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ROLE OF NON PERFORMING ASSETS – A MSMEs PERSPECTIVE

Dr.J.Venkatesh[1*], Ms.R.Lavanya Kumari[2]
[1*]Associate Professor Department of Management Studies Anna University Regional Centre Coimbatore,Navavoor, Tamil Nadu, India
[2]Ph.D (PT) Research Scholar in Management, Karpagam University, Coimbatore, Assistant Professor, St. Joseph's Degree & PG CollegeBasheerbagh, King Koti Main Road,Hyderabad – 500 029, Andhra Pradesh, India
Correspondence Author: drjvmba@gmail.com

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Abstract
This article is to provide an insight into the concept of Non-Performing Asset(NPA), a standard criterion for Micro Small Medium Enterprises sector.An asset becomes non performing when it ceases to generate income for the Bank. Non-performing assets are one of the biggest challenges facing the global banking system, and particularly Indian banks. The extent of the challenge for nationalized banks is that non-action is no longer an option. But on the same time SME units are prone to various business risks due to which they fall sick or sometimes closed due to heavy losses or many of them becomes NPA in the accounts of the banks. This issue is likely to get worse due to the overall economic slowdown impacting most customer segments across banks' portfolio like MSMEs (Micro, Small and Medium Enterprises), large corporates, and agriculture.

Introduction
NPA can be defined as an advance where payment of interest or repayment of installment of principal (in case of term loans) or both remains unpaid for a certain period. In India, the definition of NPAs has changed over time. According to the Narasimham Committee Report (1991), those assets (advances, bills discounted, overdrafts, cash credit etc.)for which the interest remains due for a period of four quarters (180 days) should be considered as NPAs. Subsequently, this period was reduced, and from March 1995 onwards the assets for which the interest has remained unpaid for 90 days were considered as NPAs.A non-performing asset shall be a loan or an advance where:

- Interest and/or installment of principal remain **"overdue"*** for period ofmore than 90 days in respect of a Term Loan.
- The account remains **„Out of Order"**@ for period of more than 90 days,in respect of an Overdraft/Cash Credit (OD/OS).
- The bill remains overdue for a period of more than 90 days in the case ofBills purchased and discounted.
- In the case of agricultural loans, other than direct finance to farmers forAgricultural purposes, identification of NPAs would be done on the samebasis as non-agricultural advances.
- Any amount to received remains overdue for a period of more than 90Days in respect of other accounts.A non-performing asset (NPA) is a loan or an advance where it is due or outstanding for the following instances:

Overdue interest:
Interest amount and/ or instalment of principal amount remain overdue for a period of more than 90 days in respect of a term loan is characterized as non-performing assets or non-standard assets.

Overdraft or cash credit:
The account remains "out of order" for more than 90 days in respect of an Overdraft/Cash Credit (OD/CC).

Overdue bills:
The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

Short duration crop:
The instalment of principal amount or interest thereon remains overdue for two crop seasons for short duration crops.

Long duration crop:
The instalment of principal or interest thereon remains overdue for one crop season for long duration crops.

Securitization liquidity:
The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction undertaken in terms of guidelines on securitization dated February 1, 2006.

Overdue of derivatives:
In respect of derivative transactions the overdue receivables representing positive mark to-market value of a derivative contract, if these remainun paid for a period of 90 days from the specified due date for payment. Banks and financial institutions should have to divide the assets and resources in the form of NPA when the contractual obligations interest, related charges are due during for any quarter is not serviced fully within 90 days from the end of the quarter. Any amount due to thebanks and lending institutions under any credit facility is "overdue" if it is not paid on the due date fixed by the lending institutions and banks is called non

performing asset.

