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Non-Performing Assets (NPA) and Their Effects on Countries Progress

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Abstract - Most people associated with banks are familiar with NPAs. NPA means non-performing assets, that is, when a person takes any kind of loan and does not give it on time or its instalment, interest etc. remains overdue for three consecutive months, then that account becomes NPA. In this paper, we have given detailed information about your NPA. What is NPA? What are the types of NPAs? We have given information about all the things like what is banking properties etc. in this paper. NPA accounts have a very bad effect on the profit of the banks and this also has a bad effect on the country. Therefore, the bankers should make continuous efforts to secure the accounts before they become NPA.

Keywords :- Bank, NPA, Assets, Properties, Bad loan, Cash credit

Concepts of NPAs- During the few decades before the rapid expansion and nationalization of the bank in 1969, the growth of the financial industry was truly extraordinary in terms of existence. As the branch network of the banking system grew at a rapid and massive rate in the early 1990s, it became clear that the efficiency of the monetary system was assessed not only in terms of quantitative growth (increased bank branch growth and deposits or advances), but also in terms of qualitative development (fulfilment of social responsibility). After the first phase of economic liberalization in 1991, significant changes took place in the banking industry and therefore in debt management. Whereas the main objective of banks is to lend money to various industries including agriculture, small scale industries, micro loans, education loans, personal loans, housing loans and industrial loans.

"Proverb" Without money, a person is like a bird without wings; it highlighted the importance of money. A bank is a type of financial institution that specializes in dealing with money. Accepting and lending money are the basic activities of all commercial banks. Banks play a vital role in raising capital and allocating them to priority and non-priority sectors for the growth and development of the economy. The major issue of commercial banks is to successfully disburse funds to high quality assets (loans and advance), lest they become NPAs. A bank is considered efficient when it is able to manage or overcome both external and internal factors and constraints, as well as keep up with the development of new technology. A sound financial system of a country is an important component of that country's economic prosperity.

The primary role of the banking industry is to receive customer deposits to lend money. As a result, it raises cash and then loans them to others, resulting in bank assets. The money that is raised is lent out in the form of loans and advances, which is the prime and major activity of banking and is the biggest asset of the bank. The money lent is referred to as loan or advance, and it helps the bank to earn income in the form of interest. In addition, the bank invests a portion of its funds in securities or equipment (debt as well as equity), and a smaller portion of the total funds available is invested in real assets such as land and buildings, office equipment and other banking-related property, goes.

Funds are supplied in the form of loans with the intention of receiving interest payments at fixed regular intervals, as per the contractual responsibilities of the lender and the borrower. An asset that fulfills its contractual responsibilities, such as payment of interest on time and repayment of principal when it is due, is referred to as a performing asset or a standard asset. Non-performing or non-standard assets are assets that fail to meet their commitments of timely interest payment and principal repayment within a specified time period.

Reserve Bank of India defines a non-performing asset as one that fails to generate income for the bank within the specified time frame. In other words, if the interest or principal installments are not paid for the time specified in the rules and regulations of the Reserve Bank of India, an asset will be said to be as a non-performing asset (NPA). Following are the criteria for declaring an account as NPA as per RBI guidelines and rules and regulations: -

In case of a term loan, the interest or the principal installment remains outstanding or outstanding for more than 90 days.

In case of overdraft or cash credit, the account remains out of order or remains dormant for more than 90 days.

In case the bills are received and discounted, the bills are delayed or remain unpaid for more than 90 days.

For crops of extended duration for a cropping season, the principal or interest installment is overdue or underpaid. Interest or principal installment is overdue or unpaid for two harvesting seasons, but not more than two and a half years in the case of loans for agricultural purposes.

