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NPAs of Nationalised Banks of India: A Critical Review

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A B S T R A C T

Containment of NPAs has been in focus ever since the banking reforms were initiated in 1992. All the nationalised banks have been making efforts to contain the NPA level and reduce the *drag on their profitability*. Each individual bank has tried to grapple with this problem; the magnitude of the slippage of performing assets to NPA category has become a cause of permanent concern. Though the recoveries affected in NPA accounts by the nationalised banks during the last few years were significant but the level of fresh accretion during the period was also significant. Consequently the level of NPA has gone up, eroding whatever reduction was made with the ever increasing level of fresh NPAs and tightening of norms by RBI from time to time. Total elimination of NPAs is not possible in banking business owing to *externalities* but their incidence can be minimized. It is always prudent to follow proper policy for credit appraisal, supervision and follow-up of advances to avoid NPAs. Armed with the Securitisation Act made recently, the banking industry is targeting to reduce its NPA with full vigour. Although the Act has given a lot of leverage to the banks to recover their NPAs, the success shall lie in its proper and forceful enforcement. Given the situation that a large amount of NPAs is towards big industrialists who wield a considerable influence in the corridors of power, only strong political will on the part of the government to act against such elements will bring some tangible results to the fore.

Introduction

Before 1991 profits were seldom a matter of serious concern to banks. Deposit mobilization was the main goal. Till early 1990s, the nationalized banks made reckless loans and advances. However, since 1991 profits became a driving force through cutting of operational costs and avoiding unnecessary expenditure, upgrading technology and customers' standards. The convergence, competition and consolidation dominate the banking system. Since the introduction of prudential norms on income recognition, asset classification and provisioning thereon with effect from 1992-93, the banking operation in India has undergone a drastic change. The pace of transformation has further been accelerated by the paradigm shift in regard to the opening up the entry gate to foreign banks, allowing private banks to operate in India, reduction in interest rates, raising the cap of foreign direct investment from 49% to at least 74% in private sector banks, extending set off and carry forward of accumulated losses, lower cap on the lending rates for agriculture and small sectors, along with change of monolithic mindset of the workforce in the event of exposure of banking activities top the market forces i.e. competition. However, huge amount of bank credit has been tied as NPA and not available for the productive purposes. The nationalised banks were saddled with NPAs of Rs. 34027 cores during 2000-01. The growing menace of NPAs takes toll on efficiency and profitability of the banking sector. The Narsimham Committee-1 stated that the quality of asset portfolio has been eroded. Thus, proper management of NPAs for the economic growth of the country is necessary.

Non-Performing Asset (NPA)

An asset becomes non-performing when it ceases to generate income for the bank. It actually is the ratio of Non-performing Credit to Total Credit. Earlier a non-performing asset was defined as a credit facility in respect of which the interest or installment of principal has remained due for a specified period of time which was reduced from four quarters to one quarter in a phased manner. Due to the improvements in the payment and settlement system, recovery climate, upgradation of technology in the banking system, etc., it has been decided to dispense with *past due concept* with effect from March31, 2001. With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the 90 days overdue norms for the identification of NPA's from the year ending March31, 2004.

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

(i) Sub-standard Assets,
(ii) Doubtful Assets, and
(iii) Loss Assets.

According to RBI directives, all banks are required to maintain NPAs both on gross and net basis. It is usually expressed in percentage term.

NPAs= [(Gross or Net NPAs) / Total Advances]*100

All the banks have been advised to phase the provisioning against NPAs over the period and continuously improve their capital base.

Methodology

The study relates to all the nationalised banks and covers the period from 2000-01 to 2010-11 (Eleven years period). The main sources of secondary data used in the study are RBI Bulletin, RBI Reports, Economic and Political Weekly etc. The study makes bank-wise and sector-wise analysis of the magnitude of NPAs over the period of the study. For this purpose, ratios with gross and net advances have been computed.

