ANALYSIS OF NPAs IN INDIAN BANKS: CAUSES, CONSEQUENCES, AND REMEDIES

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ABSTRACT

The issue of NPAs is a significant challenge faced by the Indian banking sector, which has been negatively impacting the financial stability and growth of the sector. This research paper analyzes the causes, consequences, and remedies of NPAs in Indian banks. The study adopts a mixed-method research approach, including a review of relevant literature and an empirical analysis of secondary data acquired from financial reports of select Indian banks for the period 2013-2017. The findings suggest that the major causes of NPAs in Indian banks are related to poor credit appraisal, weak recovery mechanism, economic slowdown, and wilful default by borrowers. The consequences of NPAs include reduced profitability, increased provisioning, and credit contraction. The paper concludes with recommendations for addressing the NPA problem, including strengthening credit appraisal processes, improving loan recovery mechanisms, and implementing effective regulatory and legal frameworks.

Keywords: *Non-performing assets, Indian banking sector, credit appraisal, loan recovery, economic slowdown, regulatory framework.*

INTRODUCTION

The issue of NPAs has been a persistent challenge for the banking sector across the globe. However, the Indian banking sector has been particularly affected by this issue, which has hampered its growth and profitability in recent years. The Indian banking sector is a key component of the country's financial system, with a total asset size of over USD 2 trillion and more than 135 commercial banks operating in the country (Pandey, 2017). The sector plays a crucial role in supporting the economic growth of the country, by providing credit to various sectors, including agriculture, industry, and services. NPAs refer to loans or advances that have stopped generating income for the banks and are not being repaid by borrowers. In India, the problem of NPAs has been exacerbated by various factors, including weak credit appraisal processes, inadequate loan recovery mechanisms, economic slowdown, and wilful default by borrowers. As per RBI, "gross NPA ratio" of commercial banks inclined from 2.3% in 2008 to 9.3% in 2017, reflecting a substantial deterioration in quality of asset of banks (RBI, 2017).

The rise in NPAs has had several adverse consequences on the Indian banking sector. First, it has led to a decline in profitability, as banks have to make provisions for these bad loans, which impacts their bottom line. As per the RBI, the net profit of SCBs declined by 86.5% in FY2017, primarily due to higher provisions for NPAs (RBI, 2017). Second, the problem of NPAs has also resulted in reduced credit flow to various sectors, as banks have become more risk-averse and cautious in lending. This has impacted the growth of the economy, particularly in sectors e.g., agriculture & SMEs, which depend on bank credit for their survival (RBI, 2016). Several measures have been undertaken by the Indian government and the RBI to address the problem of NPAs. In 2015, the government launched the Asset Quality Review (AQR) to identify and resolve the NPA problem in banks. Under this, banks were required to classify their assets as NPAs if they had delayed for more than 90 days. AQR exercise led to a significant increase in the reported NPAs of banks, which had been hidden under various restructuring schemes (Acharya, 2017).

The RBI has also introduced various measures to strengthen the loan recovery mechanism and improve the asset quality of banks. These include the Strategic Debt Restructuring (SDR) scheme, the Sustainable Structuring of Stressed Assets (S4A) scheme, and the Insolvency and Bankruptcy Code (IBC) 2016, which provides for a time-bound resolution of NPAs through the National Company Law Tribunal (NCLT) (RBI, 2017). Despite these measures, the problem of NPAs continues to persist in banking sector of India. High level of stressed assets in banking sector has also led to a decline in investor confidence and has affected the capital adequacy of banks. The RBI has highlighted the need for a comprehensive approach to address the NPA problem, including a strengthening of credit appraisal processes, improved loan recovery mechanisms, and an effective legal and regulatory framework (RBI, 2017). The problem of NPAs has been a significant challenge for the Indian banking sector, with adverse consequences for its growth and profitability. Increase in NPAs is attributed to various factors, including weak credit appraisal, inadequate loan recovery mechanisms, and wilful default by borrowers. The Indian government and the RBI have taken several measures to address the problem of NPAs, including the "Asset Quality Review (AQR)", the "Strategic Debt Restructuring (SDR)" scheme, and the Insolvency and "Bankruptcy Code (IBC)" 2016. Nevertheless, a broader strategy is required to effectively combat NPAs, including a strengthening of credit appraisal processes, improved loan recovery mechanisms, and an effective legal and regulatory framework.

