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Review Article

A STUDY ON DETERMINANTS INFLUENCING SURGE IN NPAS: SPECIAL REFERENCE TO IDBI BANK

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Abstract
A secure and strong banking sector is essential for a constant growth of economy. The major hurdle faced by a majority of Scheduled Commercial Banks in India at present is a surge in Non-performing Assets (NPAs). The surge in NPAs is threatening the profitability of banks and the economy as a whole. Low profitability of a bank has a spiraling effect viz., lower Credit Rating of the Bank results in reduced Earnings Per Share (EPS), low or no dividends impacting International Business transactions, bank borrowings and discouraging investors. Hence it is the need of the hour and absolute necessity to contain / tackle NPAs for better economic conditions and future of the nation. The objective of this paper is to analyze the causes for increase of NPAs. Data were collected among 371 employees of IDBI Bank and factors influencing surge in NPAs are ranked with the aid of Garrett Ranking method. Thus, in order to maximize profitability, banks have to ensure that NPAs are reduced and contained effectively.

Keywords: Bank, NPAs, Profitability.

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INTRODUCTION

Banking sector is the lifeline of the economy. The core activity of banking is to mobilize deposits from the public and lend money to different sectors. A secure and strong Banking Sector is a prerequisite for consistent growth of any economy. This is more particularly true in respect of developing economies like India's, as the process of growth generally involves more intense challenges than those of Developed Economies.

Lending is a core activity of the banking business and is exposed to risks. In simple terms, credit risk arises due to non-payment or delayed payment of loan installments (EMI's). Timely recovery of loans and advances by banks play a vital role in ensuring sufficient liquidity, income generation, profitability and result in further lending. Hence banks should ensure that:

a) Strong and stringent Credit Appraisal systems are in place,
b) Loans are given to borrowers who have the ability to repay regularly without default,
c) Ensure 100% compliance of pre and post disbursement terms and conditions,
d) Regularly monitor accounts exhibiting early warning signals and initiate measures to rectify non-conformance / compliance to terms & conditions etc. to contain NPAs.

NPAs increases risk-weighted assets of the bank and has a spiraling effect viz., increased provisioning, additional capital to be maintained as per regulatory norms, which involves extra cost to the Bank. Banks' funds are blocked in NPAs and cannot be used for further lending. These result in reduction in the volume of business and earnings and also create liquidity problems for the banks and hence banks are reluctant in granting fresh loans / advances, which slows down economic growth.

Hence it is the need of the hour and absolute necessity to contain / reduce NPAs for better economy and future of the nation.

Need for the Study

Banking sector in India comprises Public and Private Sector Banks, Co-Operative Banks and Foreign Banks. The market stake of Public Sector Banks is around 72% and continues to dominate the Banking industry. Public Sector Banks play a crucial role by influencing GDP. In spite of the above, NPAs are the major cause of concern impacting Banking fraternity and the economy as a whole. The objective of this paper is to analyze the grounds for increase in NPAs and is ranked with the aid of Garrett Ranking method. Thus, in order to maximize profitability, banks have to ensure that NPAs are reduced and contained effectively. A sound and stable Banking System in turn is the foundation thereof.

REVIEW OF LITERATURE

Bloem & Gorter (2001) has opined in his study that NPAs, to a certain extent, are caused by wrong economic decisions at macro level, inadequate provisioning, under-insurance etc. Under such conditions, banks may either increase the spread by lending at higher rate or cover the risk by insurance.

Koeva (2003) has focused on analyzing the effects of liberalization, globalization etc. on cost and profitability, and ultimately adversely affecting the performance of Indian banks. He has analyzed the same through empirical data and has shown that ownership of the bank has a major effect during financial liberalization and globalization and has been linked with lower costs and profitability of the Indian banks.