Capital Adequacy Ratio (CAR)

The CAR was introduced form 1992 after the acceptance of the Narsimham Committee Report -I. The motive behind such requirement was that the banks should attain their competitiveness as well as remain sound in their operation. They have to maintain minimum capital funds against their risk weighted assets and other exposure on an ongoing basis. The Basle Committee prescribed minimum 8 per cent capital adequacy standard with a view to regulate banking operation on a global basis in 1987. Banks in India are required to attain this ratio on an incremental basis in phased manner, 9 per cent with effect from March 31, 2000 to 10 percent from March 2001. The figure of CAR is arrived by applying the following formula:

CAR= [(Capital Fund of the Bank/ Risk Weighted Assets)] ×100

Capital Fund: Capital inclusive of Tier-I and Supplementary Capital respectively.

Tier-I Capital consists of (i) Issued Capital; (ii) Subscribed and Paid up Capital; (iii) Statutory Reserves, Capital Reserves, (iv) Share Premium, Revenue and other Reserves, and (v) Balance in Profit & loss Account.

Tier-II Capital consists of Unsecured, Redeemable and Non-Convertible Debentures. Basle-II Accord made in January 2000 effective from 2005 added operational risk in the Risk Weighted asset (RWA). The operational risk will constitute approximately 20 per cent of overall capital requirements. Thus, under the new method, RWA constitutes Credit Risk along with Market Risk and Operational Risk.

The revised formula for calculating CAR is as under:

CAR= [(Capital Fund of the Bank/Credit Risk+ Market Risk+ Operational Risk)] ×100

Risk Weighted Assets and Other exposures may be computed as (Assets × Risk Weight) + (Off Balance Sheet items × Conversion factors)

Bank-wise Achievement of Capital Adequacy Ratio

It is observed that all the nationalised banks with the exception of Indian Bank and Dena Bank achieved the Capital adequacy Ratio of 9 per cent as on March 31, 2001. Three banks namely Canara Bank, UCO Bank and Dena Bank failed to achieve the medium term capital adequacy target of 10 per cent. The average capital adequacy ratio of 12 per cent or more was achieved by most of the nationalised banks by the end of March 31, 2011. However, Bank of Maharastra, Central Bank of India, United commercial Bank, Dena Bank, Punjab & Sind Bank, and Syndicate Bank could not achieve the target of average 12 per cent capital adequacy ratio.

Quantum of NPAs

Till 2005 NPAs problem was acute. It is found that the Gross NPAs hovered around Rs. 35000 crore with a range of 8% to 13%. Since 2005, the percentage of Gross NPAs to Gross Advances has been declining, and at present it is settling at two percent. On the other hand, the percentage ratio of Net NPAs to Advances has declined from the peak of7.58 to 0.96 in 2011. Some of the factors for such a situation may be stated as under:

There is a perceptible change in the asset mix of the nationalised banks in favour of investment in Government Securities.

Success on the part of the banks in using one time settlement scheme.

The enactment and strict enforcement of Securitisation Act and its specific provision of Debt Recovery.

Gross NPAs

It is observed that there are certain banks like Bank of Baroda, Bank of India, Canara Bank, and Central Bank of India which have average gross NPAs exceeding Rs. 2228 crore or more. However, gross ratios have recently settled around two per cent. The banks like United Bank, United Commercial Bank,and Vijaya Bank have more than 2.5 per cent gross ratio. The Indian Bank has done exceedingly well in this respect. Since 2005 its Gross NPAs has been declining continuously and presently the ratio is less than one per cent. The average gross ratio of the Oriental Bank of Commerce is 4.6 with55.6% Coefficient of variation.