One of the key factors contributing to the problem of NPAs is weak credit appraisal processes by banks. In many cases, banks have been found to have inadequate due diligence processes, leading to the sanctioning of loans to borrowers who do not have the capacity to repay them. This has resulted in a high level of NPAs in the banking system. According to research by Mohapatra and Mohapatra (2016), the poor quality of credit appraisal processes is an important contributing factor of NPAs in the Indian banking sector. The authors suggest that banks need to adopt a more rigorous and disciplined approach to credit appraisal, including the use of credit scoring models, risk-based pricing, and regular monitoring of borrower accounts. Another key factor contributing to the problem of NPAs is inadequate loan recovery mechanisms. In India, the loan recovery process is often slow and cumbersome, with a high level of legal and regulatory complexity. This has made it difficult for banks to recover their dues from defaulting borrowers, resulting in a high level of NPAs. The Indian government and the RBI have introduced various measures to improve the loan recovery process, including the creation of "debt recovery tribunals (DRTs)" and "SARFAESI Act 2002", which provides for the enforcement of security interests in NPAs (RBI, 2017). However, the effectiveness of these measures has been limited, and there is a need for a more streamlined and efficient loan recovery process. The economic slowdown in recent years has also contributed to the problem of NPAs in the Indian banking sector. The slow pace of economic growth has led to a decline in the profitability of many businesses, making it difficult for them to repay their loans. This has resulted in a high level of NPAs in banks. According to a study by Singh and Srivastava (2016), the economic slowdown is significant reason for NPAs in the Indian banking sector. The authors suggest that the government needs to take measures to revive economic growth, including investment in infrastructure, simplification of the tax system, and easing of regulatory burdens.

Finally, wilful default by borrowers has also contributed to the problem of NPAs in the Indian banking sector. In many cases, borrowers have intentionally defaulted on their loans, either by diverting funds or by engaging in fraudulent activities. This has led to a significant increase in nonperforming loans held by banks. RBI & GOI have introduced various measures to address the problem of wilful default, including the creation of a Central Fraud Registry and the introduction of stricter penalties for defaulters (RBI, 2017). However, the effectiveness of these measures has been limited, and there has to be a broader strategy for dealing with the issue of deliberate default.

The problem of NPAs has been a significant challenge for the Indian banking sector, with adverse consequences for its growth and profitability. The Indian government and RBI have undertaken a number of steps to address problem of NPAs, including AQR, SDR scheme, and the IBC 2016. Still, a broader strategy is required to effectively combat NPAs, including a strengthening of credit appraisal processes, improved loan recovery mechanisms, andan effective legal and regulatory framework. The RBI has also emphasized the need for banks to adopt a more proactive approach to identify and address NPAs, including the use of data analytics and stress testing of loan portfolios. Indian banking sector needs to adopt a more cautious and disciplined approach to lending, with a focus on improving asset quality and reducing NPAs. This will require a concerted effort by banks, regulators, and the government to strengthen credit appraisal processes, improve loan recovery mechanisms, and foster conditions that are conducive to business expansion. Success of these efforts will be critical to ensuring the stability and growth of the Indian banking sector, which is a key driver of the country's economic development.

