A Study on Non-Performing Assets in Select Banks

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Introduction

NPAs adversely affect lending activity of banks as non-recovery of loan installments as also interest on the loan portfolio negates the effectiveness of credit-dispensation process. Non-recovery of loans also hurts the profitability of banks. Besides, banks with high level of NPAs have to carry more owned funds by way of capital and create reserves and provisions to provide cushion for loan losses. NPAs, thus, make two-pronged attack on the grassroots of banks. Interest on such assets is not taken into account because such interest is to be taken into account only on its realization unlike interest on performing assets which is taken into account on accrual basis. Banks have to make provision for NPAs from out of the income earned by them from performing assets. Persistently high level of NPAs in loan portfolio of banks makes them fragile, leading ultimately to their failure. This will shake the confidence of both domestic and global investors in the banking system which will have multiplier effect, bringing disaster to the economy. Thus, the most critical condition for bringing about an improvement in the profitability of banks is reduction in the level of NPAs. In fact, it is a pre-condition for the stability of the financial system.

In India, the magnitude of the problem of bad debts was first realized only in early 90s, following the recommendations of Narasimhan Committee (1991, 1998) and Verma Committee (1999). Some steps were initiated to solve the problem of NPAs. Though concern regarding the reduction of NPAs in the balance sheets of banks, particularly Public Sector banks continues to be expressed from every corner, there has hardly been any systematic evaluation of the best way of tackling the problem. There seems to be no unanimity in the proper policies to be followed in resolving this problem. There is also inconsistency in the application of NPA norms, ever since these have been recognized.

Today, the Indian banking system has undergone significant transformation following financial sector reforms and adopting international best practices. Several prudential and provisioning norms were introduced, and these are pressurizing banks to improve efficiency and trim down NPAs to improve the financial health of banking system. It is among the best in the world because Indian banks are showing favourable prospects in terms of growth, asset quality and profitability. RBI and Government of India have made some notable changes in policies and regulations to strengthen the sector.

Statement of the problem

NPA involves the necessity of provisions. Any increases in NPAs would bring down the overall profitability of banks. It is the indicator of banking health. It is always important to have periodical assessment in order to have an idea of the impact of different measures designed and implemented for improving the situation. Such evaluation helps in better planning or in improvising the existing mechanisms. Since the nature and magnitude of the problem of NPAs is likely to differ in different types of banks, uniform measures or interventions may not yield expected or same results. Hence, it sometimes necessitates specific remedies in different situations. This can be done only through periodical study of the problem in different types of banks. Many such studies have been taken up so far on the management of NPAs. However, the main focus was laid only on identifying causes of NPA's and extending suggestions in the form of measures to be taken at micro level, that too specific to some individual banks. Therefore, there is a every need to conduct a study on management of NPA's of Schedule Commercial Banks (SCBs) in both Public and Private Sectors. Against this background, the present study is an attempt to make a comparative study in both the public and private sector commercial banks.

Need for the study

The review of existing literature on the topic of research reveals that there are quite a number of studies on NPAs at macro level either covering all types of banks or covering only a particular state. Further, a number of studies were taken up so far on the management of NPAs with the main focus on the causes for NPAs and suggested measures to be taken at micro level, that too on some individual

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banks. In the present scenario, in the light of economic reforms, public and private sector banks of schedule commercial banks play an equal role in the development of Indian economy. But it is believed that the magnitude of NPAs in the private sector banks is less than that of public sector banks. Hence, there is a need to find out possible answers to certain issues. What is the magnitude of NPAs in public and private sector banks? What are the causes for incidence and trend of NPAs in these kinds of banks? What are the recovery measures and strategies followed to reduce the incidence and burden of NPAs? To answer the aforementioned queries, there is a need to undertake an enquiry into public and private sector scheduled commercial banks. In view of the gaps in the existing available literature and also the aforesaid, it is strongly believed that there is a dire need to carry out a detailed study covering aforesaid aspects. The present study is carried out in that direction.

