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NEGATIVE IMPACT OF NPA ON INDIAN BANKING SYSTEM WITH EFFECT TO DIGITALISATION

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Abstract

The Indian banking sector has arisen together as the strongest drivers of India's economic growth. The Indian banking system has made outstanding advancement in the foregoing couple of periods, even during the days when the rest of the world was floundering with financial meltdown. Moment, all the banks face the matter of non-performing assets whether it's public sector bank or private sector bank. Unfortunately, the Covid-19 has stopped economic activity across multifold sectors and hypercritically affected the banking sector. This paper is aimed towards the review of on non-performing assets in Indian banking sector. According to RBI (Reserve Bank of India), for any asset on which the interest remains un-payable for a period of 90days,the asset becomes non-performing. Fast forward to 2021 digital lending has become a reality and preferred route for the vast majority of Indian for its speed and convenience, many player are available for providing MSME financing such as Lending kart, Aye Finance, Kreditbee,

Keywords: *Banking sector, Non-performing assets.*

Introduction:

Objective and research methodology: The objective of this paper is to discuss why NPA is threat to the banking system in India and its possible solution.. This paper is explorative by nature and secondary sources have been used as the source of information.

Banking Sector: The Indian banking system consists of 12 public sector banks, 22 private sector banks, 46 foreign banks, 56 regional rural banks, 1485 urban cooperative banks and 96,000 rural cooperative banks in addition to cooperative credit institutions As of September 2021, the total number of ATMs in India reached 213,145 out of which 47.5% are in rural and semi urban areas. Indian banking system provides financial security to the people by providing loans at competitive rates, paying reliable remittance services, etc. It helps people save their money and invest it in different financial instruments like Government securities, long-term bonds, etc.

History of Banking system in India: Although the banking system in India has around 300 years old history but the real growth happened after independence. Major changes in the banking system and management have been seen over the years with the advancement in technology, considering the needs of people.

Given below is a pictorial representation of the evolution of the Indian banking system over the years:

Nationalization's of banks created a wave of development in our country. Government has entrusted various function to the banks for eradication of poverty, development of agricultures.. The watershed period of banking sector was introduction of Liberalization by then government. A committee was formed under former RBI Governor M. Narsimham in August 1991 to look into all aspects of the financial system of India. The report of this committee had comprehensive recommendations for financial sector reforms including the banking sector. The key recommendations with respect to the banking sector were as follows:

(1) Reduction in the Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR)

(2) Redefining the priority sector

(3) Deregulation

Many of the recommendations of the committee were acceded to by the government. The government also enacted Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993 Debt Recovery Tribunals with an appellate Tribunal at Mumbai for quicker recovery of bad debts.

What is NPA?

NPA is nothing but the loans that are being given by the Indian banks and other operating financial institutions whose interests as well as the principal amounts have been in a state of overdue status for a fairly long time. When we talk about a long time, it is 90 days or more than 90 days. NPA is not a desirable phenomenon in India's banking system. This is like cancer that is destroying the overall banking system in India. The RBI has defined NPA in banking more specifically.

1. An account is 'out of order' with respect to a Cash Credit/Overdraft.
2. A bill remaining overdue for more than 90 days.
3. The installment of a principal or interest would remain overdue for two crop seasons in the case of crops that grow for a short duration.
4. The amount of liquidity that is outstanding for a continuous period of 90 days.

Types of NPAs (Non-Performing Assets) :

Substandard NPA: That particular NPA that remains overdue for less than or equal to 12 months.

Doubtful NPA: That NPA remains in the category of Substandard NPA for equal to or less than 12 months.

Loss Assets: The Loss Assets occur when the NPA has been recognized as a loss incurred by the bank or financial institution as per the inspection done by the Reserve Bank of India (RBI).