Significance of non-performing assets

The Importance of Non – Performing Assets has become more and more since the formation of Shri M. Narshimham Committee on banking sector reform in 1991. It is a second landmark in banking sector in India after nationalization of banks. After nationalization of banks it has been given much attention on the lending policy of nationalized banks but not much attention has been given to the recovery of advances of nationalized banks by Reserve Bank of India (RBI). Recovery of non – performing assets has become critical performance area for all banks in India. The level of NPA reflects not only on the quality of loan portfolio but also the capability of the bank management in managing their advances portfolio. So it is necessary for bank to recognize, manage and reduce the Non Performing Assets. Almost Rs 6000 crores of Public Sector banks are blocked in small enterprises NPAs. Hence these banksare risk averse to expanding their small enterprises portfolio or to plans what they have for the times of crises.

Causes of non performing assets

The causative factors for rising NPAs in the banks are elaborated as under the following: Business Environment, Borrower & Banker.

Business environment

Business environment refers to economy, regulatory regime, legal system and political climate in which banks are operating. The causative factors attributing to business environment are as under:

1. Recession in the economy
2. Sudden change in Global & Domestic markets
3. Lack of conducive legal system for loan recovery i.e. inadequate legal provisions on foreclosure & bankruptcy laws and dilatory legal procedures in enforcing security rights
4. Lack of cohesive regulatory framework
5. Political pronouncements like debt relief
6. Socio-political pressures on commercial credit decisions
7. Vitiated loan repayment culture
8. Policy reversal i.e. changes in governmental policies, for example cancellation of Telecom & Coal mine licenses in recent times.
9. Natural Calamities
10. Scams

Borrower

The causative factors attributing to borrowers are as under:

1. Improper choice of project/activity
2. Adoption of obsolete technology
3. Promoters/ Management disputes
4. Inefficient management
5. Resource crunch
6. Strained labour relation
7. Diversion & siphoning of funds
8. Willful defaulter
9. Fraudulent intention

Banker

The causative factors attributing to bankers are as under:

1. Lack of credit skill
2. Delay in credit decision & disbursement
3. Credit decision taken under extraneous influences
4. Lack of proper credit monitoring
5. Lack of effective NPA management

Significance of MSMEs towards NPAs

The MSME sector, with its significant contribution to the Gross Domestic Product of the country, has become a critical part of the economy; The MSMEs are the growth engine of the nation. It is the link between agriculture and the large industries. It contributes to the growth of GDP and brings down inflation. The significance of MSMEs is, therefore, the biggest priority today, especially in view of the ongoing recession. India is primarily a nation where majority of business are Micro Small and Medium

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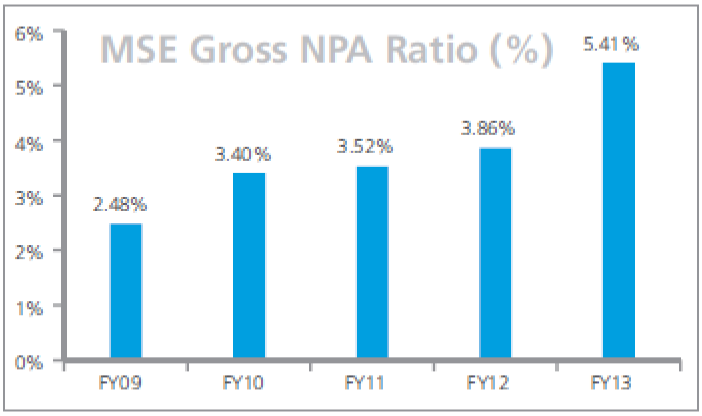
Enterprises (MSME). Almost 40 per cent of our exports come from this sector which contributes about 8% of the GDP. SMEs account for 110 million jobs and generate two and half million jobs every year. Some of the most fertile and brilliant minds have risen from the ranks of these enterprises. Growth of MSME is vital to our economy and yet today they are badly crippled by the poor policies of the banks and government.Large numbers of MSME companies are plagued by their inability to repay the loans from banks and as a consequence stand to forfeit their business altogether.

