DOI: 10.21917/ijms.2016.0032

NON-PERFORMING ASSETS IN INDIAN BANKING AND THE ROLE OF ASSET RECONSTRUCTION COMPANIES

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Abstract

Reform in the banking industry in India is not anything new. It is true that the financial sectoral reforms have resulted in giving a new direction in the industry because of the significant impact that it led to. In recent times, following the financial crisis of 2008 and the economic slowdown worldwide since then, including a slump in the domestic country, non-performing assets are in the focus. It has severely impacted the industry performance because of the need for higher provisioning. To be more specific, the effect on the public sector has been more severe. The policy regulator and top management of banks have expressed their worries since it is affecting the stability of the banks.

In this regard, it can be mentioned that in spite of the SARFAESI Act passed in the beginning of the last decade, the problem of rising non-performing assets (NPAs) has not been arrested yet to a substantial extent in spite of the setting up of the asset reconstruction companies (ARCs) in the country. The present study focuses not only on the NPA trends in the sector during the period 2005-06 to 2014-15 but also critically analyses the role of the ARCs and the issues pertaining to them.

Keywords:

Banking, Non-performing Assets, Asset Reconstruction Companies

JEL Codes: G01, E44

1. INTRODUCTION

The importance of banking is known to all. The prosperity of any country depends on several factors which may be in the category of externalities or internalities. In the context of internal factors, banking industry has tremendous role to play to ensure a stable economy. In our country, since the financial sector reforms that took place in the beginning of the 1990s, things have changed a lot in several industries, including banking. The entry of private sector banks with a new zeal has posed competition to the public sector banks. But, despite their existence for more than three decades, almost 75% of the total advances are rendered by the public sector.

However, in recent times, the banking sector as a whole is in the limelight not due to good reasons, but instead due to the increasing non-performing assets (henceforth to be mentioned as NPAs) in the sector. In very simple words, one can define NPA to be a non-performing loan or a loan in which interest and principal is not being repaid and instead getting overdue for several months in a row. Hence, the non-repayment of interest leads to a fall in the performance and the credit worthiness of the banks. Though both sets of players have been affected, the public counterpart has been affected to a larger extent.

The poor quality loans in the industry have affected the financial performance of the banks as they have either led to losses or have called for higher provisioning in their income statements. As at the end of 2014, the public sector banks have a total of Rs. 20,73, 094 million and Rs. 11,79, 861 million as gross and net NPAs in their books. Hence, one can imagine the burden these loans are imposing on the performance of banks. Regarding the quantum of NPAs, as per the recent industry estimates, the gross NPAs of the Indian banks as per their books would be around Rs. 3,00,000 crores and the restructured loans would be around Rs. 5,50,000 crores.

The finance minister and the RBI regulator have expressed their worry through various statements regarding NPA levels. In a recent event in Delhi, the thoughts of the Finance Minister were clear when he mentioned, "NPAs, which have reached to the present level are unacceptable. They reached this level partly because of indiscretion, partly because of inaction and partly because of challenges in some sectors of the economy, which were evident through the high NPA levels in these sectors." Regarding the huge pile of NPAs, banks are not the only ones to be blamed. There are thousands of cases of willful defaulters who do not repay the loans. As per the All India Bank Employees Association data, as on 31.3.2015, 7,035 cases of willful defaulters have resulted in a bad loan to the extent of Rs 58,792 crores. Hence, it is very relevant to express that the causes of NPAs can be caused by three Bs, namely Business environment, Bank and Borrower. Therefore, the seriousness of the issue can be easily understood and it is time to take the matter more seriously. In spite of such escalation in the NPAs across banks in recent times, some credit needs to be given to the RBI since things seem to be slowly coming under control. The present article critically analyses the NPA position of the public sector banks in the country.

2. LITERATURE REVIEW

A brief of the different literatures available on the issue and related areas are given below in a chronological order.

