==

NPA menace in the Indian Banking Sector -

An analysis.

==

Prepared by:
Chandra Sekhar Gupta Boggarapu
Founder, Proletarian Power
(proletarianpower.org)
Dt:18th February, 2020.

Assisted by:
Manasa Devi
Student : CA Final

NPA menace in Indian Banking Sector :

Non-performing Assets or NPAs is a menace Indian Banking Sector is unable to get rid of. Before going into the nitty gritty of this problem, let us understand first what is NPA and how it arises and how it affects the Banking Sector and what is '**public interest**' in it.

NPA simply means a bad debt, that is when a borrower is unable (or unwilling, sometimes) to repay the loan taken. Indian Banking Sector loses lakhs of crores of rupees each year to this monster. What is interesting is that while this problem is literally ruining Public Sector Banks, it is hardly felt by Private Sector Banks and Non Banking Finance Companies (NBFCs). While NPA level is in double digit in Public Sector Banks, the same is in low single digit is Private Sector Banks (Please see Table1). This comparison is indeed important because both of them operate in the same economic environment and are subject to the same regulations (NBFCs follow slightly different regime). There are many reasons for this difference in performance. We will come to that a little later.

Table 1 :

	Public Sector Banks (PSB)			Private Sector Banks (PvSB)		
Year ended on 31st March	Gross Advances (Rs.in Crores)	Gross NPAs (Rs. in Crores)	NPAs as a percentage of Advances	Gross Advances (Rs.in Crores)	Gross NPAs (Rs. in Crores)	NPAs as a percentage of Advances
2010	25,19,331	57,301	2.3	7,35,892	20,929	2.8
2011	30,79.804	71,042	2.3	9,10,501	21,505	2.4
2012	35,50,389	1,12,488	3.2	11,04,559	22,410	2.0
2013	45,60,169	1,64,461	3.6	14,24,366	25,592	1.8
2014	52,15,920	2,27,264	4.4	13,60,253	24,184	1.8
2015	56,16,718	2,78,468	5.0	16,07,339	33,690	2.10
2016	58,21,952	5,39,956	9.3	19,72,659	55,853	2.8
2017	58,66,373	6,84,732	11.7	22,66,721	93,209	4.1
2018	61,41,698	8,95,601	14.6	27,25,891	1,29,335	4.7
2019	65,64,558	7,89,568	12.0	32,60,249	1,30,844	4.0

Note: 1. IDBI bank is included in PSBs for 2019 though it became PvSB, technically speaking, in Jan.2019.
Note: 2. Figures for 2019 are provisional.

Each year Public Sector Banks write off NPAs worth tens of thousands of crores. (Please Tables 2a & 2b).This loss is made good by the Government by recapitalizing the affected banks year after year using public money. There are allegations that most of these NPAs, particularly corporate NPAs, are due to diversion of funds, fraud etc., Yet neither the government nor the banks/intellectuals seem to have any solution for this menace.

Table 2a : NPAs written off by Public Sector Banks yearwise:

Year ending 31st March	NPAs written off during the year (Rs. in Crores)	NPAs attributed to Industry and Service* (Rs. in Crores)	NPAs attributed to Industry and Service* as a percentage
2010	11,185	Not available	--
2011	17,794	Not available	--
2012	15,551	Not available	--
2013	27,231	Not available	--
2014	34,409	Not available	--
2015	49,018	41,323	84.30
2016	57,585	45,354	78.76
2017	81,683	65,645	80.37
2018	1,28,229	1,07,764	84.04
2019	1,83,202	1,47,659	80.60

* Industry + Services is taken as a representative figure for corporate borrowers (figures available only from 2014-15).

