CHAPTER - 4

NPA—GENESIS, GROWTH AND MANAGEMENT
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4.1 Introduction

The concept of NPAs originated when Reserve Bank of India (RBI) introduced prudential norms, on the recommendations of the Narashimam Committee in the year 1992-93. As per the prudential norms laid down by RBI, “An asset is considered as ‘non-performing’ if interest on instalments of principal due remain unpaid for more than 180 days (from March 31, 2004, it has been decided to adopt the, 90 days, overdue norm for identification of NPAs). In simple words, as long as the expected income is realized from the asset, it is treated as performing asset but when it fails to generate income or deliver value on due date it is treated as non-performing asset. Growth of non-performing assets on the balance sheet of banks erodes the solvency, profitability and financial health of banks. RBI has been advised the bank that they should identify the non-performing assets and ensure that interest on such assets is not recognized as income and taken to the profit and loss account. Banks are to recognize their income on accrual basis in respect of income on performing assets and on cash basis in respect of income on non-performing assets. Any interest accrued and credited to income account must be cancelled by a reverse entry once the credit facility comes under the category of NPAs.

The Co-operative Banks and Regional Rural Banks play an immense role in the development and growth from the very inception. The Co-operative Banks and Regional Rural Banks which were operating on social model by mobilizing the huge resources and directing them to social and priority sectors for social and economic development of the country. Due to their socio-economic role, there was high level of NPAs in their asset portfolio. After the liberalization in 1991, they faced high level competition from private and foreign banks. Due to this ferocious competition and challenge on their survival, they were forced to improve the performance and to reduce weakness. The biggest weakness and problem they faced was huge NPAs in their portfolio. This study aims to check what is the position and level of NPAs of Co-operative Banks and Regional Rural Banks which is core
and heart of rural development in India and which handles the major portion of banking business in India.²

4.2 Broad NPA Management

It is a known fact that the Co-operative Banks and RRBs in India as well as West Bengal face the problem of growth, Non-Performing Assets (NPAs) and the issue is becoming more and more unmanageable. In order to bring the situation under control, some steps have been taken recently. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SRFAESI, 2002) was passed by the Parliament, which is an important step towards elimination or reduction of Non-Performing Assets (NPAs).³

4.3 Prudential Accounting Norms

Before to the financial sector reforms in India in the year 1992-93, banks used to debit interest to the loan account on accrual basis and recognized the same as income even in accounts with poor record of recovery. With a view to preparing the Profit and Loss A/c and Balance Sheet, reflecting bank’s actual financial health, a proper system for recognition of income, classification of assets and provisioning on a prudential basis is necessary. Recognizing income on accrual basis in accounts where the realization is in doubt is not a prudential practice. As per the recommendations of the Narsimham Committee, the RBI introduced prudential accounting norms applicable from the year 1992-93, 1995-96, 1996-97 & 1997-98 in CBs, RRBs, St. CBs & DCCBs and SCARDBs & PCARDBs respectively, shows in Table-4 below. According to the prudential norms interest is not to be debited on the accrual basis but on the cash basis. The prudential accounting norms are based on the N.P.A concept, N for No income, P for Provisioning and A for Asset classification.⁴ The prudential accounting norms comprise of the following:

1. Income Recognition
2. Asset Classification
3. Provisioning
Table 4.1: Introduction of Prudential Norms

<table>
<thead>
<tr>
<th>Prudential Norms</th>
<th>Commercial Banks</th>
<th>Regional Rural Banks</th>
<th>St.CBs &amp; DCCBs</th>
<th>SCARDBs &amp; PCARDBs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets Classification</td>
<td>1992-93 (With three years phasing of NPAs)</td>
<td>1995-96 (With three years phasing of NPAs)</td>
<td>1996-97 (No phasing of NPAs)</td>
<td>1997-98 (No phasing of NPAs)</td>
</tr>
<tr>
<td>Provisioning</td>
<td>1992-93</td>
<td>1996-97</td>
<td>Phased over 4 years from 1996-97</td>
<td>Phased over 3 years from 1997-98</td>
</tr>
</tbody>
</table>


4.3.1 Income Recognition

The prudential norms for income recognition should be objective and based on record of recovery rather than on any subjective consideration. For the purpose of income recognition, banks are required to classify their loan account into two categories:

1. Performing Assets (PA)
2. Non-Performing Assets (NPA)

If the asset is performing (PA), income is recognized on an accrual basis. If the asset is non-performing assets (NPA), interest thereon is to be recognized only on cash basis, i.e. when it is actually realized. Recognizing income on realizable basis in accounts where the realization is doubtful is not a prudent practice. The prudential norms for income recognition should be objective and based on the record of recovery. However, NPAs involve significant uncertainty with respect to its ultimate collection. Considering this fact, in accordance with the guidelines for income recognition issued by the RBI, banks should not recognize interest income on such NPAs until it is actually realized.
4.3.2 Asset Classification