In the case of other accounts, any funds received are late or underpaid by more than 90 days. (Bansal, 2015)

Criteria for Asset Classification and Provisioning:

The following are the major categories into which banks divide their loan assets:

- standard property
- sub-standard property
- doubtful assets and
- loss assets

Standard Property:

Standard assets are assets that provide income on a regular basis at fixed intervals and do not pose additional risk to the firm. These assets are called performing assets.

a. 2% direct credit to the agriculture sector and small and micro enterprises (SMEs).

b. Growth of 1.00 per cent in the commercial real estate sector.

c. 0.75 per cent advance in Home Housing Sector - Corporate Real Estate (CRE - RH).

d. all additional loans and advances not governed by policy (a), (b), or (c) at the rate of 0.40 per cent.

Sub-Standard Property:

Non-performing assets are any assets that are not standard. These are Sub-standard assets: A non-performing asset that has been non-performing for less than or equal to one year is considered sub-standard. Assets are segregated by the specific probability that the bank will incur losses on certain types of assets, thus the bank must set aside 15% of the outstanding balance of substandard assets.

- A normal provision of 15% will be provided on the entire outstanding amount, without any adjustment for ECGC guarantee cover or available securities.
- Unsecured exposures classified as "sub-standard" will be subject to an additional provision of 10% for the aggregate (15% + 10%) 25% on the outstanding asset account's amount. Infrastructure loan portfolios that are classified as sub-standard, but on the other hand, will be subject to a provisioning rate of 20% instead of the previously prescribed 25% due to several safeguards such as escrow accounts.

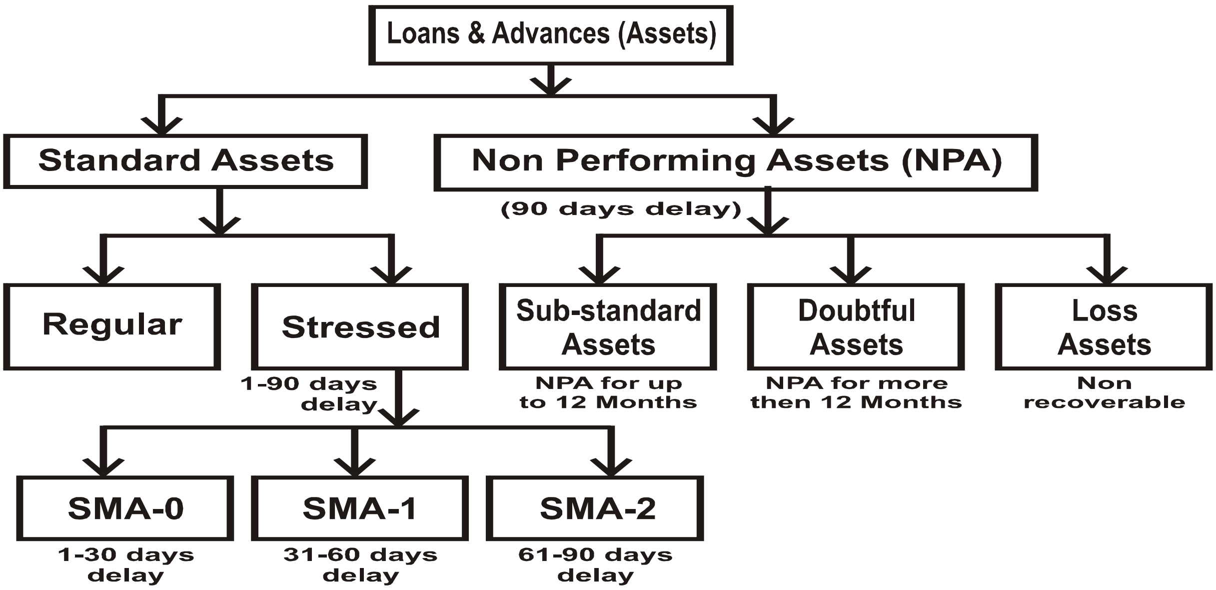

Figure 1. Classification of Assets

Doubtful assets:

Assets that are non-performing for more than one year but are not declared assets are referred to as doubtful assets. Banks will be required to provide 100% of the outstanding advance of the unsecured asset portion, after the amount recovered under the DICGC scheme and the amount of guarantee cover realized or likely to be received under ECGC (Export Credit Guarantee Corporation) schemes.

