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Impact of Non-Performing Assets on Indian Banking Sector: A Post Pandemic Analysis

Dr Pavan Kumar Gupta
Associate Professor ,Deptt. Of Commerce
Govt. Model Degree College ,Arniya, Bulandshahr

Abstract:

As per an official statement by RBI on 22nd May, 2020, every one of the commercial banks, co-operative banks, all-India financial institutions and NBFCs were allowed to permit a moratorium on instalment of portions of all term-advances up till 31st August, 2020 for the first time. On May 5, 2021 the RBI governor announced yet another moratorium for individuals and small businesses. The borrowers were given an opportunity to avail for a moratorium of 2 years or less for which they last date of application was till Sept 31, 2021. The greater parts of the borrowers in India are hard-headed defaulters and stay away from paying instalment of the credit portions either on schedule or not in the slightest degree. By giving the arrangement of conceded instalment of credit portions the RBI has in a manner given a free pass to the borrowers and they might keep on defaulting now like never before. The pandemic continues, and a third wave is expected in the near future. So, the world economy is still completely not recovered. Indian economy especially, was hard hit by the second wave of CoVid-19. However, the vaccination drive being successful has given a hope of revival to different sectors and it is being expected that the disease is now under control as maximum population has been vaccinated. The current paper is an attempt to discuss the financial implications of CoVid-19 on the banking sector and how it has contributed to the amplification of NPAs.

Introduction

Non-performing assets (NPAs) have become an integral part of every banking sector lately. They continue to impair financial progress of banks in world economies. Due to the rising levels of NPAs, the banks tend to suffer which in turn decelerates the prosperity of financial system in a country. Banks are the heart of a financial system. They bridge the gap between givers and takers i.e., the ones who have surplus money are given options to invest that money and the ones who lack money are provided

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with different opportunities to borrow such money. Financial intermediation is a valuable service offered in a stable banking framework that rouses individuals with surplus cash to change over their reserve funds into investments for rapid development of the economy (Alhassan et al., 2014). The banks provide interest to those who invest their money and charges interest from those to whom it lends. The spread between these two is the bank's income. When the borrower ceases to make interest/principal amount payments to the bank for a period exceeding 90 days, it becomes a Non-Performing Asset. As per the master circular released by Reserve Bank of India (RBI) in 2009, a non-performing asset would be a loan or advance where:

i. interest and/or instalment of principal loan remain overdue for a period of 90 days in respect of a term loan,
ii. the account remains 'out of order' continuously for 90 days in case of an Overdraft/Cash Credit.
iii. the bill remains overdue for a period of more than 90 days for bills purchased and discounted,
iv. the installment of principal or interest thereon remains overdue in case of two crop seasons for short duration crops,
v. the installment of principal or interest thereon remains overdue in case of one crop season for long duration crops,
vi. the amount of liquidity facility remains outstanding in case of more than 90 days, in respect of a securitization transaction undertaken in terms of guidelines on securitization dated February 1, 2006.
vii. for derivative transactions, the overdue receivables that represent a positive mark-to-market value of a derivative contract, if these continue to be unpaid for a period of 90 days from the specified due date for payment.

Review of literature: This section covers published articles, papers etc., regarding the topic under discussion in this paper. NPAs are being analyzed from a long time, but the study of impact of CoVid-19 on various economic sectors is an up-and-coming area to be examined as the pandemic still continues in various parts of the world.

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Yurttadur et al (2019) established a connection between the health of financial markets and banks' performance stating that any choppiness in the financial sector disturbs the financial performance of banks. Non-performing assets acting as a disturbance, tend to deplete the efficiency of banks.Indian banking sector has witnessed a great deal of changes over the years with respect to the value of NPAs. The NPAs were higher in the 90s. Around the late 90s the management of NPAs got better and till early 2000s the number of NPAs started to fall (Sen&Ghosh, 2005; Nagarajan et al., 2013). The common view has been that NPAs started to rise after Global Financial Crisis hit the whole world (Maji, 2019). Batra&Batra (2020) posit that due to the high rise of NPAs after 2008, the public banks have suffered the most (when compared to domestic private and foreign banks).Kiran& Jones (2016) noticed the poor management of NPAs by public banks in India. Sharma (2019) identified that private and foreign banks are better performers in terms of NPAs as compared to the public banks in India. Rising NPAs can have detrimental impact on banks' monetary position. Michael et al (2006) discovered that the rise of NPAs result in subsequent rise in the bank reserves thereby reducing the overall liquidity and profitability of the bank, thus disturbing its solvency position. Chiesa&Mansilla-Fernandes (2021) observed that NPAs decrease the loaning limit of banks. Gaur &Mohapatra (2021) identified an indirect relationship between NPAs and profitability i.e., as NPAs rise, the profitability of the banking enterprises starts to fall. NPAs can rise due to a number of macroeconomic and bank specific factors. Bayar (2019) found out that unemployment and public debt gave a boost to NPAs while growth in economy, lending/ borrowing operations of government, inflation, freedom of operation curbed the value of NPAs. They also revealed that credit growth, rise in capital adequacy ratio, rise in return on assets and equity ratios and increasing non-interest income also reduced the NPAs to a great extent. They also noted the highly positive impact the 2008 financial crisis has had on the NPAs. Rizvi et al (2019) put forth the role of political as well as economic environment in defining level of NPAs in a country. Vouldis and Louzis (2017) believed that macroeconomic factors have proven to be prominent determinants of NPAs. Apart from these return on equity, return on assets and bank efficiency also determines the value of NPAs in banking sector. Abid et al (2014) proffer that growth in GDP, inflation and lending

