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**Ravi Shankar Kumar**  
Research Scholar, Department  
of Commerce Business  
Administration, Lalit Narayan  
Mithila University,  
Darbhanga, Bihar, India

**Dr. ID Prasad**  
Retired Associate Professor,  
Department of Commerce  
Business Administration, Lalit  
Narayan Mithila University,  
Darbhanga, Bihar, India

#### Correspondence

**Ravi Shankar Kumar**  
Research Scholar, Department  
of Commerce Business  
Administration, Lalit Narayan  
Mithila University,  
Darbhanga, Bihar, India

## NPA: Conceptual exposition

**Ravi Shankar Kumar and Dr. ID Prasad**

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#### Abstract

Non-Performing Assets (NPAs) are such loans which dispersed by bank, to which borrower makes default in making payment of principal or interest amount. Whenever a bank is not in a position to recover the loan or regular interest on such a loan, the flow of fund in banking system is adversely affect, This dilemma related to Non-Performing Assets is distressing for the bank and for the economy of the country. An NPA is such loan assets, ceased to generate any income for the bank in the form of repayment of interest or principal.

**Keywords:** Assets, bad loan, borrower, RBI, NPA, loan

#### 1. Introduction

The NPA are the advances from banks to clients, (Customers) unable to repay the amount. The significance of resolution for NPA is understood. It is normally understood that NPA reduce profitability of a bank, weaken financial health and halt banks solvency. Resolving NPA enables banks to make free its capital available resources and make is ready for productive use. Hence, the recycling of capital in the economy of the nation in time is the prime objective of NPA resolution. NPA are major problems for the banking industry balance sheet on the asset side, having adverse impact on the income statement as the result of provision for losses. In other words, a high level of NPA in bank poses risk, which affects harmful effect on financial soundness of bank and growth in economy. Non-Performing Assets is an advance or loan amount for which interest and principal amount remained overdue for the 90 days' time-period. It is actually any type of loans or advance which is overdue for 90days or more. Any assets become non-performing whenever it ceases to generate income for the said bank. Knowledge of asset cycle can be helpful in proper management of NPA. It is asset cycle which shows how an asset move various positions depending on the repayment and recovery, for risk associated with it. Further, the recoveries are the main parameter for determination of its status of the asset cycle. The Bank get cash, fund by way of repayment from the borrowers. On sanction of a loan the bank transforms its cash into a loan asset. In the beginning, each loan the bank transforms a performing one, to generated income to the Bank. This type of performing asset is known as Standard Asset, Which do not have any problem other than simple business risk. Further whenever signal it shows of delay in recovery of dues payment and it will become NPAs.

#### NPA in Banking in India

Whenever customers, retailers or corporate houses are not in a position to pay the interest the assets becomes non-performing for the bank because it do not earn profit for the bank. In India the origination of the NPAs in the Banking Sector, can be grouped into two steps:-

1. Pre-liberalization period.
2. Post-liberalizing period.

**Pre-liberalization period:** In India NPA in the banking sector the main factors during this period are below: Down-ward trend in agriculture sectors affected by monsoon, faced all-round economic and demand recessions for the nation.

**Sectorial Reservation:** Further the Reservation of core sectors for investment by the Government in the public sector in post-independence days became significant for many

causes. In coming years most of the PSU became unviable in lack of a proper growth plan.

**Licensing:** The Standard economy with regard to global. Standard has been compromised, leading high capital costs of production of the product. This is responsible for low labour cost. In real sense labour productivity. Automation, created benefit of low labour costs in the country. Reservation in these sectors due to setting of uneconomical facilities, improper quality and product pricing despite subsidization by the Government.

**Interest Rate:** Further in the controlled interest rate era, bank are not in a position to fix price for the risk. Which led to cross-subsidization around the risk profile of the loan. Whenever additional collaterals are considered for such loan assets, in the absence of proper Legal system, the banks are not in a position to realize value from this collaterals.

**Tariff Policy:** In the absence of a long-term tariff policy, it has been problematic for the banking sector to appraise project stability during the loan pay-back era<sup>[3]</sup>.

**Role of financial Institutions:** The DFI has played a major role in the growth during the pre-liberalization period. In a way, the DFI in the country played the role of VC funding. The success of DFI can, hence be compared only with VC funding. Whenever, because of Lack of favourable legal environment, they are discredited with failures in the country.