Types of Assets	Provisioning Norms
Standard Asset	(a) 0.25 percent direct advances to the agriculture and Small and Micro Enterprises (SMEs) sectors. (b) 1.00 percent growth in the commercial real estate sector. (c) Commercial Real Estate Advances – Residential Housing Sector (0.75%). (d) 0.40 percent for all additional loans and advances not covered by (a), (b), or (c) above.
Substandard Asset	(i) A general provision of 15% of total outstanding should be provided, with no adjustments for ECGC guarantee cover or accessible securities. (ii) The ‘unsecured exposures' designated as ‘substandard' would be subject to an additional provision of 10%, for a total provision of 25% on the outstanding sum. Infrastructure loan portfolio that are considered as sub-standard Instead of the previously specified prescription rate of 25%, a provisioning rate of 20% will be used. due to specific protections such as escrow accounts accessible in relation to infrastructure financing.
Doubtful Assets	Within one year: 100% of the unsecured component and 25% of the secured component.
	100 percent of the unsecured component and @ 40% of the secured component for 1 to 3 years.
	Over 3 years: 100% of the unsecured component and 100% of the secured component.
Loss assets	100% of the unsecured component and 100% of the protected component.

RBI

Figure : 2

Up to one year: 100% of the unsafe component and 25% of the safe portion.

For 1 to 3 years: 100% of the unsecured portion and 40% of the protected portion

More than 3 years: 100% of unprotected portion and 100% of protected portion.

Loss Property:- Banks have identified a lost asset, but it was not completely or partially erased. In other words, despite the fact that it may have some scrap or recoverable value, such asset is considered noncollectible. However, only those assets that have no security are classified as loss assets. Asset portfolios with no protection, DICGC, or ECGC insurance were not loss assets. Banks should make 100% provision for lost assets. (Sukul, 2017).

The following formula can be used to calculate provisioning requirements:

Total Provisions = [B-S(100-P)/100]×(1-C/100)

where; B = Balance outstanding in non-performing asset accounts.

S = stands for the realizable value of the asset.

P = Percentage of provisioning required for the secured component depending on the age of the account and doubts.

C = DICGC/ECGC cover available as a percentage of the total outstanding amount.

When a DICGC or ECGC cover limit is determined, it should be translated into a percentage.

Types of NPAs:

Gross NPA and Net NPA are two types of non-performing assets (NPAs).

Gross NPAs:

$$\text{Gross NPA Ratio} = \frac{\text{Gross NPA}}{\text{Gross Advances}}$$

Gross non-performing assets (NPAs) are advances that are considered irreversible or unpaid for which the bank has made provisions and are still recorded as assets in the bank's books. In other words, it is all accumulation of substandard, doubtful and lost assets like NPAs.

Net NPAs:

$$\text{Net NPA Ratio} = \frac{\text{Gross NPA - Provisions}}{\text{Gross Advances}}$$

After deducting the above adjustments from the Gross NPAs, the Net NPAs shows the actual burden of the banks.

The Reserve Bank of India defines Net Non-Performing Assets as follows: Net NPA = Gross Non-Performing Assets – (Balance in Interest Suspense Account and DICGC/ECGC Part Outstanding Balance and Suspense Account, and Total Provisions Maintained).

Gross NPAs reflect the problem assets, while Net NPAs reflect the actual pressure on the banks. {Agwan, Volume 6, Issue 1 (January, 2016)}.

Identification of NPAs- The process of determining whether an asset or account is performing or not is known as NPA identification. Non-Performing Assets (NPAs) should be recognized or fixed on the basis of position of Balance sheet date. Consequently, even if the account has been in default for two quarters, an advance which is booked by repayment of outstanding interest and instalment of principal before the balance sheet date cannot be treated as NPA. The following is one method of determining whether an asset is performing or non-performing:

In other countries, non-performing asset (NPA) revenue is not recognized on an accrual basis, and is treated as income only when it is actually received. In order to achieve reconciliation, it was agreed to follow a similar procedure in our country. Banks have been directed not to charge interest or accept interest revenue on all NPAs. When an asset ceases to generate revenue for a bank, it is classified as non-performing. From 1992 to 1995, the basis for classifying all credit facilities as non-performing was reduced to quarters 4, 3 and 2, and from April 2004, this two-quarter definition was reduced to one quarter, and the following are the grounds for classifying a credit facility as non-performing:

Cash Credit / Overdraft

Interest payable up to 30th September of the audited year is collected on or before 31st March of the respective audited year.