In order to help the banking sector to assess the quality of their credit portfolio, RBI introduced the ‘Health Code System’ (HCS) of classification of loan accounts in 1985. Such classification, however, had nothing to do with the assessment of provisioning requirements against bad and doubtful loan accounts, which are being assessed on the basis of shortfall in realizable value of securities charged to the banks when compared to the amount of loan outstanding. In this background, the Committee on the Financial System suggested that the loan accounts/assets may be classified under the four categories viz. 7

1. Standard Assets (SA)
2. Substandard Assets (SSA)
3. Doubtful Assets (DA) and
4. Loss Assets (LA).

4.3.2.1 Standard Assets (SA)

Those assets, which do not carry more than the normal risk and are regular in all respects, are called standard assets. Standard asset is one which does not create any problem and which does not carry more than normal risk attached to business. These are also treated as performing assets, as they bring in income expected of them, and the borrowers are regular and prompt in paying instalments of interest and capital. Thus, in general, all the current loans, agricultural and non-agricultural loans which have not become NPA may be treated as standard asset.

4.3.2.2 Sub-Standard Assets (SSA)

Sub-standard asset is a credit facility, which remains overdue for a period of not exceeding three years. All the substandard assets are treated as NPA. The following guidelines are used to classify sub-standard assets:

- An asset which has remained overdue for a period not exceeding 3 years in respect of both agricultural and non-agricultural loans should be treated as substandard.
• In case of all types of term loans, where instalments are overdue for a period not exceeding 3 years, the entire outstanding in term loan should be treated as sub-standard.

• An asset, where the terms and conditions of the loans regarding payment of interest and repayment of principal have been renegotiated or rescheduled, after commencement of production, should be classified as sub-standard and should remain so in such category for at least one year of satisfactory performance under the renegotiated or rescheduled terms.

• In other words, the classification of an asset should not be upgraded merely as a result of rescheduling unless there is satisfactory compliance of the above condition.

4.3.2.3 Doubtful Assets (DA)

A Non-Performing Asset may be classified as doubtful on the basis of following criteria:

• As asset which has remained overdue for a period exceeding 3 years in respect of both agricultural and non-agricultural loans should be treated as doubtful.

• In case of all types of term loans, where instalments are overdue for more than 3 years, the entire outstanding in term loan should be treated as doubtful.

• As in the case of sub-standard assets, rescheduling does not entitle a bank to upgrade the quality of advance automatically.

NPA accounts belonging to this category are further classified as given in Table - 4.2.

Table 4.2: Category-wise Distribution of Doubtful Assets

<table>
<thead>
<tr>
<th>Category</th>
<th>Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doubtful – I</td>
<td>Overdue above 3 years not exceeding 4 years</td>
</tr>
<tr>
<td>Doubtful – II</td>
<td>Overdue above 4 years but not exceeding 6 years</td>
</tr>
<tr>
<td>Doubtful – III</td>
<td>Overdue exceeding 6 years</td>
</tr>
</tbody>
</table>
4.3.2.4 Loss Assets (LA)

A loss asset is one which considered uncollectible and of such little value that its continuance as a bankable asset is not warranted, although there may be some salvage or recovery value. Loss assets are those where loss is identified by the bank/auditor/RBI/NABARD inspectors but the amount has not been written off wholly or partly. In other words, an asset which is considered unrealizable and/or of such little value that its continuance as a doubtful asset is not worthwhile, should be treated as a loss asset. Such loss assets will include overdue loans in cases—

- Where decrees or execution petitions have been time barred or documents are lost or no other legal proof is available to claim the debt;
- Where the members and their sureties are declared insolvent or have died leaving no tangible assets;
- Where the members have left the area of operation of the society (refers to the borrower in whose name the respective Loan Account with St.CB/CCB) leaving no property and their sureties have also no means to pay the dues;
- Where the loan is fictitious or when gross misutilization is noticed; and
- Amounts which cannot be recovered in case of liquidated societies.