The Micro, Small and Medium companies that default on their borrowings from banks face closure and even lose their assets pledged as collaterals. NPA has been pioneering in assisting the MSME sector to achieve a turnaround from their debt crisis and guiding them on the means and methods to counter the situation. "Any company defaulting on its loan repayment for more than 90 days is considered to be a Non Performing Asset (NPA). After the statutory 90 days period the Banks/ Financial Institutions initiate the process of selling the mortgaged assets to recover the dues. By doing so, the Bank virtually cripples the day to day operations of the company by adjusting all monies deposited against their dues. Instead of extending helping hand to extricate the companies from the situation, the banks are essentially putting them out of business. The borrowers find themselves in a helpless situation and at the mercy of the Bank." NPA borrowers since a decade has helped many such MSME companies that have defaulted on their bank loans deal with the banks and work out a revival proposal by using NPA property as 3rd party security for an eligible borrower and developing a viable business proposal between the two.

The role of MSEs in Indian economy is becoming vital. MSMEs thus require higher credit facility tooperate efficiently. The credit to MSE sector witnessed an upward trend since the beginning of the current financial year. However, medium enterprises credit growth has been lower in comparison with the credit growth in the MSE sector. The Reserve Bank of India announced three special policy measures in order to extend the liquidity support to MSMEs. A Re.50 billion refinance fund specifically for micro & small enterprises (MSEs), enhancing the exposure limit for MSMEs to Rs.10 Crore from Rs.5 Crore and extension of the priority sector lending status (PSL) to incremental loans made out to medium enterprises (MEs) givingPSL status to incremental loans extended to MEs which may to lead to higher willingness among banks tolend to the sector. Moreover, the enhancement of the exposure limit is also likely to incentivize banksto extend credit flow to the MSME sector. Economic slowdown, high input costs and high interest rates have affected MSEs' repayment ability, leading to increase in NPA levels as shown in the below figure:



Source: RBI

Non performing assets life cycle

The lifecycle of NPAs in banks has three main stages: Identification of stressed assets and NPAs, investigation bymeasurement and obtaining insight and lastly, resolution through crisis management and revitalization assets. The Reserve Bank of India (RBI) has taken a number of steps which are pushing banks in India to be more proactive in recognition of stress and to take remedial steps so as to preserve the economic value of assets. As a part of such efforts, Special Mention Accounts (SMAs) classification has been recently introduced with defining a time bound procedure towards deciding the course and nature of remedial actions. In addition, it is also strengthening the NPA resolution ecosystem in India including increase in foreign participation rules in ARCs in India and bringing a sunset clause to the regulatory forbearance accorded to restructured accounts. There is also an increasing demand from industry to keep MSMEsout of the ambit of SMAs.

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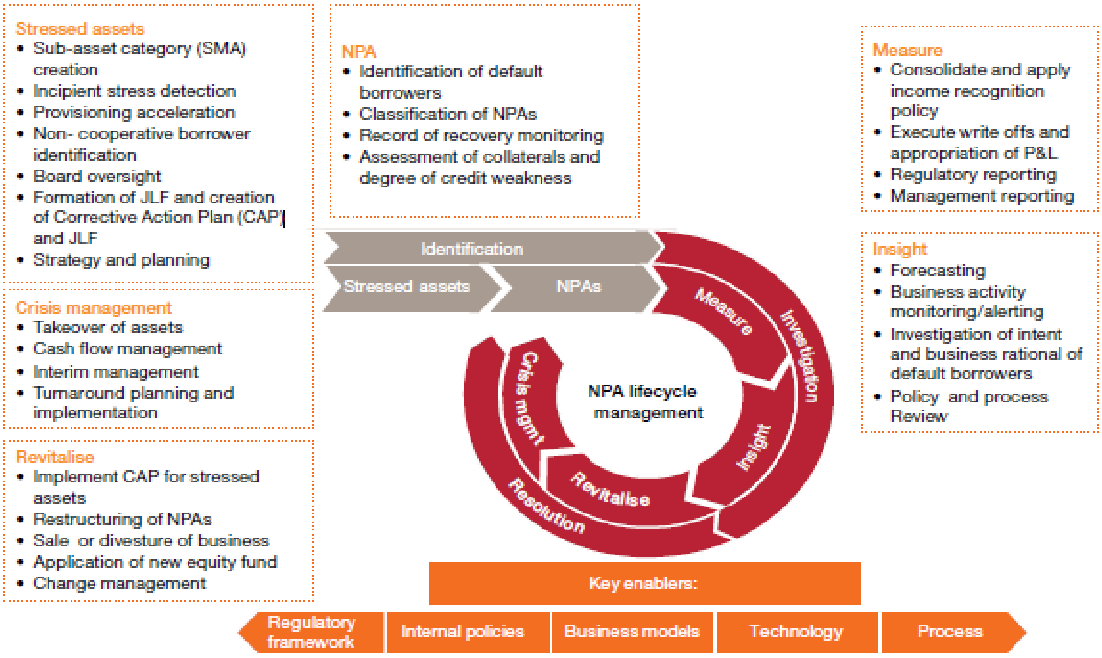