Chakrabarti [1]: The researcher discusses the vital role of asset reconstruction companies (since 2002) in managing NPAs in the banking sector in the light of the sudden rise in NPAs in the industry. The author mentions that RBI points to the fact that NPAs plus stressed assets equal almost 10% of the bank loans. The discussion focuses on the performance and the problems of the Asset Reconstruction companies (ARCs).

Jana and Thakur [3]: The researchers look into the trend of NPAs by studying variables like the gross and net NPA ratios only on the data of the nationalized banks for the period 2008 to 2012. The study reveals that though the overall trend is negative and is, therefore, upward rising, it is heterogeneous in nature.

Sahoo [8]: The researcher looks into the position of gross NPAs and net NPAs among the public sector banks of the country. The study points to the impact of non-performing assets on the banking industry and the banks, in particular. An analysis of the descriptive statistics with regard to different poor loans measuring parameters is done for the period 2008-2010 on the Indian nationalized banks.

CARE [7]: The report looks into the NPA trend in the Indian banking sector apart from the causes that have been responsible for the rising trend in the poor loans that we are seeing recently. A brief discussion is made about the different measures that have been adopted to bring the non-performing loans (NPLs) under control.

DTA [6]: The report points to the several problems that the country and banking industry has been grappling with which include economic slowdown, low credit off-take, increasing defaults in the banking sector, among many others. It points to the fact that almost 86% of the bad loans in the sector were generated from the nationalized banks (56%) and SBI group (30%) as at the end of September, 2013. With respect to rising bad loans, the report points to measures like independent appraisal of all credit application cases, sensitivity analysis for infrastructure projects, increasing importance of the ARCs etc.

Kothari [4]: The research report discuss about the different models of asset reconstruction companies followed at the national and international level apart from the different features of these types of companies.

Samir and Kamra [5]: The researcher analyses the comparative position of three leading public sector banks in terms of NPAs for the period 1996-97 to 2009-10. They point out that the declining net NPA percentage shows improving performance. In terms of NPA break-up, it is seen that the priority sector poor loans are almost half of the industry NPA. The researchers throw light on the significance of asset quality since it affects interest income, profitability, capital base, capital-risk weighted assets ratio.

Chaudhury and Singh [2]: The researchers point to the impact of economic reforms in the country on the asset quality of the banks. In terms of group-wise results, the authors find a significant difference in their quality of loans. However, a positive trend reflected through declining NPA is seen. The researchers recommend risk management and governance, cost and recovery management, financial inclusion to be the key areas that will determine the stability and competitiveness in the Indian banking system.

Therefore, though the aspect of NPA has been studied by researchers from time to time, the present research aims to seen whether there has been any significant effect or trend following the financial crisis that commenced in 2007 and has still not lost its grip on some major economies of the world.

3. OBJECTIVES OF THE STUDY

The present empirical study aims at the following objectives-

- To examine the trend of NPAs during the study period.
- To look at any difference in NPAs between banks of different sizes
- To look into the role of Asset Reconstruction companies

4. RESEARCH DESIGN

This study investigates into the status of NPAs among public sector banks in India. The research is based on analysis of twenty public sector banks in India which are selected on the basis of total assets. In order to arrive at a meaningful study, the banks are divided into three categories, viz. large, medium and small. The large banks are those that lie in the first quartile. Medium-sized banks are those that lie in the second quartile, whereas the small-sized banks are the one that lie below the second quartile. The data period is from 2006-2014. In order to arrive at the results, different research analytical techniques are used that include trend analysis, growth parameters, analysis of variance etc.

5. ANALYSES AND RESULTS

5.1 NPA POSITION OF PUBLIC SECTOR BANKS

The following paragraph discussion focuses on how the NPAs have been emerging in case of PSBs.