4.4 Non-Performing Assets (NPAs)—its Meaning and Definition

4.4.1 Meaning

The Non-Performing Assets (NPAs) is the sum total of last three categories of assets, i.e. NPAs = Sub-standard assets + Doubtful assets + Loss assets. In general when, loans and advances given by banks to its customers are asset to the bank. But, when repayment of interest and principal is overdue, such asset is classified as NPA in the financial reports of banks. As per norms of RBI on NPAs of co-operative bank, with effect from March 31, 2004 year end, all urban co-operative banks will have to classify a loan as NPA if interest and/or instalment of principal remain overdue for a period of more than 90 days as against 180 days permitted previously. Banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the
quarter. Any amount due to the bank under any credit facility is “overdue” if it is not paid on the due date fixed by the bank.8

4.4.2 Definition of NPAs as per RBI Guidelines
As per RBI guidelines NPAs consist of substandard assets, doubtful assets and loss assets. Any loan assets usually turn as NPA when it fails to yield income during a certain period. As a result, doubtful assets find their way from sub-standard assets after 18 months in Indian context (against 12 months under the international norms of NPAs). If it is found irrecoverable, then it migrates to loss assets category. Banks are allowed to make full provisions for such assets, that is 100% for unsecured portion of doubtful assets plus 20-50% of secured portion, depending on the period for which the account is doubtful and a general 10% (20% under international norms) of the outstanding balance in respect of sub-standard assets.9

4.4.3 Definition of NPAs as per Prudential Norms
As per prudential norms, an asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. NPAs was defined as a credit facility in respect of which interest remained ‘past due’ for a period of four quarters in the year ending March 31, 1993, three quarters during the year ending March 31, 1994 and two quarters during the year ending March 1995 and onwards.10

4.4.4 Definition of NPAs as per Narasimham Committee
The Narasimham Committee has recommended prudential norms on income recognition, assets classification and provisioning. In changed form, the past income recognition is now not on an accrual basis but when it is actually received. Past problems faced by banks were to a great extent attributable to this.11 Narasimham Committee clearly defined that an asset may be treated as Non-Performing Asset (NPA), if interest or instalments of principal or both remain unpaid for a period of more than 180 days. However, with effect from March 2004, default status is given to a borrower account if dues are not paid for a period of 90 days.12
4.5 Guidelines for NPAs Recognition

From time to time RBI has issued guidelines in respect of recognition of NPAs and their classifications. Below is the summary of these guidelines in Table-4.3.

Table 4.3: Summarized RBI Guidelines for NPAs Recognition

<table>
<thead>
<tr>
<th>Loans and Advances</th>
<th>Condition</th>
<th>Guidelines applicable from 31/03/2001</th>
<th>Guidelines applicable from 31/03/2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term Loan</td>
<td>Instalments of principal and/ or interest remains overdue for more than 180 days</td>
<td>180 days</td>
<td>90 days</td>
</tr>
<tr>
<td>Bill Purchased</td>
<td>Bills purchased and discounted remains overdue for more than 180 days</td>
<td>180 days</td>
<td>90 days</td>
</tr>
<tr>
<td>Cash Credit</td>
<td>Accounts remain out of order for more than 180 days</td>
<td>180 days</td>
<td>90 days</td>
</tr>
<tr>
<td>Agricultural Loans</td>
<td>Instalments of principal and/ or interest remains overdue for more than Two harvest seasons not exceeding two half years.</td>
<td>For short duration of crops overdue period is two harvest seasons and for long duration crops, one harvest season</td>
<td></td>
</tr>
<tr>
<td>Other Accounts</td>
<td>Facility remains overdue for more than 180 days</td>
<td>180 days</td>
<td>90 days</td>
</tr>
</tbody>
</table>
4.6 Identification of NPAs

NPAs can be identified under Credit Monitoring System (CMS) as on last Friday of every quarter for reviewing purpose. Charging of interest in first three quarters till the annual closing date, if on the annual closing date is 31st March, the account continues to be NPA, the interest applied during the year, but not realized, should be reserved by debiting ‘interest account’ and crediting ‘interest not collected account’.13

4.7 Types of NPA

There are two types of NPA viz.

1. Gross NPA (GNPA)
2. Net NPA (NNPA)

4.7.1 Gross NPA (GNPA)

Gross NPAs are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on Balance Sheet date. Gross NPA is advance which is considered irrecoverable, for bank has made provisions, and which is still held in banks' books of account. Gross NPA reflects the quality of the loans made by banks. The Gross NPA is a better indicator than Net NPA of the quality of the loan portfolio.14 High GNPA ratio indicates low quality of credit portfolio. It consists of all the non-standard assets like as sub-standard, doubtful, and loss assets. It can be calculated with the help of following formulae:

\[
\text{GNPA} = \text{Sub-standard Assets} + \text{Doubtful Assets} + \text{Loss Assets}
\]

\[
\text{GNPA Ratio} = \frac{\text{GNPA}}{\text{Gross Advances}} \times 100
\]

