10. 11. 20

Non-Performing Asset →

Any Bank Loan or Asset becomes non-performing when it ceases to generate income for the Bank for the specified period such as 90 days. In other words the amount of principal or interest or both remain overdue for a period of 90 days.

The problem in India is that most of the NPAs are concentrated in Public Sector Banks that are owned by Govt. Further, there had been a tendency in the past that the management of such banks tried to hide the bad loans to the extent possible. There were no rigid rules for Asset Classification or Loans Disclosure. But when RBI implemented the Prudential Norms for Banking on Asset Classification & took serious steps against some Banks who were not giving proper disclosures the NPA came in limelight. According to, the Prudential Norms on Asset Classification, Banks are required to catagorised their loans under the following heads :

I) Standard Assets

II) Sub-Standard Assets [which are overdue & remain as NPA for a period ~~less than~~ ≤ 12 months]

III) Doubtful Asset [which are catagorised as Sub-standard for more than 12 months]

IV) Loss Asset [which are identified as loss or irrecoverable loans under audit or RBI inspection]

According to Provisioning Norms Banks are required to keep sufficient profit to meet the loss asset & such amount is called "the Provision". Banks must keep 100% Provision for the loss asset while general provision of 15% can be done for the sub-standard asset.

Twin Balance Sheet Problem

The corporate Balance Sheet shows the loan account under liabilities & investments made out of loan money on the asset side. When due to business issues or economic recession companies can't perform well, their asset values goes down. It creates loss in the Balance Sheet & the Balance Sheet becomes stressed.

When corporates failed to meet their obligation to the Bank, then the stress is transmitted to the Banking Sector & it becomes a twin balance sheet Problem.

The Banking Sector in India is suffering from Bad loans belonging to several sectors of Indian Economy. There are several ~~pt~~ reasons behind this problem but the important reasons are as follows :→

1) Aggressive lending by Public Sector Banks during 2008—2014.

2008	₹18t
2014	₹52t

ii) No parallel reforms were proposed to utilised such loans & boost the economic growth.

iii) Willful Default

iv) Economic slowdown

v) Corruption

vi) Asset Quality Review of Bank's Balance Sheet conducted by RBI in 2015,

Due to transparent & honest ~~reg~~ recognition NPAs of PSBs increased from ₹2·26t as on March 2014 to ₹8·96t as on March, 2018. Actually, the NPA existed for many years, but disclosure was made during these periods. An important reading in this respect is that the NPAs are concentrated in the Public Sectors Banks. RBI admitted in 2019 that 17 Indian Banks have a bad loan ratio of more than 10% & of these 16 were PSBs.

PSBs ↓ public Sector Banks

$$\boxed{\text{Bad Loan Ratio} = \left(\frac{\text{NPA}}{\text{Total Loan}}\right)}$$

Another issue associated with this problem is the size of loans. Only 12 big loans of the defaulters account for 25% of Total NPAs & these amounts range from 5000 to 40,000 cr. Rs.

Some sectors of economy are worst effected which belong to infrastructure & core industries. Most of the defaulting companies have poor interest coverage ratio

$$\text{Interest Coverage Ratio} = \left(\frac{\text{Profit before Interest}}{\text{Interest}}\right)$$

$$= \frac{(4\% \times 1000)}{(10\% \times 1000)}$$

Interest Coverage Ratio of less than 1 indicates that the profit of the company is not enough even for interest payment.

The Public Sector Banks in India have kept lending at a faster rate after 2004 without proper credit evaluation & recovery procedures. The other factors that contributed to NPA problem were high interest rates, economic fluctuations, complex legal framework, lack of Ease in doing Business & Willful Default. Further, we know that the companies under Infrastructure & Real Estate Sectors have long gestation period (10-20 years). & any delays would lead to bad loans. Any failure of companies in such sectors under stress would shift the problem to the lending banks, causing "Twin Balance Sheet Problem"

Fortunately RBI took serious measures after 2014 to resolve this issue & consequently the Banks become more cautious of lending. When Banks refrained from lending in order to reduce NPAs, the corporates went to NBFCs for further loans. Some short term loans were taken at high interest rates to meet the long term loans which were due. But this did not solve the problem & only postpone it. After August 2018, we saw collapse of 2 Big Companies i.e. IL & FS Ltd. & DHFL. These failures transmitted shockwaves to the NBFC sector & the entire financial system of India. It was called the "Triple Balance Sheet Problem" involving Corporates, Banks & NBFCs.

At the end of 2019, it was observed by experts that the stress has been transmitted to four sectors i.e. Public Sector Banks, NBFCs Infrastructure Sector & Real Estate Sector & Hence causing ~~4 Balan~~ "Four Balance Sheet Problem"

Measures to solve the NPA problem

1) Recapitalise → Recapitalise Public Sector Banks by providing more capital to them for meeting their losses & improving capital Adequacy Ratio.

Pre Stress B/S

	Asset
Capital 500	=
Deposit 9500	
10,000	10,000

Post

capital 500	Other 2000
+ 4000	NPA 8000
	10,000

loss → 4000 cr

2) Restructure Bad loans through some Reconstruction companies such as Public Sector Asset Rehabilitation Agency (PARA) which can take over the Bad loans of Several Banks.

iii) Regulate & Monitor NBFC sector through better mechanism.

iv) Make changes into Insolvency & Bankruptcy code for resolution of pending cases in minimum time.

v) Prepare Early warning System for the Banks & NBFCs.

vi) Bank consolidation or Merger. (weak banks to strong Banks)

vii) Strengthen the Debt Recovery System by further amending the SARFAESI Act.

Economic Survey 2020

gross NPA of PSBs have increased to around 7.4 t rupees at the end of 2019 which is around 80% of the total NPAs of Indian Banking System.

govt. has invested more than 4.3 t Rupees as govt. Equity in PSBs & the expected return on their investment is (−23%) as against (+9.6%) for the private banks.

A large proportion of NPAs would have been prevented if technology were employed in business analytics using Artificial Intelligence. There is a need for early warning system (EWS) to detect the defaulters. Moreover, information should be ~~pulled~~ pooled from various sources including employees & customers of company, tax department, share market, & other agencies. Following are the leading indicators of default :-

i) Delay in repayment of loan.

ii) Issues in Business Operation.

iii) Non-compliance with provisions of taxation laws.

iv) Non - compliance with companies Act.

v) Payment of excessive salaries to the Promoters & top management.

vi) Objections & Disclaimers in the Audit Reports.