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# Emerging stress in Asset Quality: a study of PSU Banks in India

**Dr. C. K. Goyal**[1]
Reader & Head of Department, IBMR IPS Academy, Indore

**Mr. Gagan Bhati**[2]
Assistant Professor IBMR, IPS Academy, Indore

## ABSTRACT

Asset quality is one of the most grave locale which determines the overall strength of a bank. The most important factor upsetting on the whole asset quality is the eminence of the loan portfolio and the credit supervision program. Loans classically encompass a majority of a bank's assets and carry the furthermost quantity of risk to their capital. Securities may also comprise a hefty portion of the assets and also restrain significant risks. Other items which can impact asset quality are other off-balance sheet items, real estate,, to a smaller degree, ready money and due from accounts, and premises and fixed assets. While asset quality is an imperative pointer of the wellbeing of banks and is commonly unstated in terms of Gross Non Performing Assets, a ascend in the latter as a proportion to total loans is painstaking as corrosion in asset quality and vice versa. After the global financial crisis, decline in asset quality along with slower economic growth has posted severe confronts to the banking industry in India. An effort is made in this paper to take broader view of the asset quality in Indian banks encompassing loan assets.

**Key words:** Asset quality, Gross Nonperforming asset, loan assets.

**Introduction:**

Asset quality is the most important indicator of a bank's overall condition and thus, at the aggregate level, asset quality explains the performance of banking system as a whole. Before and after liberalization public sector banks are facing tough challenges on the fronts of productivity, profitability and efficiency. The crucial factor affecting the quality of asset is the quality of loan portfolio. Massive amount of loan blocked up in form of Non-Performing Assets has proved a drag on the profitability and productivity of banks. Non-Performing Assets includes loans to the borrowers who do not pay the interest or installments, rendering their accounts irregular or out of order for a period of more than 180 days.

Central banks of developed economies after the global financial crisis went through a variety of significant measures viz. quantitative easing, lower interest rates, purchases of private assets, liquidity provision for smooth functioning financial markets. These measures became fruitful as markets started smooth functioning and witnessed declined risk. Though, the preventive measures have led to a substantial expansion in the positional statement of the corresponding central banks with an increase in the time span and asset quality. Consequently the asset quality became poor. The non performing share in total bank loans is an important indicator of banking health. The non performing asset ratio in aggregate at country level is a macro financial indicator of bank's profitability. The increase in level of NPA is not a good sign for asset quality of banks. Non recovery of installments as also interest on the loan portfolio negates the effectiveness of the process of the credit cycle and renders negative impact on the asset quality of banks. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions for better asset quality.

**Asset Classification and Provisioning Norms**

**a)** **Standard Assets –** These are those assets which do not create any problem while paying interest/ installments of the principal. It usually carries more than normal risk attached to the business. Banks are required to keep 0.25% of advances as a provision under this category of asset.

b) **Substandard Assets –** Those assets which has remained non performing for a period less than or equal to 12 months. Generally, banks are required to make 10% on total outstanding balance & 10 % on unsecured exposures as provisions.

c) **Doubtful Assets –** Assets remained in the sub-standard category for a period of 12 months. 100% to the extent advance not covered by realizable value of security. In case of secured portion, provision may be made in the range of 20% to 100% depending on the period of asset remaining sub-standard

d) **Loss Assets –** These assets are those where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. Generally 100% of the outstanding balance is kept as a provision.

**Literature review:**

**Roopak Kumara Gupta and Ekta Sikarwar (2010)** stated that large Commercial banks, especially the dominant public sector banks, have been facing tough competition from the in the private sector banks. They stated that Asset Quality is one of the components of performance of banks which can be assessed by Net NPA to Net Advances (NNPA/NA). Asset Quality determines the existing and potential credit risk associated with loan and investment portfolios and other off Balance Sheet transactions. Higher the ratio, lower is the asset quality of the bank.

