Abstract

India’s banking industry could become the fifth largest banking sector globally by 2020 and the third largest by 2025. These days, banks in India are turning their focus to servicing clients and improving their technology infrastructure, which can help better customer experience and give them a competitive edge. Stressed loans in the banking system in India make up for Rs 5.5 lakh crore gaping hole by some estimates and poses a grave risk to the economy and the financial sector. A Non-performing asset (NPA) is defined as a credit facility in respect of which the interest and/or instalment of principal has remained ‘past due’ for a specified period of time. The angst of common man on NPAs is well founded. Major objectives of the study are to ascertain the gravity of problem about NPAs in India. Further this paper highlights the defaulting companies in this respect and threats emerging out of it. At the end the paper tells about the steps to be taken by the government and banks to revive loans.

1 Introduction

NPA is a classification used by financial institutions that refer to loans that are not meeting its stated principal and interest payments. Banks usually classify as non-performing assets any commercial loans which are more than 90 days overdue and any consumer loans which are more than 180 days overdue. More generally, an asset which is not producing income is called as non-performing. In other words, loans are classified as NPAs when the bank considers that the borrower has not serviced his debt or are unlikely to service his debt as per the terms of the contract. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. When companies began to get stressed on servicing loans, banks restructure loans. This is an earlier stage of NPA. These loans are where banks give extension on payment, cut interest rates or a time moratorium. Some companies come out of a restructured package while others become NPAs. These are then sold to asset reconstruction companies. While taking a small loan, a common man is subjected to many checks, including income, solvency, identification, personal guarantees and umpteen reminders on a delayed EMI payment.
2 Classification

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the reliability of the dues:

1. Sub-standard assets: a substandard asset is one which has been classified as NPA for a period not exceeding 12 months.
2. Doubtful Assets: a doubtful asset is one which has remained NPA for a period exceeding 12 months.
3. Loss assets: where loss has been identified by the bank, internal or external auditor or central bank inspectors. But the amount has not been written off, wholly or partly number.

3 Recent Trends In India

The alleged corrupt practices in public sector banks and their burgeoning bad loans have come under dubious spotlight in the last few days with the CBI arresting Sudhir Kumar Jain, chairman and managing director of Syndicate bank, on bribery charges for extending credit to defaulting companies, Bhushan Steel and Prakash Industries. Neeraj Singhal, managing director, Bhushan Steel, has also been arrested by the CBI in what has become a high-profile case involving a major PSU bank and large corporate, bringing into focus the scourge of bad loans or non-performing assets (NPAs) and detection of underhand dealings in allocating loans.

The CBI has also begun investigations against IDBI Bank for extending an Rs 950 crore loan to Vijay Mallya’s Kingfisher Airlines, a debt-strike company, even when the bank’s internal report had warned against it.

There was another major incident in February when Kolkata-based United Bank of India had to suspend lending after reporting a massive loss of Rs 1,200 crore. The RBI conducted a special audit and its chairman and managing director Archana Bhargava stepped down later.

The extent of the NPA problem is massive. A report by Kotak Institutional Equities says the RBI puts the total quantum of impaired assets at 9.8 percent loans or Rs 5.5 lakh crore at the end of financial year 2014.

RBI Governor Raghuram Rajan has sounded a note of caution, saying the Syndicate Bank case does not reflect the banking system. “I think the balance has to be maintained, and we do a thorough investigation and culprits are brought to book, it doesn’t become a witch-hunt which then stalls the entire credit process. We have to be careful,” he said.