The Committee on Banking Sector Reforms suggested that for the banks with an international presence the minimum objective should be to reduce the Gross NPA level below 5% and 3% in the year 2000 and 2002 respectively.15
Table 4.4: Position of Gross Non-Performing Assets (GNPAs) to Gross Loans and Advances of BCCBL & PBGB

<table>
<thead>
<tr>
<th>YEAR</th>
<th>BCCBL</th>
<th>PBGB</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross NPA</td>
<td>% of GNPA to Gross Loans &amp; Advances</td>
</tr>
<tr>
<td>2006-07</td>
<td>5727.07</td>
<td>16.20</td>
</tr>
<tr>
<td>2007-08</td>
<td>6737.41</td>
<td>16.27</td>
</tr>
<tr>
<td>2008-09</td>
<td>7098.53</td>
<td>15.93</td>
</tr>
<tr>
<td>2009-10</td>
<td>7692.89</td>
<td>18.34</td>
</tr>
<tr>
<td>2010-11</td>
<td>7951.55</td>
<td>15.33</td>
</tr>
<tr>
<td>2011-12</td>
<td>8788.38</td>
<td>14.49</td>
</tr>
<tr>
<td>2012-13</td>
<td>10475.56</td>
<td>16.59</td>
</tr>
<tr>
<td>2013-14</td>
<td>11546.42</td>
<td>17.11</td>
</tr>
<tr>
<td>2014-15</td>
<td>11520.75</td>
<td>16.06</td>
</tr>
<tr>
<td>Average</td>
<td>8615.40</td>
<td>16.26</td>
</tr>
</tbody>
</table>

Source: Compiled from Annual Reports of BCCBL & PBGB for the period from 2006-07 to 2014-15.

Table 4.4 shows the position of Gross NPAs to Gross Loans and Advances ratio of BCCBL and PBGB for the period 2006-07 to 2014-15. The Gross NPA of BCCBL have been increased from ₹5,727.07 to ₹11,520.75 for the period from 2006-07 to 2014-15 with an increase of 101.16%. In case of PBGB Gross NPA have been increased from ₹7,472.19 to ₹12,239.00 for the period from 2006-07 to 2014-15 with an increase of 63.80%. The rate of increase in Gross NPA is significantly higher in BCCBL than PBGB during the study period. However, the Gross NPA as a % of Gross Loans and Advances in BCCBL was fluctuating from 18.34% to 14.49% with an average 16.26% during the study period. In case of PBGB the Gross NPA as a % of Gross Loans and Advances has continuously declined over the year from 11.56% in 2006-07 (with the exception of the year 2009-10) to 7.72% in 2014-15 with an average 10.51%. This decline in Gross NPA ratio is because of increasing rate of Gross Loans and Advances is higher than the increasing rate of Gross NPA. The average rate of Gross NPA as a % of Gross Loans and Advances is higher in BCCBL than PBGB.
4.7.2 Net NPA (NNPA)

Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA shows the actual burden of banks. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the provisions the banks have to make against the NPAs according to the RBI guidelines, are quite significant. That is why the difference between gross and net NPA is quite high. High NNPA indicates the existence of high risky loans in the bank for which no adequate provision has been made. It can be calculated by following formulae:

\[
\text{NNPA} = \text{GNPA} - \text{Provision against NPA}
\]

\[
\text{NNPA Ratio} = \frac{(\text{GNPA} - \text{Provisions})}{(\text{Gross Advances} - \text{Provisions})} \times 100
\]

The Committee on Banking Sector Reforms suggested that those banks with an international presence the minimum objective should be to reduce the Net NPAs to 3% and 0% in the year 2000 and 2002 respectively. As per international standard, the NNPA should be below 2.5%.

**Table 4.5: Position of Net Non-Performing Assets (NNPAs) to Net Loans and Advances Ratio of BCCBL & PBGB**

<table>
<thead>
<tr>
<th>Year</th>
<th><strong>BCCBL</strong></th>
<th><strong>PBGB</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NNPA (₹ in lakh)</td>
<td>% of NNPA to Net Loans &amp; Advances</td>
</tr>
<tr>
<td>2006-07</td>
<td>1609.87</td>
<td>5.16</td>
</tr>
<tr>
<td>2007-08</td>
<td>1676.69</td>
<td>4.61</td>
</tr>
<tr>
<td>2008-09</td>
<td>1677.46</td>
<td>4.29</td>
</tr>
<tr>
<td>2009-10</td>
<td>2129.59</td>
<td>5.08</td>
</tr>
<tr>
<td>2010-11</td>
<td>2142.04</td>
<td>4.65</td>
</tr>
<tr>
<td>2011-12</td>
<td>2664.67</td>
<td>4.89</td>
</tr>
<tr>
<td>2012-13</td>
<td>4079.01</td>
<td>7.19</td>
</tr>
<tr>
<td>2013-14</td>
<td>4633.67</td>
<td>7.65</td>
</tr>
<tr>
<td>2014-15</td>
<td>4367.18</td>
<td>6.76</td>
</tr>
<tr>
<td>Average</td>
<td>2775.576</td>
<td>5.59</td>
</tr>
</tbody>
</table>