The prudential norms provide for banksis for the diminution in the value of non-performing assets based on their categorization in 'sub-standard', 'doubtful' and 'loss'. This categorization of a non performing asset is based upon its ageing as a non-performing asset. The norms also take into account the availability and quality of collateral in determining the amount to be provided. Further, the norms also require banks to provide for assets other than their non-performing assets, referred to as 'Standard assets'. In the case of standard assets, there is additional segmentation according to agriculture and SME sectors, commercial real estate and residuary category. In the past, the RBI has used the provisioning requirements of standard assets, as a monetary policy tool to also adjust flow of credit to sectors where there were signs of overheating.

Factors leading to non performing assets

The origin of the problem of rising NPAs lies in the quality of managing credit risk bythe banks. The banking sector has been facing severe problems of rising NPAs. TheNPAs in Indian commercial banks are growing due to external as well as internal factors.

External factors

The major external factors which lead to increase/rise in NPAs and non-controllable byBanks are, namely: Ineffective Statutory Recovery Procedures, Willful Defaults, Lack of Demand and Change in Government Policies etc apart from these factors other factors also play important to the country.

- Sluggish legal system.
- Scarcity of raw material, power and other resources.
- Industrial recession.
- Excess capacity and natural calamities like floods, accidents.
- Failures, non-payment/over dues in other countries, recession in other countries, externalization problems, adverse exchange rates etc.
- Government policies like excise duty changes, import duty changes etc.

Internal factors

The major internal factors which lead to increase/rise in NPAs and being internal innature and controllable by the Banks are namely: Defective Lending Process or PoorLending Decision (Non execution of Principles of Safety, Principle of Liquidity andPrinciple of Profitability), Inappropriate Technology, Improper SWOT analysis, Poorcredit appraisal system, Managerial deficiencies, Absence of regular industrial visits, Reloaningprocess etc. The following other causes which affect the Non-Performing Assets are as follows:

- Funds borrowed for a particular purpose but not used for the said purpose.
- Project not completed on time.