Norms of Provisioning NPAs: The norms of provisioning are being set by the Reserve Bank of India and are the same for all the banks in respect to NPA. They may vary to an extent as per the NPA category. These are as follows:

- 10 percent of the allowances applicable for the total amount unpaid without making any kind of budget for the securities or any other coverage of government guarantee.
- The NPA that falls in the substandard category

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would add another 10 percent coverage making this a total of 20 percent on the complete outstanding amount.

- The provisional requirement for a doubtful or unsecured NPA is declared to be 100 percent.

Factors that Contribute to Non-Performing Assets

- The bank's lending to the corporations/persons etc. whose credit worthiness is not guaranteed and taking a lot of high risks. (NPA in Banking)
- The banks are not able to diminish their losses by a complete understanding of the sufficiency of the bank in terms of the loan or capital loss at a specific time frame.
- The funds are being redirected elsewhere by the promoters of the companies.
- Not enough means to collect as well as distribute credit information in between the commercial banks and
- Non-efficient recovery of the debts from the overdue borrowers.

Negative impact of NPA on Banking system: The problem of NPAs in the Indian banking system is one of the foremost and the most formidable problems that had impact the entire banking system. Higher NPA ratio trembles the confidence of investors, depositors, lenders etc.The non-recovery of loans effects not only further availability of credit but also financial soundness of the banks. The most basic impacts of NPAs on the banks of India are as follows:

Liquidity Position: If the bank evaluates less capital the future business concern, which affects the position of banks and creating a mismatch between the assets and liability and they force the bank to raise the resources at a high rate. So, there will be an impact on the profitability of banks, were they not able to recover the amount from the borrower the level of profit will come down.

Higher Cost of Capital: It shall result in increasing the cost of capital as banks will now have to keep aside more funds for smooth operations. HIGH RISK High on non-performing assets, low profitability, high risk in business and work against the bank and may take the two circumstances survival of the bank. And it affects the risk-bearing capacity of the bank.

Bank Profitability: The which makes low profits have lower capital adequacy ratio and the low capital ratio which limits the further creation of assets. Such kind of banks face difficulties in their growth, expansion, and plans and there they need not wherewithal to March boldly on these fronts. In these growth failures in the expansion, the only consequences and stagnation and negative growth.

Strategies to Solve the Problem of NPAs in Bank:

Accountability: Junior executives are often made accountable for lapses, however, major decisions are made by the Credit Sanction Committee consisting of senior-level executives. Hence it's important to make senior executives accountable, if PSBs need to tackle NPAs.

Corporate Governance: Even though, the government had set up Banks Board Bureau in April 2016 to attract talent, corporate governance hasn't improved to the desired level with certain issues persisting and need to be resolved urgently.

Stricter NPA Recovery: The government needs to amend the laws and give more powers to banks to recover NPAs. The Insolvency and Bankruptcy Code has brought in discipline because of fear of losing the asset. Since debtor control amendments to the Banking Regulation Act, the present scenario allows the RBI to conduct an inspection of a lender

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but doesn't give them power to set up an oversight committee. The RBI has asked for nine additional powers under the Banking Regulation Act with regards to PSBs including the ability to remove CMDs and appoint them, the power to supersede the Board of Directors and make application for winding up errant banks, sanction scheme of voluntary amalgamation etc.

Credit Risk Management: Proper credit appraisal of the project, creditworthiness of clients and their skill and experience should be carried out. While conducting these analyses, banks should also do a sensitivity analysis and should build safeguards against external factors. Effective Management Information System (MIS) needs to be implemented to monitor early warning signals about the projects. The MIS should ideally detect issues and set off timely alerts to management so that necessary action is taken.

