



NPA AS A CHALLENGE TO SCHEDULED COMMERCIAL BANKS IN THE POST-COVID PERIOD

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ABSTRACT

The speed of economic development of any country largely depends on a flow and distribution of financial resources from excess units to deficit units. The fitness of the financial sector has become a matter of policy concern especially in the developing countries like India. Scheduled Commercial Banks are major elements in the financial service sector. However, NPA poses a serious danger to the efficiency of the banking sector in the smooth functioning for development purposes. Rapid increase in NPA during the last few years and unexpected COVID-19 Pandemic along with consequential nationwide lockdowns have added in the collapse of many banking institutions across the country. The present paper is a sincere attempt to deal with the issues concerned with the term NPA in detail. It focuses on the theoretical as well as statistical analysis of NPA extensively. It also extends to deal with some of the reasons behind increasing NPAs of Scheduled Commercial Banks during the COVID-19 Pandemic and the remedies to be taken up for reducing the NPAs in order to make the banks function smoothly in the post- pandemic period.

Key Words: Financial sector, COVID pandemic, non-performing asset, efficiency of banking, zero-yielding assets, remedies.

INTRODUCTION

The primary source of income of any bank is the interest on loan given to the customers of the bank. The smooth functioning and activities of the bank are dependent on the profitability

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or the income. But the outbreak of the pandemic early in the 2020 changed the whole scenario and activities during most part of the year. At the very beginning of the FY 2020 the whole country was caught in the grip of COVID-19 Pandemic that resulted in nationwide lockdowns for many months. The first phase of nationwide lockdown started from 24th March 2020. It lasted till the end of the month of May 2020 in the form of subsequent phases of lockdown. Later on the process of unlock took place in different phases in the selected parts of the country. However, the strict restrictions were implemented on the highly affected areas. That process also continued more or less till the ending of the month of December 2020. Even so, at present i.e. at the last quarter of the FY 2020 many banks have been facing the problem of non-performing assets. If bank is not able to recover interest amount and principal amount then it creates non-performing assets. The restraint in the gross non-performing assets (GNPAs), which started after the climax in March 2018, continued through 2019-20 and in 2020-21 so far, to reach 7.5 per cent by the end of September last year.

Enhancing the performance of assets is the most important part of overall asset management. If the assets are not managed in an appropriate manner, they turned to non-performing state. If the quantity of such non-performing assets increases, it can cause serious problem for the bank. In the present scenario most of the banks are suffering from the problem of non-performing assets. It has become a thing of severe concern for the bankers, authorities regulating the working of the banks and to the policy makers at the national level.

OBJECTIVES OF THE STUDY:

The following are some of the objectives of the study.

- 1) To analyse critically the reasons behind high percentages of NPAs in Indian banking sector
- 2) To shed light on the effects of NPAs on efficiency of the banks and ultimately on Indian society in the Post-COVID period
- 3) To suggest some of the remedies to overcome the burden of high NPAs on banking sector in the Post-COVID period

RESEARCH METHODOLOGY:

The present study is based on the secondary data and information collected from variety of sources like the books, published articles, financial reports, websites etc. A sincere attempt has been made to interpret and analyze the current status of NPAs at the backdrop of the COVID-19 pandemic in India using the critical analytical method. This paper, however, is much more theoretical and limits itself to concern the statistical data of NPAs of the Public, Private and Foreign banks during the limited period of 3rd quarter of financial year 2020 after the COVID -19 Pandemic.

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Origin of the term NPA (Non Performing Assets)

The term NPA was in existence in olden days also without having a proper title for it. A non-performing asset in the banking sector was termed as an asset not contributing to the income of the bank. In other words it is a “zero-yielding asset”. The zero-yielding assets include surplus cash and banker’s balance held over the norms, amount lying in suspense account, investments in shares or debentures of companies not yielding any dividend or interest, advances where interest is not realized and even the principal amount is difficult to recover.