NPA - Interest payable up to 30th September which has not been collected by 31st March of the respective audited year. If the cash credit or overdraft account remains 'irregular' for two quarters (not necessarily consecutive) during the year, it will be classified as a non-performing asset (NPA).

Out of Order

An account may be considered out of order if any of the following three requirements are satisfied:

• The outstanding balance in the account continues to exceed the permissible limit or drawing capacity as per the terms and conditions.

• The amount outstanding is within the limit/withdrawing power, but no credit has been made to the account for a period of six months as on the balance sheet date of the bank;

• There are some credits, but they are insufficient to meet the interest or principal due on the account in the same period.

Term loan

Performing Assets: Interest payable by 30th June and instalments payable by 31st August of the audit year is collected by 31st March of the audit year.

Non-Performing Assets: Interest due by June 30 and instalments due by March 31 of the audited year were not collected before March 31.

A term loan account is classified as a non-performing asset (NPA) if the interest or principal instalment on the loan is 'past due' for two consecutive quarters out of four, although the default need not continue.

Past Due: If an amount is outstanding or has not been paid for 30 days or more after the due date, it is called past due.

Bills bought and discounted

Interest payable by 30th June and instalments payable by 31st August of the year under audit are considered as performing assets.

Non-Performing Assets (NPAs) are bills which are due by 30th September of the year but not paid by 31st March of the year under audit.

If a bill is bought or deducted and remains late and unpaid for two quarters, it is called a non-performing asset (NPA).

On the other hand, arrears of interest should not be charged and should not be taken into account in respect of overdue challans until the same is realized.

Other account

Performing Assets: Interest payable by 30th June and instalments due by 31st August of the audited year, collected before 31st March of that year. Interest due by 30th June and/or instalments due by 31st August is not collected before 31st March of the year under audit.

Non-performing Asset: Any other credit facility is recognized or handled as a non-performing asset (NPA) if any amount due on such facility is due for two quarters during the year. Interest should not be charged on any NPA and it should not be accounted for in the revenue account. If a borrower's interest income is subject to non-accrual, the same borrower's fees, commissions, and other comparable revenues must also stop accruing. (RBI, 2015)

Some other related concept of NPA

- **Exempt Assets**

Advances against Bank's own Term Deposits/Recurring Deposits, National-Savings-Certificates, Surrender Value of LIC policies, IVP Indira-Vikas-Patras, and KVP Kisan-Vikas-Patras all fully exempted from asset classification, and they are rarely treated as "standard assets".

Even if the interest debited for two quarters is not collected, the amount outstanding should be within the value of the security.

- **Downgrading of NPAs**

In respect of accounts where there is a potential threat of recovery due to diminution in the value of the security or the inability to obtain the security, or the existence of other factors such as fraud on the borrowers, RBI had directed banks that such accounts should be made as soon as possible are considered as non-performing assets, regardless of how long they have been classified as non-performing assets.

- **Upgradation of NPAs**

Non-performing assets are assessed for upgrade only when they become standards assets, that is, when the account becomes regular. In other words, upgradation of NPAs from doubtful to sub-standard in doubtful condition will not lead to further recovery unless the account is brought in good standing and is removed from the NPA list.

- **Employee demand and housing loan**

Since monthly instalments due will be recovered on a regular basis, staff accounts may be treated as distinct assets, and interest on such accounts may be reported as income for the year ended.

- **Borrower who has multiple facilities**

When a customer has multiple accounts, all accounts should be considered non-performing assets (NPAs), not just one or the part of the account that has remained unregulated.