Source: Compiled from Annual Reports of BCCBL & PBGB, 2006-07 to 2014-15
Table 4.5 shows the position of Net NPAs to Net Loans and Advances ratio of BCCBL & PBGB for the period 2006-07 to 2014-15. The Net NPA of BCCBL has been increased from ₹1,609.87 to ₹4,367.18 for the period from 2006-07 to 2014-15 with an increase of 171.27%. In case of PBGB Net NPA has been increased from ₹4,675.86 to ₹8,138.00 for the period from 2006-07 to 2014-15 with an increase of 74.04%. The rate of increase in Net NPA is higher in BCCBL than PBGB during the study period. However, the Net NPA as a % of Net Loans and Advances in BCCBL was fluctuating from 4.29% to 7.65% with an average 5.59% during the study period. In case of PBGB the Net NPA as a % of Net Advance has continuously declined over the year from 7.56% in 2006-07 (with the exception of the year 2009-10 and 2010-11) to 5.27% in 2014-15 with an average 7.22%. This decline in Net NPA ratio is because of increasing rate of Net Loans and Advances is higher than the increasing rate of Net NPA. The average rate of Net NPA as a % of Net Loans and Advances is higher in PBGB than BCCBL. However, in last three years the % of Net NPA to Net Loans and Advances is higher in BCCBL than PBGB.

Gross NPA is a better indicator than net NPAs since the former does not incorporate the endogenous provisioning process; this is because banks make provisioning for NPAs according to their capacities. Net NPAs does not present a true picture of NPAs so they will have to be supplemented by gross NPAs figures.17

4.8 Categories of NPAs

Banks are required to classify NPAs further into the following three categories based on the period for which the assets have remained NPA and the realisability of dues:

1. Sub-Standard Assets (SSA)
2. Doubtful Assets (DA)
3. Loss Assets (LA)

4.9 Factors Causing NPA

For efficient management of NPAs, it is important to identify the factors which are responsible for creation of NPAs in Co-operative Banks. They can be classified into three broad categories like, internal factors, external factors and factors related to borrowers, which can be shown in Table-4.6 that follow.
### Table 4.6: Factors Causing NPA

<table>
<thead>
<tr>
<th>Internal Factors</th>
<th>External Factors</th>
<th>Factors Related to Borrowers</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Defective credit appraisal and lending</td>
<td>• Natural calamities like floods, cyclones, earthquakes, drought etc.</td>
<td>• Mis-utilization of loans</td>
</tr>
<tr>
<td>• Improper identification of borrowers</td>
<td>• Non-cooperation of Govt. agencies in recovery</td>
<td>• Diversion of funds for low productive purposes</td>
</tr>
<tr>
<td>• Delay in credit disbursement</td>
<td>• Target oriented approach under Govt. sponsored programmes</td>
<td>• Lack of technical and managerial skills</td>
</tr>
<tr>
<td>• In sufficient gestation or repayment period</td>
<td>• Change in Govt. policies</td>
<td>• Poor maintenance of assets created out of borrowing funds</td>
</tr>
<tr>
<td>• Lack of post disbursement follow-up supervision</td>
<td>• Political interference</td>
<td>• Attitude to default willfully</td>
</tr>
<tr>
<td>• Under financing as well as over financing</td>
<td>• Loan waiver, subsidy and ban on recovery of Co-operative dues</td>
<td>• Personal accident, death, etc.</td>
</tr>
<tr>
<td>• Lack of borrower &amp; lender contact and poor understanding of rural members</td>
<td>• Lack of conducive legal system for loan recovery</td>
<td>• Traditional types of crop cultivation</td>
</tr>
<tr>
<td>• Poor management information system</td>
<td>• Slow process of initiating legal proceedings through arbitration and civil suits</td>
<td>• Lack of basic education</td>
</tr>
<tr>
<td>• Lack of supervision and training</td>
<td></td>
<td>• Migration</td>
</tr>
<tr>
<td>• Low motivation of staff</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Irrational lending to achieve the budgetary targets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Lack of credit as well as NPA management</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Lack of professional credit personnel</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Lack of transparency in credit delivery and recovery systems.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
4.10 General Reasons for Mounting NPAs of DCCB and RRB

Some important reasons for mounting NPAs which are not mentioned above are greatly affected to the all DCCBs and RRBs and also the banks under the study. Therefore, it will not be irrelevant to mention a few important reasons for mounting NPAs in DCCBs and RRBs as well as BCCBL and PBGB in the following sub-sections.