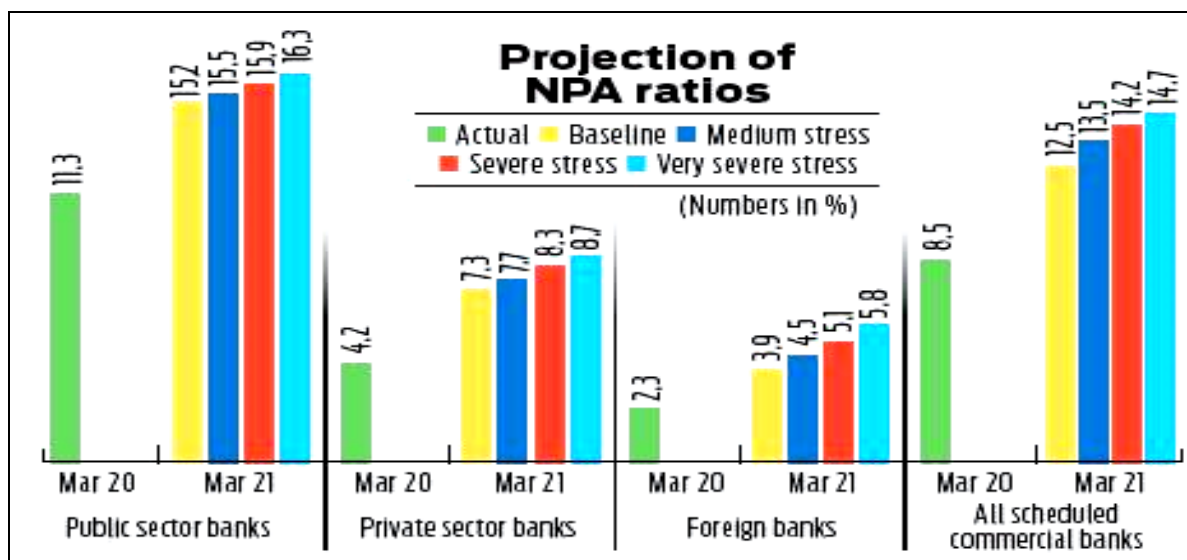
Definition of NPA

The Narasimham Committee on Banking Sector Reforms (1998) concentrated on this zero-yielding assets. The committee formulated various norms for the zero-yielding assets and the new term “Non-Performing Assets” was coined by the committee. According to Narasimhan Committee NPA is “...an advance where a date of Balance sheet on Amount paid to the bank (Interest or Installment of the principal) is a part due for a period more than 90 days”.

A.N. Agarwal in the book entitled *Indian Economy: Problems of Development and Planning* opines in this regard that in order to deal with NPA problem, The Narasimham Committee, 1991 made it mandatory on the part of the banks to publish annually the magnitude of NPAs. According to The Narasimham Committee, 1991 NPAs are those categories of assets (advances, bills discounted, overdraft, cash credits etc.) for which any amount remains due for a period of 180 days (1997: 504-507).

RBI on NPAs in the Post-COVID Period

The highlights of the 21st Issue of The Financial Stability Report released by RBI on 24th July 2020 reflect that Gross NPAs of all banks may reach to 12.5 per cent by March 2021 under the baseline scenario from 8.5 per cent in March 2020 (RBI Press Release: July, 2020).



(Source: <https://www.newindianexpress.com>)

The graph shows that the public sector banks are likely to be the worst hit, which could see the rise of their gross NPAs from 11.3% in March 2020 to 15.2% by March 2021 in the “baseline scenario”. It is expected to reach 15.5 % in the “medium stressed scenario”. It could rise up to 15.9 % under the “severe stress situation” and under the “very severe situation” reach to 16.3 % by the March 2021. The report also warned that because of the declining macroeconomic factors, even private banks and foreign banks would see a great rise in the gross NPAs. The gross NPA of the private sector banks was 4.2 % in March 2000. It is also projected that under the “baseline”, “medium stress”, “severe stress” and “very severe stress” situations it could reach up to 7.3 %, 7.7%, 8.3 % and 8.7 % respectively by March 2021. The NPA of the foreign banks could also see gross NPA rise from 2.3 % a year earlier in the baseline scenario to 3.9 %, 4.5%, 5.1%, and 5.8 % under the “baseline”, “medium stress”, “severe stress” and “very severe stress” situations respectively by March 2021. Thus, after stress-testing of 53 scheduled commercial banks the report said that the gross NPA ratio which was 8.5% in March 2020 can increase up to 12.5% under the “baseline scenario”. It could go high to 13.5 % in “medium stress” situation. Further, it is projected that the gross NPA may rise up to 14.2 % in “severe stressed” scenario. The gross non-performing assets of the banking sector could go up to 14.7% of total loans by March 2021.

As explained by Nilanjan Das (2020) the Corona virus pandemic has had a shocking impact on banks and financial institutions around the world. The condition is rather serious for Indian banks that are already struggling to survive in rising bad loans. For banks in India, dealing with the expanding non-performing assets will be the major challenge in 2021 as loan defaults have to spike harshly in Covid-pandemic in 2020. Many small, medium and large-scale industries are still struggling to refund dues payable toward banks.