Objectives

The specific objectives of the study are: to

(i) understand the performance of public and private sector banks;
(ii) make a comparative study of the magnitude and dimensions of NPA's in public and private sector banks;
(iii) examine the causes for incidence and trend of NPA's in public and private sector banks; and
(iv) examine the recovery measures and strategies followed to reduce the burden of NPAs by public and private sector banks; and

Sampling

Public sector banks include State Bank of India and its associates along with other nationalized banks and regional banks while private sector banks include Indian private banks and foreign banks. Again private sector banks can be categorized into old private banks and new private banks. There are 26 public sector banks in India. They include the SBI and its 6 associate banks, 19 nationalized banks and IDBI Bank limited. In addition to the above, there are 64 regional rural banks (RRBs) at the end of March, 2013. During the same period, there were 7 new private banks, 15 old private sector banks and 29 foreign banks. In total, there are 155 banks operating in both the categories. For the purpose of present study, two banks from public sector and two banks from private sector are selected. The selection is purely based on profit during 2013. In each sector, one bank with relatively highest profit and another with lowest profit are picked up. In total, four banks are selected i.e., two banks each from public and private sectors are brought in the sample. Accordingly, SBI and Central Bank of India from the public sector and ICICI and Dhanalakshmi Bank Limited from private sector are selected. Foreign banks, co-operative banks and RRBs are out of the purview of the study. The co-operative banks and RRBs are different from commercial banks in certain respects. Similarly, foreign banks do not have any legal bondage towards social responsibility.

Data collection

The study makes use of only the secondary data. The secondary information is gathered through books, journals, periodicals, magazines, reports, handouts, pamphlets and websites. The secondary data is confined to 10 years, i.e., from 2004 to 2013.

Tools of analysis

The collected data is processed, tabulated, analyzed and interpreted with the help of appropriate statistical tools. While analyzing the incidence and trends of NPA's, usual statistical techniques like percentage, 't – test' and correlation of coefficient are used to determine the significance of difference in averages between public sector and private sector banks and among the four banks individually.

Limitations

Study of the causes and analysis of NPA's is confined to public and private sector banks only. In other words, RRBs, foreign banks and co-operative banks are excluded from the study. Since the analysis has been restricted to four banks only, the inferences may not hold good hundred percent for other banks and also when looked at individual branch level. The percentage and averages as tools of analysis lack absolute accuracy as they are adjusted to the nearest decimal points. Preventive measures which are initiated by select banks to reduce the NPAs are not available to the researcher, though the statistical figures relating to the same are published by RBI from time to time. At macro level, the data is available but at micro level the data is not available. The study considered the impact of NPAs on the exclusive parameter of financial performance of select banks. The price level changes are ignored because of conceptual issues in several methods of inflation accounting.

Major findings

Financial performance of select banks

To assess the relative efficacy of different banks, different ratios of return on total assets and heads of expenditures to total assets are analyzed for a grasp. Among all the banks, the gross profit to total assets ratio is the highest in ICICI Bank Ltd whereas it is the lowest in DB Ltd. There is a significant difference in the mean gross profit ratio. Of the sample public sector banks, the ratio of SBI is greater. Similarly ICICI Bank Ltd is in the private sector. It means that the ratio in the CBI and DB Ltd is lesser. Net profit to total ratio in the SBI, CBI and ICICI Bank Ltd was positive while it was negative in the DB Ltd. Further, there is a significant difference in the mean value between SBI and CBI banks only. With regard to interest income to total assets ratio, among the public sector banks, it is greater in the CBI as compared to SBI. Further, among private sector banks, it is higher in DB Ltd relative to ICICI Bank Ltd. In both the cases there is a significant difference in the mean value. Furthermore, there is an upward trend in the proportion of interest income to total assets ratio. The net interest income to total assets ratio has declined in SBI, CBI and DB Ltd. A converse trend prevails in the ICICI Bank Ltd. The ratio of other income to total assets has declined in 2013 over 2004 in the sample banks. The difference in the mean value of the individual banks is significant at five per cent level. There is a growing trend in the interest earned to total assets ratio. Further, the difference in the mean value between SBI and CBI is significant while insignificant between ICICI Bank Ltd and DB Ltd. The operating expenses to total assets ratio has declined in sample banks in 2013 as compared to 2004. The difference in the ratio between ICICI Bank Ltd and DB Ltd is significant. On an average, profit per branch was the highest in SBI while it is the lowest in CBI.