In May, the All India Bank Employees Association (AIBEA) issued a list of top 406 defaulters against whom banks have initiated legal actions. Here are some of them in a table showing the name of the company, their ranks and amount of loan not repaid by them:

<table>
<thead>
<tr>
<th>Serial No.</th>
<th>Name of Company</th>
<th>Rank</th>
<th>Loan Not Repaid (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Kingfisher Airlines</td>
<td>1</td>
<td>2,673 crore</td>
</tr>
<tr>
<td>2</td>
<td>Moser Baer India Ltd. &amp; Group Companies</td>
<td>25</td>
<td>581 crore</td>
</tr>
<tr>
<td>3</td>
<td>Century Communication Limited</td>
<td>24</td>
<td>624 crore</td>
</tr>
<tr>
<td>4</td>
<td>Indian Technomac</td>
<td>23</td>
<td>629 crore</td>
</tr>
<tr>
<td>5</td>
<td>ICSA (India)</td>
<td>22</td>
<td>646 crore</td>
</tr>
<tr>
<td>6</td>
<td>K.S. Oil Resources</td>
<td>21</td>
<td>678 crore</td>
</tr>
<tr>
<td>7</td>
<td>Deccan Chronicle Holdings Limited</td>
<td>20</td>
<td>700 crore</td>
</tr>
<tr>
<td>8</td>
<td>Pixion Media Pvt. Limited</td>
<td>19</td>
<td>712 crore</td>
</tr>
<tr>
<td>9</td>
<td>Zylog Systems (India) Limited</td>
<td>18</td>
<td>715 crore</td>
</tr>
<tr>
<td>10</td>
<td>Surya Pharma</td>
<td>17</td>
<td>726 crore</td>
</tr>
</tbody>
</table>
11. STCL Limited 16 860 crore
12. National Agricultural Co-Operative 15 862 crore
13. Murli Industries & Exports Limited 14 884 crore
14. Kemrock Industries & Exports 13 929 crore
15. Orchid Chemicals & Pharmaceutical 12 938 crore
16. Varun Industries Limited 11 1,129 crore
17. Sterling Oil Resources 10 1,197 crore
18. Forever Precious Jewellery & Diamonds 9 1,254 crore
19. Corporate Ispat Alloys 8 1,360 crore
20. Surya Vinayak Industries 7 1,446 crore

4 The Challenges
The NPA problem is more pronounced in public sector banks. Apart from large macro issues like economic slowdown leading to increase in bad loans, PSU banks have intrinsic issues like government ownership, implementation of welfare schemes, management, culture and remuneration.

Delivering a lecture recently at Assocham, RBI deputy governor R Gandhi said the total stressed assets in the banking system (including NPA's and restructured standard assets) as on December 2013 was 10.13 percent of the gross advances of banks. “A slowing economy is bound to see an increase in the NPAs. Notwithstanding economic weakness, the NPAs have registered increases since financial year 2012 which is a cause of concern. The NPA increases have been more pronounced in public sector banks,” he said.

However, Gandhi said shortcomings in credit appraisal, disbursal and recovery mechanism, besides the slowdown, were responsible for high NPAs. Lack of robust verification and screening of application, absence of supervision following credit disbursal and shortfalls in recovery have led to the deterioration of asset quality, he added.

5 Sector Push
Some sectors contribute to the bulk of NPAs. Sanjay Doshi, partner, transaction and restructuring, KPMG in India, says sectors like infrastructure, iron and steel and textile industries are the largest contributors to the NPAs. Stalled projects, delayed policy decisions, slowdown, macro factors relating to the supply and demand and mismanagement are the reasons for the stress in these sectors.

Jaitley said in Parliament that bad loans amounts of PSU banks were much higher than private sector banks and there was no comparison between the two as their functioning was different. He said private banks were circumspect on whom to give a loan while PSU banks have social commitment and cater to a large segment of population, particularly in rural areas.

6 How The Heist Happens
NPAs result from what are termed “Bad Loans” or defaults. Default, in the financial parlance, is the failure to meet financial obligations, say non-payment of a loan installment. These loans can occur due to the following reasons:
• Usual banking operations /Bad lending practices
• A banking crisis (as happened in South Asia and Japan)
• Overhang component (due to environmental reasons, business cycle, etc.)
• Incremental component (due to internal bank management, like credit policy, terms of credit, etc.)

Middlemen card: - The CBI has arrested 11 persons, some of whom were middlemen between the bank and companies for extending credit facilities. These people on behalf of companies and others allegedly enter into criminal conspiracy and obtain gratification meant for the public servant and deliver it to the middlemen on behalf of the public servant, the CBI said.