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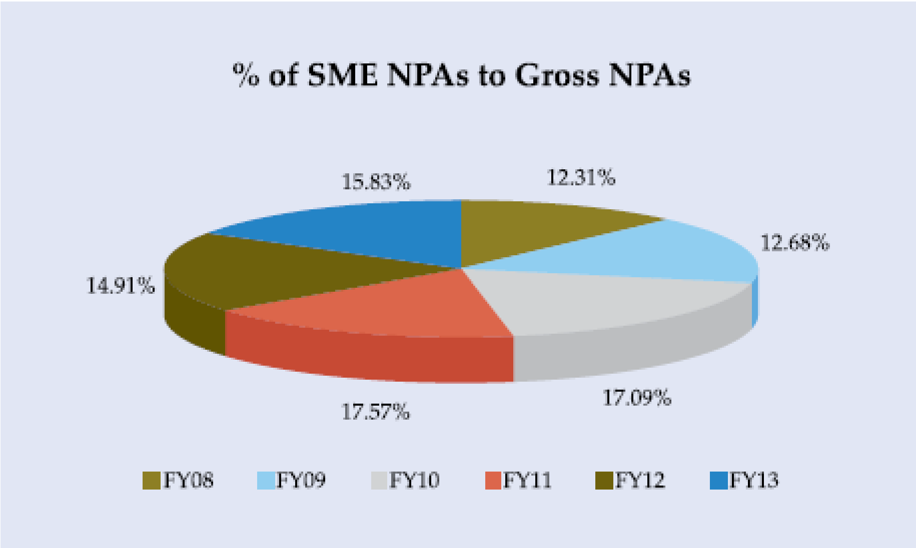
- Poor recovery of receivables.
- Excess capacities created on non-economic costs.
- In-ability of the entity to raise capital.
- Business failures.
- Diversion of funds for expansion/modernization/setting up new projects/helping or promoting sister concerns.
- Willful defaults, siphoning of funds, fraud, disputes, mis-appropriation etc.
- Deficiencies on the part of banks i.e. in credit appraisal, monitoring and follow-ups, etc.

Measuring credit quality

Credit quality of the segment can be measured by the level of Non-Performing Assets (NPA) in the segment, proportion of restructuring of business loans and impaired asset ratio. As per the RBI guidelines, once the borrower has failed to make interest or principal payments for 90 days, the loan is considered to be NPA. Troublesome pressure from the economy can lead to a sharp increase in NPAs and often results in massive write-downs; thus, not only affecting the financial health of banks but having a cascading effect on the overall economy at large. Restructuring of business loans refers to a loan where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider. It normally involves modification of terms of the loans, which would generally include, among others, alteration of repayment period, repayable amount, the amount of instalments and rate of interest. Impaired assets, in banking, applies to all problem assets which banks hold, and is not limited to problem loans. In addition to loans, it also captures off- balance sheet exposures and assets which have come onto bank's balance sheets throughenforcement of security conditions. Impaired Assets Ratio (IAR) refers to **{Gross NPA+ Restructured Standard Advances+ Cumulative write off}/ {Total Advances + Cumulative write off}**. Thus, it is the impaired assets ratio which should be considered by banks for determining the credit quality of the SMEsegment rather than NPA or restructuring of business loans as it provides a holistic picture of the bank's asset quality.

Small proportion of SME's in NPAs to gross NPAs

The information on proportionate share of SMEs in grotss NPAs is showing the percentage of SME NPAs to Gross NPAs over the financial year2008-2013 has given below.



It can be noted from the figure, that the composition of SME NPAs in Gross NPAs has been fluctuating over the aforesaid period. The same has continuously increased from financial year 2008-11, improved in financial year2012 and has again deteriorated in financial year2013 reflecting the sluggish growth of the domestic economy impacting the SME segment. The Indian economy grew 5% in financial year2013, the slowest pace in a decade, as high borrowing costs forced companies to put fresh investments on hold and consumers to cut spending. Delays in securing mandatory government approvals and problems in land acquisition have stalled many big ticket projects, stopping the cash flows of companies and dented their ability to repay debt. This has led to increase in NPAs in banks in the recent time which is more so in case of the SME sector.