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rate are chief determinants of NPAs in an economy. Goyal&Verma (2019) regard inflation as an important factor in rise of NPAs that further results in decreasing overall credit growth and demand. Das &Ghosh (2006) uncovered a link between several variables and NPAs. They pointed out that as NPAs rise, the bank's efficiency reduces thereby increasing banks' expenditure to manage the bad loans. This in turn also diminishes the overall growth of economy due to the augmented interest rate spread. Apart from these factors, priority sector lending has also resulted in the magnification of NPAs among Indian banks. Ahmed (2009) highlighted a noteworthy increase in the NPAs of priority sector due to negligence of banks in employing stringent measures to recover the bad loans. Also, it was noticed that priority sector advances (and thus NPAs) are higher in the public banks compared to private sector banks (Shabir&Mujoo, 2014). Another prominent factor that has been affecting level of NPAs is the recent CoVid-19 pandemic.

Discussions

Since the end of 2019, the coronavirus rapidly spread all over the world. A small sized virus created huge ripple effects encapsulating the whole world. Past two years have been very tough for many business organizations. Banking sector particularly suffers the most because it connects different businesses. It helps in provision and receipt of finance through these firms. Banking is linked to all other industries like tourism, aviation, telecom, agriculture, real estate and construction, education, etc., If these businesses, especially those who took huge loans and advances from the banking industry are unable to carry on their business efficiently, they would be unable to pay back the loaned amount. Also, the individuals who work in such organization are mostly out of jobs and they too indulge in huge amount of borrowing via personal loans, educational loans, automobile loans, housing loans, etc., causing difficulties for them to pay back those loans

Another aspect to be considered is that people who used to invest in banks or borrow fresh loans are now very discouraged due to do so because of the fear created by the pandemic. Also, the buying-selling equilibrium has been disturbed. People who lost their jobs in the pandemic are using their savings not for investment but for fulfilling needs of routine nature, children's education, medical bills, etc. Hence, the savings-investment cycle has also been disrupted as savings are not being infused in the

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economy as they used to be earlier. The flourishing businesses in the pandemic are Information Technology (IT) and telecom as work-from-home became the new normal during the pandemic. Office meetings, conferences, seminars, classes of schools/colleges/universities, etc., were conducted through online mode. E-commerce websites like amazon, myntra, urbanic, derma co., nykaa, etc., have been providing services in these tough times as well only through good internet connectivity and proper infrastructure in place. Banks through their internet monetary assistances also have aided ease in carrying on such businesses. The term 'cashless-delivery' gained a lot of popularity during the pandemic and helped in lower contraction of the CoVid-19 disease. This was possible through the internet banking facilities. Such services helped different firms maintain their business in these tough times. As far as statistics are concerned, the Trends & Progress Report of RBI, 2020, conveyed that NPAs have declined from 9.1% in 2019 to 8.2% in 2020. However, the figures are dubious because of the fact that more than 40% of borrowers have opted for the two-year moratorium. Without knowing the actual figures of recovery from these borrowers' accurate conclusions can't be made. Thus, the current Gross NPA ratio doesn't reflect the real pressure the Indian Banking sector is facing. In my opinion, the moratorium is going to have a detrimental impact on the economy in the long run. Another measure the government took was to infuse Rs. 20,000 Crore into public sector banks for their revival. The private banks on the other hand have been self-dependent in arranging for the finance to maintain stability during and after the CoVid-19 crisis. Banks themselves also need to incorporate measure to avoid piling of NPAs due to CoVid-19. With the assistance of legitimate innovation and joint effort with the IT sector Indian banks can limit the impact of CoVid-19 on taking off NPAs. For example, BCT Digital presented the very first continuous Early Warning System (EWS) to control the troubles cause by NPAs in India. With the assistance of creative advancements like artificial intelligence (AI), machine learning (ML) and streaming, the banks and different moneylenders can now recognize questionable exchanges in advance records on a constant or a close to continuous premise, which will work on the general wellbeing and state of the financial framework overall. Along these lines, leap forwards like this should be accomplished by the financial sector in the hour of this pandemic to keep away from

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shattering totally. Financiers need to create better habits by which the bad loans could be limited. In the coming time they need to assess the advances significantly more forcefully by placing in tough advance examination standards. The screening process of the advances should bedeepened all the more intently so that defaults are least. This should be possible with the assistance of most recent advances along with help of IT firms. Lastly, banks must find the right market for selling bad loans to recover appropriate amount of money lost in NPAs. For this purpose, some kind of foreign intervention would prove to be very beneficial. Foreign investment in the sector could increase in the near future, but this could be another far sighted assumption which can hold to be true or not.

Limitations of the study

The study is conceptual in nature due to paucity of time and data required to conduct it. It is based on secondary sources of information. Further studies could be conducted using empirical methods and tools of analysis. The possibility of subjectivity also exists.

Conclusion

The CoVid-19 pandemic changed the life of every human on this planet. This pandemic has taught people to survive and maintain their existence in the possible way under given circumstances. Business firms have suffered considerable number of shocks since the pandemic has started. In case of individuals, be it the labor class or a highly paid company official, everyone has faced the severe crunch of finance due to loss of jobs and reduction in salary. While some entities got a chance to grow and experiment, several others found it difficult to even survive through this tough time. In between all of this chaos, banks being the managers of finance, have too suffered due to the increased defaults.

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