**Bhavani Prasad G.V. and Veena D. (2011)** in their research reported that the best indicator of the health of the banking industry in a country is its level of Nonperforming assets. NPAs generally give the impression that banks have strengthened their credit appraisal process over the years and NPAs involves the necessity of provisions, which bring down the overall profitability and productivity of banks. Indian banks have been facing a problem of NPA. It is a serious disease associated with banking sector of the country. The magnitude of such problem is comparatively higher in PSU banks. For better efficiency of asset quality and profitability of banks the NPAs needs to be reduced and controlled.

**Khalid Ashraf Chisti (2012)** stated that The more brittle banking sector of a country is, the more it needs to pay attention on better asset quality management in order to ensure the sound development of the banking industry. Managers in banks need to keep a special eye on credit-enquiring effectiveness. Although more thorough credit-enquiring activities consume more costs in order to identify the credit of the accommodators in advance, it can reduce the non-value-added activities of coping with a large number of trouble loans afterwards. Finally, investors can invest in valuable banks according to indicators of asset quality, such as the overdue loan ratio or credit receivable ratio.

**A V Jose (2013)** reported in his research that banking system is the platform for economic development in a country like India .The key drivers for the growth of the banking system are Globalization, Competition, financial inclusion, Consolidation on the external front. The regulatory drivers like KYC and AML issues, fair treatment to customers, proper risk management also assume significant attention of Bank Management. He states that asset quality is suffering because of the enthusiasm and pressure, to somehow perform and meet the magical target figures. The problem requiring serious attention for a sound asset quality management of banks.

**Objective of the study:**

1. To study the raising stress in loan portfolio of PSU Banks in India.
2. To suggest various measures for better asset quality management in Indian PSU banks.

**Research Methodology:**

Research pursued is Exploratory Research based on the latest published secondary data from 2008 to 2013 availed from Report on Trends and Progress of Banking in India RBI. For the purpose of analysis of collected data appropriate trend analysis is used. Apart from it percentage analysis is also used for accurate interpretation of the available secondary data.

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**Data analysis:**

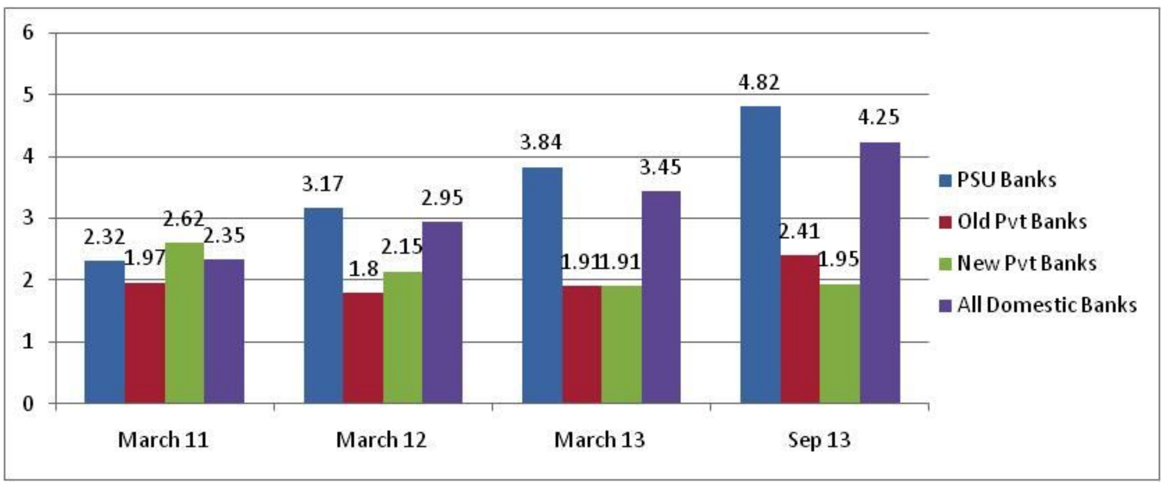
**Trends in stressed loan Assets**

| Year | Public Sector Banks | | Private Sector Banks | |
|---|---|---|---|---|
| | Gross NPA | Net NPA | Gross NPA | Net NPA |
| 2007-08 | 2.20 | 1.00 | 2.30 | 0.70 |
| 2008-09 | 2.00 | 0.94 | 2.36 | 0.90 |
| 2009-10 | 2.20 | 1.09 | 2.32 | 0.82 |
| 2010-11 | 2.40 | 1.20 | 1.97 | 0.53 |
| 2011-12 | 3.30 | 1.70 | 1.80 | 0.60 |
| 2012-13 | 4.10 | 2.00 | 0.20 | 0.50 |