4.10.1 Natural Calamities

Frequently monsoon failures, water problems, low ground water potentials, pest attacks, crop failure, unsuitable climatic conditions, frequent droughts, mass migration to industrial areas and towns due to under employment and unemployment etc. in Burdwan district, in particular, and other districts, in general, are the major reasons attributed to mounting NPAs of DCCB and RRB as well as BCCBL and PBGB.

4.10.2 Diversion of Funds

Some of the borrowers in the DCCBs and RRBs as well as BCCBL and PBGB did not utilize the loan amounts for the purpose for which they were disbursed. The diversion of funds badly affected the productivity and repayment capacity. Therefore, it will create mounting NPAs of DCCB and RRB.

4.10.3 Power Shortage

In the rural areas the electricity authority failed to give adequate uninterrupted and timely supply of power to the agricultural pump sets and industrial units in the summer and almost throughout the year also, that the production is badly affected, the repaying capacity of the borrower was apprehended.

4.10.4 Over Financing

By some reasons repeated renewal of crop loans, loans to more than one member in a family, fixation of high level of finance for potato and banana, failure to close watch the loan utilization, corruption and nepotism etc. are some of the reasons for over financing in the crop loan segment of DCCBs and RRBs.
4.10.5 Government Policies

Some Government policies like stoppage of recovery of overdue loans by reasons of weak marketing system, poor procurement price of the agricultural products, announcement of interest waiver schemes, unnecessary political interference etc. in the bank management and unworthy borrowers caused considerable hardships to the DCCBs and RRBs. As a result, the NPAs were increased to a large amount.

4.11 Provisioning Norms

After proper classification of loan assets, the bank is required to make sufficient provision against each of NPA account for possible losses as per prudential norms. RBI has directed banks to provide provisions in respect of NPA accounts on the basis of classification of assets into sub-standard assets, doubtful assets and loss assets. The provisioning should be made taking into account the time lag between an accounts becoming doubtful of recovery. The minimum amount of provision required to be made against a loan asset is different for different type of asset as follows:

Table 4.7: Provisional Norms

<table>
<thead>
<tr>
<th>Asset Classification</th>
<th>Provision requirements</th>
</tr>
</thead>
</table>
| Standard assets      | a) direct advances to agricultural & SME sectors at 0.25 per cent;  
                       | (b) residential housing loans beyond ₹20 lakh at 1 per cent;  
                       | (c) advances to specific sectors, i.e. personal loans (including credit card receivables), loans and advances qualifying as Capital Market exposures, Commercial Real Estate loans, etc. at 2 per cent  
                       | (d) all other advances not included in (a), (b) and (c) above, at 0.40 percent |
| Sub-standard Assets  | 10 per cent of the total out standings for sub-standard assets |
| Doubtful assets      | 100% to the extent of deficit (deficit=advance – security)  
                       | 20% of tangible security available. |
| (i)Doubtful up to 1 yr( NPA more than 2 yrs but up to 3 yrs) | |

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Table 4.8: RBI’s revised NPA provisioning norms for the financial year 2011-12

<table>
<thead>
<tr>
<th>Asset Classification</th>
<th>Provision requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Secured</td>
</tr>
<tr>
<td>Sub-Standard Assets – normal*</td>
<td>15%</td>
</tr>
<tr>
<td>Sub-Standard – in clean loans (Unsecured ab-initio)*</td>
<td>25%</td>
</tr>
<tr>
<td>Doubtful – I</td>
<td>20%</td>
</tr>
<tr>
<td>Doubtful – II</td>
<td>30%</td>
</tr>
<tr>
<td>Doubtful – III</td>
<td>50%</td>
</tr>
<tr>
<td>Loss*</td>
<td>100%</td>
</tr>
</tbody>
</table>

*There is no classification of ‘secured’ and ‘unsecured’ in the RBI’s revised NPA provisioning norms for the financial year 2011-12.

Table 4.9: Phasing of Provisioning Norms Applicable to STCCS

<table>
<thead>
<tr>
<th>Year of introduction of Prudential Norms</th>
<th>Year</th>
<th>Provisioning Norms</th>
</tr>
</thead>
</table>
| First year                               | 1996-97 | • 100% in respect of Loss Assets.  
|                                           |       | • Not less than 30% of Provisioning needed in respect of Doubtful and Loss Assets. |
| Second Year                              | 1997-98 | • 100% in respect of Loss Assets.  
|                                           |       | • 20% of residual amount of provisioning needed in respect of Sub-standard and Doubtful Assets and  
|                                           |       | • Current provision in respect of such assets as classified in second year. |
### Third Year 1998-99
- 100% in respect of Loss Assets.
- 20% of residual amount of provisioning needed in respect of Sub-standard and Doubtful Assets and
- Current provision in respect of such assets as classified in third year.

