International Journal of Financial Management and Economics

P-ISSN: 2617-9210
E-ISSN: 2617-9229
IJFME 2022; 5(1): 40-43
Received: 19-11-2021
Accepted: 21-12-2021

Ekta Singh
Assistant Professor,
Department of Commerce,
Quantum University,
Roorkee, Uttarakhand, India

Corresponding Author:
Ekta Singh
Assistant Professor,
Department of Commerce,
Quantum University,
Roorkee, Uttarakhand, India

Impact of NPA on economy in India

Ekta Singh

Abstract
The financial institution of any economy works as a foundation of any Finance sector to make the economy run. In India frauds and scams are on the rise which has a drastic effect on the economy. This paper shows how these activities in India have affected the economy of the country. The topic has significance as the working of any country depends on the financial sector of that country. Such scams disturb the whole circular flow in the country which leads to leakage of a fund or financial asset from the economy. The findings of this paper are about how these scams make an effect on the economy. Regulatory and Non-regulatory are two-component of Financial Institution where Regulator of these banks keep check on such scams but are somehow unable to deduct these activities in the earlier stage which result in a scam always highlighted as the biggest scam in history. These Bank scams cause a huge disequilibrium in the economy which often leads to the weakening of the financial market. Due to such scams, stock markets and other financial markets also face huge crashes thereby affecting the economy in a big way. This whole process causes a slowdown in GDP and economic growth which often leads to weakening of the economy and often disappearance of foreign trust and foreign investment whether in the form of direct or portfolio investment.

Keywords: NPA, economy, gross domestic product

Introduction

Scams in India is not a new thing to observe, the thing which needs to be observed is the amount of scam which is increasing and always reported as the biggest scam in history even after having more stringent regulatory bodies in the country. The year 2022 have faced some of the biggest scams in history which are the "Himalayan Yogi" scam which has completely shaken the stock market. Its reason was found out to be insider trading. The stock market is a sentiment indicator and can impact gross domestic product GDP. GDP measures the output of all goods and services in an economy. The arising stock market may indicate favourable economic conditions for firms, resulting in higher profitability. The second scam that happened was of ABC shipyard company which costs Rs. 22800cr. Financial institutions provide different types of financial services in the country. It is the backbone of any economy to work. These institutions help in mobilisation of saving, capital formation, selection of projects, providing information, reducing the cost of transactions, minimising the risk of portfolio management, it works as a payment mechanism. It also helps in the selection of projects. Now the scam with these institutions affects the economy too. Research has been conducted to find this effect on the economy because of non-performing assets, scams and frauds going within the country. Secondary data has been collected to complete the study. Internet, Research Paper, Journal, RBI reports has been used. Non Performing assets are also categorised in Non-Performing Assets commonly known as NPA. This has been seen that Public Sector Undertaking PSU has been the most problematic area in NPA. Five months back in 2020 in October 5 PSUs with the lowest NPAs was categorised which were HDFC whose NPA has been 0.5% till 2009 second is Indusland Bank which is providing loan on the better asset, third is Kotak Bank whose NPA is less than 1.5%, fourth is Federal Bank and fifth is ICICI Bank. Growing NPAs has become an unending nightmare for the Indian Banking Sector due to the pandemic. Now, these Non Performing Assets leads to the financial loss of the country. When there is no comeback of the amount given as loan or interest for 90 days it becomes Non-Performing Assets. If it continues for some duration it leads to shutting down of financial institutions because of non-ability to pay the amount of public. When the public doesn't get their fund from the institution it leads to financial distress in the economy.

Demand will get reduced and supply will be more in comparison to demand in the economy which further leads to wastage of resources and an increase in unemployment. In 2015 RBI and the government decided to recognise bad debts. To recover these Non Performing assets finance minister Nirmala Sitharaman has announced Bad Bank in 2021. A bad bank is a corporate structure that isolates illiquid and high-risk assets held by a financial organisation. The government set up NARCL to take over the bank's Rs 2 lakh crore bad debt. Indian Banks' Association chief executive Sunil Mehta on October 4 announced that the National Asset Reconstruction Company Limited (NARCL) has received a license from the Reserve Bank of India (RBI), enabling it to start operations and so-called bad bank, an entity formed to take over and dispose of the identified stressed assets worth Rs 2 lakh crore of commercial banks. NARCL will acquire stressed assets of about Rs 2 lakh crore in a phased manner. The stressed assets will be acquired through a 15 per cent upfront cash payment and 85 per cent in the form of security receipts. The main reason to create this bad bank was to make concentrate financial institutions on the core banking function which is to mobilise the fund. Before coming into the existence of Bad Bank 28 private Asset Reconstruction Companies look into medium and short term loans only.