Source: RBI

Gross Non Performing assets is important indicator of bank's health. Above data shows that level of Gross NPAs is increased in recent year and reached up to top by the end of March 2013 particularly in PSU banks as a whole are sitting on an time bomb of NPA that is ticking away fast. Net NPA has also been increased and become just double in the year 2012-13 as compared to 2007-08. The situation is worst and requiring severe concentration.

**Gross NPA to Advances by Bank Groups**




Statistics in the Bar-diagram shows that NPAs in the Indian Banking Industry have been on the ascend in topical period; that an overpoweringly elevated share of the boost in absolute NPAs was on account of PSU Banks and that the condition is likely to become shoddier before it starts improving. Level of Gross NPAs to Advance is radically increased in Sep 2013 by 4.82 percent then in March 2011 by 2.32 percent in PSU Banks while the same ratio is slighter in Old Private Banks 1.97 to 2.41 percent in same phase and in New Private Banks it's Gross NPA to Advance is decreased from 2.62 in march 2011 to 1.95 in September 2013.

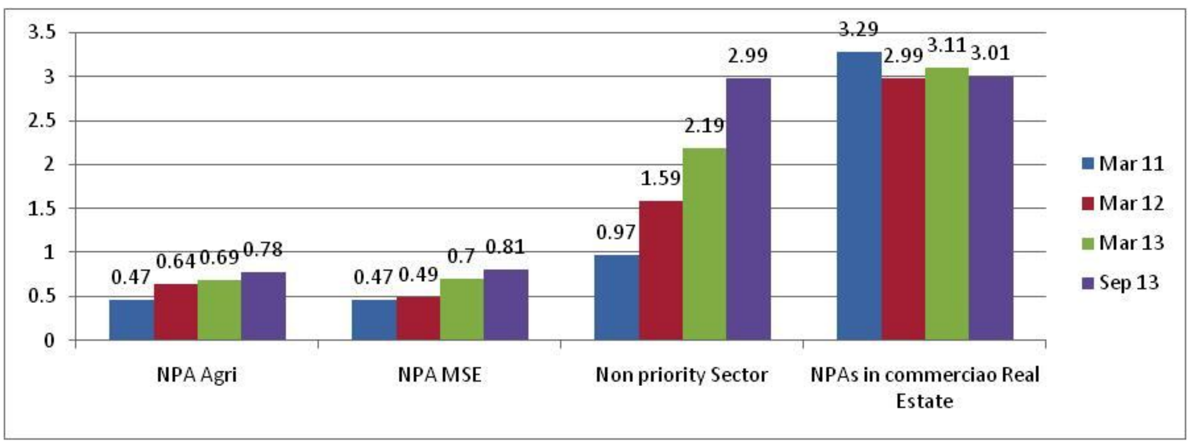
**Bank Group-Wise Classification of Loan Assets of Schedule Public and Private Sector Banks from 2008 to 2013 (Rs.Billion) As on March 31**

