Non Performing Assets in Select Commercial Banks of India: A Comparative Analysis

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Abstract

This paper explores an empirical approach to the analysis of Non-Performing Assets (NPAs) of select public and private sector banks in India. The NPAs are considered as an important parameter to judge the performance and financial health of banks. The level of NPAs is one of the drivers of financial stability and growth of the banking sector. This paper aims to find the trend existing in occurrence of NPA in different sectors over the past four years ranging from 2006-07 to 2009-10. The empirical analysis assesses the percentile relation of gross and Net NPAs to total assets. The results show that NPAs in private sector are less as compared to public sector banks as the private sector lends major part of its loans to Non-priority sector. The other important results derived from the analysis include the finding that banks' exposure to priority sector lending reduces NPAs.

Introduction

Non-performing Assets are loans made by a bank or finance company, on which repayments or interest payments are not being made on time. A loan is an asset for a bank as the interest payments and the repayment of the principal create a stream of cash flows. Banks usually treat assets as non-performing if they are not serviced for some time. If payments are late for a short time a loan is classified as past due. Once a payment becomes really late (usually 90 days) the loan classified as non-performing. Loans need to be looked at in the context of the type of lending being done. Some banks lend to higher risk customers than others and therefore tend to have a higher proportion of non-performing debt, but will make up for this by charging borrowers higher interest rates. RBI has issued guidelines to banks for classification of assets into four categories.

1. Standard Assets: These are the loans which do not have any problems are less risk.
2. Substandard Assets: These are assets which come under the category of NPA for a period.
3. Doubtful Assets: These are NPA exceeding 12 months
4. Loss Assets: These NPA which are identified as unreliable by internal inspector of bank or auditors or by RBI.

The nationalization of banks in India happened in two stages In the first phase 14 largest commercial banks were nationalized in July 1969, whereas 6 more commercial banks were added to the list in 1980. The need for the nationalisation arose mainly because private commercial banks were not fulfilling the social and developmental goals of banking. Purpose for the nationalization was to give the government more control of credit delivery. After second phase of nationalization, 91% of the banking business of India was controlled by GOI.

After Nationalization, It was made mandatory for banks to provide 40 per cent of their net credit the Priority Sectors, such as agriculture, small-scale industry, retail trade, small business and small transport operators etc. The positive effect of landing was funds being transferred from the system to productive purposes, which results into economic growth. However lending carried a risk called credit risk, which arises from the failure of borrower. Non-recovery of loans along with interest forms a major hurdle in the process of credit cycle. Thus, these loan losses affected the bank's profitability on a large scale.

Narasimham Committee Report – 1991 and 1998

The Narasimham Committee was set up in order to study the problems of the Indian financial system and to suggest some recommendations for improvement in the efficiency and productivity of the financial institution.

- The committee gave the following major recommendations:-
- Reduction in the SLR and CRR
- Phasing out Directed Credit Programme
- Interest Rate Determination
- Structural Reorganizations of the Banking sector
- Establishment of the ARF Tribunal
- Removal of Dual control
- Banking Autonomy

In 1998, the government appointed Banking Sector Committee again under the chairmanship of Mr. Narasimham. The focus of this committee switched to review the banking reform progress and design a programme for further strengthening the financial system of India. The committee focused on various areas such as capital adequacy, bank mergers, bank legislation, etc. It submitted its report to the Government in April 1998 with the following recommendations.

- Strengthening Banks in India
- Narrow Banking
- Capital Adequacy Ratio
- Bank ownership
- Review of banking laws

Apart from these major recommendations, the committee also recommended faster computerization, technology up gradation, training of staff, depoliticizing of banks, professionalism in banking, reviewing bank recruitment, etc.

Literature Review

Though many published articles are available in the area of credit management and non-performing assets, which are either bank specific or banking sector specific, but this

particular paper focuses on the comparative study of five leading Indian public and private sector banks for their Gross and Net percentiles of NPAs with assets and trend analysis of past four years ranging from 2006-2010.