Ghosh (2003) has categorized NPAs in terms of various factors viz., asset size, credit growth, macroeconomic conditions and operating efficiency. He has also pointed out that Public Sector Banks had shown improvement in profitability and asset quality in the year 1990, but at a higher operating cost, lower rate of return etc., which shows weak asset quality resulting in higher provisions.

Kumar (2004) in his article has analyzed that as per recommendation of Narasimam Commmitee and post liberalization of Banking Sector, Private Sector Banks have played a key role in the development of the economy. The banking sector was conquered by Public Sector Banks in pre – reform era. With the advent of new technology and professional management, there was a paradigm shift in banking space due to foray of Private Sector Banks.

Vradi & Nagarjuna (2006) in his study has established that the economy would remain stable based on performance of Banking Sector which depends on various factors viz., productivity, profitability, asset quality etc. He also established that the performance of Public sector banks is far more efficient than that of other banks.

Singh (2006) has used ratio analysis and evaluated the same with a benchmark to measure the performance of banks and advised measures for improving the banking industry. The analysis of the NPA insisted that the ideal benchmark is less than 1 percent.

Banks are in the business of lending to various large sectors viz., Agriculture, Health Care, MSME, Infrastructure Financing etc. Banks play a pivotal role in developing economies, and help in the growth and development of economically weaker sections of the society by lending to Sectors like Agriculture, Rural Housing etc. However, granting of loans and advances without due diligence, and proper Credit Appraisal etc. results in surge in NPAs.

The past decade has witnessed the aftermath of surge in NPAs across the globe. High Level of NPAs had adversely affected the economic growth to a great extent. The same has resulted in banks resorting to stringent lending and recovery norms.

The profitability of Banks has eroded to a great extent and hence resolution of NPAs is a significant game changer for banks and the economy as a whole. The present study attempts to find out the reasons for increase in NPAs and to rank the reasons to have effective control by banks.

Objectives of the Study

1. To identify the factors / causes for increase of NPAs
2. To rank the factors influencing surge in NPAs to have effective control by the banks.

Data Source and Research Methodology

The present Study is carried out using both primary and secondary data. The primary data are collected through a convenient sample of 371 employees in IDBI Bank, using a self-administered questionnaire, observation, discussion etc. The secondary data were extracted from journals, newspapers and websites.

Research Design

The research was carried out in Southern Region consisting of Tamil Nadu, Karnataka, Kerala, Telangana and Andhra Pradesh. Data were collected with the help of self-administered questionnaire using a convenient sampling technique and the data have been arranged in a tabular form to ascertain the reason for surge in NPAs, and the data are analyzed using Garrett Ranking Technique.

Major factors influencing surge in Non-performing Assets (NPA) of Banks

The banking sector is witnessing grave problems on account of surging NPAs. The level of NPAs is comparatively low in Private Sector Banks and Foreign Banks vis-à-vis Public Sector banks.