Asset Reconstruction Company: There's a need to set up an ARC or an Asset Management Company to fast track resolution of stressed assets of PSBs. The government should initiate necessary steps to explore the feasibility after thorough discussions on pricing and capital issues. The number of fraud cases of more than Rs 1 lakh stood at 5,904 involving an amount of Rs 32,361 crore during FY18, whereas during FY16, it was 4,693 cases involving an amount of Rs 18,698 crore. There's an urgent need to tighten banks' internal and external audit systems. For the past few years, the banking industry is facing a tough time. The rise in NPAs is proving to be a key challenge. Three decades ago, too, the banking industry faced a similar situation of high NPAs, at 24 per cent. However, we overcame the situation and similarly, the prevailing stress won't last long.

These are some Digital technological strategy by which we can try to solve this problem-Digital integration and use of technology to reduce the NPAs: According to a survey by global research firm Ernst and Young (E&Y) among Indian bankers, 87% said that Non-Performing Assets (NPAs) occurred due to diversion of funds to unrelated business or duplicity, while an additional 64% accredited them to gaps in due diligence. Around 72% of the survey respondents were of the view that the crisis is set to get worse. In the worst ever financial crisis since 2008, bad loans in India grew to Rs. 3,41,641 crore in September 2017, striking at the root of India's Rs. 95 trillion banking sector. Total NPAs, as a percentage of the total loans, has grown from 2.11 per cent to 5.08 percent. Eight out of ten banks highlighting on the list are public sector banks. The banking system is veering on the verge of a crisis. Stocks of state-run banks have plummeted. Banking regulator RBI had fixed March 2017 as the deadline for banks to fix their balance sheets; however, little has changed on the ground. According to the Ernst and Young survey, 56% of Indian bankers felt that technology and data analytics should be leveraged to identify red flags and early warning signals. Moreover, 86% opined that there is need for a mechanism to identify hidden NPAs.

How technology can curb India's NPA crisis: Most of the bankers feel that the main problem is that banks can't monitor and check the finances of an enterprise thoroughly as they have no visibility into its operations. Although banks do ask for a number of documents to sanction a loan, they are found fumbling as far as real-time transactions of an enterprise are concerned, since they don't have access to its financial records or the feasibility of

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projections. The data that the banks have is not enough to authenticate claims, making them ill equipped to take decisions based on solid facts. Hence, banks require the technology to screen enterprises always. This can be achieved through a two-pronged approach: ensuring transparency and implementing automation. Banks require maintaining a proper record of an enterprise's key financial transactions: invoices, inventory, account receivables, balance sheet, etc. Business resources—cash, raw material, production capacity—and the status of business commitments: orders, purchase orders, and payroll need monitoring as well.

The ERP can be connected to the banks' own system, helping the financial institution tap into the real-time transactional data of businesses. Information in the ERP could help a bank decide whether the company has been meeting its financial obligations on time. Evidence of monetary discipline might also encourage banks to offer loans at lower interest rates to SMEs, who are usually low on finances. Enterprises could also use the digital platform to apply for loans, which could be quick and hassle-free.

Conclusion: The overall findings point to a worrisome situation for the banking sector as a whole. An analysis of the growth rate in the NPA level shows that the problem is evident not only with small-sized banks but also with big names in the banking space. Hence, the entire sector is gripped in the crisis. The poor asset for the banks is a problem because as per the guidelines, given by the RBI, banks are required to keep some amount as provision depending on their asset quality thereby leading to declining profitability of the banks. Hence, it impacts not only the profitability level of these banks but also affects the shareholders' wealth. Thus, the time is apt that the RBI has been coming up with very stringent norms so that the growth in these assets can be put under control. The Insolvency and Bankruptcy Code of 2016 is playing an important role with regard to recovery of assets of those creditors whose case has been filed with the National Company Law Tribunal. In fact, figures are given by the RBI point to a declining phase in the NPA growth rate, which is a positive development. But, there is still a lot to be done. Only time will say how successful has the RBI been in controlling the NPA growth in the sector. It is necessary to pull the trigger hard as these poor loans are having a severe impact on the liquidity position of banks and even the banks have been asked to go slow with regard to lending, which is ultimately having an impact on the economic growth, which has been slow during the past few quarters.

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