Direct negotiations: - In one case, a public servant was allegedly negotiated with a company for Rs 50 lakh in lieu of credit extension. The officials of the company transferred the money to the middlemen who were also relatives of the public servant. The CBI laid a trap and recovered Rs 50 lakh.

FDs easy target: - Officials of Oriental Bank of Commerce and Dena Bank are also suspected of misappropriating funds worth Rs 436 crore from fixed deposit customers. The government has initiated a forensic audit in the alleged scam.

7 Steps to Recover Bad Loans

With net non-performing loans (NPLs) and restructured loans comprising 8 percent of total loans of banks, the banking system faces serious challenges, especially given several banks’ low capital adequacy ratios. Another challenge is that banks need to raise capital of over Rs 2 lakh crore over the next two years to meet capital adequacy norms. However, there are some solutions for fixing the NPA and other issues:

Revive economy: - Economic recovery can lead to better financial conditions of troubled infrastructure companies. Revival of growth and investment cycle will relieve stress on bank balance sheets. The outlook for NPAs in the coming year is elevated. ICRA estimates as regards asset quality, public sector banks fresh NPA generation rate may remain at elevated levels in the short term. Economic revival will hold the key for reduction in the fresh NPA generation rate. ICRA expects gross NPAs of PSBs to remain at 4.4-4.7 percent March 31, 2015, as against 4.4 percent as on March 2014.

Get projects moving: - A report by Societe Generate says kick-starting stalled projects will boost the economy and reduce NPAs. Around $134 billion worth of projects are stalled and close to 57 percent (about $75 billion) is stalled for land acquisition and clearance. The government will be able to revive projects worth $60 billion, or about 45 percent of stalled projects at various government officials.

Strive to recover: - The RBI’s enabling framework for addressing the NPL challenges and the government’s weak fiscal solution will help, says a research note by Kotak Institutional Equities. The Finance Minister has said many industries have suffered losses in the last two years leading to their inability to repay loans. The RBI has taken steps to recover bad loans of PSU banks that include creation of the Central Repository of Information on Large Credits to collect, store and disseminate credit data to banks on credit exposures of Rs 5 crore and above, formation of joint lenders’ forum, corrective action plan and sale of assets.

Create bad bank: - Establishment of a bad bank and transfer of impaired assets to the bad bank. Asset reconstruction companies can play a similar role in the Indian context.

Lower interest rates: - These can result in lower interest expenses for the borrowers and investment gains for banks that can offset NPLs.

Review borrowal accounts: - The Management Committee of board should review top 100 borrowal accounts of below Rs 5 crore in each category of NPA, Jaitley has said. The government has asked banks to be more focused in coordination with other members of consortium, assigning the
responsibility at the executive director level, hiring best lawyers and monitoring their performance in
defending the bank’s interest in Debt Recovery Tribunals and high courts.

**Improve performance:** - Jaitley has said they have taken some decisions to professionalize the
management of banks and expect banks to have better risk management. RBI Governor Raghuram
Rajan has said the RBI and government are working on solutions to improve performance of public
banks, including improving boards, separation of CEO and chairman role and reducing the
government stake to improve bank governance. About 70 percent assets are handled by PSU banks.
Banks have been asked to share information about lenders, cooperate in recovery, and form the Joint
Lenders Forum.

**Fortify legal framework:** - In a report, Crisil has called for policy makers to strengthen legal and
recovery frameworks, and work towards a stronger bankruptcy code to ensure that recoveries become
structurally faster.

### 8 Conclusion
A part of the NPA problem of PSU banks is owing to welfare programmes, agricultural loans,
government schemes, financial outreach for the unbanked and loans to state power boards. A big hit
accrues when farm loans are waived. Banks have been protesting the decision of Andhra Pradesh
Chief Minister Chandrababu Naidu to waive loans. The problem of NPA can be offset by following
the measures explained above and our economy can benefit through it.

### References

[1] Table b7 :bank wise and bank group-wise gross non-performing assets, gross advances and gross npa ratio of