the rising bad loans. The 6-month loan moratorium and the Supreme court's order barring banks from classifying loans as NPAs for one year will lead to a tremendous increase in NPA and the biggest challenge for banks in 2021. The bank's asset, classified as NPA, ceases to generate income to the bank, and banks have to make provision for NPA. Therefore NPA is a double-edged razor, damaging the profit, weakening the capital structure and reducing the bank's rating. NPA poses a big threat to the macro-economic stability of the Indian economy. NPA is not just about recognition; the emphasis should be on resolution and recovery. The government and RBI had taken steps to bring transparency in the banking sector. This paper gave an overview of NPA's strenuous problem in the pre-COVID times faced by the public sector banks and the steps taken by the government to control them. The author used secondary data in the form of existing reports, published articles, literature and data available on the public domain.

**Keywords:** Loan moratorium, Macro-economic, Non-performing Asset (NPA), Pandemic.

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## Introduction

The liberalization of financial sector in the 90s brought many banking reforms. In this era, the economy was booming and business was buoyant, large corporations were granted loans for projects based on extrapolation of their recent growth and performance. With loans being available more easily than before, corporations started financing through external borrowings rather than internal promoter equity. But as economic growth stagnated following the global financial crisis of 2008, the repayment capability of these corporations decreased. This contributed to what is now known as India's Twin Balance Sheet problem, where both the banking sector (that gives loans) and the corporate sector (that takes and has to repay these loans) have come under financial stress.

When the project for which the loan was taken started underperforming, borrowers lost their capability of paying back the bank. The banks at this time took to the practice of 'evergreening', where fresh loans were given to some promoters to enable them to pay off their interest. This effectively pushed the recognition of these loans as non-performing to a later date, but did not address their unprofitability's root causes. This led to a huge accumulation of non-performing assets in banks. The aggregate amount of gross NPAs of Scheduled Commercial Banks(SCBs), which was Rs 2.78 lakh crores in 2015, had become Rs. 9.49 lakh crores in 2019. India has the second-highest ratio of NPA's among the major economies of the world. The working paper titled 'Bank Capital and Monetary Policy transmission In India" said that the presence of non-performing assets in a bank weakens monetary policy transmission and lowers the loan growth rate. The Indian banks were already struggling with a huge crunch of bad loans and this coronavirus pandemic and the national lockdown had worsened the situation. The

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**Table 1:** Gross and Net NPAs of PSBs(in crores and percentage)

| *Year* | *Gross Advances* | *Net Advances* | *Gross NPA Amount* | *Gross NPA percentage* | *Percentage to Total Assets* | *Net NPA Amount* | *Net NPA percentage* | *Percentage Total Assets* |
|---|---|---|---|---|---|---|---|---|
| 2014-15 | 5616718 | 5476250 | 248468 | 4.3 | 2.7 | 159951 | 2.4 | 1.5 |
| 2015-16 | 5818348 | 5593577 | 539956 | 7.5 | 4.7 | 320376 | 4.4 | 2.7 |
| 2016-17 | 5866373 | 5366399 | 684732 | 11.67 | 6.8 | 383089 | 6.7 | 3.8 |
| 2017-18 | 6141698 | 5525609 | 895601 | 14.58 | 8.7 | 454473 | 7.7 | 4.4 |
| 2018-19 | 6382461 | 5926286 | 739541 | 11.59 | 7.3 | 285123 | 4.8 | 2.8 |

Source: Reserve Bank of India, Time series tables

**Table 2:** Gross NPA and Gross NPA percentage in 2018-19

| *PSBs in year 2018-19* | *Gross NPA(Rs. Crores)* | *Gross NPA percentage* |
|---|---|---|
| State Bank of India | 172750 | 7.53 |
| Punjab National Bank | 78473 | 15.5 |
| Bank of Baroda | 69924 | 10.02 |
| Bank of India | 60661 | 15.84 |
| Union Bank of India | 48729 | 14.98 |

Source: RBI Time series tables

Supreme court had ordered a 6-month loan moratorium and barring banks from classifying loans as NPAs for one year. Now the banks have to maintain loan accounts as standard even if borrowers defaulted. Further, the government had announced various financial incentives along with the stimulus package of 20 lakh crore towards economic revival that will only aggravate the situation of NPA.