- **Consortium Advance**

Consortium advances occur when more than one bank or financial institution jointly advance an entity. When it comes to borrowing units the members should follow the classification chosen by the union leader so as to achieve uniformity in approach. The information about the classification by the leader bank should be shared with other banks.

- **Agricultural advance**

The RBI, in a circular dated March 4, 1998, stated that advances given for agricultural purposes can be classified as non-performing assets (NPAs). If interest or principal instalment is not paid after two seasons of harvest; In any case, it should not exceed two and a half years.

- **Rescheduling of Advances**

As per RBI norms, an account which is not yet NPA can be rescheduled before the commencement of production or an instalment becomes due for payment as per the original terms. In such cases, the NPA position should be assessed in the light of the rescheduling conditions.

Causes for non-performing assets

The high rate of non-performing assets (NPAs) in both public and private sector banking institutions has caused public concern, as bank credit is the driving force behind the country's economic growth, and one of the reasons for this is rising NPAs, which will inevitably be counterproductive. impact on the economy. The breakdown of the banking industry can have an impact on other industries. The Indian banking sector, which historically functioned in a closed economy, is now facing the problems of operating in a free market. On the one hand, a secure environment guaranteed that banks were not required to acquire complex Treasury functions or asset liability management capabilities, while on the other, a mix of directed financing and social banking drove profitability and competition in the background. The end result was volatile non-performing assets (NPAs) and, consequently, a higher effective cost of banking services. It is a different floor when the RBI and the government are accused of having a soft stance or failing to take extra precautions with banks failing to meet specified objectives.

For lending to the priority sector, especially in agriculture and small scale industries. Under priority sector advances, especially in agriculture and small-scale businesses, outsiders may make it difficult to recover NPAs. In Indian banks, especially public sector banks, several practical issues have emerged. For example, under the Prime Minister of Mr. VP Singh, Government of India gave a huge rebate of fifteen thousand crores for rural loans in 1989-90. This was not an isolated incident in India, and it left a bad impression on the borrower. Poverty alleviation programs like IRDP, SUME, SEPUP, JRY, PMRY, and others have failed to meet their goals and have had harmful consequences. Due to political influence, pressure or misappropriation of funds and unreliability of target consumers in these sectors, the large amount of loans provided under these schemes were completely unrecoverable by the banks. Bank loans are their assets, and because some of them were not repaid on time, the quality of these assets was deteriorating progressively. The process of loan allocation came to be known as 'Loan Mela'. Review of loan proposals was slow, and repayment was low as a result.

The factors that cause assets to go from performing to non-performing conditions can be classified under the following three heads or points:

Causes Attribute to Borrowers

- Reluctance of borrowers to repay loans Many a times, a certain group of debtors makes a deliberate attempt to declare their units sick to obtaining financial assistance from various sources. Even a deposit group of careful borrowers does not hesitate to take advantage of some banker errors, as they have learned through experience, and do not pay off purposefully, these loans will be eventually become non-performing.

- Using funds to increase, modernize, or build new initiatives that that benefit or promote a sister company If the advance is misappropriated or diverted to other purposes, the unit may be unable to earn more revenue, and the account may become non-performing.
- Inappropriate technology and obsolescence of products A company cannot compete in the market with goods made of obsolete technology. As a result, the product remains unsold, thereby blocking money without providing any return or minimum return, resulting in NPA.
- Because the project was not completed on time, the entire phase of project implementation was time-costed, leading to liquidity stress. As a result, the unit will not be able to repay the advance in time, resulting in NPA.
- Mismanagement and lack of proper planning: If management makes poor decisions, such as investing in very ambitious projects, creating excess capacity at uneconomic costs, or spending unnecessarily, NPAs will result.
- If there is a disagreement between the co-borrowers or if one of them dies after taking a bank loan, the manufacturing activity may not continue to provide sufficient revenue, resulting in NPAs.
- The company's inability to raise funds through the financial markets by issuing equity or other debt instruments. This would result in a liquidity crisis or lack of funds, which would limit production. In this situation, the end result would be the conversion of such loans into non-performing assets (NPAs).
- Exporters face difficulties due to unfavourable currency rates, overdues in other countries, recession in other countries, externalization issues and other factors. This increases the cost of material imports and reduces demand, preventing units from growing at the right rate as they must compete with better efficiency in the world market
- Shortage of raw materials, rising raw material/input prices, and weak financial markets are all factors. It inhibits productive activities because the returns are insufficient.