Net NPAs

The position of the nationalised banks of India has consolidated during the period of study. The higher degree of coefficient of variation signifies larger variation in the percentage of net NPAs to net advances. Since 2004, the volume and ratio of Net Non-Performing Assets (NNPAs) has been declining almost for all the nationalised banks. However, for the last two years the declining trend has reversed. The volume of NNPAs of the Indian Overseas Bank, Bank of India, Panjab National Bank, Canara, Union Bank India, And United Commercial Bank has gone up in a significant manner. Bank of Baroda since 2006 has maintained NNPAs ratio at less than one per cent and it has settled at 0.35 in 2011. Dena Bank, Indian Overseas Bank, United Commercial Bank have more than one percent NNPAs ratio.

NPA Provision

All the banks have been providing for the provision against bad assets. More provision means loss of interest income. With the increase in annual provision for NPAs, the loss of interest is also on the rise. Approximately Rupees 6000 core have been lost as interest besides servicing and litigation cost. The following Table makes the picture clear.

Composition of NPAs

It is observed from the Table No.3 that the Index of priority sector NPAs has gone up by more than 68% in 2011 as compared to 2001, while the total NPAs increased by only 30%. It means the share of priority sector NPAs has been on the rise, the peak being 66.8% achieved in 2008.Thecompound growth rate (Cgr) of priority sector NPAs is comparatively higher than that of the total NPAs. The slope of the non-priority sector is negative, while for the priority sector it is positive; it implies that the priority sector advances are becoming bad every year.

NNPAs to Net Worth and Ratio of Standard Assets

Of the 19 Nationalised banks, 10 banks namely Allahabad Bank, Bank of India, Bank of Maharastra, Central Bank of India, Dena Bank, Indian Overseas Bank, Punjab

Table.1 Year-wise Gross and Net NPAs

Year as on March 31	Amount (Rs crore)	Gross NPAs to Gross Advances (%)	Amount (Rs crore)	Net NPAs to Net Advances (%)
2001	34027.36	12.94	18553.84	7.58
2002	36763.05	11.80	19017.25	6.64
2003	36882.66	10.21	17081.13	5.10
2004	35548.97	8.48	13368.02	3.41
2005	31964.01	6.33	9693.20	2.19
2006	27246.37	4.32	7930.31	1.30
2007	24665.61	2.80	8385.03	0.94
2008	23409.60	2.02	8244.62	0.74
2009	25368.00	1.77	9339.45	0.71
2010	34264.17	2.06	15407.23	0.96
2011	40122.66	1.99	19603.46	0.96

Table 2 Interest Income Lost

Year as on March 31	Provision (Rs Crore)	Rate (%)	Interest (Rs Crore)
2001	4237.19	9.18	388.97
2002	4787.41	8.87	424.64
2003	5246.31	8.48	444.89
2004	6791.07	7.56	513.40
2005	3513.82	7.01	246.32
2006	3495.43	6.84	239.09
2007	4568.15	6.91	315.66
2008	5481.66	7.22	395.78
2009	6182.2	7.50	463.67
2010	11457.16	9.79	1121.66
2011	15141.19	9.37	1418.73
		Total	5972.80

Table.3 Statistics of the Composition of NPAs During 2001-2011

Item	Priority Sector	Non-Priority Sector	Total
Index (2001=100)	168.62	97.56	130.10
CGR	16.86	-89.77	13.01
Intercept	13852.00	18367.00	32665.00
Slope	571.85	-612.06	-60.16

Table.4 Showing Coefficient of Correlation Results of Ratio of Net Profit to Assets & Ratio of Net NPAs to Assets