The Financial Stability Report released by RBI in July indicated that NPAs of all banks may jump to 12.5% by the end of the fiscal under the baseline scenario from 8.5 percent in March 2020. It is also expected that the Indian banking sector's bad loans to shoot up to 10-11 percent of the total loans as on March 31, 2022, from 8 percent in June 30, 2020.

The RBI stress tests results show that public sector banks could see their gross NPAs rise to 15.2% by March 2021 from 11.3% in March 2020 in the baseline scenario. In the "very severe stress" scenario, this could go as high as 16.3%. Private banks and foreign banks would also see a spike in their bad loans because of the worsening macroeconomic factors.

## Meaning of NPA

Bank's assets are the loans and advances given to customers. If customers don't pay either interest or part of principal or both, they turn into bad loans.

According to RBI, terms loans on which interest or installment of principal remain overdue for a period of more than 90 days from the end of a particular quarter is called a Non-performing Asset.

However, in terms of agriculture/farm loans; NPA is defined as under-

"For short-duration crop agriculture loans such as paddy, Jowar, Bajra etc., if the loan (installment/interest) is not paid for 2 crop seasons, it would be termed as NPA. For Long Duration Crops, the above would be 1 Crop season from the due date."

NPA are further characterized into three types-

1. *Substandard assets:* Assets which has remained NPA for a period less than or equal to 12 months.
2. *Doubtful assets:* An asset would be classified as doubtful if it has remained in the substandard category for 12 months.
3. *Loss assets:* Loss 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.

## NPA in Banking Sector

The Indian banking system has been struggling with NPA issue for long, but things became worse when, at the end of the third quarter of 2015-16, the public sector banks started reporting huge surge in their NPA levels.

Public sector banks constitute more than 65% of total banking business of all SCBs(Rs 136 Lakhs crores deposits and 104 Lakhs crores advances as of March 2020) and the private sector banks covers 30% of the business, and Foreign banks and Small finance banks cover the rest 5%. The past five years of performance shows that PSBs share 85% of total gross NPAs, 13% share to private sector and 2% to other sectors.

The Table 1 shows that from 2015-16 to 2018-19 in Indian Public sector banks, Gross NPAs share to Gross Advances increased at above 11% in all the years. The NPA has gone up despite the poor credit growth. The Gross and Net NPA as a percentage share of total assets of PSBs have also increased. The Gross non-performing assets (NPAs) or bad loans stood at 2.48 lakh crores in FY 2014-2015, which reached to its peak in at Rs 8.95 lakh crores in the FY 2017-18, but reduced to 7.39 lakh Crores in FY2018-19 due to unhealthy prudential write-offs started by the government. Each bank follows this practice in order to show a reduced NPA. Gross NPA percentage has increased from 4.3 percentages in FY 2014-15 to 14.58 percentages in FY2017-18 and 11.59% in FY 2018-19. The Net NPA, which was only 2.4 percentages in FY 2014-15 rose to 7.7 percentages in FY 2017-18 and reduced to 4.4 portions in FY 2018-19 because of large write-offs.

### Composition of NPA in Public Sector Banks

The Table 2 shows the names of the PSBs having largest NPA share in 2018-19. It can be seen that State Bank of India have the highest gross NPA amount with Rs. 172750 Crores followed by other PSBs.

## Sectors with Higher NPA

The nationalization of banks saw an expansion of the banking sector by opening bank branches in rural, semi urban and urban areas. It led to massive deposits of money by the general public as they started trusting on government banks. Nationalization's main objective was to develop our priority sector by providing credit facility to them at low rate of interest. Every year RBI prepares sector wise priority list of lending for all PSBs. Agriculture and MSME sector being the highest employment provider had always been in the priority list. But after liberalization the lending norms and priority sector list were modified. It has been observed that it is the non priority sector that is getting the largest amount of advancement and has the highest amount of NPA.

It can be easily observed from the Table 3 and 4 that the percentage share of loan advancement to priority sectors constituting agriculture, small and medium scale industries (19.94%) is very less in comparison to large scale industries, services and retail sector(77.38%) in FY2018-19.