Table.1. NPA position of public sector banks (figures are in Rs. million)

Year	Public sector banks	
	Gross NPA	**Net NPA**
2006	375041.2	131844.2
2007	359988.2	141463.6
2008	376760.8	166848.9
2009	420960.9	198856.9
2010	557235.4	275666.4
2011	691731.1	333729.2
2012	1085375.3	544259.1
2013	1518797.2	827823
2014	2073094.4	1179861
CAGR	23.83%	31.51%
CAGR (post 2008)	37.55%	42.78%

Source: Computed by the author

Net NPA = Gross NPA minus provisions

The Table.1 shows a comparison of the gross and net NPAs during the study period from 2006 to 2014. One interesting point is that during the entire period, the growth rate of gross NPA and net NPA is 23.83% and 31.51% respectively. Furthermore, post-2008, following the emergence of the financial crisis, there was increasing defaults from borrowers and the compounded annual growth rate (CAGR) was a phenomenal 37.55% and 42.78% respectively.

The Table.2 shows the results relating to analysis of variance (ANOVA). The hypothesis that is tested is as follows:

H_0: There is no difference between banks of different sizes with respect to gross NPA and net NPA.

H_1: There is a significant difference between banks of different sizes with respect to gross NPA and net NPA.

The result shows that the null hypothesis is accepted in all years of the study period, excepting 2006 and 2012 when there was a significant difference between the banks of various sizes at 10% level with respect to gross NPA and net NPA respectively.

Table.2. ANOVA Results: Testing of NPA based on size

Year	Gross NPA based results		Net NPA based results	
	p-value	Whether significant?	p-value	Whether significant?
2006	0.098	Yes*	0.175	No
2007	0.167	No	0.286	No
2008	0.195	No	0.336	No
2009	0.205	No	0.383	No
2010	0.182	No	0.297	No
2011	0.203	No	0.216	No
2012	0.224	No	0.098	Yes*
2013	0.193	No	0.126	No
2014	0.167	No	0.154	No

Source: Computed by the author
* at 10% significant level

As per Table.3, the trend in sectoral lending does not show a wide deviation during the last decade, ranging from 2001 to 2014. The average percentage of credit to the priority and non-priority sectors were 32.5% and 67.5% respectively. But, a look at the average percentage of non-performing assets shows that the contribution to the NPA from the priority sector has been very serious during the years. The default among the priority sector loan seekers has been very high compared to the non-priority sector loan seekers. The movement of lending shows that the credit to this sector reached a peak of 34.4% in 2007, up from 31.3% in 2001 after which it moved downwards to reach 31.4% in 2012. In terms of NPA arising from the priority sector, no uniform pattern is observed. Rather, there have been ups and downs during the period. The early part of the period till 2008 shows an upward trend after which it declined. However, a noteworthy point is the rising percentage of non-performing loans following the financial crisis that took shape in late 2007 or early 2008.

5.2 SOURCE OF NPA IN PSBs

The following paragraph highlights how the priority and non-priority sectors have been contributing towards NPAs.

Table.3. NPA from priority and non-priority sector lending of Public Sector Banks

Year	Priority sector		Non-Priority sector	
	Credit (%)	NPA (%)	Credit (%)	NPA (%)
2001	31.3	41.7	68.7	58.3
2002	29	39.4	71	60.6
2003	30.8	39.3	69.2	60.7
2004	33.3	41.7	66.7	58.3
2005	33	44.5	67	55.5
2006	34.3	48.6	65.7	51.4
2007	34.4	52.1	65.6	47.9
2008	33.5	52.1	66.5	47.9
2009	32.6	41.5	67.4	58.5
2010	33.3	44.5	66.7	55.5
2011	32.8	49.9	67.2	50.1
2012	31.4	45.3	68.6	54.7
2013	INA	42.9	INA	57.1
2014	INA	36.5	INA	63.5
Avg.	32.5	44.3	67.5	55.7