Reasons due to banks

- Lending process that is not working Commercial banks follow three basic principles of bank lending. (i) profit principle (ii) liquidity principle (iii) Security Principle
- Technology that is inconsistent Market driven choices cannot be made in real time due to inadequate technology and management information systems. In banks, proper MIS and financial recording systems are not implemented and managed, resulting in poor credit collection and NPAs. All branches of the bank should be computerized and up to date.
- SWOT (strength, weakness, opportunity and threat) analysis that isn't appropriate another cause for the growth in NPAs is a lack of adequate strength, weakness, opportunity, and threat assessments. Due to the rise in nonperforming assets (NPAs), banks rely more on the borrower's honesty, integrity, financial health, and credit worthiness when making unsecured advances.
- Credit Appraisal System Is Inadequate Another factor contributing to the growth in NPAs is poor credit assessment. Due to a bad credit assessment, the bank makes advances to people who are unable to

repay them according to their ability. To reduce NPAs, they should employ appropriate credit evaluation.

- Inefficiency in management to protect its interests, the banking should always carefully choose the borrower and take actual assets as collateral. The following variables should be considered by banks while accepting securities:

(i) Marketability\s
(ii) Acceptability\s
(iii) Safety\s
(iv) Transferability.

- Wrong borrower selection, inaccurate evaluation of the borrower's expertise or competence to pursue the activity intended to be conducted, thereby jeopardising a fundamental premise of lending. If the market report, creditworthiness, and family background of the borrower are not thoroughly checked, there is a very significant risk of the fund being misused.
- Repayment schedule that isn't right Fixing the payback schedule and gestation duration in the operating region of the brands, notably in agricultural advances, regardless of the operational and marketing seasons is also a cause for an asset becoming NPA.
- Improper development of the borrowers' credit requirements due to a lack of comprehensive market and industry data on demand and supply, the bank may be unable to appropriately analyse the borrower's credit requirements, resulting in under or over financing, which may change the cost revenue structure of the activity, rendering it unviable.
- Improper evaluation of the project site, geographical drawbacks and benefits, forward and backward connections, all of which have a significant impact on the feasibility of the project to be undertaken.
- Coverage of a wide geographic region Injudicious and intermittent advances with vast coverage areas, limited transportation, and a staffing deficit, and the inability to maintain effective control over the advances.
- Delay in credit facility approval or pay-out due to delayed section and credit disbursement, units are unable to take advantage of possibilities.
- Faulty paperwork and loan disbursement prior to compliance with the terms and conditions may lead to the possibility of fraud or loan default.
- For different reasons, there was a lack of monitoring and inadequate follow-up on the park of the hank branches. An effective monitoring system has two goals: to ensure that credit is used properly and to identify problems that may arise during the project's execution. The lack of such a system will have a negative impact on the performance of loan assets. If warning signs are not detected quickly and appropriate remedial measures are not taken, these loans will eventually become nonperforming assets (NPAs).
- Unavailability of essential data pertaining to the borrower's debts to other institutions and persons, among other things, impacting his ability to satisfy all of his payback obligations credit the information department does not gather and maintain complete information about borrowers for

the bank as a whole. The defaulting borrower takes advantage of this void and raises cash from one branch of the same bank while ignoring the other bank's branch.

- Because there are insufficient authorities to enforce securities (possession and sale), banks are avoiding risks by investing a higher- than-required share of their assets in sovereign debt papers.
- Manipulation of the debtors by political clout. Due to the demands of politicians and bureaucrats, a large share of NPAs result from lending to the priority sector. The NPA problem might have been controlled, if not eliminated, if banks had properly supervised their loans. Politicians and bureaucrats compelled bank top management to pour good money after bad in the instance of dishonest borrowers. The fundamental cause of NPAs in India is the lack of adequate bankruptcy laws and other legal procedures for enforcing security claims.

