# An Analysis of NPA in Indian Commercial Banks

## What ails Non Performing Assets

AUTHOR
**Dr. A. R. Krishna**
*Reader in Commerce, Guru Ghasidas University, Bilaspur, Chhatisgarh*

**ABSTRACT**

*NPA is non-performing assets, which are not producing any new income. Indian banking industry has undergone several changes during the liberalization process. However, one nagging problem affecting the baking sector has been the high level of non- performing assets. High non-performing assets affect the profitability, productivity, capital adequacy and competitiveness of banks. Management of NPAs , therefore, assumes significance in management of banks. Regulators and policy makers for banks have been taking measures to bring down the level of NPA in Indian commercial banks. This paper analyses the trend of NPAs in the last five years and suggest measures to reduce them. The reforms measures and policy initiatives have resulted in reducing the level of NPAs in Indian commercial banks. Categorywise analysis shows that the public sector banks have hier levls of NPAs in comparison to private and foreign banks. Sectorwise analysis reveals that priority sector lending accountsf or major portion of NPAs in public sector banks, while non-priority sector lending account for major portion NPAs in private and foreign banks. Agriculture sector also is an important contributor to the NPAs in commercial banks.The paper is divided into three sections. Section I describes the concept, causes and consequences of NPA. Section II Analyses the trend of non-performing assets in Indian commercial banks. Section III contains conclusive remarks.*

## 1. INTRODUCTION

Non-performing assets (NPAs) are those assets that cease to provide any income for the banks. NPA has ever been a major concern for the bank promoters and government. Management of NPAs has been a significant aspect of bank management and has always drawn the attention of bankers. Accumulation of NPAs in the balance sheet of a commercial bank always affects the profitability and solvency of a bank. This paper analyses the trend of non- performing assets in Indian commercial banks and discusses its significance for the banking industry.

The paper is divided into three sections:

Section I describes the concept, causes and consequences of NPA.

Section II Analyses the trend of non-performing assets in Indian commercial banks.

Section III contains conclusive remarks.

## 2. NON-PERFORMING ASSETS: DEFINITION, CAUSES AND CONSEQUENCES

Non-performing asset generally refers to those assets which cease to provide any return to the bank. However, for practical purposes the concept NPA has been changing. The Reserve Bank of India, the regulator of commercial banks in India has been issuing guidelines for identification of NPAs and their management. As per RBI guidelines NPAs consist of sub-standard assets, doubtful assets and loss assets. An asset generally turns into NPA when it fails to yield income during a certain period. As per the RBI guidelines for recognition of NPAs, with effect from 31st March, 2004 an asset is considered to have gone bad when the borrower has defaulted on principal and interest repayment for more than one quarter or 90days.

According to RBI guidelines every bank must make provisions for NPAs. For the purpose of provisioning, assets of a bank can be categorized into four different classes such as, Standard assets, Sub-standard assets, Doubtful assets and Loss assets.

**i) Standard Assets**: Standard assets are treated as performing assets. They do involve business risks. In case of standard assets of domestic portfolios, no provisioning is required, but in case of global portfolios, these assets require a minimum provisioning of 0.25 per cent.

**ii) Sub Standard Assets**: These are assets which have been classified as NPAs for a period less than or equal to 18 months. The general provision of 10 percent of total outstanding principal plus entire outstanding interest should be made on sub standard assets.

**iii) Doubtful Assets**: These are accounts which have remained as NPAs for a period exceeding 18 months. On these assets the banks are required to provide 100 percent for the unsecured portion and an additional provision of 20 to 50 percent of advances, if doubtful for 3 and more than 3 years.

**iv) Loss assets:** Loss assets are those NPA accounts, which are lost by the bank or auditors or by RBI on inspection. A provision of 100 percent of the outstanding amount must be made for these assets.

Thus, the RBI treats all assets except standard assets, as NPA and all banks must make provisions for these assets.

**v) Consequences of NPA:** Accumulation of high level of NPAs in the balance sheet is not a healthy sign for a bank. Non-performing assets ultimately affect the profitability of a bank and if not controlled could lead to serious consequences.

High level of NPA requires higher provisioning which adversely affect he capital adequacy of the bank. Lower profitability leads poor ROA, which affects the banks capacity to raise additional capital from the market. High level of NPAs also affects the competitiveness of banks and the credibility is severely affected.

## 3. ANALYSIS OF NPAs IN INDIAN COMMERCIAL BANKS

To analyse the trend of non-performing assets, data for 90 commercial banks were collected, out of which 27 were public sector banks, 31 private sector banks and 33 foreign banks. The data were collected for the period 2001 to 2006.