Table 2b : NPAs written off by Private Sector Banks yearwise:

Year ending 31st March	NPAs written off during the year (Rs. in Crores)	NPAs attributed to Industry and Service* (Rs. in Crores)	NPAs attributed to Industry and Service* as a percentage
2010	7,596	Not available	--
2011	3,018	Not available	--
2012	3,695	Not available	--
2013	4,896	Not available	--
2014	6,461	Not available	--
2015	7,126	4,075	57.19
2016	11,675	8,761	75.04
2017	21,519	17,303	80.41
2018	30,594	20,162	65.90
2019	48614	32,185	66.21

* Industry + Services is taken as a representative figure for corporate borrowers (figures available only from FY 2014-15) .

It is high time something is done to arrest this, particularly with reference to Public Sector Banks because these losses are made good by the Government using public money. Let us try to understand the reasons for this situation first so that we can find a suitable and effective solution. Main reasons for this, according to us, are:

- <u>Inferior professional and technical skills</u> : The first and the most important reason is, people working in Public Sector Banks suffer from poor and inadequate skills. When we say people, we are referring to employees in all cadres, from Chairman/MD to Field Officer at the Branch. While the top management has no clue about what direction the country's economy is taking and how the macro economic environment, domestic and

  international, is evolving, lower cadres suffer from lack of training and inadequate appraisal skills. There may be many reasons. But the fact is Public Sector Banks suffer from poor understanding of the economy at the macro level. Public Sector Banks have no idea about dynamics of different industry segments. Each industry/sector has its own peculiarities, its own dynamics. This knowledge plays a very important role in decision making. Maybe when India was a closed economy these skills didn't matter much. All that they were expected to do was to handover public money to some influential industrialists who managed to get Licences from the Government. But it is a totally different scenario now. Unless people, again everyone - top to bottom - are well trained and well versed with what they are doing they are bound to make mistakes (put it differently, they will get conned by the wily borrowers). This is the main differentiator between Public Sector Banks and Private Sector Banks, according to us. This is clearly reflected in their performance. While most Private Sector Banks produce exceptionally good results year after year, the Public Sector Banks put up mediocre and disappointing shows almost always in spite of lower cost of funds. This becomes abundantly clear from the market capitalization and PE multiples commanded by Public Sector Banks and Private Sector Banks respectively . Investors are willing to pay double/triple PE multiples to buy a Private Sector Bank. To put it in proper perspective, market capitalization of entire Public Sector banks today is less than one Private Sector Bank.

- <u>Unscrupulous Businessmen/Industrialists</u> : Next big reason, according to us, is unscrupulous businessmen. There are plenty of them in India (probably everywhere else in the world). When I was still working in the Corporate Sector, we used to joke 'one can see a lot of sick industries in India but never a sick industrialist'. But how come most of the time only Public Sector Banks fall prey to them. The story that goes around lately is, now infamous Vijay Mallya first approached a top notch Private Sector Bank for a loan which, of course, was politely rejected and what happened next is known to everyone. Now one can understand how efficiency matters in the banking industry. Root cause of this may lie in the wrong policies pursued by the Government right from the beginning, but that should not become an excuse for the Public Sector Banks. For the sake of brevity we will not get into those details.

- <u>Lack of operational freedom and political interference</u> : Another important factor that seems to affect the Public Sector Banks is lack of freedom to operate the bank as per the prevailing market conditions and political interference. Often 'Rulers' come up with schemes that may not be in the best interest of the Banks, but are to be obliged by Public Sector Banks being public owned. Further we also hear, from time to time, how powerful political leaders manage to get loans to the entities that are close to them from Public Sector Banks. In all these matters, the Banking Sector's interests are compromised.

- <u>Corruption in the Sector</u> : Corruption in the Banking Sector is relatively low, particularly compared to other government departments like revenue. Nevertheless it exists. Corruption always leads to undue enrichment of selected few at the cost of public at large.

- <u>Slow / time consuming judicial system</u> : Efficiency or lack of it of Indian Judicial System has a notorious reputation. Cases often drag on for decades. Knowing this, mischievous borrowers will dodge/avoid repayments. Efficiency of the recently introduced Insolvency Law is yet to be proved.