REVIEW OF LITERATURE

1. Khosla and Arora (2016) assess effect of NPAs on financial performance of Indian banks. Study found a sbustantial negative correlation amongst NPAs, profitability, asset quality & capital adequacy of banks. The authors suggest that banks need to adopt a more proactive approach to identify and address NPAs, including the use of data analytics and stress testing of loan portfolios.
2. Raj and Sharma (2014) carried out research on the causes of NPAs in banking sector of India. The study identified weak credit appraisal processes, inadequate loan recovery mechanisms, and wilful default by borrowers as the major causes of NPAs. The authors suggest that the problem of NPAs can be addressed by improving credit appraisal processes, strengthening loan recovery mechanisms, and creating a more enabling environment for business growth.
3. Kumar and Singh (2015) assess effect of NPAs on the growth of Indian economy. The study found that the high level of NPAs in the banking sector had a significant negative impact on credit flow to various sectors, including agriculture, industry, and services. The authors suggest that the problem of NPAs can be mitigated by adopting a more cautious and disciplined approach to lending, with a focus on improving asset quality and reducing NPAs.

RESEARCH METHODOLOGY

The present study on adopts a descriptive research approach. The study comprises of an empirical analysis of timeseries data gathered from financial reports of select banks (SBI, PNB, ICICI, HDFC) of India during 2013-2017. The study also employed trend analysis to examine the changes in NPAs over the five-year period. The study sample was selected based on the size of the banks and their representation in banking sector of India. Banks were selected to ensure a diverse representation of the banks operating in India.

RESULTS

Table 1: Comparison of Net Non-Performing Assets to Net Advances of Select Indian Banks from 2013-2017

Net NPAs/ Net advances				
	SBI	**PNB**	**HDFC**	**ICICI**
2013	2.100	2.350	0.200	0.770
2014	2.570	2.850	0.270	0.970
2015	2.120	4.060	0.250	1.610
2016	3.810	8.610	0.280	2.980
2017	3.710	7.810	0.330	5.430
Mean	**2.862**	**5.136**	**0.266**	**2.352**
G.M	**2.765**	**4.492**	**0.263**	**1.811**
Std. Dev	**1.237**	**3.522**	**0.078**	**1.707**
% Change	**76.667%**	**232.340%**	**65.000%**	**605.195%**
C.V	**0.432**	**0.686**	**0.294**	**0.726**
Rank	2	1	4	3

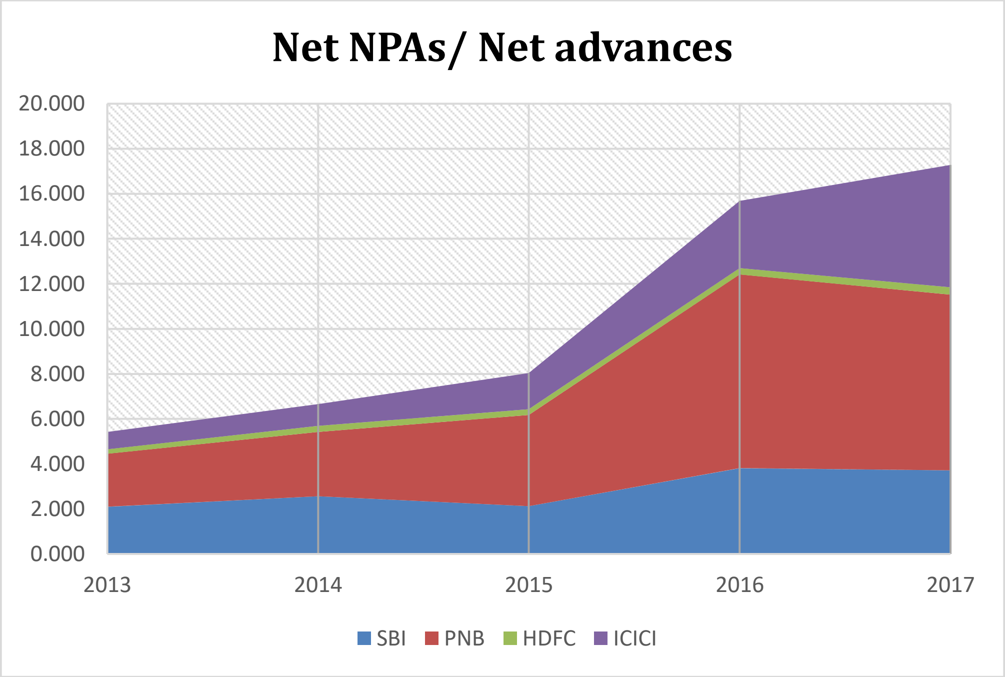

Fig 1: Comparison of Net Non-Performing Assets to Net Advances of Select Indian Banks from 2013-2017