Source: RBI Publication
INA: information not available

Table.4. Priority sector lending details

Year	Agriculture		SSI		MSME		Other priority sectors	
	Credit (%)	NPA (%)	Credit (%)	NPA (%)	Credit (%)	NPA (%)	Credit (%)	NPA (%)
2001	9.9	12.2	11.1	18.2	INA	INA	10.3	11.2
2002	9.3	11.9	9.4	17	INA	INA	10.4	10.4
2003	9.7	11.8	8.4	16.5	INA	INA	12.7	11
2004	10.2	12.2	8.1	16.1	INA	INA	14.9	13.4
2005	10.6	13.3	7	15.3	INA	INA	15.4	15.8
2006	11.7	13.1	6.6	15.2	INA	INA	16	20.3
2007	12.2	14.7	6.6	13.1	INA	INA	15.6	24.3
2008	11.7	17.5	8.1	11.7	INA	INA	13.6	23
2009	12.2	10.5	8.3	11.5	INA	INA	12.1	19.5
2010	13.1	12.7	9.6	15.9	INA	INA	10.6	15.9
2011	12.6	17.7	INA	INA	11.2	17	8.9	15.1
2012	12.3	18.1	INA	INA	10.3	14.5	8.7	12.7

Source: RBI Publication
INA: information not available

The Table.4 is a further refinement of the earlier table where only consolidated figures for priority and non-priority lending were given. The Table.4 gives interesting facts about how the credit flow has been to the various sub-sectors of the priority segment and also the NPAs that have generated from those sub-segments. But, due to some information that was not available, a complete analysis cannot be done. A look at the agricultural credit shows the rising credit flow to the sector. But, the rate of increase in the percentage of NPA is higher than the loans granted to the sector. With respect to the loans to the SSI, the initial downward trend is followed by a rising curve, but the NPA trend shows a declining phase throughout the period. No definite comments can be made about the Micro, Small and Medium Enterprises (MSME) sector due to lack of information. The flow to the other priority sectors shows a peculiar phenomenon. There is a positive relationship between the two credit flow and non-performing asset. The curve relating to both is an inverted U-shaped; during the initial years, there was a rise followed by a decline post-2008.

Table.5. Exposure to sensitive sectors (in Rs. million)

Year	SBI		Nationalized banks	
	Capital market exposure	Real estate exposure	Capital market exposure	Real estate exposure
2006	23387	327213	100948	1118901
2007	32665	407211	165221	1574296
2008	65884	578705	225729	1976570
2009	69743	641050	244457	2413660
2010	78953	871252	275256	2687463
2011	103353	1346535	331110	3073592
2012	35703	1446684	336019	3441798
2013	72094	1735864	323903	3843232
2014	80319	1911643	312886	4667377
CAGR	16.68%	24.69%	15.19%	19.55%
CAGR (Post-2008)	2.86%	24.42%	5.06%	14.10%

Source: Computed by the author

The Table.5 gives important information about the exposure to the different sensitive sectors that include capital markets and real estate sector. The growth with respect to exposure for both SBI and the nationalized banks is quite significant. However, an interesting point is that the CAGR for the SBI exceeds those of the nationalized banks during the nine-year period. But, even more relevant is the fact that the CAGR with respect to real market exposure exceeds the capital market exposure substantially. In the post-2008 period, SBI and Nationalized banks show a CAGR with regard to exposure to real estate of 24% and 14% respectively. Thus, it is obvious that the increasing vulnerability to bad loans arises due to a huge rise in exposure to real estate market which has slowed down substantially after an initial growth.

Table.6. Percentage growth in exposure

Year	SBI		Nationalized banks	
	Capital market exposure	Real estate exposure	Capital market exposure	Real estate exposure
2006	-----	-----	----	----
2007	39.67	24.45	63.67	40.70
2008	101.70	42.11	36.62	25.55
2009	5.86	10.77	8.30	22.11
2010	13.21	35.91	12.60	11.34
2011	30.90	54.55	20.29	14.37
2012	-65.46	7.44	1.48	11.98
2013	101.93	19.99	-3.61	11.66
2014	11.41	10.13	-3.40	21.44

Source: Computed by the author

The Table.6 is related to Table.5, as it denotes the growth in exposure to the different segments of the sensitive sector. One common point is that the growth has come down drastically in the aftermath of the financial crisis. During the earlier years, the year-on-year growth was quite high. But, the fall started severely following the year of the subprime mortgage crisis; however, things are coming back on track as things are now under control to some extent and the RBI has also adopted several measures in order to reduce the exposure to such sensitive sectors.