### Fourth Year 1999-2000
- 100% in respect of Loss Assets.
- 20% of residual amount of provisioning needed in respect of Sub-standard and Doubtful Assets and
- Current provision in respect of such assets as classified in third year.


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### 4.12 Impact of NPAs on Banks Performance

The NPAs impact drastically on the working of the banks. The efficiency of a bank is not always reflected only by the size of its balance sheet but by the level of return on its assets. NPAs do not generate interest income for the banks, but at the same time banks are required to make provisions for such NPAs from their current profits. NPAs have a harmful effect on the efficiency of the banks in several ways that follow.

- Effect on Profitability
- Effect on Liquidity
- Effect on Involvement on Management (IM)
- Effect on Credit Loss (CL)
- Effect on the Image of the Bank
- Effect on Recycling of Funds
- Effect on Net Worth
- Effect on Financial Cost
- Effect on Refinance from Higher Financing Agencies

RBI has also tried to develop many schemes and tools to reduce the NPAs by introducing internal checks and control scheme, relationship managers as stated by RBI who have complete knowledge of the borrowers, credit rating system, and early warning system and so
on. Though RBI has taken number of measures to reduce the level of the non-performing assets the results is not up to the expectations. The RBI has also tried to improve the Securitization Act and SRFAESI Act and other acts related to the pattern of the borrowings. To reduce NPAs each bank should be motivated to introduce their own precautionary steps. Before lending the banks must evaluate the feasible financial and operational prospective results of the borrowing companies. Bank must evaluate the business of borrowing companies by keeping in considerations the overall impacts of all the factors that influence the business. While gross NPAs reflects the quality of the loans made by banks, net NPA shows the actual burden of banks. At this time it is increasingly evident that the major defaulters are the big borrowers coming from the non-priority sector. The banks and financial institutions have to take the initiative to reduce NPAs in a time bound strategic approach. Public sector banks figured prominently in the debate not only because they dominate the banking industries, but also since they have much larger NPAs compared with the private sector banks. This raises a concern in the industry and academia because it is generally felt that NPAs reduce the profitability of banks, weaken its financial health and erode its solvency. For the recovery of NPAs, a broad framework has evolved for the management of NPAs under which several options are provided for debt recovery and restructuring. Banks and FIs have the freedom to design and implement their own policies for recovery and write-off incorporating compromise and negotiated settlements.  

4.13 Management of NPA

Management of NPA is essential for bank’s survival and growth. Credit risk is inherent in banking operation. It should be controlled through prudent risk management mechanisms, credit appraisal and follow-up. The management of NPA has reached such a stage where a hard look at some of the basic issues will have to be taken to improve general capabilities of banks and to meet the prudential requirements. Reduction of NPA should be treated as a national priority item to make the Indian banking system stronger, resilient and geared to meet the challenges of globalization.

NPA management is a real challenge to day and the entire staff members need to be sensitized to the urgency of task on hand. Before preparing an action plan for the NPA management, one has to see the background of NPA and reasons for its origin. There are
certain factors, which are beyond the control of the borrowers as well as banks. But, constant and effective monitoring and control will definitely minimize this problem. Few measures for reduction and management of NPA can be broadly classified into (1) Legal measures and (2) Non-legal measures as follows:

4.13.1 Legal Measures
- Recovery through court (Filing of suit) & Execution of decreed cases
- Debt Recovery Tribunal (DRT)
- Lok Adalat
- Corporate Debt Restructuring (CDR)
- Asset Reconstruction Companies (ARC)
- Settlement of claims with DICGC/ECGC
- Other legal measures

4.13.2 Non-Legal Measures
- Personal contact with the borrowers at periodical intervals
- Proper selection of the borrower and financing only in viable schemes
- Reminder system
- Preparation of ‘Know Your Client’ (KYC) profile
- Follow up of potential NPA
- Credit Appraisal and Risk Management Mechanism
- Rehabilitation of Potentially Viable Units
- Recovery through Compromise Proposal
- Recovery camp/Settlement camp
- Staff Training
- Staff Incentives for Recovery
- Special Incentives for Prompt Repayers
- Better management information system and credit investigation set up
- Seasonal/Area based recovery drive
- Preparation of village-wise/Area-wise list
- Circulation of list of defaulters
- Writing off the outstanding

Financial sector reforms require not only setting rules, articulating standards, approving legislation and creating new institutions, but also a change in behaviour of financial institutions.\(^2\) Thus NPA management requires a change in behaviour of bankers towards loan portfolio in addition to the vast number of proactive and reactive measures to manage NPA.