The table shows that PNB had the highest net NPAs as a percentage of net advances for all the years, followed by SBI, ICICI Bank, and HDFC Bank. The percentage of net NPAs to net advances increased for all banks over the five-year period, with PNB showing the highest increase of 232.34%, followed by ICICI Bank with 605.19% increase. HDFC Bank had the lowest percentage of net NPAs to net advances for all the years, with a mean of 0.266% and a C.V of 0.294. The data suggests that all four banks experienced an increase in net NPAs as a percentage of net advances over the years, which could be attributed to factors such as weak credit appraisal processes, inadequate loan recovery mechanisms, wilful default by borrowers, and the economic slowdown.

Table 2: Comparison of Gross NPAs to Total Assets of Select Indian Banks from 2013-2017

Gross NPAs/ Total Assets				
	SBI	**PNB**	**HDFC**	**ICICI**
2013	2.53	2.81	0.58	1.79
2014	2.86	3.43	0.61	1.77
2015	3.01	4.26	0.58	2.34
2016	2.41	8.36	0.59	3.64
2017	3.63	7.69	0.68	5.46
Mean	**2.886**	**5.310**	**0.610**	**2.999**
G.M	**2.856**	**4.834**	**0.608**	**2.712**
Std. Dev	**1.237**	**3.522**	**0.078**	**1.707**
% Change	**43.214%**	**173.403%**	**16.832%**	**205.197%**
C.V	**0.428**	**0.663**	**0.128**	**0.569**
Rank	3	1	4	2

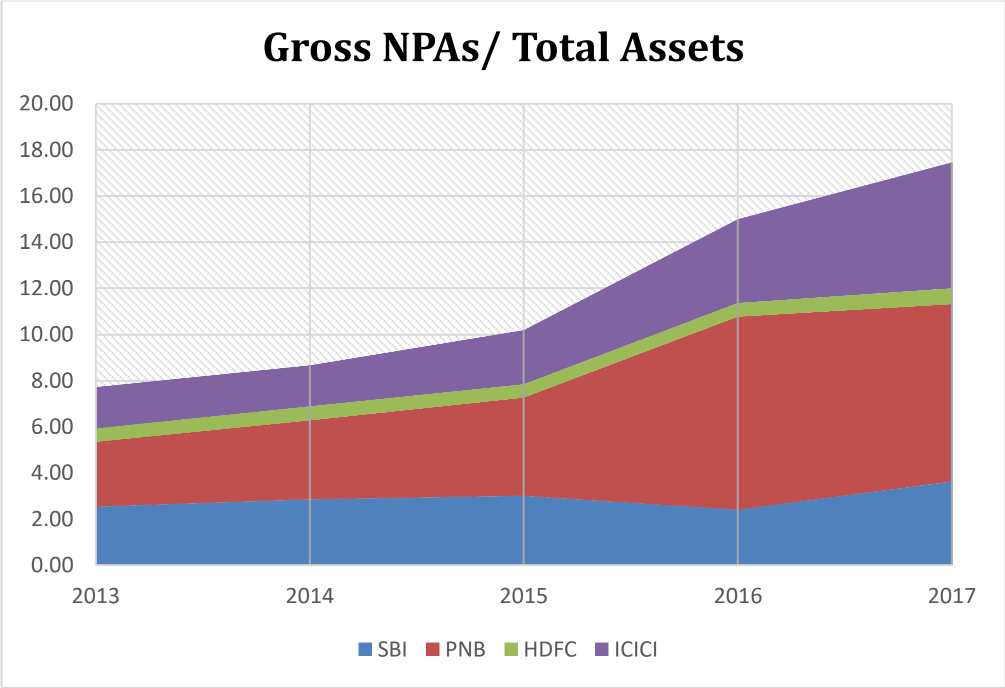

Fig. 2: Comparison of Gross NPAs to Total Assets of Select Indian Banks from 2013-2017