The last five years of data show that the percentage share of NPA of the priority sector is much less than the

**Table 3:** Lending to Key sectors(in percentage)

| *Year* | *Agriculture* | *Micro & Small industry* | *Medium industry* | *Large industry* | *Services* | *Retail* | *Others* |
|---|---|---|---|---|---|---|---|
| 2017-18 | 14.27 | 5.00 | 1.51 | 29.45 | 23.91 | 23.23 | 2.63 |
| 2018-19 | 14.00 | 4.63 | 1.31 | 27.71 | 24.31 | 25.36 | 2.68 |

Source: RBI Time series tables

**Table 4:** Composition of NPA in PSBs(Rs Crores)

| *Year* | *Priority sector* | | *Non Priority sector* | | *Public sector* | | *Total* |
|---|---|---|---|---|---|---|---|
| | *Amount* | *Percentage* | *Amount* | *Percentage* | *Amount* | *Percentage* | *Amount* |
| 2015 | 96611 | 34.69 | 181598.4 | 65.2 | 258.92 | 0.09 | 278468 |
| 2016 | 125809 | 23.3 | 414148 | 76.7 | 3482 | 0.64 | 539957 |
| 2017 | 160941.6 | 23.5 | 523790.7 | 76.5 | 15466 | 2.26 | 684732 |
| 2018 | 187511 | 20.94 | 708090 | 79.06 | 17388 | 1.94 | 895601 |
| 2019 | 197334.5 | 26.68 | 542206.5 | 73.32 | 13394 | 1.81 | 739541 |

Source: http//bit.ly/2KMOxb

**Table 5:** Sectoral breakup of NPAand total advances of major PSBs

| | *Agriculture* | | *Industry* | | *Services & Trade* | | *Personal Loans* | |
|---|---|---|---|---|---|---|---|---|
| *Year* | *Percentage share of Total NPA* | *Percentage share of Total Advances* | *Percentage share of Total NPA* | *Percentage share of Total Advances* | *Percentage share of Total NPA* | *Percentage share of Total Advances* | *Percentage share of Total NPA* | *Percentage share of Total Advances* |
| 2015-16 | 8.97 | 13.39 | 71.76 | 46.45 | 14.38 | 23.78 | 4.16 | 16.38 |
| 2016-17 | 10.14 | 14.23 | 67.33 | 46.36 | 13.32 | 21.64 | 8.69 | 17.77 |
| 2017-18 | 8.74 | 11.35 | 77.65 | 43.17 | 12.55 | 26.95 | 4.06 | 18.53 |
| 2018-19 | 13.52 | 15.02 | 65.16 | 35.15 | 17.27 | 28.61 | 4.05 | 21.22 |

Source: http//Titanic-NPA-study, Centre for Financial Accountability Report non-priority sector. The priority sector share of NPA is only 26.68% as compared to non-priority sector share of 73.32% in the year 2019.

## Industrial Sector Wise Breakup of NPA

It has already been found that the major crunch of credit amount of PSBs has gone to non-priority sector, now the following Table 5 shows the spectral allocation of advances of PSBs and NPA share in different sectors like industry, agriculture, services and personal loans of the economy.

From the above Tables 5 and 6, we can easily draw inferences that Industries contribute the biggest share of NPAs with 70.44% and their share percentage of total credit (42.78%) is also highest. The next services sector that shares 14.38% of total NPA and their total credit sharing is 25.24%. Agriculture contributed only 10.34% of total NPAs, whereas share is only 13.5% of total advances. In India more than 50% of total working employment comes under Agriculture, whereas the sector enjoys only a limited share of 13.5% of total credit.

## Reasons for the Rise in NPA In Recent Years

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 fall due to the slowdown in the global economy. Public Sector banks provide around 80% of the credit to these industries; it is this part of the credit distribution that forms a great chunk of NPA.

The Lack of Bankruptcy code in India and a sluggish legal system make it difficult for banks to recover these loans from both corporate and non-corporate houses.

The government's economic policy and the politician-corporate nexus is behind the current state of the banking industry. The government holds considerable influence on all public banks. Without the government's tacit agreement, the large loans made out by these PSU banks couldn't have been possible.

The financial status and credit rating are not analyzed properly due to the relaxed lending norms and face competition banks are hugely selling unsecured loans that attribute to the level of NPAs.

In India, projects are inevitably delayed due to delays in procuring permissions, clearances and land acquisition. This leaves promoters with high-risk leverage and no equity to bank upon. Further, interest costs shoot up drastically by this time and interest costs further erode profitability.

Another thing that happened was with projects getting delayed. The investors started requesting banks to infuse more capital into the projects hoping that the project can be turned around with the increased funding. Banks' wait and watch approach is also one reason for rising NPAs as banks allow deteriorating asset class to go from bad to worse in the hope of revival and often offer restructuring options to corporate.