Bank	Correlation Coefficient R	Coefficient of Determination R-Square (%)	~~Decision~~
Allahabad Bank	-0.888	78.77	Reject
Andhra Bank	-0.217	4.69	Do Not Reject
Bank of Baroda	-0.304	9.22	Do Not Reject
Bank of India	-0.212	4.48	Do Not Reject
Bank of Maharastra	-0.199	3.96	Do Not Reject
Canara Bank	-0.151	2.29	Do Not Reject
Central Bank of India	-0.397	15.73	Do Not Reject
Corporation Bank	0.774	59.88	Reject
Dena Bank	-0.709	50.29	Reject
Indian Bank	-0.953	90.87	Reject
Indian Overseas Bank	-0.726	52.67	Reject
Oriental Bank of Commerce	-0.012	0.01	Do Not Reject
Punjab & Sind Bank	-0.862	74.27	Reject
Panjab National Bank	-0.808	65.22	Reject
Syndicate Bank	0.567	32.14	Do Not Reject
Union Bank of India	-0.555	30.83	Do Not Reject
United Commercial Bank	-0.263	6.93	Do Not Reject
United Bank of India	-0.242	5.85	Do Not Reject
Vijaya Bank	-0.247	6.08	Do Not Reject
Max	**0.774**		
Min	**-0.953**		
Range	**1.727**		

Table.5 Regression Results Category-Wise

Category I

Y Earning Ratio= -0.5176-0.15 NPA +3.0314 MPR +3.3012 OTH. EXP
SE: (0.6525), (0.1787), (1.9528), (2.1034)
t-value: -0.7884, -0.8393, 1.5524, 1.5694
p-level: 0.4563, 0.4290, 0.1645, 0.1605
R =0.883, R^2 = 0.779
F (3,7) = 8.2455 Table Value F =8.8868

ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	3	4.7623	1.5874	8.2455	0.0107
Residual	7	1.3476	0.1925		
Total	10	6.1099			

Note: SS = Sums of Squares; MS = Mean Sum Squares

Category II

Y Earning Ratio= 0.2665+0.1578 NPA -08196 MPR +6.5092 OTH. EXP
SE: (0.4450), (0.1113), (1.1644), (2.0455)
t-value:0.5987, 1.4180, -0.7039, 3.1822
p-level: 0.5682, 0.1991, 0.5042, 0.0154
R =0.946, R^2 = 0.895
F (3,7) = 19.922 Table Value F =8.8868

ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	3	3.0689	1.0230	19.9220	0.0008
Residual	7	0.3594	0.0513		
Total	10	3.4284			

Note: SS = Sums of Squares; MS = Mean Sum Squares

Category III

Y Earning Ratio= -0.1495+0.1113 NPA -0.2604 MPR +6.0307 OTH. EXP
SE: (0.8214), (0.1150), (0.9334), (2.2699)
t-value: -0.1820, 0.9670, -0.2789, 2.6568
p-level: 0.8608, 0.3658, 0.7884, 0.0326
R =0.898, R^2 = 0.807
F (3,7) = 9.7546 Table Value F =8.8868

ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	3	3.2362	1.0787	9.7546	0.0068
Residual	7	0.7741	0.1106		
Total	10	4.0103			

Note: SS = Sums of Squares; MS = Mean Sum Squares

Category IV

Y Earning Ratio= -0.2614-0.1193 NPA +1.1589 MPR +4.9258 OTH. EXP
SE: (0.3558), (0.0556), (0.7493), (1.8307)
t-value: -0.7347, -2.1457, 1.5467, 2.6906
p-level: 0.4864, 0.0691, 0.1658, 0.0311
R =0.972, R^2 = 0.946
F (3,7) = 40.4738 Table Value F =8.8868

ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	3	3.9488	1.3163	40.4738	0.0001
Residual	7	0.2277	0.0325		
Total	10	4.1765			

Note: SS = Sums of Squares; MS = Mean Sum Squares

Category V

Y Earning Ratio=1.1136 -0.2597 NPA +2.4359 MPR - 0.9995OTH. EXP
SE: (0.9676), (0.1285), (0.9693), (4.0438)
t-value:1.1509, -2.0215, 2.5132, -0.2472
p-level: 0.2876, 0.0829, 0.0402, 0.8119
R =0.903, R^2 = 0.816
F (3,7) = 10.3587 Table Value F =8.8868

ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	3	2.9855	0.9952	10.3587	0.0057
Residual	7	0.6725	0.0961		
Total	10	3.6580			

Note: SS = Sums of Squares; MS = Mean Sum Squares

& Sind Bank, Syndicate Bank, Union Bank of India, and United Commercial Bank had more than 26% NNPAs to net worth of their respective banks. These banks need to raise their Capital base immediately. The average proportion of standard assets ratio to gross advances has been hovering around 94.2 with 4.8% coefficient of variation during 2001-2011. However, in the last three years, most of the banks had this ratio around 98%. In recent times most of the banks have raised their capital base along with measures taken to reduce the size of NPAs.