A synoptic review of the literature brings to the fore insights into the determinants of NPL across countries. A considered view is that banks' lending policy could have crucial influence on nonperforming loans (Reddy, 2004). He critically examined various issues pertaining to terms of credit of Indian banks. In this context, it was viewed that 'the element of power has no bearing on the illegal activity. A default is not entirely an irrational decision. Rather a defaulter takes into account probabilistic assessment of various costs and benefits of his decision'. Mohan (2003) conceptualized 'lazy banking' while critically reflecting on banks' investment portfolio and lending policy. The Indian viewpoint alluding to the concepts of 'credit culture' owing to Reddy (2004) and 'lazy banking' owing to Mohan (2003a) has an international perspective since several studies in the banking literature agree that *banks' lending policy is a major driver of non-performing loans* (McGoven, 1993, Christine 1995, Sergio, 1996, Bloem and Gorters, 2001). Furthermore, in the context of NPAs on account of priority sector lending, it was pointed out that the statistics may or may not confirm this.

There may be only a marginal difference in the NPAs of banks' lending to priority sector and the banks lending to private corporate sector. Against this background, the study suggests that given the deficiencies in these areas, it is imperative that banks need to be guided by fairness based on economic and financial decisions rather than system of conventions, if reform has to serve the meaningful purpose. Experience shows that policies of liberalisation, deregulation and enabling environment of comfortable liquidity at a reasonable price do not automatically translate themselves into enhanced credit flow. Although public sector banks have recorded improvements in profitability, efficiency (in terms of intermediation costs) and asset quality in the 1990s, they continue to have higher interest rate spreads but at the same time earn lower rates of return, reflecting higher operating costs (Mohan, 2004). Bhattacharya (2001) rightly points to the fact that in an increasing rate regime, quality borrowers would switch over to other avenues such as capital markets, internal accruals for their requirement of funds. Under such circumstances, banks would have no option but to dilute the quality of borrowers thereby increasing the probability of generation of NPAs. In another study, Mohan (2003) observed that lending rates of banks have not comedown as much as deposit rates and interest rates on Government

bonds. While banks have reduced their prime lending rates (PLRs) to some extent and are also extending sub-PLR loans, effective lending rates continue to remain high. This development has adverse systemic implications, especially in a country like India where interest cost as a proportion of sales of corporates are much higher as compared to many emerging economies. The problem of NPAs is related to several internal and external factors confronting the borrowers (Muniappan, 2002). The internal factors are diversion of funds for expansion/ diversification/ modernisation, taking up new projects, helping/promoting associate concerns, time/cost overruns during the project implementation stage, business (product, marketing, *etc.*) failure, inefficient management, strained labour relations, inappropriate technology/technical problems, product obsolescence, *etc.*,while external factors are recession, non-payment in other countries, inputs/power shortage, price escalation, accidents and natural calamities. In the Indian context, Rajaraman and Vasishtha (2002) in an empirical study provided an evidence of significant bivariate relationship between an operating inefficiency indicator and the problem loans of public sector banks. In a similar manner, largely from lenders' perspective, Das and Ghosh (2003) empirically examined non-performing loans of India's public sector banks in terms of various indicators such as asset size, credit growth and macroeconomic condition, and operating efficiency indicators. Sergio (1996) in a study of non-performing loans in Italy found evidence that, an increase in the riskiness of loan assets is rooted in a bank's lending policy adducing to relatively unselective and inadequate assessment of sectoral prospects. Interestingly, this study refuted that business cycle could be a primary reason for banks' NPLs. The study emphasised that increase in bad debts as a consequence of recession alone is not empirically demonstrated. It was viewed that the bank-firm relationship will thus, prove effective not so much because it overcomes informational asymmetry but because it recoups certain canons of appraisal. In a study of loan losess of US banks, McGoven (1993) argued that 'character' has historically been a paramount factor of credit and a major determinant in the decision to lend money. Banks have suffered loan losses through relaxed lending standards, unguaranteed credits, the influence of the 1980s culture, and the borrowers' perceptions. It was suggested that bankers should make a fairly accurate personality-morale profile assessment of prospective and current borrowers and guarantors.