## Government Initiatives

The government takes many initiatives to revamp the public sector banking system. These initiatives have been strategically planned by the government.

### New Rules of NPA

The Reserve Bank of India's (RBI's) has come with new rules for NPA. In banking parlance, accounts that have remained unpaid for 60-90 days are termed Special Mentioned Account (SMA2). Over Rs 2.8 trillion worth of loans, where payments have remained outstanding for 60-90 days, carry the risk of slipping into the category of non-performing assets (NPAs) due to the revised framework for stressed loans. Now, banks would have to harmonise the treatment of specific accounts across their books. If one bank has treated a particular account as an NPA, other lenders on the same account will have to treat it as an NPA in their books as well.

A second reason for greater transparency is the introduction of weekly reporting for defaults over

**Table 6:** Consolidated table of above figure is given below

| | *Four years average 2015-16 to 2018-19* | | |
|---|---|---|---|
| *Sector* | *Total NPA share percentage* | *Total Advances share percentage* | *Gross NPA percentage (2019)* |
| Industries | 70.44 | 42.78 | 17.3 |
| Services | 14.38 | 25.24 | 6.3 |
| Personal loans | 5.24 | 18.48 | 1.8 |
| Agriculture | 10.34 | 13.5 | 10.1 |
| Total | 100.00 | 100.00 | 12.7 |

Rs5 crore to RBI's centralized database, CRILC (Central Repository of Information on Large Credits). More information sharing will mean that there is less scope for so-called divergences—the difference between a lender's and RBI's assessment on loans turned bad.

## SARFAESI ACT

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act 2002 is a powerful instrument in the banks' hands and financial institutions (FIs) as secured creditors. SARFAESI Act allows bankers to take possession of the assets charged to the bank and auction these without the court's intervention. The Bill also empowers the District Magistrate to assist banks in taking over the management of a company in case the company is unable to repay loans.

Debt Recovery Tribunals and Debt Recovery Appellate Tribunals were set up in 1993 for expeditious adjudication of disputes with regard to ever-increasing non-recovered dues. They take cases from banks for disputed loans above Rs. 10 Lakhs. There are 33 DRTs and 5 DRATs at present. By amendment done in RDBBFI Act in 2016, time taken in various steps in the adjudication process has been fixed. The government has decided to establish six new Debt Recovery Tribunals (DRT) to speed up the recovery of the banking sector's bad loans.

### Indradhanush Plan

In order to overcome challenges, the government, in 2015, developed Indradhanush Plan. This was the most comprehensive reform taken by the government for revamping public sector Banks.

*Appointments:* The Government decided to separate the post of Chairman and Managing Director, and the members of Banks Board Bureau (BBB) will be of eminent professionals and officials.

### Capitalization

The government of India wants to adequately capitalize all the banks to keep a safe buffer over and above the minimum norms. It proposed to make available Rs.70,000 crores out of budgetary allocations for four years.

*De stressing PSBs:* RBI has been requested to grant banks to restructure existing loans wherever the banks find viability.

*Recapitalisation of Banks:* The government has sought to recapitalize PSBs, with maximum allocation in the year 2018, to the tune of Rs 2,11,000 crore over the next two years through Budgetary provisions of Rs. 18,000 crore, issue of recapitalization bonds of Rs 1,35,000 crore, and Rs. 58,000 from equity issuance. The capital infusion will also help public sector banks build their provisioning coverage ratios as they will be able to allocate much of their operating profits towards loan-loss provisioning without having to worry about the impact on their capital positions,

### NPA Disclosures

RBI released guidelines for early recognition of Financial Distress, Prompt Steps for resolution and fair recovery for lenders. RBI has came out with a new category of borrowers called non-cooperative borrowers.

RBI has tightened the norms for Asset Reconstruction Companies where the minimum investment in security receipts should be 15% which was earlier 5%.

### Accountability

Key Performance Indicators (KPIs) are to be measured for the performance of PSBs. The government issued a circular to Public Sector Banks laying down strict timelines for filing of complaints of fraud cases with CBI and monitoring each case on a day-to-day basis.

Insolvency and Bankruptcy Code in May 2016 was enacted, to consolidate the laws relating to insolvency of companies and limited liability entities, unlimited liability partnerships and individuals, presently contained in much legislation, into a single legislation. Under IBC, once the insolvency petition is accepted by the National Company Law Tribunal (NCLT), court approved plaintiff appointed insolvency professionals take over. The IPs try to revive the company over the next 180 days. If an agreeable resolution is not reached by the deadline, the company is deemed insolvent automatically, thus starting the liquidation. It also ensures that willful defaulters are discouraged to bid again for their own stressed assets, creating huge NPAs for banks.