Other Causes of NPAs

- **Natural calamity**

This is a primary element that contributes to bank nonperforming assets (NPAs). Because of this, the borrower is unable to repay their loans. As a result, due to the detrimental impact on bank profitability, banks must make substantial provisions in accordance with standards.

- **Unsoundness in the Industrial Sector**

Industrial illness is caused by improper project management, poor management, a lack of appropriate resources, a lack of advanced technology, and constantly changing government rules and policies. As a result, banks fund sectors that lack cutting-edge technology, lowering their profit and liquidity.

- **Insufficient Demand**

Entrepreneurs in India were unable to accurately anticipate product demand, resulting in their inability to repay the money they borrowed to carry out these operations. The banks are recouping the funds by selling their assets, but there is still a significant increase in nonperforming assets (NPAs).

- **Government Policies That Are Changing**

The banking industry receives new policies for its functioning with each new government. As a result, it must adapt to evolving concepts and policies for regulating the rise in nonperforming assets (NPAs).

Impact of NPAs on profitability of the Banks

The rising number of nonperforming assets (NPAs) has a significant impact on both the bank and the economy as a whole. The following are a few of the consequences:

- The presence of nonperforming assets (NPAs) has a negative influence on bank profitability. It's a two-edged sword in that banks don't make any money off of it; instead, they have to spend money to recover.
- As NPAs rise, banks' attitudes toward lending alter, thereby impeding bank growth and credit expansion for productive purposes.
- Banks may favour risk-free investments that are neither beneficial or helpful to the nation's economic growth.
- Banks may raise interest rates to compensate for the loss on nonperforming assets (NPAs), which has a negative impact on the viability of many businesses.

- Because of the negative impact on the return on investment, NPAs will limit the earning capability of bank assets (ROI).
- Higher provisioning requirements for rising NPAs have a negative impact on banks' capital adequacy ratio (Capital to Risk Adjusted Assets Ratio).
- Banks' Economic Value Add (EVA) is thrown off since EVA is the difference between net operating profit and the cost of capital.
- Nonperforming assets (NPAs) undermine consumer trust by lowering the market value of shares, frequently down under their book value in the capital market.
- Reduces asset earning capacity: Nonperforming assets (NPAs) diminish asset earning capacity, and as a result, return on assets is impacted.
- NPAs have a risk weight of 100 percent to the extent that they are uncovered, according to Block's capital. As a result, they put capital on hold in order to maintain capital adequacy. Because nonperforming assets (NPAs) generate no revenue, they have a negative impact on a bank's capital adequacy ratio.
- Carrying NPAs entails incurring costs such as "Operating Cost for Monitoring and Recovering NPAs," "Cost of Capital Sufficiency," and "Cost of Financing in NPAs".
- Low yield on advances: Because of nonperforming assets (NPAs), the yield on advances is lower than the actual rate on "regular Advances." The reasons why yield is based on weekly average total advances, including nonperforming assets (NPAs).
- Effect on Return on Assets: NPAs diminish the earning capability of assets, which has an impact on ROA.

Conclusion- We have already seen that the more prosperous the banking system of any country, the more it progresses. NPA accounts are like a hindrance in the progress of the country because having NPA causes loss to the bank, which weakens the banking system and which affects the economy of the country and weakening of the economy hinders the progress of the country. We have seen that NPA accounts in private sector banks are less as compared to government banks; one of the main reasons for this is that any loan in private banks is taken care of, whereas in government banks, loans are taken to complete many government schemes. It is given in which the ineligible also get loans and those people are unable to repay the loan due to one reason or the other and the account becomes NPA, which affects the economy of the country. Therefore, banks should take care of the loan and keep taking care of that loan from time to time, so that the account can be prevented from becoming NPA.

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