| Banks | Year | Standard Advance | Percent Share | Sub-Standard Advance | Percent Share | Doubtful Advance | Percent Share | Loss Advance | Percent Share | Gross NPAs | Percent Share | Total Gross Advance |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Public Sector Banks | 2008 | 16564.51 | 97.67 | 168.46 | 0.99 | 190.83 | 1.13 | 36.72 | 0.22 | 396 | 2.33 | 16960.51 |
| | 2009 | 20546.01 | 97.9 | 195.21 | 0.93 | 207.08 | 0.99 | 38.03 | 0.18 | 440.32 | 2.1 | 20986.33 |
| | 2010 | 24551.47 | 97.72 | 276.85 | 1.1 | 246.79 | 0.98 | 49.28 | 0.2 | 572.93 | 2.28 | 25124.39 |
| | 2011 | 29888.72 | 97.68 | 336.12 | 1.1 | 319.55 | 1.04 | 55.14 | 0.18 | 710.8 | 2.32 | 30599.53 |
| | 2012 | 34379 | 96.83 | 603.76 | 1.7 | 470.75 | 1.33 | 50.37 | 0.14 | 1124.89 | 3.17 | 35503.89 |
| | 2013 | 38999.85 | 96.16 | 765.89 | 1.89 | 734.85 | 1.81 | 58.15 | 0.14 | 1558.9 | 3.84 | 40558.74 |
| Private Sector Banks | 2008 | 4597.22 | 97.25 | 72.81 | 1.54 | 44.53 | 0.94 | 12.44 | 0.26 | 129.78 | 2.75 | 4727 |
| | 2009 | 5031.87 | 96.75 | 105.27 | 2.02 | 50.18 | 0.96 | 13.45 | 0.26 | 168.9 | 3.25 | 5200.77 |
| | 2010 | 5677.23 | 97.03 | 86.78 | 1.48 | 65.43 | 1.12 | 21.66 | 0.37 | 173.87 | 2.97 | 5851.1 |
| | 2011 | 7149.78 | 97.55 | 44 | 0.6 | 107.36 | 1.46 | 28.39 | 0.39 | 179.75 | 2.45 | 7329.53 |
| | 2012 | 8628.96 | 97.92 | 51.33 | 0.58 | 103.16 | 1.17 | 28.72 | 0.33 | 183.21 | 2.08 | 8812.16 |
| | 2013 | 10226.73 | 98.09 | 58.54 | 0.56 | 110.69 | 1.06 | 30.69 | 0.29 | 199.92 | 1.91 | 10466.65 |

Source: Department of Banking Supervision, RBI

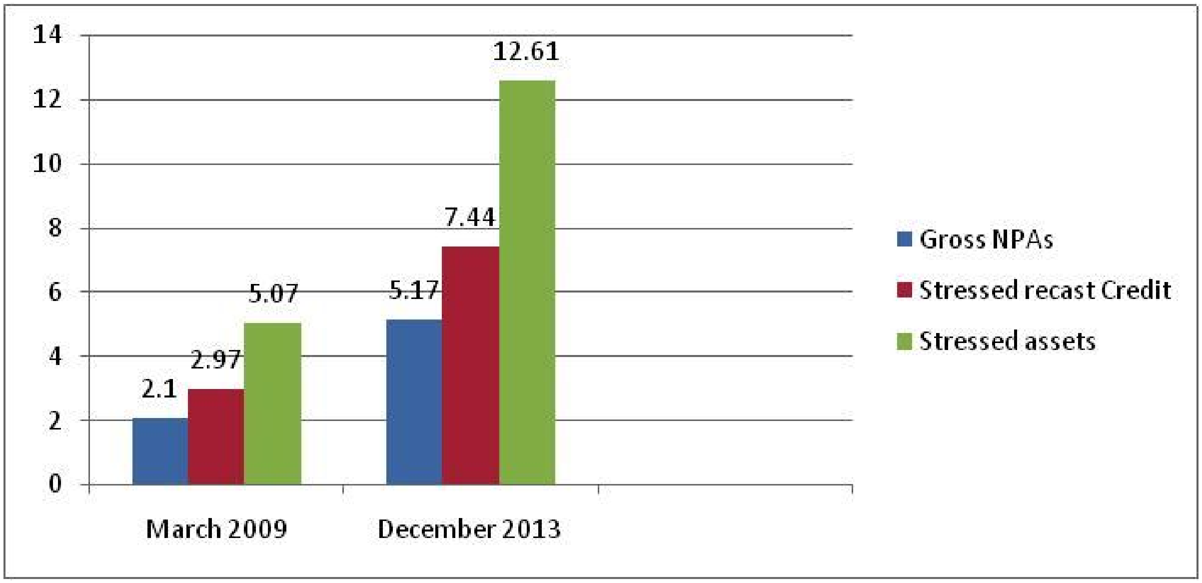
The gross NPA ratio at the aggregate level stood at 3.6 per cent at end-March 2013 up from 3.1 per cent at end-March 2012 which reflects the asset quality is weakening. The deterioration in asset quality was most observable for the SBI Group with its NPA ratio reaching a high of 5 per cent at end-March 2013. With the gross NPA ratio reaching about 3.6 per cent by end-March 2013, the nationalized banks were sited next to the SBI Group. Thus asset quality or PSU Banks destabilized during the period.