RBI and Financial Institution

There are categories in a financial institution some are regulated and others are non-regulated. Financial institutions work as an intermediary between borrowers and savers who assist in the smooth running of the financial system by providing different financial services to the community. The development of any financial system depends on its financial structure are a combination of financial institutions, financial markets, Financial instruments and financial services. In the organised sector of the Banking Institution, there is always a body on the top which run, supervise, regulate and develop these sectors. In the case of Commercial Bank RBI is a governing body. These all the things work together to develop the economy. To make the economy grow and develop certain factors are being measured such as infrastructure, employability, education etc. Now to make these factors work people need funds in the form of loans that are provided by a banking institution and are based on monetary policy. Some instruments of monetary policies are Cash Reserve Ratio, Statutory Liquidity Ratio, Bank Rate, Repo Rate, Reverse Repo Rate, and Open Market Operations. If RBI decreases the CRR in case of deflation the money is pumped into the economy via banking channels and thus the spending capacity increases and more amount is available with the banks to circulate in the market. More money in the hands of the public will lead to more expenditure on capital goods and more expenditure on capital will lead to the development process in the market & vice versa. When this loan is provided in the market on some per cent of interest with the motive of profit but this converts into Non Performing Assets it makes financial institutions available with less fund to provide in the market. So this is how economic growth is hampered. The same is with the case of Fiscal Policies. It is the policy in which government expenditure and revenue are to influence economic conditions, especially macroeconomic conditions, including aggregate demand for goods and services, employment, inflation, and economic growth. When government want to pump money into the market they start increasing the expenditure in several ways such as for hospital, infrastructure, roads etc. This creates employment in the economy leading to economic development.

Foreign trade and Financial Institution

Foreign Trade is something which has become crucial to any country in this globalised world. Countries import things for which resources are not available or comparatively are less capable than any other country and in same way countries export those items for which they have huge resources or are specialised in. This is how the globalised world works. To make this trade happen financial institutions play a major role in the economy. Businesses involved in export and import also need fund to make their business work and so takes a loan from financial institutions but several cases of Non-performing assets are being found in foreign trade industries. A recent example is of ABC shipyard company which has taken a loan from a total of 28 banks and made a scam of Rs. 22,842 crore. This company have become insolvent. The loan amount was led by ICICI Bank. A complaint about this fraud was filed by SBI. This is being called the biggest scam in history.

Last 5 year status of NPA

According to Business Standard Gross non-performing assets fell from 7.5%in March 2021 to 6.9% at end of September 2021 and Net NPA declined by 10 basis points to 2.3% in September 2021 from 2.4% in March 2021. According to the Times of India Gross NPA of public sector banks have doubled in a year from 2014 to 2021i.e from 2.24lakh crore to rs. 5.40 lakh crore. According to RBI, Gross Non-Performing Assets in Indian public sector banks are Valued at rs 400000crore which represents 90% of the total non-performing assets in India and private banks comes in the remainder. Now for comparing NPA data of last 5 years have been collected from Financial Stability Report by RBI. This report is prepared by the sub-body of the Financial Stability and Development Council. This report started publishing from the year 2010 at the time of Mr Pranab Mukherjee as president. In the year 2021, the December 24th report was published by RBI by collective assessment of financial stability and development council in which it has been found that Gross non-performing assets of the scheduled commercial bank were 6.9% in September 2021. Also, it has been reported that it may increase to 8.1% in September 2022 on the baseline scenario and 9.5% under a severe stress scenario. Rbi consider 4 possible scenarios with worsening macroeconomic indicators which are 1) Baseline Scenario 2) Medium Stress 3) Severe stress 4) Very Severe Stress. Non Performing Assets in March 2021 was 7.48%, September 2020 was 7.5%, March 2020 was 8.5%, September 2019 was 9.3%, March 2019 was 9.3%, September 2018 it was 10.8%, March 2018 it was 11.6%. In September 2017 it was 10.2%.

Source: RBI

This has been observed from the line graph that Gross Non-Performing Assets are being decreased from the year 2018 to the year 2021, September. Despite coronavirus prevailing in the economy from the year 20219.

Adjustment of Bad Debts

An increase in Non Performing Assets leads to more losses in a decrease in the capital of financial assets from the balance sheet. Decrease in capital further leads to less ability to lend money in the market this happens because of RBI guidelines which say. This loss in the capital because of Non Performing Assets leads to writing off this loss from the balance sheet. NPA of schedule Commercial Banks Recovered through various channels. Bank group-wise classification of loan assets of scheduled commercial banks. Movement of NPA of scheduled commercial banks.