Surabhi (2021) has studied the Trends for the 3rd Quarter in the Financial Year 2020 which shows proforma NPAs are higher in all the selected Scheduled Commercial Banks in India.

The growth in gross NPAs in the 3rd Quarter of the FY 2020 (in %)

Bank	Gross NPA	Proforma gross NPA	Bank	Gross NPA	Proforma gross NPA
SBI	4.77	5.44	Bank of Baroda	8.48	9.63
HDFC Bank	0.81	1.38	Bajaj Finance	0.55	2.86
ICICI Bank	4.72	5.42	Union Bank	13.49	15.28
Axis Bank	3.44	4.55	DCB Bank	1.96	3.70
YES Bank	15.36	20.00	IDBI Bank	23.52	24.33
RBL Bank	1.84	4.57	Ujjivan Bank	1.00	4.80
IndusInd Bank	1.74	2.97	Canara Bank	7.46	8.95
Federal Bank	2.71	3.38	Bandhan Bank	1.10	7.12

(Source: <https://www.thehindubusinessline.com>)

The table shows the increase in the NPAs of all the public sector banks in India in the third quarter of the FY 2020 i.e. during the months of October 2020 to December 2020. This is the unlock period in India when many small, middle and large scale industries were still struggling to be back on track after the historic decline and the economic stress caused of COVID-19 Pandemic. The RBI Press Release Issue released on 7th January 2021 also states that the GNPA ratio of all Scheduled Commercial Banks may increase from 7.5 per cent in September 2020 to 13.5 per cent by September 2021 under the baseline scenario.

Reasons behind high NPAs

COVID-19 pandemic has created a havoc and challenge for Indian economy at large. The banks have collapsed to the greater extent due to the high NPAs in the pre-pandemic period which became even more deteriorate in the post-pandemic period. Following are some of the reasons for increase in the NPAs in the post-pandemic period in India.

1) Downturn in market: Because of the effect of economic cycles, the profits of the firm decreased. The horrible pandemic situation all over the world hit badly all the sectors in India as well for a long period of time. The lockdown also affected the small scale industries. Majority of venders and retailers had to suffer a lot of sudden discontinuity in the monetary transactions. Industries like aviation, entertainment and restaurants also have been severely



impacted by COVID-19 pandemic. Though the vaccine for COVID-19 is available and being given as per the priority, no one has a clue of its authenticity and effectiveness. On the top of all these things, the risk of spread of the second wave of COVID has become the thing of worry for Indians.

2) Sudden imposition of lockdown: This is one of the major reasons behind increase in the NPA. The lockdown was imposed with a very short time notice and that allowed a very less time for borrowers to manage their debts. The uncertain condition and ever longing phases of lockdowns could result in no production of the domestic as well as industrial raw materials. When the recession became very harsh, it resulted into the ruin of the firms, which resulted into bankruptcy and ultimately the NPA. In addition to this, a large number of individuals are also struggling to pay back their loans after losing means of income or employment due to the historic monetary crisis caused by the COVID-19 pandemic and the resultant lockdowns.

3) Incapacity and unwillingness of the borrower to pay: The borrowers who took loan from the bank in a large amount were unable to repay the same due to the sudden closures, and insufficient availability of cash. High profile fraudsters take loan from the bank and do not pay it back. In the pre pandemic period Indian banks have faced a lot of problems of NPAs because of such fraudsters. It further led to decrease in the selling of the already produced goods. Sometimes borrowers are reluctant to repay the amount. Such amount is not recognized back by the bank and as a result the NPA is created. Sometimes willful avoidances, deceptions and misuses of accounts by the debtors also results in NPA.

4) Lack of good management, digression of funds and Failure of the activity Because of the lack of good management of the fund or because of digression of the investment, the fund is invested in low interest securities or the securities that don't pay any interest. Such kind of investment creates the NPA.

When the borrower has taken the loan for any specific business activity and that very activity fails, the borrower is incapable to repay the loan. This creates NPA in the bank. During the pandemic period many newly opened businesses and the firms had to shut down. The activities for the loan was taken were totally failed and resulted in the rise of NPAs.

5) Unsuitable selection of borrowers/ activities: Sometimes the banker makes the mistake in the selection of borrower or the business activity. When the loan is sanctioned to less creditworthy borrower, the amount given as a loan cannot be paid back to the bank and thus increases the NPA. While sanctioning the loan, the bank must consider the economic size of the unit to which the loan is being allowed. If the amount sanctioned is insufficient for the commercial activities, the business will face the financial crisis and it will not endure for

longer. It will result into NPAs for the bank. It will not be able to generate enough income to repay the amount of loan and finally it will result into NPAs.