Among the private sector banks, ICICI Bank Ltd has recorded profit whilst DB Ltd, loss. There is an increase in the profit per employee in 2013 over 2004 in SBI and ICICI Bank Ltd. A contrary picture prevails in CBI and DB Ltd. In the case of CBI, the bank pushed from profit in the initial year to red in the last year of the reference period. With regard to provisions and contingencies to total assets, there is a decline in SBI and CBI. The Capital Adequacy Ratio (CAR) of SBI may be favourably compared with that of CBI and that of ICICI Bank Ltd with DB Ltd. Of all the four banks, it is the least in DB Ltd. It means that the capital base is inadequate in DB Ltd to absorb shocks in operating losses in the years to come. The business per branch was the highest in ICICI Bank Ltd while the least in DB Ltd. The difference in the average business per branch between SBI and CBI and ICICI Bank Ltd and DB Ltd is significant at five per cent level. The business per employee has risen in SBI, CBI and DB Ltd. In ICICI Bank Ltd, it has declined. In respect of burden ratio, among the sample banks, on an average, ICICI Bank Ltd ranked first followed by SBI, CBI and DB Ltd. The burden to total income ratio is higher in the CBI as compared to SBI. The ratio is negative in the ICICI Bank Ltd while positive in DB Ltd. There is a significant difference between the ratio of ICICI Bank Ltd and that of DB Ltd while it is insignificant in the rest of the cases.

Trend and magnitude of NPAs in select banks

The NPAs in the SBI were Rs.14,808 crores in 2004 as compared to Rs. 72,317 crores in 2013. The sub-standard assets have formed nearly 50 per cent. The NPAs in CBI were Rs. 1,901 crores in 2005 as compared to Rs.11,500 crores in 2013. There is not much change in the proportion of loss assets in the CBI as in the case of SBI. With regard to ICICI Bank Ltd, all the components of NPAs have grown. The trend in the loss assets is similar to that of public sector banks. The aggregate NPAs of DB Ltd have risen from Rs. 51 crores in 2007 to Rs. 73 crores in 2013. If DB Ltd is compared with the ICICI Bank Ltd, there is no change in the rank of loss assets.

In the case of SBI, the share of gross NPAs to gross advances has declined from 6 per cent in 2004 to 4.9 per cent in 2013. With regard to CBI, the former was 9 per cent in 2004 as compared to 6.3 per cent in 2013. In the case of ICICI Bank Ltd, the gross NPAs to gross advances were 3.0 per cent in 2004 as well as 2013. In respect of DB Ltd, the ratio of gross NPAs to gross advances has decreased from 8.5 per cent in 2004 to 6.0 per cent in 2013. The gross NPAs to total assets ratio in the SBI has increased from 2.7 per cent in 2004 to 3.4 per cent in 2013. In the case of CBI, the ratio was 3.8 per cent in 2004 vis-à-vis 4.0 per cent in 2013. With regard to ICICI Bank Ltd, the ratio was 1.7 per cent in 2004 as compared to 1.8 per cent in 2013. In respect of DB Ltd, the ratio has decreased from 4.7 per cent in 2004 to 3.3 per cent in 2013. In terms of mean ratio, the CBI is the best followed by ICICI Bank Ltd, DB Ltd and SBI. In respect of public sector, it is favourable in CBI relative to SBI. With regard to private sector, it is better in the ICICI Bank Ltd relative to DB Ltd.

In the SBI, of all the items, the movement is the highest in additions while the lowest in opening amount. In case of CBI, the movement in the yearly gross NPAs is noticeable, particularly, opening, additions and closing. The opening gross NPAs of ICICI Bank Ltd have gone up from Rs. 3,048 crores to Rs.9,608 crores during the period 2004-13. The movement in reductions is far greater than that of additions. With regard to DB Ltd, there is an increase in opening, additions, reductions and closing gross NPAs in 2013. The movement in the additions to gross NPAs is the highest. The movement in the closing gross NPAs is greater in the CBI than that of SBI. This might be on account of the highest movement in additions to gross NPAs in CBI relative to SBI. In the private sector, the movement of the closing gross NPAs in the DB Ltd is higher than the movement of closing gross NPAs in ICICI Bank Ltd. This is on account of higher movement in the reductions to gross NPAs than movement in additions to gross NPAs in the ICICI Bank Ltd.