Profitability and NPAs

Net Profit to total assets has been considered as the yardstick. The ratio for all the nationalised banks has improved a lot from less than 0.2% to 1.3 in 2011.The profit of three loss making banks constituting Category V if excluded, the same ratio still goes up by more than 0.15.

The profitability which is explained by the composite ratio defined as spread less burden ratio (s-b) has also improved to some extent. Thus, factors affecting the profitability need further analysis.

Hypothesis:

Ho= “Net Non-Performing Assets are correlated with Net Profits but do not affect the Net profits of the Bank concerned.”

H1= “Net Non-Performing Assets are correlated with Net Profits and affect the Net profits of the Bank concerned.”

Observations based upon Table No. 4

Twelve banks out of the nineteen nationalised banks concur with the Null hypothesis; it implies that the profitability of the banks does not get affected due to non-performing assets.

Seven banks out of the nineteen nationalised banks do not concur with the Null hypothesis; it implies that the profitability of the banks gets affected due to non-performing assets

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The seven banks are (i) Allahabad Bank (ii) Corporation Bank, Dena Bank, Indian Bank, Indian Overseas Bank, Punjab & Sind Bank, Panjab National Bank.

Interdependency among the variables

In order to identify the interdependency among the variables, multiple regression equation has been fitted considering earnings ratio (i.e. Interest earning ratio plus non-interest earning ratio less interest expended ratio as dependent variable and ratio of NNPAs to net advances (NPA), manpower ratio (MPR), other establishment expenses ratio (OTH EXP), as independent variables for all the categories of the nationalised banks.

The analysis reveals that R^2 (0.78, 0.90, 0.81, 0.95, and 0.82) means that the relationship is explained eighty to ninety five per cent by the independent variables. In four out of the five equations F ratio is not statistically significant. It indicates that regression is not significant. It also implies that there are other variables (not considered in this equation) contributing much in the overall earning of the banks. Provisioning against NPAs is one of the items in the computation of profit, the other main items are spread, operating expenses and other income (Non-funded), profit on sale of investments, foreign exchange and derivative revenues. It is further observed that NPAs have negative effect on the profitability of the banks.

The positive regression coefficient of manpower ratio implies that there is an ample scope of raising the profitability of the nationalised banks with proper utilization of the human resources. In the wake of deregulation, the interest earned ratio and non-interest ratio have been rising, spread is hovering around three per cent and other establishment expenses ratio is well below one per cent, the higher degree of profitability over the years has not been achieved. Thus, it may be argued that NPAs are not the only factor in eroding the profitability of the banks as the NNPAs to Net Advances ratio has been continuously on the decline. This further confirms the influence of other exogenous factors in the banks’ profitability. There is a need to look into the managerial aspect of the banks. The management has to maintain good relationship with the investors in raising the profitability of the banks.

Measures

Arrest of fresh addition of NPAs by ensuring close monitoring and other control measures.

Reduction in NPA through strict enforcement (invocation) of SARFAESI Act and other legal measures for logical conclusion.

Increase in income from derecognized interest through recovery in written off debts.

Strengthening credit risk management.
Thrust on upgradation of fresh NPAs accounts and accounts under restructuring /CDR.

Settlement scheme for differential segment of borrowers like Small and Marginal farmers; Government sponsored loans, agriculture credit etc.

Recovery of small and cluster loans (including written off debts through settlement camps/recovery camps and Lokadalats).

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