### 4.14 Ratio Analysis and the NPA Management

At the bank level to assess the financial strength, quality of loan assets and defectiveness of NPA management, it is necessary to analyze various parameters with respect to NPA. Ratios serve as important financial analysis. Ratios are the small numerical expressions facilitating examination the relationship between two variables. The important following ratios can be used to measure the effectiveness of NPA management: \(^3\)

1. Gross NPA Ratio
2. Net NPA Ratio
3. Substandard Assets Ratio
4. Doubtful Assets Ratio
5. Loss Assets Ratio
6. Profitability (i.e. Return on Assets) Ratio
7. Liquidity Ratio
8. Involvement of Management (IM) Ratio
9. Credit Loss (CL) Ratio

#### 4.14.1 Gross NPA Ratio

\[
\text{Gross NPA Ratio} = \frac{\text{Gross NPA}}{\text{Gross Advances}} \times 100
\]

Gross NPA indicates the quality of credit portfolio of the bank. High Gross NPA Ratio indicates the low quality credit portfolio. The Committee on Banking Sector Reforms (GEO:
1998, p. 24) suggested that for those banks with an international presence the minimum objective should be to reduce the Gross NPA Ratio below 5% and 3% in the year 2000 and 2002 respectively. The Gross NPA Ratio is the better indicator than the Net NPA Ratio of the quality of the loan portfolio.

4.14.2 Net NPA Ratio

\[
\text{Net NPA Ratio} = \frac{\text{Net NPA}}{\text{Net Advances}} \times 100
\]

\[
= \frac{(\text{Gross NPA} - \text{Provision against NPA})}{(\text{Gross Advances} - \text{Provisions})} \times 100
\]

Net NPA indicates the risk of loan of the bank. High Net NPA Ratio indicates the existence of highly risky loans in the bank for which no adequate provision has been made. As per the international standard, the Net NPA Ratio should be below 2.5%.

4.14.3 Sub-Standard Assets Ratio

\[
\text{Sub-standard Assets Ratio} = \frac{\text{Total Sub-standard Assets}}{\text{Gross NPAs}} \times 100
\]

High Sub-standard Assets Ratio indicates that there is a high level of degradation in performing assets. However, there is no prescribed ratio at the international level.

4.14.4 Doubtful Assets Ratio

\[
\text{Doubtful Assets Ratio} = \frac{\text{Total Doubtful Assets}}{\text{Gross NPAs}} \times 100
\]

High Doubtful Assets Ratio indicates that the management of Non-Performing Loans or Assets in the bank is poor. However, there is no prescribed ratio at the international level.

4.14.5 Loss Assets Ratio

\[
\text{Loss Assets Ratio} = \frac{\text{Total Loss Assets}}{\text{Gross NPAs}} \times 100
\]
It is expected that this Loss Assets Ratio should be lower much lower. If, Loss Assets Ratio increases, it indicates that there is incidence of high erosion of securities of the loan assets. However, there is no prescribed ratio at the international level.

4.14.6 Profitability (i.e. Return on Assets) Ratio

Return on Assets (ROA) Ratio = \( \frac{\text{Net Profit or Loss}}{\text{Total Assets}} \)

It is obvious high ROA Ratio indicates the performance of bank is superior. However, there is no prescribed ratio at national as well as international level.

4.14.7 Liquidity Ratio

Liquidity Ratio = \( \frac{\text{Total Assets}}{\text{Total Loans}} \)

It is anticipated that this Liquidity Ratio should be higher as much as possible. If, Liquidity Ratio decreases, it indicates that there is incidence of erosion of liquidity position of the bank. However, there is no prescribed ratio at national as well as international level.

4.14.8 Involvement of Management (IM) Ratio

Involvement of Management (IM) Ratio = \( \frac{\text{Operating Expenses}}{\text{Total Revenue}} \)

It is estimated that this IM Ratio should be lower as much as possible. If, IM Ratio increases, it indicates that the performance of bank is poor. However, there is no prescribed ratio at national as well as international level.

4.14.9 Credit Loss (CL) Ratio

Credit Loss (CL) Ratio = \( \frac{\text{Non-Performing Loans}}{\text{Total Loans}} \)

It is anticipated that this CL Ratio should be lower as much as possible. If, CL Ratio increases, it indicates that there is incidence of high erosion of securities of the loan assets. However, there is no prescribed ratio at the national as well as international level.
References


5. ibid, p. 84.


7. ibid, p. 55.


16. ibid, p. 24.