1. Improper Credit Appraisal: Banks are in the business of lending. Banks should ensure that a strong and stringent Credit Appraisal systems are in place to ensure that loans and advances are given to borrowers who have the ability to repay regularly without default.
2. Defective Lending process: Banks have to take calculated risks and follow principles and policy guidelines. The three fundamental principles of lending followed by banks include Principles of Safety Principle of Liquidity and Principle of Profitability.
   a. Principles of Safety – Principle of Safety ensures Capacity and Willingness of the Borrower to payback the amount lent, principal amount along with Interest, well within stipulated period of time without delay / default.
   b. Principle of Liquidity – Principle of Liquidity plays a vital role in lending as banks lend public money which is repayable on demand by depositors or amount lent is repaid along with principal and interest well within the stipulated period of time.
   c. Principle of Profitability – The basic business of Banking is to accept deposits from the public and lend the same to earn profits in order to meet Operational expenses and Capital expenditures. Thus, a bank should extend the advance in a manner that it is profitable for the bank and also at competitive lending rate.
3. Improper SWOT Analysis: Banks should examine the feasibility, profitability, viability and long term capability while financing. They should scrutinize financial statements to understand the financial position of the borrower, take Credit Opinion of the borrowers from other bankers, market, external credit rating agency etc. Inappropriate SWOT analysis will lead to increase in NPA levels.
4. Non–conducting of Unit Visits: Banks should carry out pre-disbursement and post-disbursement Unit visits to ensure that Units are functioning and end use of funds are as per Terms & Conditions stipulated in Loan sanction letter. Regular visits by bank officials ensure correction of irregularities observed during visits and ultimately results in reduction of NPAs.
5. Security with unclear Title: Banks should always be cautious while selecting security. They should ensure that Collateral Security has good acceptability, safety, transferability, marketability etc. for quicker resolution of NPAs in case of default.
6. Lack of Demand: Production Units are unable to predict the demand for goods, which ultimately leads to a huge pile up of goods remaining unsold in the market. The same results in delay in realization of Sales proceeds and failure to repay the loans advanced.
7. Industrial Sickness / Job Loss: Inappropriate implementation and execution of Project, ineffective management, inadequate resources, frequent change in Govt. Policies lead to Industrial Sickness resulting in financial loss / accumulated losses over a period of time. Therefore, such units financed by Banks are unable to repay the loans ultimately leading to NPAs.
8. Natural Calamities: Natural calamities viz., floods, drought etc. also influence the increase in NPAs, making it difficult for the borrowers, farming community in particular, to repay the loans.
9. Change in Govt. policies: Frequent change in Govt. Policies viz., withdrawal of Interest Subvention, input subsidies, duty drawbacks, change in taxation, introduction of new taxes etc. result in reduced cash flow, and borrowers find it difficult to generate cash flows resulting in NPAs.
10. Ineffective MIS and Technology: Due to outdated technology, ineffective Management Information System, financial accounting systems etc., it becomes difficult to take quick and immediate decisions on real time basis for resolution of NPAs.
11. Ineffective Recovery Measures: Govt. of India has set up various acts / tribunals viz., Lok Adalat, DRT, SARFASEI, Bankruptcy code / NCLT etc., for quicker resolution of NPAs. However due to systemic delays and complexities involved in the process there is inordinate delay in quick resolution of NPAs.
12. Willful Defaults: As per RBI, willful default broadly covers: Non-payment of dues despite good net worth and adequate

cash flows, siphoning of funds, misutilisation of funds for purposes other than sanctioned for, forgery of documents, fraudulent transactions etc.

The principles of lending hover mostly around the concepts of safety, profitability and liquidity of advance. The criteria for lending are altered from time to time with economic changes. During pre-reform era banks in India used to lend on Security to traders and industries. Large industrial establishments and trading community were benefitted.

During the post-reform era and post-nationalization of banks along with Liberalization, Globalization etc., the rationale behind lending has changed drastically. The focus on the basis of lending has shifted from Security to Need, although wherever surety securities existed they continued to be accepted. Thus, a paradigm shift in lending rests with entertaining Credit Proposals on the availability of security. The basic principles that govern lending remain the same viz., safety, profitability and liquidity.

RESULTS AND DISCUSSIONS

The data collected using a self-administered questionnaire from the sample respondents on reason for upsurge of NPAs in Indian Banks are classified and summarized, and the causes for increase in NPAs ranked using Garrett Ranking technique.

Table 3: Demographic summary of the Respondents

	Demographic Factor	No. of Respondents	Percentage
	Male	246	66
Gender	Female	125	34
	Total	371	100
Category	Junior Level Management	222	60
	Middle Level Management	125	34
	Senior Level Management	24	10
	Total	371	104
Verticals	Retail Banking Group	242	65
	Mid Corporate Group	104	28
	Large Corporate Group	25	7
	Total	371	100
Group / Department	Credit Monitoring Group	106	29
	NPA Management Group	204	55
	Risk Department	61	16
	Total	371	100

From Table 3, Demographics of the respondents were analyzed, and it is inferred that a majority i.e. 60% of respondents, were male and 40% female. In terms of Category, 60% of respondents are from Junior Level Management, 30% from Mid-Level Management and 10% from Senior Level Management. In terms of Verticals, 76% of respondents are from Retail Banking Group, 16% from Mid Corporate Group and 8% from Large Corporate Group. In terms of Group / Department, 32% of respondents are rom Credit Monitoring Group, 56% from NPA Management Group and 12% from Risk Department.