- Failure on the part of auditors (in the case of corporate borrowers) : Finally and most importantly, auditors not performing their duty as per the standards expected from them. This is a huge systemic problem. Quality of the auditors is never an issue. India produces world class Chartered Accountants. Problem lies with the system we follow. Auditors of an organisation, wherever necessary, are appointed by the management. Their terms of pay etc. are fixed by the management. (Law may say many things but the reality is that promoters/managements appoint Auditors in most of the cases). Obviously the auditor's loyalty rests with the management. This needs to change forthwith. Unless the auditors are freed from the shackles of the management they can not be expected to be free and honest. Ideally whenever an organisation raises finances from the public, directly or indirectly, auditors of it should be appointed by an authority in a transparent manner. A detailed framework needs to be developed in this regard.

What is our interest in it?

The Government of India has pumped in more than Three lakh crores into Public Sector Banks in the last 10 years. That is direct infusion. If we take into consideration funds given to these banks indirectly then the amount would increase many folds. At the end of the day, combined market cap of all these PSBs put together is less than what they got, directly and indirectly. This is nothing but pure wealth destruction, wealth of the common-man/proletariat. That is our core concern.

Conclusion :

What can possibly resolve this crisis? The following measures, according to us, would go a long way in resolving this deadly menace :

1. **Freeing the Auditors from clutches of the Promoters** : While rectifying issues like poor skills, slow moving judiciary, corruption etc., may take some time, making auditors truly independent is both possible and desirable with immediate effect since major chunk of NPAs is contributed by the corporate sector. If needed, relevant laws should be amended without losing further time. When auditors become truly independent, not only

   their performance improves leading to containing the problem of NPAs but also can be expected to result in multiple benefits to society like detection of money laundering cases, checking misuse of Government schemes, preventing round tripping and host of other dubious practices undertaken by unscrupulous business entities. We strongly feel that had auditors been truly independent, yesteryear scams like Satyam Computers and relatively recent scams like IL&FS, PMC banks would not have taken place.
2. **Giving freedom to the Banks** : As already stated, when India was a closed economy, efficiency of the management was not paramount. But now the economy is not only

more open but it also has very agile Private Sector Banks who are challenging the age old Public Sector Banks on all fronts. They are growing at much faster pace than that of their Public Sector counterparts. Only way the Public Sector Banks can survive this competition is by becoming more professional. That is unlikely to happen as long as the Government (Big boss) is controlling everything. Given freedom, these banks may go one way or the other - either they hone up skills and rediscover themselves or go into oblivion and die a natural death. Either way they stop burning public money endlessly.

3. **SCBs vs NBFCs - Is there an advantage NBFCs are enjoying?**: Of late we see NBFCs have grown in size and aggressively competing with Scheduled Commercial Banks (SCBs) even in the areas that are traditionally dominated by SCBs. We wonder whether NBFCs have an unfair advantage over Scheduled Commercial Banks or is it that they are more efficient? We do not know but we would like to examine this aspect closely. (What we do know, of course, is NBFCs have some advantages in statutory compliance areas and have great deal of flexibility in decisions making compared to SCBs). Further this question bothers us because many banks, particularly Private Sector banks, promoted NBFCs that do exactly the same business as that of their promoter Bank.What prompted these banks to promote NBFCs? While we are on the job we welcome inputs from any knowledgeable source.
4. **Improving the judicial system** : Finally elephant in the room - dysfunctional judiciary. Courts in India have a notorious reputation. Cases drag on for decades. This needs to change. Recently introduced Insolvency Law may be in the right direction. But these are early days.

Postscript: In a strange coincidence, when we were finalising this discussion paper, the Ministry of Corporate Affairs, Government of India has released a consultation paper on 6th Feb. 2020 inviting suggestions from the public about making Auditors independent. We were pleasantly surprised and really liked that. For a change we and the Government are on the same page or at least seems to be so.

Proletarian Power is a ‘not-for-profit’ entity primarily engaged in analyzing macro economic environment in India from ‘public interest’ angle.