

Rising NPAs and Start Up India Initiative : A Possible Venture

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Abstract.

The Indian banking sector has been facing serious problems of raising Non-Performing Assets (NPAs). The NPAs has a direct bearing on the growth and profitability of banks. The NPAs are one of the major concerns for scheduled commercial banks in India. Based on the recommendations of Narasimham committee and Verma committee, some steps have been taken to manage the NPA problem in the balance sheets of the banks. As such there was no unanimity in terms of the policies followed by various banking institutions in resolving this problem. The figure of NPAs reflect the performance of banks. The banks unable to manage its high level of NPAs is reflective of large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The NPAs not only affect the liquidity and profitability but also pose threat on quality of asset and survival of banks. The NPAs not only affects the profitability of the banks but also affects the economy of the country. High level of NPAs as reflective in Indian banks is also a reflection of the state of health of the industry and trade. It is very much pertinent to reduce the NPAs in order to improve the financial health in the banking system. There may be various reasons for generation of these NPAs which may be due to improper assesment or fraud. This paper proposes a solution which in turn is also an start up India initiative to minimise the reasons for creation of these NPAs.

Keyword : Non Performing Assets, startup India initiative.

Introduction

1.The Indian banking system comprises of commercial as well as cooperative banks, of which the former accounts for more than 90 per cent of banking system's assets. Other than foreign banks, Indian private banks, the commercial banks also comprise of certain nationalized banks. These banks, along with regional rural banks, constitute the public sector (state owned) banking system in India The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management.

2.The measure of asset quality was not prime concern in Indian banking sector till 1991, as it was mainly focused on performance objectives such as opening wide networks/branches, development of rural areas, priority sector lending, higher employment generation, etc. In order to earn profit, the primary function of banks is to lend funds as loans to various sectors such as

agriculture, industry, personal loans, housing loans etc., but due to NPAs the profitability of the banks and get affected severely and in most of the cases of NPA is either due to improper assessment by the banking authorities or the fraud which is not anticipated or understood by the banking agencies. These problems being faced on day to day basis by various banks in recent times and this has caused banks becoming very cautious in extending loans, which is causing effect on the growth of economy. Bankers are the custodians and distributors of the liquid capital of the country. Therefore most important function of the banking system is to mobilize the savings of the people by accepting deposits from the public. The banker becomes the trustee of the surplus balances of the public. Deposit mobilization promotes the economic prosperity by controlling the money circulation and canalizing for development and productive purposes. In order to mobilize deposits, the commercial banks undertake deposit mobilization through various deposit schemes suited to the different sections of the people. The deposits along with other sources

of funds namely capital, reserves and borrowings, form the sources of funds for the banks. The lending and investment activities of the bank are based on the sources of funds. If there is an agency which can act as a catalyst to carry out analysis of the agency seeking loan and once it is confirmed to the bank or financial institution regarding credibility, the loan can be disbursed which can drastically reduce the NPAs and thus the profitability of the banks.

3. Reasons for the Rise in NPA in Recent Years.

(a) GDP slowdown - As during economic boom during 2000's to 2008 banks especially Public sector banks lent extensively to corporate. However, subsequently due to economic slowdown the profits of most of the corporate dwindled which is affected due to various other factors as well like ban in mining projects, and delay in environmental related permits affecting power, iron and steel sector etc.

(b) Relaxed lending norms especially for corporate honchos when their financial status and credit rating is not analyzed properly. Also, to face competition banks are hugely selling unsecured loans which attributes to the level of NPAs.

(c) 5 sectors Textile, aviation, mining, Infrastructure contributes to most of the NPA, since most of the loan given in these sector are by PSB, They account for most of the NPA.

(d) Public Sector banks provide around 80% of the credit to industries and it is this part of the credit distribution that forms a great chunk of NPA

(e) NPAs in the corporate sector are far higher than those in the priority or agriculture sector.

(f) The Lack of Bankruptcy code in India and sluggish legal system make it difficult for banks to recover these loans from both corporate and non-corporate.

(g) Banks did not conducted adequate contingency planning, especially for mitigating project risk.

(h) Restructuring of loan facility was extended to companies that were facing larger problems of over-leverage & inadequate profitability.

(i) Companies with dwindling debt repayment capacity were raising more & more debt from the system.

NPA Problem Areas in Public Banks and Financial Institutions.