**Table-I**
**Banking Business over the Years**

| Years | Deposits (Rs. in crore) | Loans (Rs. in crore) |
|---|---|---|
| 1950-1951 | 882 | 547 |
| 1960-1961 | 1,736 | 1,336 |
| 1970-1971 | 5,906 | 4,684 |
| 1980-1981 | 37,988 | 25,371 |
| 1990-1991 | 1,92,541 | 1,16,301 |
| 2000-2001 | 9,62,618 | 5.11,434 |
| 2006-2007 | 25,94,259 | 19,23,192 |

Source: Reserve Bank of India Bulletins

Table –I shows the general growth in banking industry in India It clearly reveals that banking activities are growing rapidly in India. The deposit collected by all commercial banks in India in 1950-51 was a mere Rs.882 crore, which has gone upto Rs.25, 94,250 crores in 2006 –2007. Similarly, loans given by the commercial banks in 1950-1951 was Rs. 547 crore , which increased to Rs. 19,23,192 crore in 2006 –2007. These figures clearly indicate the rapid growth in banking activities. The banking sector has been an important contributor in the growth story of the country. Liberalization and integration of Indian economy with the global economy have brought drastic changes in almost all sectors of the economy. With timely reforms and restructuring, Indian banking sector has played avery supportive role for the liberalization process. The rising deposits and loans sanctioned by commercial banks indicate a vibrant economy. In this backdrop, management of non performing assets assumes significance.

**Table-II**

**Advances by Commercial Banks during 2001 –2006 (Rs. In Crore)**

| Category of Banks | 31.03.2001 | 31.03.2002 | 31.03.2003 | 31.03.2004 | 31.03.2005 | 31.03.2006 |
|---|---|---|---|---|---|---|
| Public Sector Banks | 4,14,989 | 4,80,118 | 5,48,437 | 6,32,740 | 8,54,214 | 11,06,128 |
| Old Private Sector Banks | 36,889 | 41,516 | 49,434 | 58,233 | 70,340 | 83,847 |
| New Private Sector | 30,163 | 75,559 | 89,515 | 1,12,667 | 1,48,546 | 2,28,138 |
| Foreign Banks | 38,792 | 46,757 | 52,018 | 60,507 | 75,318 | 97,555 |
| Scheduled Commercial Banks | 5,20,814 | 6,43,949 | 7,39,404 | 8,64,146 | 11,48,419 | 15,15,669 |

Source: RBI Bulletins

Table –II shows the growth of advances by different commercial banks in India during 2001 –2006. During the last five years the, advances by commercial banks have increased by about three times in comparison to the advances in 2001.

The last row in Table- II reveals that advances by all scheduled commercial banks in 2001 was Rs. 5,20,814 crores , which increased to Rs. 15.15,669 crores by the year 2006.The growth in advances shows an increasing pattern, with greater increase during year ending March, 2005 & March 2006.

Table-III shows the trend of non-performing assets as a percentage to total assets in various commercial banks in India during the last five year. It is clear from the last row in Table- III that the percentage of NPAs to total assets is decreasing in all scheduled commercial bank.

The ratio of gross non-performing assets to total assets was 4% in 2002- 03 and it has come down to 1.46 % in the year 2006-07.Similarly, the ratio of net NPA to total assets has also reduced from 1.9% in 2002-03 to 0.58% in 2006-07.

**Table -III**

**Trend of NPA in Commercial Banks**

**(as Percentage to Total Assets) as on 31st March 2007**

| Bank Category | Gross NPAs/Total Assets | | | | | Net NPAs/Total Assets | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| Public Sector Banks | 4.21 | 3.5 | 2.73 | 2.05 | 1.6 | 1.93 | 1.28 | 0.95 | 0.72 | 0.62 |
| Private Sector Banks | 3.97 | 2.82 | 2.05 | 1.37 | 1.24 | 2.32 | 1.32 | 0.98 | 0.55 | 0.54 |
| Old Private Sector Banks | 4.34 | 3.64 | 3.15 | 2.51 | 1.85 | 2.61 | 1.77 | 1.39 | 0.92 | 0.56 |
| Foreign Banks in India | 2.13 | 1.43 | 0.97 | 0.81 | --- | 0.66 | 0.42 | 0.41 | 0.33 | -- |
| Scheduled Commercial Banks | 4 | 3.3 | 2.52 | 1.83 | 1.46 | 1.9 | 1.2 | 0.92 | 0.67 | 0.58 |