A Study on Preference and Ranking of factors influencing increase in NPAs in IDBI Bank

The preference and Ranking of respondents with regard to factors influencing surge in NPAs in IDBI Bank are shown in Table 4.

Table 4: Preference and Ranking of respondents on major factors influencing increase in NPAs

Factors	Factors influencing increase in NPAs	Rank given by the respondents												Total
		1	2	3	4	5	6	7	8	9	10	11	12	
F1	Improper Credit Appraisal	106	88	66	44	22	18	12	8	2	2	1	2	371
F2	Defective Lending process	122	85	62	40	21	17	10	6	3	3	1	1	371
F3	Improper SWOT Analysis	128	76	48	33	22	21	19	9	5	4	3	3	371
F4	Non – conducting of Unit Visits	108	86	58	46	21	16	21	7	2	3	1	2	371
F5	Security with unclear Title	104	96	66	38	17	13	16	15	1	2	3	0	371
F6	Lack of Demand	5	4	6	9	23	16	31	20	26	42	62	127	371
F7	Industrial Sickness / Job Loss	3	4	2	3	3	26	46	68	42	10	21	143	371
F8	Natural Calamities	23	37	28	10	15	28	51	62	96	14	7	0	371
F9	Change in Govt. policies	31	33	12	6	5	3	2	3	16	28	70	162	371
F10	Ineffective MIS and Technology	92	78	42	36	23	28	21	13	10	5	12	11	371
F11	Ineffective Recovery Measures	121	75	49	34	23	22	21	11	7	5	1	2	371
F12	Willful Defaults	125	58	66	30	12	17	13	17	9	18	4	2	371

Table 4 shows the Preference and Ranking based on major factors influencing increase in NPAs by the respondents at IDBI Bank.

Among the 371, the Improper Credit Appraisal is ranked first by 106 respondents, second by 88 respondents, third by 66 respondents, fourth by 44 respondents, fifth by 22

respondents, sixth by 18 respondents, seventh by 12 respondents, eighth by 8 respondents, ninth by 2 respondents, tenth by 2 respondents, eleventh by 1 respondent and twelfth by 2 respondents.

Defective Lending Process is ranked first by 122 respondents, second by 85 respondents, third by 62 respondents, fourth by 40 respondents, fifth by 21 respondents, sixth by 17 respondents, seventh by 10 respondents, eighth by 6 respondents, ninth by 3 respondents, tenth by 3 respondents, eleventh by 1 respondent and twelfth by 1 respondent.

Improper SWOT Analysis is ranked first by 128 respondents, second by 76 respondents, third by 48 respondents, fourth by 33 respondents, fifth by 22 respondents, sixth by 21 respondents, seventh by 19 respondents, eighth by 9 respondents, ninth by 5 respondents, tenth by 4 respondents, eleventh by 3 respondents and twelfth by 3 respondents.

Non-conducting of Unit Visits is ranked first by 108 respondents, second by 86 respondents, third by 58 respondents, fourth by 46 respondents, fifth by 21 respondents, sixth by 16 respondents, seventh by 21 respondents, eighth by 7 respondents, ninth by 2 respondents, tenth by 3 respondents, eleventh by 1 respondent and twelfth by 2 respondents.