4. It is also a well known fact that Public sector banks in India have been sitting over huge amounts of non-performing assets which they are forced to disclose and provide for at the behest of Reserve Bank of India resulting in huge losses quarter over quarter. It is beyond the scope of this paper to go in detail over the losses reported by various banks but it will suffice to say that the PSU Bank Nifty index has gone down by 50% in the last year itself. However, disclosing and providing for huge losses is not a cure for the ills of the banking sector. It is merely owning up to the fact that a cancer exists in the system which was hidden till now. By making the banks set off the losses it is letting the defaulters as well the officers making error in judgments in giving out such loans off the hook with no hope of recovery of the lost amounts.

5. If one is to find out a cure for this, a short view can be taken on why such huge amounts of loans are turned into non-performing assets:-

(a) **Unprofitable Sectors.** A very big chunk of such loans has been provided to sectors which have huge capital expenditure and long gestation periods such as airlines, metal and sugar industries. Any adverse economic factor adds to the woes of these industries making them defaulters in the medium term. Kingfisher airlines and Electro Steel Steels are examples of such companies which have been unable to pay off thousands of crores of loans.

(b) **Internal Factors.** Banks while providing loans take various types of guarantees to secure their loans. However while on paper all the conditions

are met, ground realities of the values of the assets put on guarantee very much differs from the value shown. A study of the advertisements put out by various banks regarding possession and sale of assets of defaulters is enough to show that the assets are hugely overvalued and in no way can cover the outstanding amount. In some cases, outstanding amount has been allowed to go way beyond the value shown of the assets so that even if they get real value for the assets it is not enough to cover the losses.

(c) **Collusion and Fraud.** There is a third category of wilful defaulters who make it a practice to take loans and then disappear never to be found again. All this happens with the collusion of various parties to the granting of the loan.

6. Above mentioned factors are just indicative of the factors behind loans becoming unproductive. While there are mechanisms existing in the banking system to prevent and detect non-performing assets, it is not enough to keep the banks in good health. There is need for an external resource to help out banks in this process so that wilful default is reduced in the long run.

Start up India Initiative.

7. Keeping in view of the start up India campaign, a private agency can be set up to keep tab on loans at multiple levels as follows:-

(a) **At Application Stage.** For a small fee per application or a lump sum amount per branch some physical checking can be done of the persons/companies asking for the loans. This amount can be paid from the processing fees as well as by creating funds specially earmarked for this to prevent loans being defaulted. There can also be a downsizing of staff given the task of inspecting loan applications because they have been unsuccessful so far to a large extent.

(b) **At Disbursement Stage.** Again for a small fee per case or a lump sum amount for each branch there can be a physical inspection as to the actual progress of the project for which loan was granted

especially where it is disbursed in instalments. This amount can be charged from customers itself for each visit.

(c) **Health of Large Accounts.** For a chosen few accounts involving moderate to heavy amounts the agency will keep a tab on the working and cash flow of the projects and report periodically to the management. For this also a case to case basis or lumpsum monthly fees can be earmarked.

(d) **Unearthing Defaulters and Assets.** Banks have to depend on the police to recover assets and arrest wilful defaulters. While the normal field police network is ill equipped to understand and investigate such economic offences, it is also unable to go beyond its territory to apprehend absconding defaulters. State or national level agencies rarely have the manpower to go after small and medium level defaulters. For this, the agency can enlist retired police officers well versed in economic offences to locate the defaulters as well as their own assets and those hypothecated to the bank. In this process a percentage of the outstanding amount can be fixed as remuneration for the agency.

8. While above mentioned measures are just indicative, the scope of actions and tasks can be enhanced with time and experience. There can be an argument against involving a private agency on account of utility and trustworthiness but that is where the implication of a start up is defined. It is only with execution and results that the efficacy and performance of such an agency can be judged over a period of time. As for trustworthiness, it can be noted that various private agencies are involved in sensitive matters like checking of OMR sheets of various examinations held by governments. The execution of Adhaar is being done by a private company successfully, so there is no harm in giving this a try for the betterment of the entire banking industry.

9. Summary.

The increasing NPAs in the Indian banking system is a cause of worry as it not only affect the liquidity and profitability but also pose threat on quality of asset and survival of banks and overall economy. It reflects the economy of the country poorly and thus affect the international trade as well as the confidence of the foreign investors which ultimately has a negative impact on the economy. It is very much pertinent to reduce the NPAs in order to improve the financial health in the banking system. One of the proposed idea which could an effective start up India initiative for providing the services to the banking and financial sector so as to reduce the bad loans by verifying and validating the credibility of the applicant and assisting the financial institution's taking informed decisions.

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