Source: www.rbi.org.in

Analysing the trend of NPA in various categories of commercial banks, it is seen that both the ratio of gross and net NPAs to total assets is lowest for foreign banks. It is 0.81% and 0.33% respectively for the ratio of gross and net NPAs to total assets in the year ending March 2006. The same figures for all scheduled commercial banks taken together are 1.83% and 0.67%. Thus, record of NPA management in foreign banks is much better than all other commercial banks. The trend of ratio of gross and net NPAs to total assets in case of public sector banks is showing a declining trend. It was 4.21% in 2002-03 and has come down to 1.6% in 2006-07. While the declining trend in NPAs is a positive sign for management of public sector banks, a comparison with the average of all scheduled commercial banks reveals that the ratio of gross and net NPAs to total assets has been consistently higher than that of all scheduled commercial banks taken together. Thus, the relative efficiency of public sector banks in managing NPAs is poor in comparison to other categories of banks.

Considering the private sector banks, the NPA ratios are consistently lower than ratios of all scheduled commercial banks. On the other hand, the same ratios for old private sector banks are consistently higher than the industry average and are much higher to that of the public sector banks. Thus, it can be said that the NPA management of old private sector banks are poor in comparison to public sector banks. The fact that over all private sector banks' (taking old and new private sector banks together) ratios are better than the industry average and the ratios of old private sector banks are poor in comparison to industry average, indicate that the new private sector banks have done well to minimize their NPA

**Table-IV**

**Non Performing Assets of Commercial Banks- Sector wise**

**(as percentage to total NPA)**

| Category of Banks | Agriculture | Small-Scale Sector | Others | Priority Sector sector | Public Sector | Non-Priority | Total NPA (in Rs. Crores) |
|---|---|---|---|---|---|---|---|
| **Public Sector Banks** | 16.86 | 15.14 | 27.47 | 59.46 | 1.27 | 39.27 | 38601.80 |
| **Nationalised Banks** | 16.45 | 17.92 | 28.52 | 62.89 | 1.19 | 35.92 | 24665.61 |
| **Private Sector Banks** | 9.31 | 6.98 | 14.93 | 31.22 | 0.03 | 68.75 | 9239.48 |
| **Old Private Sector Banks** | 8.39 | 16.51 | 22.81 | 47.71 | — | 52.29 | 2968.51 |
| **Foreign Bank** | — | 2.2 | 11.3 | 13.5 | — | 86.5 | 2,452 |

level. New private sector banks' increasing advances and decreasing NPAs speak about the efficiency of these banks in managing their assets. However, the poor performance by public sector banks in comparison to new private sector banks and foreign banks can be explained by analyzing the sector wise contribution to NPA in different categories of banks.

Table-IV shows the contribution of different sector to the non- performing assets of commercial banks. As far as the public sector banks are concerned, about 60% of non-performing assets belong to the priority sector lending. Non-priority sector accounts for 39.27% of the total NPA in public sector banks. Agriculture sector accounts for 16.86% and small-scale sector accounts for15.14% of the total NPA of public sector banks. In case of nationalized banks, priority sector lending accounts for 62.89% of total NPA, while non-priority sector account for abut35.925%of the total NPA. In contrast, in case of private, old private and foreign banks non-priority sector accounts for major share of NPA.

In case of private sector banks, non-priority sector constitutes 68.75%, for old private sector banks it is 52.29%, while for foreign banks the percentage is as high as 86.5% of the total NPA. For new private sector banks the share of non-priority sector is still more.

Public sector and nationalised banks are subjected to provide more loans to priority sector, which results in higher non-performing assets. These banks are more exposed to political interference; they are not allowed to act in a professional manner, which results in high level of non- performing assets.

For all categories of banks except the foreign banks, agriculture is an important source of non- performing assets. Agriculture sector is still an important component of Indian economy and banks cannot ignore the need requirements of the agriculture sector. However, politics rather than pure business considerations influence the sanctioning of agricultural loans in comparison to other categories of loans.

## 4. CONCLUSION

Non-performing assets have negative impact on the profitability, productivity, capital adequacy and competitiveness of commercial banks. Hence, it is important to reduce the level of NPA in commercial banks. With the liberalization process gaining momentum and the integration of Indian economy with the global economy, the banking sector is also undergoing several reforms. An analysis of the trend of NPAs in sceheduled commercial banks in the last five years shows that across all categories of banks, the level of NPAs in relation to the total assets has declined. The reforms measures and policy initiatives have resulted in reducing the level of NPAs in Indian commercial banks. Categorywise analysis shows that the public sector banks have hier levls of NPAs in comparison to private and foreign banks. Sectorwise analysis reveals that priority sector lending accountsf or major portion of NPAs in public sector banks, while non-priority sector lending account for major portion NPAs in private and foreign banks. Agriculture sector also is an important contributor to the NPAs in commercial banks.

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