#### **Post Liberalization Period**

Macroeconomic policies of India were old upto 1980. Several attempts were made for liberalization in the form of de-licensing of few industries and relaxation of import duties. There was an industrial boom in the early 1985 to 1988. Again a rising financial deficit resulted into macroeconomic crisis in 1992, banks were allowed to follow the Basel Capital Accord. Further, the RBI issued the first set of guideline for Income Recognition and also, Asset Classification in 1992. The central bank, with a cautions move, adopted a time-based method had changed the situation. Again, towards the end of the yester decade, the mistakes were found as those loan assets started reached up to peak, attention. Many banks set up taskforces, special asset management groups, to deal with the situation in a proper manner. By that time there was economic crisis found by the high level of NPA in the banking industry.

#### **NPA Classification in Indian Bank**

PNB further provides a wide range of bank services including personal and corporate banking, agriculture finance and industrial finance. In 1975 Tandon Committee recommended for categorizing the account of borrower into five classes namely: Excellent, Good, Average and bad and doubtful. In 1981 Pendharkar Committee was set up that recommended the grouping of advances in various categories, to measure the total quality of asset portfolio. It is the starting point for the introduction of coding system of classifying bank loan in 1985 by RBI. Till Middle of 1980, management of NPAs was left to the bank and the auditor. In the year 1985, the first time classification of assets for the

banking sector had been introduced on the recommendation of Ghosh Committee on Final Accounts. The mechanism was Health Code System for classification of bank advances into 8 classes. From satisfactory to bad and doubtful. In 1980 RBI introduced Health Code System credit. According health code system, the bank loan assets were grouped under 8 classes:

#### **This mechanism was started for grouping of the accounts as per the health code in below stated ways**

The committee on financial system, known as Narasimham committee, examined the various issue and made many recommendations. The RBI has accepted these recommendations by making modifications and laid down norms in a phased manner (1992). The entry of prudential accounting norms, which were based on the concept of NPA, Narasimha committee 1998 has submitted its second report tightening of prudential accounting norms. The Narasimham committee and the Verma committee laid the foundation for the reforms and improvement of the banking in India. At a macro level the reforms placed the structural changes in the financial sector<sup>[6]</sup>. The reforms include increase in the number of banks due to the entry of new private and foreign players, increase in the transparency of the bank's balance sheets through the introduction of prudential norms. For the encouraging speedy recovery of NPA, the Narasimham committee laid directions to introduce special tribunals.

#### **Recognition of incomes**

In the international accounting the income from NPAs are not only on the ground of accrual accounting system but on occurrence of right receipts of income. Hence, Reserve Bank of India focused banks to consider interest incomes from NPAs based on the records of recovery<sup>[7]</sup>. With regard to NPA, fees, commissions and same other incomes must be accrue in the current period and must be reversed to the past periods, if it is uncollected. Any interest of incomes on NPAs are to be treated as incomes provided it is not arise out of fresh or additional credit.

#### **Provisioning**

According to the Reserve Bank of India the RBI guidelines, the provision of loan assets, investments and some other assets, becoming doubtful of recovery, bank require to make provisions against the four group of loan assets as stated below

#### **Writings-off NPA**

Under Income tax Act, 1961, sec 43(D) interest to loan assets under bad and doubtful debts, will be chargeable to the tax imposed in the preceding year in which it has accounted in the bank profit and loss account, practiced which is earlier fit for tax deductions. But it is not in the NPAs accounts which is set aside for making provisions. Hence, the banks in India must make full provisions as per the guidelines / write-off advances and claim like tax benefits as applicable, by adopting appropriate methodology in consultation with its tax consultants. Recoveries made in this account must be offered for tax purposed according to the rule.

## Methods of Setting NPA

### 1) Prior to loan account transforming in NPAs

- Checking to compliance of authorized terms to sustain asset quality.
- Recover over dues amount fastly so that guarantee account doesn't go to NPA mode.
- Timely review of charged assets along with financial data.
- Re-structure dues before the loan accounts grow NPA.

### 2) Later on loan accounts transforming in NPAs

Below stated methods can be used for recovery of dues. The following methods must be practiced for setting of NPA.