**Public Sector NPAs by Sector (Percent of gross advances)**




NPA has increased noticeably in non priority sectors by 2.19% in March 2013 then 0.97% in the March 2011. On the other hand in Priority sector NPAs has not increased up to high level. Aggressive lending in non priority sector in recent past led to the problem of NPA now and resulted in poor asset quality of PSU Banks.

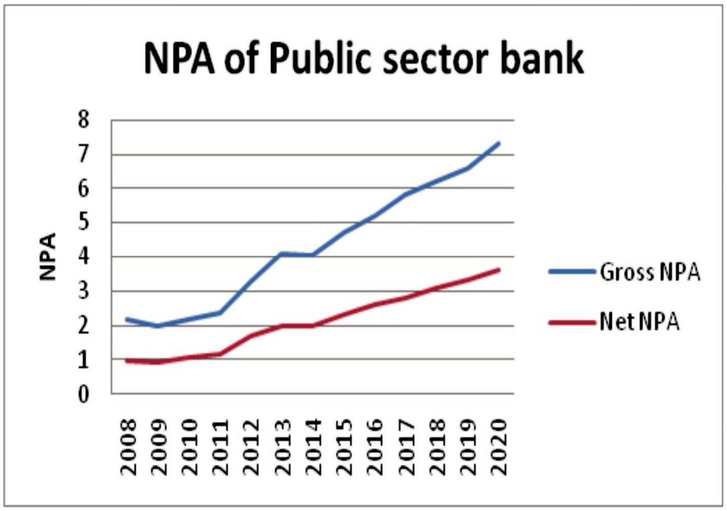
**A rising tide of stress asset portfolio in five years of PSBs**




Source: Department of Banking Supervision, RBI

Stressed assets stood at of 12.61% of PSU Banks in December 2013 which is severely increased from 5.07% in March 2009. Stress recast assets have also been increased in the same period of PSU Banks. Above diagram shows that level of GNPA is also increasing in PSU banks which will unfavorably affected the profitability of these Banks.

| | Public Sector Banks | |
|---|---|---|
| Year s | Gross NPA | Net NPA |
| 2008 | 2.2 | 1 |
| 2009 | 2 | 0.94 |
| 2010 | 2.2 | 1.09 |
| 2011 | 2.4 | 1.2 |
| 2012 | 3.3 | 1.7 |
| 2013 | 4.1 | 2 |
| 2014 | 4.06 | 2 |
| 2015 | 4.7 | 2.3 |
| 2016 | 5.2 | 2.6 |
| 2017 | 5.8 | 2.8 |
| 2018 | 6.2 | 3.1 |
| 2019 | 6.6 | 3.3 |
| 2020 | 7.3 | 3.6 |




**Findings:**

PSU Banks in India needs capital injection in order to cope up with the problem of raising level of Non Performing loans and also for the problem related to country's slowing economy and delays in infrastructure projects, bottlenecks in aviation industry. Internal capital in insufficient for the same purpose. Till the end of December 2013 selected large public sector banks reported an average gross NPL ratio near about 4.29% (of total loans) up from 3.39% in March 2013 which is an alarming signal and greater sign of poor asset quality management and it is inclined towards further rising in fiscal 2015. Gross non-performing assets (GNPAs) of banks in India reflected significant rose of Rs.2.4 trillion till end of December, which is about 35.98% comparatively higher with last year for same period. Nationalized bank's (except SBI group) share in non priority sector lending was grown up drastically up to 57.70% in 2013 in comparison to 31.94% in the year

2008 in the same sector. Entire SBI group's lending into the non priority sector has drastically grown up from 40.85% to 55.82% for the same period which rendered negative impact on the profitability of the entire group.