Security with unclear Title is ranked first by 104 respondents, second by 96 respondents, third by 66 respondents, fourth by 38 respondents, fifth by 17 respondents, sixth by 13 respondents, seventh by 16 respondents, eighth by 15 respondents, ninth by 1 respondent, tenth by 2 respondents and eleventh by 3 respondents

Lack of Demand is ranked first by 5 respondents, second by 4 respondents, third by 6 respondents, fourth by 9 respondents, fifth by 23 respondents, sixth by 16 respondents, seventh by 31 respondents, eighth by 20 respondents, ninth by 26 respondents, tenth by 42 respondents, eleventh by 62 respondents and twelfth by 127 respondents.

Industrial Sickness / Job Loss is ranked first by 3 respondents, second by 4 respondents, third by 2 respondents, fourth by 3 respondents, fifth by 3 respondents, sixth by 26 respondents, seventh by 46 respondents, eighth by 68 respondents, ninth by 42 respondents, tenth by 10 respondents, eleventh by 21 respondents and twelfth by 143 respondents.

Natural Calamities is ranked first by 23 respondents, second by 37 respondents, third by 28 respondents, fourth by 10 respondents, fifth by 15 respondents, sixth by 28 respondents, seventh by 51 respondents, eighth by 62 respondents, ninth by 96 respondents, tenth by 14 respondents and eleventh by 7 respondents.

Change in Govt. Policies is ranked first by 31 respondents, second by 33 respondents, third by 12 respondents, fourth by 6 respondents, fifth by 5 respondents, sixth by 3 respondents, seventh by 2 respondents, eighth by 3 respondents, ninth by 16 respondents, tenth by 28 respondents, eleventh by 70 respondents, twelfth by 162 respondents.

Ineffective MIS and Technology is ranked first by 92 respondents, second by 78 respondents, third by 42 respondents, fourth by 36 respondents, fifth by 23 respondents, sixth by 28 respondents, seventh by 21 respondents, eighth by 13 respondents, ninth by 10 respondents, tenth by 5 respondents, eleventh by 12 respondents, twelfth by 11 respondents.

Ineffective Recovery Measures is ranked first by 121 respondents, second by 75 respondents, third by 49 respondents, fourth by 34 respondents, fifth by 23 respondents, sixth by 22 respondents, seventh by 21 respondents, eighth by 11 respondents, ninth by 7 respondents, tenth by 5 respondents, eleventh by 1 respondent, twelfth by 2 respondents.

Willful Defaults is ranked first by 125 respondents, second by 58 respondents, third by 66 respondents, fourth by 30 respondents, fifth by 12 respondents, sixth by 17 respondents, seventh by 13 respondents, eighth by 17 respondents, ninth by 9 respondents, tenth by 18 respondents, eleventh by 4 respondents, twelfth by 2 respondents.

The Percent Position and Garret Value

Table 5: Percent Position and Garrett Value

S. No.	100 (Rij – 0.5)/ Nj	Percent Position Value	Garrett Score
F1	100 (1-0.5)12	4.17	83
F2	100 (2-0.5)12	12.50	73
F3	100 (3-0.5)12	20.83	66
F4	100 (4-0.5)12	29.17	61
F5	100 (5-0.5)12	37.50	57
F6	100 (6-0.5)12	45.83	52
F7	100 (7-0.5)12	54.17	48
F8	100 (8-0.5)12	62.50	44
F9	100 (9-0.5)12	70.83	40
F10	100 (10-0.5)12	79.17	34
F11	100 (11-0.5)12	87.50	27
F12	100 (12-0.5)12	95.83	17