6) Selection of borrower under pressure: RBI has issued guidelines for sanctioning the loans from the banks. Banks have to compulsorily follow these guidelines but sometimes the banks have to act under the pressure from variety of factors such as political, social and pressure from relatives or closed ones. The banks sanction the loans to the borrowers who are not creditworthy. The amounts of such loans are not recovered and therefore the NPA is created. Generally this happens more in co-operative banks.

7) Non-fulfillment of terms and conditions: The banks must follow the terms and conditions provided by the RBI for sanctioning the loan. In some cases, the banks do not fulfill the terms and conditions and they sanction the loan. In such cases, there are chances of NPAs. Sometimes proper follow-up is not taken by the bank. In such situation the bank does not get the repayments regularly and sometimes such loan is converted into NPA.

Remedies for reducing the NPAs

The non-performing asset is a big hurdle for the banking sector in India in the current scenario where all the sectors in India have been facing a big crisis due to the COVID-19 Pandemic. The following are some of the remedies which if applied effectively will be helpful for reducing NPAs with instant effect.

1) Establishment of a recovery cell: The efforts made by the banks to recover the amount of loan are not enough. In such situation the quantities of NPAs are constantly increasing. The bank should create a special recovery cell to recover the amount of loan. This recovery cell should be accountable to recover the outstanding loans. The recovery cell is authorized to take necessary actions to recover the loans. The Union budget presented on the 1st February, 2021 plans the formation of an Asset Reconstruction Company for the management of NPA. It has also been announced that the government will establish a Bad Bank-Like structure to solve out the issues related with NPAs. This will help to manage non performing loans in a better way by taking over the bad loans on public sector bank balance sheets and managing recoveries.

2) Proper selection of borrower/ activity: When the borrower/activity is wrongly selected, it definitely results into NPAs. To decrease this danger, the banks should take enough care in selection of the borrower/activity. For this the banks are expected to perform a detailed inquiry about the creditworthiness of the borrower. The bank must collect the utmost information. After making detailed analysis of this information, the bank should take the decision whether to sanction the loan or not.

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3) Regular post-sanction follow up: Generally it happens that after sanctioning the loan, banks do not take any follow up of the borrower. This makes the borrower careless in the repayment of loans and it results into nonpayment. To eradicate this danger, the bank must have regular follow up of the borrower after sanctioning the loan. Regularly taken Follow up will keep the borrower alert and the chances of default will be reduced.

4) Setting up of credit investigation and information agency: The banks should found an agency which is assigned the duty to examine about the creditworthiness of the borrowers. The information achieved by such agency should be easily available by all the bankers. This will be helpful in the selection of right borrowers. Before permitting the loan, such agency should be contacted to get the information about the creditworthiness of the borrowers. This will not lead to the chances of wrong selection of borrower.

5) Publishing the names of non payers in local, state as well as national newspapers: This can be an effective step for recovering the outstanding loans from the non payers. The banks should publish the names of such defaulters in the local, state and national level newspapers with outstanding sums. This will affect the self-esteem of such defaulter and there are chances that they may repay the amount of loan. This will be a supportive remedy for other banks also.

In addition to the above remedies, many policies have been announced in the budget 2021. However, the policy makers have to implement those ideas into practice as soon as possible to minimize the impact of shock on the banking sector in India. The borrowers should be provided with economical assistance for the further short period of time during the critical situations like pandemic so the debtor shall not seek loan from other banks and further increase the NPA of the other bank. There should have no at all or very less human participation in the process of document verification as human participation has more scope for objective and biased attitude towards the borrowers and many times loans are sanctioned to unsuitable or unreliable borrowers.

CONCLUSION

To conclude, recently we have observed the decline of the banking sector because of the increasing ratio of non-performing assets of the banks. NPA has resulted in not only problem for the banks but for the economy as a whole in the COVID-19 Pandemic. Although various steps have been taken by government to reduce the NPAs, still there seems the need of implementation of feasible remedies to be adopted to control this problem. The government should also make more provisions for faster clearance of pending cases. RBI norms must be followed at the time of sanctioning the loan. Political pressure and interruption should be

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avoided in the process of loan sanctioning. So the problem of NPA needs lots of serious efforts or else NPAs will keep killing the productivity, profitability and effectiveness of the banks for the well-being of growing Indian economy and the Indian society at large.

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