Research Methodology

Objectives of the study are:

i. To understand the meaning and nature of NPAs.

ii. To examine the percentile relation of Gross and Net NPAs to total assets in select public and private sector banks.

iii. To examine the NPAs in select public and private banks arising in priority and non – priority sector using Trend Analysis as a tool over a period of 4 years i.e., 2006-07 to 2009-2010.

In this study the available empirical data of five leading public and five leading private sector Indian banks has been analyzed for their Non-performing assets, The Banks considered for analysis are:

Public Sector Banks: State Bank Group, Punjab National bank, Central bank of India, Bank of India and Union Bank of India. Private Sector Banks: ICICI Bank, HDFC Bank, Axis Bank, IndusInd Bank and Development Credit Bank Ltd. The selection is based on the fact that the above banks represented about 70 percent of total NPAs of Indian banking system sanctioned to various quarters during past four financial years 2006-2010 The study has been divided into two phases:

1. Trend analysis of Sector wise distribution of NPAs of both public and private sector banks
2. Review Gross and Net NPAs as percentile of total assets.

Results and Discussions

Phase I – Trend Analysis

This part studies the sector wise distribution of NPAs of all three main sectors of loan disbursals:

Priority Sector – As per the revised draft guidelines issued by RBI on 8th November 2006, the priority sector will broadly comprise agriculture, small scale industries, small business/service enterprises, micro credit, education loans and housing loans.

Non-Priority sector: Any business areas excluding the above mentioned categories in priority sector.

Public Sector: The loans disbursed to government bodies.

Priority Sector

Table 1 Non-Performing Assets of Public Sector Banks – (Amount in Rs. Crore)

S.No.	Financial Year	State Bank Group	Chg wrt last yr. (%)	Punjab National Bank	Chg wrt last yr. (%)	Central Bank of India	Chg wrt last yr. (%)	Bank of India	Chg wrt last yr. (%)	Union Bank of India	Chg wrt last yr. (%)
1	2006-07	7,175		2,511		1,598		1,280		1,167	
2	2007-08	8,901	24	2,761	10	1,651	3	1,339	5	1,258	8
3	2008-09	8,447	-5	2,436	-12	1,587	-4	1,564	17	1,272	1
4	2009-10	10,940	30	2,471	1	1,658	4	2,147	37	1,632	28

Source – Reserve Bank of India (www.rbi.com)
Note: Chg: changes, wrt: With regard to, yr: year

Table 1 depicts that in the year 2006-07 to 2007-08, there has been an increase in NPAs of all the public sector banks catering to priority sector loans under study. In 2008-09, there is a slight decrease in NPAs of State Bank Group, Punjab national bank and Central bank of India but in Bank of India and Union Bank of India they are still increasing. In 2009-10 there is a sharp increase in NPAs of all the banks, recession may be the possible reason. It can be finally concluded that non-performing assets of all the public sector banks under study have been showing an increasing trend for the past four years.

Table 2: Non-Performing Assets of Private Sector Banks–(Amount in Rs. Crore)

S.No.	Financial Year	ICICI Bank	Chg wrt last yr. (%)	HDFC Bank	Chg wrt last yr. (%)	Axis Bank	Chg wrt last yr. (%)	IndusInd Bank	Chg wrt last yr. (%)	DCB Ltd.	Chg wrt last yr. (%)
1	2006-07	983		166		110		83		64	
2	2007-08	1,359	38	194	17	210	91	63	-18	11	-83
3	2008-09	1,449	7	380	96	297	41	99	17	40	264
4	2009-10	1,941	34	400	5	528	78	84	-5	68	70

Source – Reserve Bank of India (www.rbi.com)
Note: Chg: changes, wrt: With regard to, yr: year

Table 2 portrays that in the year 2006-07 to 2008-10, there has been an increase in NPAs of all the private sector banks catering to priority sector loans under study, Although DCB Ltd and Indusind Bank are the exceptions to this trend. It can be finally concluded that non-performing assets of all the private sector banks under study have been showing an increasing trend for the past four years.