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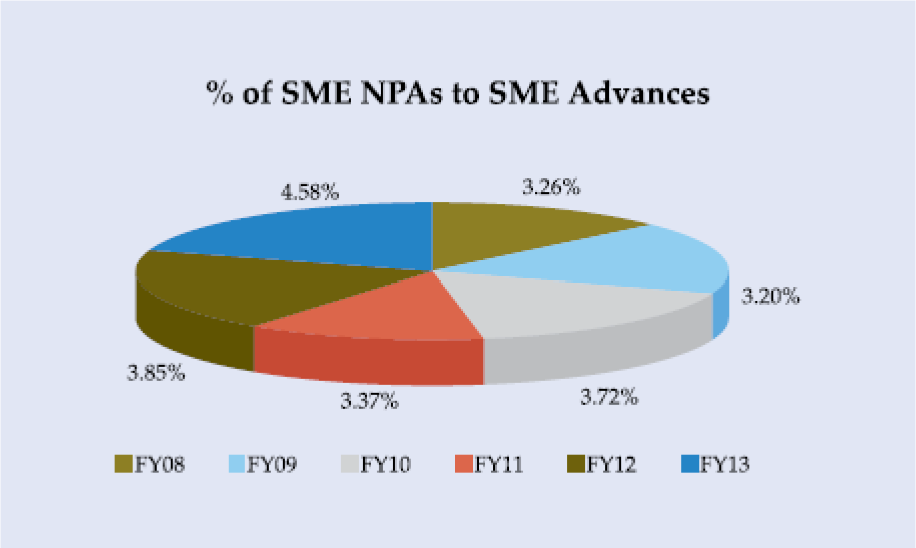
Relatively higher proportion of SMENPAs to SME Advances

While analyzing the NPA proportionate of SMEs in total advances indicates that the over financial year2008-2013 has been covered below:



From the given chart, the composition of SME NPAs in SME Advances has fluctuated over the aforesaid period. The same has continuously deteriorated in the last three years (i.e. financial year2011-2013) mainly due to deterioration in the financial risk profile of SMEs both on account of sluggish growth being witnessed in the western economies (i.e. US & Europe) in addition to sluggish growth being witnessed in India.

Effects of non performing assets

- The day to day operating the account becomes difficult as Bank starts adjusting money deposited against their dues.
- The reputation of the borrower in the market is adversely affected.
- The Bankers attitude towards the borrower becomes more arrogant, authoritative and threatening, instead of extending helping hand to them to get out of the situation.
- This leads to demoralization of the borrower who has been working with the Bank for number of years and as customer has contributed in the profit of the Bank.
- The principle of customer care is neglected and customer torture begins. This brings the borrower in a helpless situation and at the mercy of the Bank.

There are many instances where a borrower had been a very valued customer of the Bank, but becomes vulnerable after being declared as NPA. The SME's are still far more in a pitiful condition.NPA (Non Performing Asset) is an industrial phenomenon which indicates industrial sickness. The national growth of a country particularly country like India depends upon the growth and health of SME's. The so called banking reforms are targeted towards killing the Sick units rather than curing them. There has to be serious attempt on the part of the banks particularly for the SME sector to give them a special treatment before taking the recourse of SARFAESI ACT. Though at various places the state High Courts and Supreme Court has prescribed some guidelines but they are seldom followed.

Similarly there are thousands of MSME units in the country whose accounts have become NPA due to reasons beyond the control of the promoter; if right treatment was provided in time, the units would have revived through rehabilitation. MSMEs are either closed or sick or suffering from incipient sickness. The banks have been provided with targets to fund MSMEs. The banks have also got their own funding parameters. If a unit is NPA or even with stressed assets, the banks normally do not fund such projects. Also, if an account has been settled under OTS (one-time settlement) scheme, the banks normally do not fund such a promoter. Under the above circumstances, the banks are only left with hardly about 30 per cent of MSMEs whom they find eligible for funding. How do they achieve their targets under such circumstances. Hence, the banks find it easier to extend credit to other sectors such as retail and heavy industries and the MSMEs remain neglected.

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Conclusion

The large corporate and the extent of financial exclusion in the SME sector apart from the importance of the sector for the overall economy, banks need to urgently step up lending to the sector. For evaluating loan proposals and for facilitating SME financing, banks need to employ low cost and quick decision making alternatives which would help accelerate credit flow to this sector. Since, it is increasingly being recognized by the policy makers that if India has to regain its high growth trajectory, it needs a vibrant SME sector.

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