Impact on Economy

Non Performing Assets are simply the loss for the financial sector which leads banks with fewer funds to lend to other projects. Now the shortage of funds for the development project becomes a hurdle for completing the next project. To recover the loss faced by the financial sector institution they increase the interest rate on different loans. Ultimately some burden is shifted to the common people and some to the financial institution which reduces the profitability of the financial institution. Lack of funds with institutions to start new projects also leads to a lack of investment in the country which further leads to unemployment in the economy. The government faces a lot of problems in the economy because of non-performing assets, they are unable to generate taxes which hamper the development. Government is unable to spend money on the welfare of the public. This way both government and corporate sectors have stressed balance sheets. To save financial institutions government has to recapitalise these banks so their minimum capital can be maintained.

Political decisions impact on financial institutions

Despite making so many efforts by the government and RBI Financial institutions have failed to recover the NPA which has resulted in losses of the financial institution and economy as a whole. According to CARE rating, India has ranked 5th on a list of countries with the highest NPA level and also top among BRICS nations followed by Greece with 36.4%, Italy with 16.4%, Portugal with 15.5%, Ireland 11.9%. SBI was at the top of NPA in 2021 with Rs. 1.21 lakh crore from Rs 74,482 crore in June 2014. Low earnings because of unemployment created Affect the ability to pay back loans which further leads to unemployment. This process keeps ongoing for a long and so is the way how bank leads to bankruptcy and insolvency of the bank. The Gross NPA of public sector banks has doubled in the last seven years.

Impact of foreign banks functions on Indian Financial Institutions

The advantages of foreign bank participation in India have given the rise to competition. These Foreign banks tend to increase the efficiency of the local banking system, bring in more sophisticated financial services and have the ability to correct the health of banks going into losses. Foreign banks are connected with domestic banks in some or another way. Foreign banks like the World Bank consistes of 5 bodies which are International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the International Centre for Settlement and Disputes ICSID. International Monetary Fund (IMF), United Nations Confrence on Trade and Development (UNCTAD) and many other banks working in India. If Non Performing Assets of the country increases it will have a direct effect not only within the country but the outside country as well. An increase in NPA will decrease the rating which will further get affect Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). A decrease in rating will induce investors to not invest because of huge losses already occurring in the market and will try to pull back the already invested amount because of the risk prevailing in the financial institution. This will worsen the scenario and will lead halt in development. This fragile financial security will give rise to sick collaboration with other countries. When international collaboration becomes an issue because of weak financial security it will lead to affect trade between the countries too. Serious changes are then required in Foreign trade policy to increase export and decrease imports so that the value of Rs in terms of the dollar can be maintained.

Steps were taken for resolution of the NPA problem

1. Asset Reconstruction Company (ARC): It was introduced to India under the SARFAESI Act 2002, as a special company to protect banks from NPAs. ARC buy bad loans from banks at a steep discount at a mutually agreed value and attempts to recover the debts by itself. These companies take special measures to recover the money owed. If they can recover the money they make a profit if not they lose the money. To recover the due amount it functions as an acquirer of financial assets, it also changes or takeover of management. It can also reschedule debts.
2. Asset Quality Review (AQR):AQR verifies whether banks are assessing loans in line with RBI loan classification rules or not. AQR also revealed the actual extent of NPAs.
3. Debt Recovery Tribunal: This tribunal is governed by the Recovery of debt due to banks and financial Institution Act, 1993. It was set up to reduce the time required for settling cases.
4. Credit Information Bureau: This is a third-party agency that maintains records of individual defaulters and shares them with the perspective banks to aid them in making effective lending decisions.
5. Lok Adalats: This provides resolution of disputes through Arbitration, Conciliation, Lok Adalats and Mediation.
6. Bad Banks known as UNCRF: They will take all stressed loans and will tackle them according to flexible rules and mechanisms. It will also ease the balance sheet of PSBs which will give them the space to fund new projects.

The rationale of the study

NPA in the country according to RBI is decreasing year after year from 2018 to 2021 but still, there are the scams that were in the economy with a big amount. According to a report by the Reserve Bank of India Banks reported a total fraud of Rs 71,543 crore in 2018-19, a 74 per cent increase as against Rs 41,167 crore in the previous financial year. The number of fraud cases reported by lenders also jumped to 6,801 in 2018-19, compared to 5,916 cases in 2017-18. The Non Performing assets are the root cause of the Indian financial crisis that we observed recently. The problem of NPA has received considerable attention after the liberalisation of the financial sector in India. Various measures have been placed to shorten the ratio of Non Performing Assets. It is still true that NPA in the priority sector is still higher than that of the non-priority sector. NPA is considered an important parameter to judge the performance of banks and the financial health of a country. If a bank has a high NPA its financial position is considered to be weak and the growth of the economy is hampered by the same also creates a bad effect on the economy, If a company has a low NPA ratio it is considered as more stable in financial health. The study of NPA on the economy is important because India's whole Financial system transactions are operated by one of the components of the financial system that are a financial institution of the country. The working of these financial institutions depends on the capital from which they have to run the business. If these funds get stuck or become non-performing assets the whole circular flow will get disturbed and will lead to economic crises in the country. Banks after a high amount of NPA will be unable to create credit by way of advancing and losses. Stoppage of creating credit in the economy will lead to low Gross Domestic Product GDP, National Domestic Product NDP, Unemployment, High-interest rate to the public to recover the cost. More technology and data analytics should be made to identify the early warning signals. More focus should be on internal skills Development for credit assessment. Public Sector Bank should be given more autonomy to deal with the loan so that they are under no pressure of any political factor.