Non-Priority Sector

Table 3: Non-Performing Assets of Public Sector Banks – (Amount in Rs. Crore)

S.No.	Financial Year	State Bank Group	Chg wrt last yr. (%)	Punjab National Bank	Chg wrt last yr. (%)	Central Bank of India	Chg wrt last yr. (%)	Bank of India	Chg wrt last yr. (%)	Union Bank of India	Chg wrt last yr. (%)
1	2006-07	5,192		788		962		603		705	
2	2007-08	6,022	16	504	-36.0	697	-28	403	-33	398	-44
3	2008-09	9,250	54	331	-34.3	675	-3	626	55	527	32
4	2009-10	10,646	15	739	123.3	792	17	2,317	270	1,032	96

Source – Reserve Bank of India (www.rbi.com)

Table 3 describes that in the year 2006-07 to 2007-08, there has been an decrease in NPAs of all the public sector banks except State Bank Group catering to Non priority sector loans under study. The Trend bar graph also shows a continuous trend. In 2008-09, there is a slight decrease in NPAs of Punjab national bank and Central bank of India but in rest of the three they are still increasing. In 2009-10 there is a sharp increase in NPAs of all the banks but in bank of India it raise to Rs. 2,317 crore from Rs 626crore i.e. equal to 200 percent. , recession may be the possible reason. It can be finally concluded that non-performing assets of all the public sector banks understudy havebeen showing an increasing trend for the past four years.

Table 4: Non-Performing Assets of Private Sector Banks–(Amount in Rs. Crore)

S.No.	Financial Year	ICICI Bank	Chg wrt last yr. (%)	HDFC Bank	Chg wrt last yr. (%)	Axis Bank	Chg wrt last yr. (%)	IndusInd Bank	Chg wrt last yr. (%)	DCB Ltd.	Chg wrt last yr. (%)
1	2006-07	3,142		478		300		259		78	
2	2007-08	6,211	98	709	48	275	-8	328	27	52	-33
3	2008-09	8,116	31	1,604	126	519	89	156	-52	266	412
4	2009-10	7,321	-10	1,407	-12	767	48	171	10	251	-6

Source – Reserve Bank of India (www.rbi.com)

Table 4 depicts that in the year 2006-07 to 2007-08, there has been an increase in NPAs of all the private sector banks catering to non priority sector loans under study but Axis bank and DCB Ltd is an exception. The Trend bar graph also shows a continuous trend. And in 2008-2009 they are still increasing but the percentage increase is more in HDFC Bank Axis Bank

and DCB Ltd.IN 2009-2010 again they are increasing except ICICI Bank and DCB Ltd. It can be finally concluded that non-performing assets of all the private sector banks under study have been showing an increasing trend for the past four years.

Public Sector

Table 5: Non-Performing Assets of Public Sector Banks – (Amount in Rs. Crore)

S.No.	Financial Year	State Bank Group	Chg wrt last yr. (%)	Punjab National Bank	Chg wrt last yr. (%)	Central Bank of India	Chg wrt last yr. (%)	Bank of India	Chg wrt last yr. (%)	Union Bank of India	Chg wrt last yr. (%)
1	2006-07	187	-	90	-	10	-	46		-	-
2	2007-08	96	-49	52	-42	0.81	-92	40	-13	-	-
3	2008-09	177	84	1	-98	59	-	-	-	124	-
4	2009-10	244	38	4	300	8	-86	18	-	-	-

Source – Reserve Bank of India (www.rbi.com)

Table 5 illustrate that in the year 2006-07 to 2007-08, there has been an decrease in NPAs of all the public sector banks. The Trend bar graph also shows a continuous trend. In 2008-09, in 2009-10 there is a sharp increase in NPAs of all the banks but for bank of India it rose to 2,317 from 626 i.e. equal to 270 percent, recession may be the possible reason. It can be finally concluded that non-performing assets of all the public sector banks under study have been showing an increasing trend for the past four years.