6. ROLE OF ASSET RECONSTRUCTION COMPANIES

Since the passage of the SARFAESI Act in 2002, there are several legal measures that have come to the forefront in addition to some measures, one of which is the concept of asset reconstruction companies. Sale of assets to ARCs takes place at a stage when the assets have good chance of revival and fair amount of realizable value, for rehabilitation and reconstruction is encouraged.

The Table.7 highlights the asset quality in the Indian banking sector. The CAGR of gross NPAs is 31.76% during the period 2009-10 to 2013-14. Moreover, advances already granted have been restructured with the CAGR being 24.92%. Similarly, such negative news is also inferred from another parameter, viz. stressed assets to gross advance ratio which shows a continuous increase from 4.2% in 2009-10 to 5.9% in 2013-14. But, one point that one needs to observe is that the growth in book value of assets transferred to ARCs has been declining and the year-on-year growth is only a meager percentage in comparison to the sharp increase in gross NPAs in the industry. One of the reasons behind the fall is the pricing issue where the buyers of the non-performing loans find the buying price to be costly, thereby reducing the purchase of loans.

The Table.8 shows the position of restructuring of advances for which the ARCs play a vital role. The increasing quantum of bad assets is clear from the increasing restructured advances to advance ratio between 2009 and 2014. The ratio started with 2.16%, clawed up to 2.66% by 2011. After this, it jumped up to 5.37% by March 2012 beyond which the trend continued.

Table.8. Trend of restructured assets

As at the end of March	Restructured advances to advance ratio (%)
2009	2.16
2010	2.99
2011	2.66
2012	5.37
2013	6.03
2014	6.16

Source: www.bis.org

7. CONCLUSION

The banking industry in the country plays a vital role. It is true that the public sector dominates the sector in terms of percentage of assets, business, but it is recently in the news due to the increasing amount of non-performing assets or poor quality loans that it is accumulating in its books. The overall trend in the gross and net NPAs in the sector is negative. And, it is seen that during the period, the negativity has increased just after the commencement of the financial crisis towards the end of 2007. The result clearly points to the huge exposure of the banks to the sensitive sectors, more specifically the real estate sector that is showing stagnancy in terms of new business. The overall real estate sector has lost its charm and there are several cases of default. There are also cases where companies have restructured their loans in order to arrive at a loan repaying position. Moreover, priority sector loans have also almost ruined the banking business with almost more than 50% of the total NPAs being generated from this sector. The overall result on the banking sector due to this is negative. But, the asset reconstruction companies have been playing an important role in purchasing the non-performing loans at a negotiated price. But, the assets being purchased by such ARCs is showing a decline, and one of the cited reasons is the pricing factor that they are not finding to be correctly determined. Though, things are slowly coming to the track, time will say to what extent strategies of the banks and the regulator have been successful in managing non-performing banking assets.

Table.7. Asset quality position in the Indian banking system

Particulars	2009-10	2010-11	2011-12	2012-13	2013-14	CAGR
Gross NPAs	84747	97922	142300	194000	255400	31.76%
% y-o-y growth in GNPA	------	15.54	45.32	36.33	31.64	------
Restructured Advances	136326	137602	218608	301000	332000	24.92%
% y-o-y growth in RA	------	0.93	58.87	37.68	10.30	------
Gross NPA (%)	2.5	2.3	2.9	3.6	5.1	------
Restructured Advances to gross advance ratio (%)	4.2	3.5	4.7	5.8	5.9	------
Total *stressed assets** to gross advances ratio (%)	6.7	5.8	7.7	9.1	11	------
Book value of assets transferred to ARCs	82217	74088	80500	88500	92450	------
% y-o-y growth in transfer to ARCs	------	(9.88)	8.65	9.93	4.46	------

Source: Computed by the author

*equals NPAs plus restructured loans

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