The ratio of net NPAs to net advances in the SBI has declined from 2.7 per cent in 2004 to 2.6 per cent in 2013. With regard to CBI, there is a converse situation. In the case of ICICI Bank Ltd, the ratio has declined from 1.7 per cent in 2004 to 1.0 per cent in 2013. In respect of DB Ltd, the ratio was 3.9 per cent in 2004 whilst 3.8 per cent in 2013. It has declined in both the ICICI Bank Ltd and DB Ltd in 2013 over 2004. The ratio of net NPAs to total assets in SBI has increased from 1.2 per cent in 2004 to 1.7 per cent in 2013. A similar trend can be noted in CBI. In respect of ICICI Bank Ltd, the ratio was less than one per cent throughout the period. In respect of DB Ltd, the ratio was 2.3 per cent in 2004 as against 2.1 per cent in 2013. There is increasing movement in components of net NPAs of SBI and CBI. There is an increase in the opening, closing, reductions and additions to net NPAs in the ICICI Bank Ltd and DB Ltd. In both the private sector banks, movement in closing net NPAs is greater than that of the movement in opening net NPAs. Similarly, the movement in additions to net NPAs is higher than that of the reductions in Net NPAs. Among the banks, the movement in closing NPAs is higher in DB Ltd followed by SBI, CBI and ICICI Bank Ltd. The overall result is that the NPAs have moved year after year in the ICICI Bank Ltd and DB Ltd.

The provisions to gross NPAs in the SBI have constituted 53.7 per cent in 2004 as against 34.4 per cent in 2013. In the case of CBI, the share of provisions in gross NPAs has decreased from 47.8 per cent in 2004 to 39.1 per cent in 2013. With regard to DB Ltd, the ratio has increased from 31.9 per cent in 2004 to 53.1 per cent in 2013. The movement in the provisions to NPAs in the SBI in terms of opening, additions, reductions and closing balances, there is an increase in 2013 over 2004. In case of CBI, there is a progress in absolute figures in opening balance, additions, reductions and closing balance in 2013 over 2007. With regard to ICICI Bank Ltd, the trend in absolute figures in opening, additions, reductions and closing provisions is similar to that of SBI and CBI. In respect to DB Ltd, like the other three banks, there is a progress in the provisions in absolute terms.

The priority sector dominates the non-priority sector in the total NPAs of SBI. The priority sector accounts for a lion's share in the total NPAs of CBI. Between the two sample public sector banks, the share of NPAs of priority sector in CBI is greater than that of their proportion of SBI. The share of priority sector in the total NPAs is quite different from the two public sector banks. On an overall basis, it may be said that, of the NPAs, priority sector accounts for a larger share in public sector banks whereas it accounts for a relatively smaller proportion in private sector banks. In the public sector, the share of priority sector in CBI is greater than that of SBI. Among the private sector banks, it is comparatively more in the DB Ltd. The share of agriculture in the total NPAs of priority sector of SBI has ranked first followed by small scale industries and others. A similar trend prevails in the CBI. In the total NPAs of priority sector of ICICI Bank Ltd, agriculture has accounted for more than 60 per cent. Of the total NPAs of priority sector of DB Ltd, the share of agriculture has increased. When ICICI Bank Ltd is compared with the DB Ltd, in the total NPAs of priority sector, agriculture ranked first in the ICICI Bank Ltd while others in the DB Ltd.

The proportion of NPAs in the advances to priority sector in the SBI was 8.94 per cent in 2004 as against 6.65 per cent in 2013. With regard to CBI, the share of NPAs in the advances outstanding was 11.11 per cent in 2004 vis-à-vis 2.58 per cent in 2013. In case of ICICI Bank Ltd, it has increased from 0.71 per cent in 2004 to 3.30 per cent in 2013. The account of NPAs in the advances to priority sector in the DB Ltd has remarkably declined from 11.41 per cent in 2004 to 1.43 per cent. Of the two private sector banks, the trend is better in the DB Ltd as compared to ICICI Bank Ltd. There is a positive and significant correlation between GNPAs and gross return in the CBI. The relationship between NNPAs and gross profit is negatively insignificant in DB Ltd. The correlation of coefficient between GNPAs and net return and NNPAs and net return is found to be negative in all the banks leaving SBI. The correlation between NNPAs and net return is significantly negative in the CBI only. The relationship between GNPAs and net interest income is positive in all select banks. The correlation between NNPAs and net interest income is positive in all the banks bearing ICICI Bank Ltd. There is a positive correlation between GNPAs and contingencies and provisions in all the banks except in the case of DB Ltd. In the DB Ltd, correlation is negatively significant. In both the respects, it is significant at 5 per cent level in the CBI. With regard to ICICI Bank Ltd, it is significant between NNPAs and provisions and contingencies. Both GNPAs and NNPAs are negatively correlated with profit per employee in all the banks except SBI in terms of GNPAs and profit per employee. It is significant at 5 per cent level in CBI only.