Table 6: Non-Performing Assets of Private Sector Banks – (Amount in Rs. Crore)

S.No.	Financial Year	ICICI Bank	HDFC Bank	Axis Bank	IndusInd Bank	DCB Ltd.
1	2006-07	0.01	-	-	-	2.78
2	2007-08	0.01	-	-	-	-
3	2008-09	-	-	75	-	-
4	2009-10	-	-	-	-	-

Source: Reserve Bank of India (www.rbi.com)
Note: The Bar Graph has not been generated as the values are negligible

The next report has been generated to find out the Percentile allocation of NPAs to all the three sectors using data from table 1, 3 and 5 for public sector banks and 2, 4 and 6 for private sector banks. This report gives a good idea of sector wise inclination of public and private sector banks when it comes to the loan disbursals.

Table 7: Sector Wise Percentile NPA – Public Sector Banks

S.No.	Financial Year	State Bank Group			Punjab National Bank			Central Bank of India			Bank of India			Union Bank of India		
		PR	NP	PB	PR	NP	PB	PR	NP	PB	PR	NP	PB	PR	NP	PB
1	2006-07	57	41	2	74	24	2	62	37	1	66	31	3	62	38	0
2	2007-08	58	41	1	83	15	2	70	30	0	75	23	2	76	24	0
3	2008-09	47	52	1	88	12	0	68	29	3	71	29	0	66	27	7
4	2009-10	50	49	1	77	23	0	68	32	0	48	52	0	61	39	0

Source: www.rbi.org
Note: PR- Priority sector, NP- Non Priority sector, PB- Public Sector

The above analysis shows that public sector banks lend a major portion of their money to priority sector with an assumption that NPA is proportional to the money lent and it is irrespective of the sector. It can also be seen that Punjab National Bank has most of its NPA's from the Priority Sector, whereas SBI Group is leading the NPA tally in the Non-Priority sector lending's.

Table 3 Sector Wise Percentile NPA – Private Sector Banks

S.No.	Financial Year	ICICI Bank			HDFC Bank			Axis Bank			IndusInd Bank			DCB Ltd.		
		PR	NP	PB	PR	NP	PB	PR	NP	PB	PR	NP	PB	PR	NP	PB
1	2006-07	24	76	0	26	74	0	27	73	0	24	76	0	44	54	2
2	2007-08	18	82	0	22	78	0	43	57	0	16	84	0	18	82	0
3	2008-09	15	85	0	19	81	0	33	59	8	39	61	0	13	87	0
4	2009-10	21	79	0	22	78	0	41	59	0	33	67	0	21	79	0

Source: www.rbi.org
Note: PR- Priority sector, NP- Non Priority sector, PB- Public Sector

The above analysis shows that a private sector bank lends a major portion of their money to Non-Priority sector. ICICI and HDFC Bank leads the rankings with more than 75% of their NPA's attributed to Non-Priority Sector continuously since last 4 years. Whereas, Axis Bank is leading the way when it comes to lending the Priority Sector.

Gross Vs. Net NPA

Gross NPA is the amount outstanding in the borrowable account, in books of the bank other than the interest which has been recorded and not debited to the borrowable account. Net NPAs is the amount of gross NPAs less (1) interest debited to borrowable and not recovered and not recognized as income and kept in interest suspense (2) amount of provisions held in respect of NPAs and (3) amount of claim received and not appropriated. The Reserve Bank of India defines Net NPA as:

Net NPA = Gross NPA – (Balance in Interest Suspense account + DICGC/ECGC claims received and held pending adjustment + Part payment received and kept in suspense account + Total provisions held).