Calculation of Garrett Value and Ranking

The Calculation of Garrett Value

Table 6: Calculation of Garrett Value and Ranking

Factors	Factors influencing increase in NPAs	Rank given by the respondents												%	Rank
		1	2	3	4	5	6	7	8	9	10	11	12		
F1	Improper Credit Appraisal	8,798	6,424	4,356	2,684	1,254	936	576	352	80	68	27	34	68.97	2
F2	Defective Lending process	10,126	6,205	4,092	2,440	1,197	884	480	264	120	102	27	17	69.96	1
F3	Improper SWOT Analysis	10,624	5,548	3,168	2,013	1,254	1,092	912	396	200	136	81	51	68.67	4
F4	Non – conducting of Unit Visits	8,964	6,278	3,828	2,806	1,197	832	1,008	308	80	102	27	34	68.64	5
F5	Security with unclear Title	8,632	7,008	4,356	2,318	969	676	768	660	40	68	81	-	68.94	3
F6	Lack of Demand	415	292	396	549	1,311	832	1,488	880	1,040	1,428	1,674	2,159	33.60	12
F7	Industrial Sickness / Job Loss	249	292	132	183	171	1,352	2,208	2,992	1,680	340	567	2,431	33.95	11
F8	Natural Calamities	1,909	2,701	1,848	610	855	1,456	2,448	2,728	3,840	476	189	-	51.37	9
F9	Change in Govt. policies	2,573	2,409	792	366	285	156	96	132	640	952	1,890	2,754	35.16	10
F10	Ineffective MIS and Technology	7,636	5,694	2,772	2,196	1,311	1,456	1,008	572	400	170	324	187	63.95	8
F11	Ineffective Recovery Measures	10,043	5,475	3,234	2,074	1,311	1,144	1,008	484	280	170	27	34	68.15	6
F12	Willful Defaults	10,375	4,234	4,356	1,830	684	884	624	748	360	612	108	34	66.98	7

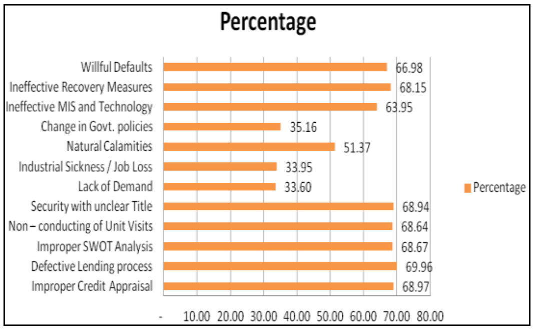

Figure 1: Respondents Preference of Causes for increase of NPAs using Garrett Value Ranking

The Table 4 shows that Defective lending process is ranked first, followed by Improper Credit Proposal as second Security with unclear Title as third, Improper SWOT Analysis as fourth, Non – conducting of Unit Visits as fifth, Ineffective Recovery Measures as sixth, Willful Defaults as seventh, Ineffective MIS and Technology as eighth, Natural Calamities as ninth, Change in Govt. policies as tenth, Industrial Sickness / Job Loss as eleventh and Lack of Demand as twelfth by the respondents in IDBI Bank. The ranks were obtained with the help of Garret Ranking method.

CONCLUSION

From Table 6 and Figure 1 it is inferred that Defective lending process is ranked first, followed by Improper Credit Proposal as second, Security with unclear Title as third, Improper SWOT Analysis as fourth, Non-conducting of Unit Visits as fifth, Ineffective Recovery Measures as sixth, Willful Defaults as seventh, Ineffective MIS and Technology as eighth, Natural Calamities as ninth, Change in Govt. policies as tenth, Industrial Sickness / Job Loss as eleventh and Lack of Demand as twelfth by the respondents in IDBI Bank.

Managing NPAs and containing them at lowest level has become pivotal and necessity for the banking sector in recent years. The capital of the Banks is getting eroded on account of surge in NPAs. The same is resulting in high cost of funds, scarcity of capital, borrowing by Banks at high rates of interest in Capital Market, lower profitability/ loss, reduced regulatory ratios viz., CAR, SLR, CRR etc., low Earning Per Share, less or no dividends. The same has a direct impact on Credit growth in economy, increase in unemployment rate, higher inflation, lower growth of Gross Domestic Product, surge in Fiscal Deficit and overall effect on economy

Thus, banks are required to ensure that effective and efficient measures are taken to contain NPAs, and recover them. Banks should be more proactive to contain NPAs and adopt a realistic approach towards resolution of NPAs.

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