Suggestions

In the light of findings of the present study, the following suggestions are made to reduce the magnitude of NPAs in the select banks. It is evident that there are certain issues which have hampered the profitability of banks due to rise of NPAs. Genuine execution of the following suggestions will enable the banking sector to reduce the adverse effect of NPAs.

'Prevention is better than cure' holds well in monitoring of credit portfolio and arresting fresh growth of NPAs as well. Hence, besides recovery of NPAs, containment of NPAs should be the focus of banks. The magnitude of the problem of NPAs calls for immediate corrective steps so that the problems are contained. The NPAs issue needs to be tackled at two inter dependent levels. NPAs are increasing year by year due to mismanagement of banking sector. To minimize these NPAs, the banker should follow different criteria when the banker goes to sanction loan to a customer. The banker should get both the formal and informal information about the customer from various sources. Uneven scale of repayment schedule with higher repayment in the initial years normally should be preferred. Public sector banks should increase their non-interest income, as rise in NPAs due to default in interest income may affect the profits drastically. Private sector banks should focus more on recovery of sub-standard and doubtful assets. Some of the enactments related to NPAs are age old and there is an urgent need to amend these and new enactments are called for in order to cater to the requirements of present. Opening more DRTs and strengthening the existing DRTs and BIFR branches and comprehensive amendment in Sick Industrial Companies Act is the need of the hour. The bank management has to undertake credit audit to prevent NPAs; identification of potential NPAs; review of problem loans and proper reporting; strong and effective credit monitoring; involvement of staff in recovery of programmes at the rural and semi-urban branches. Direct recovery is the best indicator for reduction of NPAs; close follow-up, including periodical inspection of units, borrower's education and sympathetic consideration of genuine problems of borrowers will help banks in better loan recovery. Proper evaluation of risk associated with advances/loans will help the banks to minimize the size of NPAs. Bank should examine the viability of the project while sanctioning advances/loans. In addition, service of the professional should be availed in credit appraisal. There is a dire need for an integrated information system of NPAs in banks. This system should clearly bring out the inter-relationship between the volume of NPAs and other variables like the cost of related collections and disbursements.

Conclusion

Due to changing business environment across the globe, the presence of NPAs is inevitable and the only way to come out of this is to take concrete measures to curtail the same. If the aforesaid suggestions are implemented as a whole instead of piecemeal, definitely, they would result in minimization of size of NPAs. The solution is simple and practicable. There is a need to create a fund named precautionary margin reserve. There must be rapport between the banker and borrower to improve the credit portfolio effectively and efficiently. All possible malpractices like corruption, ever greening of advances, extending undue favours and concentrate lending must be checked with proper vigilance and supervision while sanctioning of loans/advances. The taxation rules can be linked to rating so that borrowers will have inclination and incentive to be more responsible and accountable.

Hints for further research

A research study can be conducted exclusively on NPA management. A more detailed break-up of NPAs needs to be performed in order to identify potential risks; particularly, priority sector lending. It must be analyzed segment-wise. Further, another area of further research is the effectiveness of the recovery processes and the relationship between NPAs and other policy variables, especially capital adequacy and possibly cash reserve ratio and statutory liquidity ratio. In general, it is evident that the foreign bank is better in the management of NPAs as compared to domestic banks. Hence, there is a scope of research for a comparative study between domestic and foreign banks. NPAs are seen to have a great impact on the profitability of banks. Therefore, a study can be carried out on the impact of NPAs on the profitability of banks.