Table 9: Gross and Net NPAs as a Percentile of Total assets for Public Sector Banks

S.No.	Financial Year	State Bank Group		Punjab National Bank		Central Bank of India		Bank of India		Union Bank of India	
		Gross NPA	Net NPA	Gross NPA	Net NPA	Gross NPA	Net NPA	Gross NPA	Net NPA	Gross NPA	Net NPA
1	2006-07	1.6	0.8	2.1	0.4	2.8	0.9	1.5	0.4	1.8	0.6
2	2007-08	1.5	0.8	1.7	0.4	1.9	0.9	1.1	0.4	1.3	0.1
3	2008-09	1.4	0.8	1.1	0.1	1.6	0.7	1.1	0.3	1.2	0.2

Source: Secondary data survey

Above analysis indicates that Central Bank of India has highest percentile of their Total Assets as the Gross NPAs continuously since last three years, whereas comparatively lower values of Net NPA with regard to Gross NPA percentiles indicates a good recovery of interests debited to borrowable.

Table 10 Gross and Net NPAs as a percentile of Total Assets for Public Sector Banks

S.No.	Financial Year	ICICI Bank		HDFC Bank		Axis Bank		IndusInd Bank		DCB Ltd.	
		Gross NPA	Net NPA	Gross NPA	Net NPA	Gross NPA	Net NPA	Gross NPA	Net NPA	Gross NPA	Net NPA
1	2006-07	1.2	0.6	0.7	0.2	0.6	0.4	1.6	1.3	2.8	0.8
2	2007-08	1.9	0.9	0.7	0.2	0.5	0.2	1.7	1.3	0.8	0.4
3	2008-09	2.5	1.2	1.1	0.3	0.6	0.2	0.9	0.6	5.1	2.1

Source: Secondary data survey

Above analysis indicates that among private banks, DCB has highest percentile of their Total Assets as the Gross NPAs, whereas comparatively lower values of Net NPA wrt Gross NPA percentiles indicates a good recovery of Interests debited to borrowal. Data for ICICI bank shows an increasing trend of both Gross and Net NPAs. In 2008-2009 gross NPAs of DCB Ltd rose from 0.8 to 5.1 percent, recession may be the possible reasons.

Findings

- Non-performing assets of public sector banks catering to priority sector are having an increasing trend in all the year under study.

- Non-performing assets of private sector banks catering to priority sector are having an increasing trend in all the year under study.
- Non-performing assets of public sector banks catering to non- priority sector are showing a decreasing trend in the year 2007-08. The percentage increase in non-performing assets is more in later years
- Performance of Non-performing assets of private sector banks catering to non-priority sector is showing mix trend as HDFC bank is having an increase of more than 100 percent in 2008-09 and in the next year it decreases by 12 percent.
- Non-performing assets of public sector banks catering to public sector are showing a decreasing trend as the amount of loan lent by these banks is less in proportion to other sectors.
- Sector-wise percentile of non-performing assets shows that Public sector banks lend more loans to priority sector in comparisons to other sectors, which is the major reason for their piling up NPAs.
- Sector-wise percentile of non-performing assets shows that Private sector banks lend more loans to non priority sector (70 percent) in comparisons to other sectors, which is the reason for their lower NPAs compared to public sector banks.
- Gross NPAs are more as compared to Net NPAs, which indicates that public sector banks are able to recover interest on borrowable but they are unable to recover the principal amount.
- Net NPAs are 50 percent of Gross NPAs, which indicates that private sector banks are able to recover interest on borrowable as well as the principal amount to some extent.

Conclusion

A strong banking sector is important for a promising economy. The failure of the banking sector may have an adverse impact on other sectors. Over the years, much has been talked about NPAs and the emphasis so far has been only on identification and quantification of NPAs rather than on ways to reduce and upgrade them. There is also a general perception that the prescription of 40 percent of net bank credit to priority sectors have led to higher NPAs, due to credit to these sectors becoming sticky. In the changed context of new prudential norms and emphasis on quality lending and profitability, managers should make it amply clear to potential borrowers that banks re*sources are scarce and these are meant to finance viable ventures so that these are repaid on time and relevant to other needy borrowers for improving the economic lot of maximum number of households. Hence, selection of right borrowers, viable economic activity, adequate finance and timely

disbursement, correct end use of funds and timely recovery of loans is absolutely necessary pre conditions for preventing or minimizing the incidence of new NPAs.

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