Non Performing Asset ratio of all major PSU banks weakened during 2008-2013. Apart from it slower economic growth, delays in projects in obtaining statutory and other approvals as well as poor pre credit appraisal and post follow up systems by banks were the reasons for the problem. Further, credit granting in certain sectors and very higher leverage among corporate houses has resulted in stress on asset quality of banks. Restructured accounts have been increased drastically in recent years under the corporate debt restructuring. Restructured accounts have grown at a compound annual growth rate of 47.86 percent in PSU Banks by the end of December 2013. This has implications for the banks' already stressed asset quality in the period ahead. RBI's annual report states that in financial year 2014 the NPA of PSU Banks in India was 2, 27,264 Cr Rs. It means that bank's assets are under stress and need to be taken care prudentially so that the profitability of banks may increase.

**Conclusion:**

Since the beginning of the reform in 1991, the environment for the Indian banking industry has been changed drastically. The twin strands of reform are stringent prudential norms and deregulation of working environment. Regulation has improved, prudential standards have been constricted and norms for provisioning, asset classification, capital adequacy, income recognition are being progressively brought on par with global standards. The opening environment has dramatically changed, with greater freedom and discretion in fixing interest rates and allocation of banking assets. Within the existing rule of the game, the newly established private sector banks and the foreign banks have sharpened their competitive edge. The public sector banks falling behind in the competitive edge.

Financial inclusion, norm for capital adequacy, management of asset quality and effective use of technology are major key issues facing by the Indian banking industry as of now which despite serving the second largest populated country in the world with a total of 87 banks (including 26 PSU banks, 20 private banks and rest foreign banks), as per central bank of the country, reaches out to only about half of the country's households, scripting a nominal global footprint. Further there is a significant relationship between asset quality and bank performance. Advances, Loans, provisions for doubtful and loss assets are major variables in determining asset quality of a bank. These risk items are crucial in determining the profitability, productivity and efficiency of banks. If a bank does not effectively manage associated risks, its profit will be unstable and tends to decrease. This implies that the profit before tax has been responsive to the credit policy of Indian banks. The asset structure of banks also affects profit performance on long run. Banks became more concerned, because loan assets are usually the riskiest of all assets and therefore May threatened bank's liquidity position and lead to distress followed by stress in asset quality. Better risk management particularly credit risk management results in better bank performance. Hence it is of very important for banks to practice prudent credit risk management to uphold their assets and protect the investors' interests. Raising NPA may keep PSU banks mergers on hold. Merger among the public sector banks are likely to be put on backburner for a few years as a heavy bad loans among them.

**Suggestions:**

Management need to be cautious in setting up a credit policy that will not negatively affect profitability and also they need to know how credit policy affects the operation of their banks to ensure judicious utilization of deposits and maximization of profit. Improper credit risk management reduce the bank profitability, affects the quality of its assets and increase loan losses and non-performing loan which may eventually lead to financial distress. As a result, banks still need to make efforts to improve their financial soundness via the following:

1. The government and the RBI should facilitate the formation of Asset Management Co with a Goal of NPA acquisition, aggregation and resolution, including the sale of business, or assets, or management changes.

2. All credit risk managers and lending officers should adhere strictly to good lending practice; they should know the purpose of the loan and ensure the feasibility of every loan proposed.
3. The use of collaterals as security of granting loans should be further reviewed to reduce further incidence of bad debts.
4. Credit management should be viewed as part of a co-ordination group efforts made by all departments involved with customers to minimize bad debts and maximize profit instead of leaving it in the hands of the credit risk management department.
5. Rehabilitation, recapitalization and refinancing will also be a conduit to attract fresh capital, particularly international capital and expertise into this sector.

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