*Consolidation of Banks:* The RBI insist that the India Banking system will be better off if some PSBs are consolidated to have fewer but healthier entities. Recently six SBI Associate Banks and Bhartiya Mahila Bank have been merged with the SBI.

**Table 7**

| *Financial Year* | *Budget allocation* |
|---|---|
| 2015-16 | Rs. 25,000 crore |
| 2016-17 | Rs. 25,000 crore |
| 2017-18 | Rs. 10,000 crore |
| 2018-19 | Rs. 10,000 crore |

RBI introduced number of measures in last few years which include tightening the Corporate Debt Restructuring (CDR) mechanism, setting up a Joint Lenders' Forum, prodding banks to disclose the real picture of bad loans, asking them to increase provisioning for stressed assets, introducing a 5:25 scheme where loans are to be amortized over 25 years with refinancing option after every 5 years, and empowering them to take majority control in defaulting companies under the Strategic Debt Restructuring (SDR) scheme.

### Credit Information Bureau – 2000

A good information system is required to prevent loans from falling into bad hands and, therefore, prevent NPAs. It helps banks by maintaining and sharing data of individual defaulters and willful defaulters.

### Lok Adalats – 2001

They are helpful in tackling and recovery of small loans. However, they are limited to up to Rs. 5 lakh rupees loans only by the RBI guidelines issued in 2001.

### ARC (Asset Reconstruction Companies)

- The RBI gave license to 14 new ARCs recently after the amendment of the SARFAESI Act of 2002.
- These companies are created to unlock value from stressed loans. Before this law came, lenders could enforce their security interests only through courts, which was a time-consuming process.

### Joint Lenders Forum – 2014

It was created by the inclusion of all PSBs whose loans have become stressed. It is present so as to avoid loan to same individual or company from different banks. It is formulated to prevent instances where one person takes a loan from one bank to give a loan of the other bank.

## Suggestions

- Banks need to be more conservative in granting loans to sectors that have been traditionally found to be contributors of NPAs. Banks' credit sanctioning process needs to go much more beyond the traditional analysis of financial statements and analyze the history of promoters. There is a need to incorporate the significance of economic factors in the credit assessment process.
- Also, banks need to evolve strategy through which defaulters are kept out of the system unless they honor the previous payment.
- In case of non-payment of dues, convert debt to equity and, instead of acting as lenders, become the owners of these defaulting companies, appoint boards, govern these companies and bring them back to profit.
- State-owned banks should stop "ever-greening" or repeated restructuring of corporate debt to check the constant accumulation of their non-performing assets.
- Review of NPA'S/Restructured advances- There is need to assess the viability case by case. Viable accounts need to be given more finance for turnaround and unviable accounts should either be given to Asset Reconstruction Company or Management/ownership restructuring or permitting banks to take over the units.
- Improving credit risk management- This includes credit appraisal, credit monitoring and an efficient system of enforcing accountability on sanction officials and lower-level executives.
- Strengthen credit monitoring-Develop an early warning mechanism and comprehensive MIS(Management Information System). MIS enable timely detection of problem accounts, flag early signs of delinquencies and facilitate convenient management of these aspects.
- Higher transparency – It should be made obligatory for PSBs, which run on public money to make all information accessible to the public, public vigilance will ensure efficiency.
- Recruitment of vacant positions – In the last few years, thousands of posts are vacant in PSBs. These vacancies created tremendous pressure on existing staff. It is necessary of banks to look into the shortage of workforce.
- Proper mechanism of skill development – Skill imparting programs can be one of the most useful ways to create an efficient workforce. More institutes should be established for the skill development of the bank employees.

## Conclusion

The government should speed up the process of debt recovery, and create a new Bankruptcy system. These are important steps to improve the resolution process. In order to restore public confidence, the government should consider instituting forensic audit of all major loan default/stress cases. The first is to improve public sector banks' governance so that we are not faced with this situation again. The cleaning up of bank balance sheets and the restoration of credit growth are vital. It will instil a sense of transparency and more investor confidence in the financials of banks. There will be greater prudence in lending. Banks will also pay better attention to developing risk management frameworks, along with recapitalization. Discipline on honoring debt servicing commitments on time should be bought in the corporate sector.

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