- Compromise settlement (dues) by negotiation process.
- Advance recalling.
- Appropriation of liquid securities.
- Dispose of other securities with borrowers' co-operation.

### Narasimham Committee

For making reform in banking sector a committee was set-up under the chairmanship of M. Narasimham (Former governor of RBI and also architect of banking industry reform). The purpose of this committee was to examine various aspects related to the structure, organization and process of the financial structure for making proper improvement. The committee had be much more interested to negate and reduce Non-Performing Assets to 3 percent by the year 2002. This Committee has recommended as follows

1. Minimization of Liquidity Ratio
2. To negate Directed credit programme
3. Enhancement of Bank Accounting Method.
4. Determine of free interest rate
5. Set-up special type of Tribunals.
6. Deregulation of Interest rate
7. Full disclosure of accounts and accurate grouping of assets.

The M. Narasimham Committee was set-up in 1991 which contains nine members. This committee has given focus on three big banks with country by setting up of three big banks with international presence.

On the basis of recommendation of this committee below stated recommendation has be considered.

- To reduce SLR from 38.5 percent to 25 percent
- To follow CRR from 15 percent to 4.2 percent
- To attain CAN of 8 percent
- Give freeness to PSCB to set interest rate

Indian Government and also Reserve Bank of India has taken many initiatives to curb the finance of increasing trend of NPA. The Narasimham Committee had tasked to present the progress review of the implementation of the bank reform. This committee has given recommendations for achieving the vision of proper financial inclusion and also financial Deeping in proper manner in order to improve proper stability. After diagnosing the weak financial performance of banks. The Narasimham Committee has recommended for various reforms in Indian banking sector. In India banking sector has been treated as life line of economics and hence significant reform was required to promote the development of banking sector in India. For

attaining this objectives the committee recommended for making banking system more competitive, efficient and productive.

### Verma Committee

Under the chairmanship of Verma the Indian Government appointed a committee to operation the suggestions to know about the fundamental duties to the people of India, this committee submitted its report in 1999. The Verma Committee was set up on fundamental duties of the people of India, to identify the existence of legal provision for the implementation of the some of fundamental duties. Verma Committee was constituted to plan a strategy and to work on the methodology for implementation of programme initiated for the whole country for the purpose of educating fundamental duties and to make it enforceable in every education organization. Justice very was a highly regarded as eminent jury and chief Justice of Supreme Court. He was a top level judicial activist. He was the symbol of judicial innovation. Verma Committee has given focus on restructuring of poor performance of PSCBs in India. Whenever the reform process began in banking structure in 1991. The Indian banking sector has forced to adjust in new business environment with model set of objectives.

### Classes of NPA

NPA does not bring substantial income to its owner. Basically, it is have something that can perform but actually it don't perform. The RBI has issued guidelines for banks to group assets into four categories:

According to the guidelines financial assets are sub-divided into 4 classes, namely

(A) Standard Assets (B) Substandard Assets (C) Doubtful Asset and (D) Loss Assets.

Broadly speaking below stated types of NPAs must be considered

- Sub-Standard Assets
- Doubtful Assets
- Loss Assets
- Standard Assets

### Forces: External

- Effect of Trade Cycle on Business Environment
- Borrowers Willful Default
- Contingency
- Instable Government Policies
- Industrial Sickness

### Forces: Internal

- Defective MIS
- Poor Documentation of KYC
- Credit Appraisal Management Deficiencies

### Conclusion

As per study of the data available Punjab National Bank has highest NPA amount other, Commercial Banks further PNB is expecting to recover from bad loan to more than the slippages amount in the coming years. According to the mandate of the report of (1991) Narasimham Committee and Basel Accord capital standards (1992) were to be adopted. The 9 percent adequacy ratio had to be met by foreign banks in India (1993).

Indian bank with a foreign appearance had to reach the 9 percent March 1994, while domestically operating banks had until (March 1996) to implement the requirement. In 1994 various changes were taken place. The year between 1994-1998, Non-Performing loans became a major problem in banking system in India. It comes from 26.4 percent in 1995 to 18 percent in 1998 in PSCB. This scenario was not confined only to PSCB, ever Private banks were also having NPA of 11.8 percent during 1998 and 4.7 percent of NPAs were handled by foreign players. Narasimhan Committee II submitted its report in 1998 and recommend the changes in different heads.

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