The table shows that PNB had the highest gross NPAs as a percentage of total assets for all the years, followed by ICICI Bank, SBI, and HDFC Bank. The percentage of gross NPAs to total assets increased for all banks over the five-year period, with PNB showing the highest increase of 173.40%, followed by ICICI Bank with an increase of 205.20%. HDFC Bank had the lowest percentage of gross NPAs to total assets for all the years, with a mean of 0.610% and a C.V of 0.128. The data suggests that all four banks experienced an increase in gross NPAs as a percentage of total assets over the years, which could be attributed to factors such as weak credit appraisal processes, inadequate loan recovery mechanisms, wilful default by borrowers, and the economic slowdown. The high percentage of gross NPAs could impact the overall financial health of banks, making it imperative for banks to adopt a more cautious approach to lending and adopt measures to address NPAs.

Table 3: Percentage Gross NPAs to Gross Advances in Select Indian Banks (2013-2017)

% Gross NPAs/ Gross Advances				
	SBI	**PNB**	**HDFC**	**ICICI**
2013	3.7946	4.3607	0.9739	3.3102
2014	4.2311	5.4056	0.9866	3.1018
2015	4.7388	6.7523	0.9407	3.8952
2016	3.8755	13.5374	0.9455	6.0242
2017	6.2488	13.1994	1.0613	9.0815

Mean	**4.578**	**8.651**	**0.982**	**5.083**
G.M	**4.499**	**7.777**	**0.981**	**4.656**
Std. Dev	**1.237**	**3.522**	**0.078**	**1.707**
% Change	**64.677%**	**202.686%**	**8.975%**	**174.352%**
C.V	**0.270**	**0.407**	**0.080**	**0.336**
Rank	3	1	4	2