References

1. https://rbi.org.in/Scripts/AnnualPublications.aspx?head=Statistical%20Tables%20Relating%20to%20Banks%20in%20India
2. https://corporatefinanceinstitute.com/resources/knowledge/other/non-performing-assets-in-indian-banks/
3. https://www.india.gov.in/statistical-tables-relating-banks-india
4. https://www.researchgate.net/publication/341727018_The_Effect_of_Political_Factors_on_Financial_Development
5. Ashima GABA, Dr Ravinder Kumar. "Non - Performing Assets and Profitability: A Study of Private Sector Banks in India", International Bulletin of Management and Economics. 2018;9:20-30.
6. Chithralekha T, PS Nirmala. "Survey of Challenges andImpacts of Basel implementation in India", Vinimaya. 2008;3(29):27-38.
7. Dilip Kumar Karak, Subhas Chandra Sarkar. “Management of Non-Performing Assets of District Central Co-Operative Bank”, Indian Journal of Accounting. 2018;50:78-86.
8. Fareed Ahmed, Akhilesh Tripathi. “Management of Non Performing Assets- Perception of Bank Officers”, International Journal of Interdisciplinary and Multidisciplinary Studies. 2017;4:448-462.
9. Indira Rajaraman, Garima Vasishtha. “Non-Performing Loans of PSU Banks: Some Panel Results”, Economic and Political Weekly. 2002;37:429-431.
10. Kamal Das. "Management of Non-Performing Assets: Lesson from Swedish Experience", Indian Banker, IBA Journal, Published by IBA. 2008 July;3(7):35-36,
11. Krishna Banana1, V Rama Krishna Rao Chepuri. "A Study on Non Performing Assets of Indian Commercial Banks”, International Journal of Research Culture Society. 2017;1:40-45,
12. Naushad, M Mujawar. "Management of NPAs in Urban Cooperative Banks", Professional Banker, Icfai Journal, Published by Icfai University Press. 2009;56-62.
13. Ombir, Sanjeev Bansal. “An Analysis of Non Performing Assets of Indian Banks”, International Journal of Research in Commerce, Economics & Management. 2016;6(9):37-42.
14. Payel Roy, Pradip Kumar Samanta. “Analysis of Non Performing Assets in Public Sector Banks of India”, International Journal of Management (IJM). 2017;1(8):21-29.
15. Parul Khanna. “Managing Non Performing Assets in Commercial Banks” Gian Jyoti E-Journal. 2017;(1):153-163.
16. Raj Kumar Mittal, Deeksha Suneja. “The Problem of Rising Non- performing Assets in Banking Sector in India Comparative Analysis of Public and Private Sector Banks”, International Journal of Management, IT & Engineering. 2017;7(7):384-398,
17. Rama Prasad, KB Ramachandra Reddy. Management of Non-Performing Assets in Andhra Bank, Indian Journal of Applied Science. 2012;(2):13-15.
18. Samir, Deepa Kamra. A Comparative Analysis of Non Performing Assets (NPAs) of Selected Commercial Banks in India.”, Opinion: International Journal of Management. 2013;1(3):68-80.
19. Satish Chander Gupta. "Competition in Banking Sector: Changing Dynamics", The Analyst, Chartered Financial Analyst. 2009;(21):22-25,
20. Selvarajan B, Dr. Vadivalagan G. “A Study on Management of Non Performing Assets in Priority Sector reference to Indian Bank and Public Sector Banks (PSBs)”, Global Journal of Management and Business Research. 2013;13:101-113.
21. Shanabhogara Raghavendra. “Non Performing Assets in Commercial Banks in India: An Analysis”, International Journal of Research in Humanities, Arts and Literature (IJRHAL). 2018;4(6):377-386,
22. Shiralashetti AS, Lata N Poojari. Non-Performing Assets: A Case Study of Syndicate Bank”, Pacific Business Review International. 2016;10(8):87-92.
23. Sundararaman. "Recovery of Non-Performing Assets: In hot pursuit of DRT Cases", Indian Banker, IBA Journal, Published by IBA. 2008;8(3):35-36.
24. Suvitha K Vikram, Gayathri G. Analysis of Non Performing Assets”, International Journal of Pure and Applied Mathematics. 2018;20(118):4537-4540.
25. Usha Janakiraman. "From Sub-Prime Mortgage crisis to current Global Financial Crisis: An Analysis