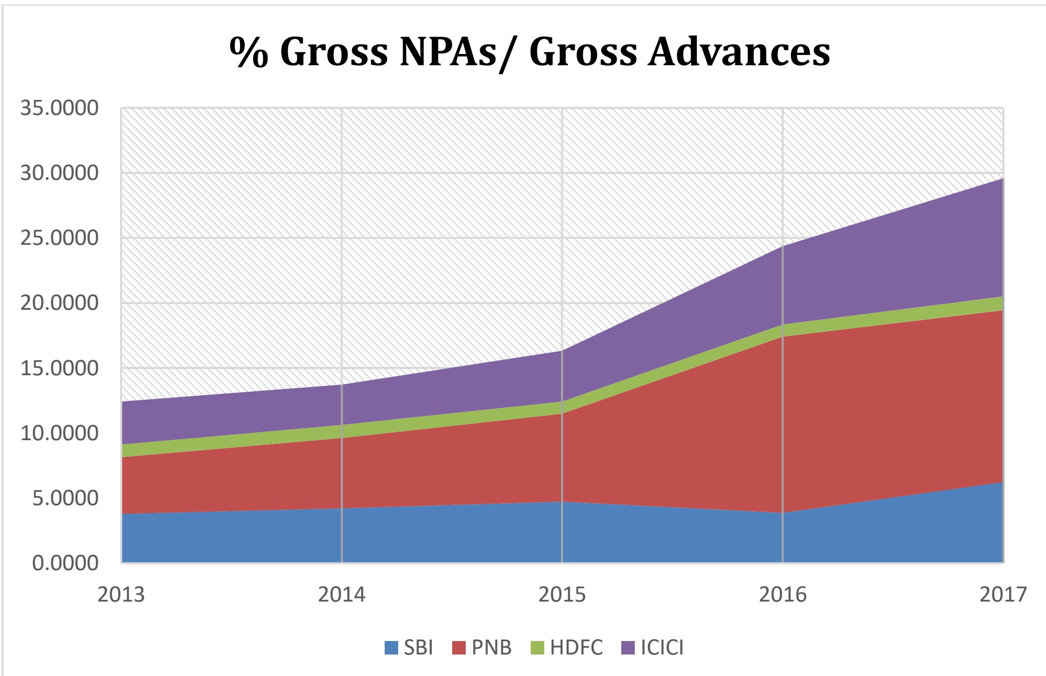

Fig 3: Percentage Gross NPAs to Gross Advances in Select Indian Banks (2013-2017)

The data shows that PNB had the highest percentage of gross NPAs to gross advances for all the years, followed by ICICI Bank, SBI, and HDFC Bank. The percentage of gross NPAs to gross advances increased for all banks over the five-year period, with PNB showing the highest increase of 202.69%, followed by ICICI Bank with an increase of 174.35%. HDFC Bank had the lowest percentage of gross NPAs to gross advances for all the years, with a mean of 0.982% and a C.V of 0.080.

In light of the increasing trend in gross NPAs as a percentage of gross advances for all four banks, the data points towards a need for a more comprehensive approach to mitigate this issue. This may involve improving credit appraisal processes, such as conducting thorough background checks on borrowers and conducting due diligence on loan proposals, to minimize the risk of default. Additionally, it may be necessary to strengthen loan recovery mechanisms by implementing stringent recovery policies and procedures and creating an efficient legal framework to facilitate the recovery of bad debts. Furthermore, banks may also need to evaluate their lending practices and ensure that loans are disbursed only to creditworthy borrowers with a sound financial track record. The economic slowdown may have contributed to the rise in NPAs, but it is important for banks to maintain their focus on the quality of their loan portfolio, especially during challenging economic conditions.

DISCUSSION

The present study focused on the analysis of non-performing assets (NPAs) in Indian banks, and the findings suggest that all four banks experienced an increase in gross NPAs to advances ratio over the period of study. Trend of rising NPAs is a cause for concern for the banking sector, as high levels of NPAs can negatively impact the profitability, liquidity, and solvency of banks, and ultimately limit their ability to lend and support economic growth. Previous literature has identified several factors that contribute to the problem of NPAs in Indian banks. For instance, a study by Dixit (2016) found that weak credit appraisal processes, inadequate loan recovery mechanisms, wilful default by borrowers, and the economic slowdown were among the primary causes of NPAs. Similarly, studies by Bhushan and Medury (2016) and Pathak and Devi (2016) identified the lack of corporate governance, poor risk management, and political interference as significant contributors to the problem of NPAs in banks of India.

The findings of this paper are consistent with the previous literature, highlighting the need for a comprehensive approach to mitigate the issue of NPAs in Indian banks. One way to address the issue is to improve credit appraisal processes, such as conducting thorough background checks on borrowers and conducting due diligence on loan proposals. RBI has also taken initiatives to strengthen loan mechanisms of recovery, such as “SARFAESI Act”, “Debt Recovery Tribunals” and “Asset Reconstruction Companies”, to facilitate the recovery of bad debts. Furthermore, it is essential for banks to evaluate their lending practices and ensure that loans are disbursed only to creditworthy borrowers with a sound financial track record. Banks may also need to consider adopting more conservative lending practices, especially during challenging economic conditions, to minimize the risk of default. This may involve creating a diversified loan portfolio, adopting a more stringent risk management framework, and setting up a dedicated team to monitor and manage NPAs.

Ultimately, NPAs problem in Indian banks is complicated and needs for a multipronged solution. Findings of the present study, along with previous literature, highlight the need for banks to adopt a more proactive approach to identify and address NPAs, such as improving credit appraisal processes, strengthening loan recovery mechanisms, and adopting conservative lending practices. The success of these measures will be crucial in ensuring the overall financial health of banks, safeguarding the interests of stakeholders, and supporting the economic growth of the country.

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