

MANAGEMENT OF NON-PERFORMING ASSETS IN HARYANA, PUNJAB AND DELHI FINANCIAL CORPORATIONS

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ABSTRACT

Granting of credit facilities for economic activities is the main objective of development banking. Apart from raising resources through fresh deposits, borrowings etc., recycling of funds received back from borrowers constitute a major part of funding credit dispensation activities. Non-recovery of installments as also interest on loan portfolio negates the effectiveness of this process of credit cycle. Non-recovery also affects the profitability of banks/FIs besides being required to maintain more owned funds by way of capital and creation of resources and provisions to act as cushion for loan losses. Avoidance of loan losses is one of the preoccupations of management of banks and financial institutions. While complete elimination of such losses is not possible, the banks/FIs managements aim to keep the losses at a low level. These loan losses are termed as Non- Performing Assets or popularly known as NPAs and their high share in the credit portfolio of bank/FIs has become a matter of great concern for the mandarins of the financial system.

INTRODUCTION

The banks and financial institutions want to earn some money in their banking business. It is however essential to sign a contract on the part of consumer or loan seeker and in return, the bank will keep some guarantee for the sanctioned loan amount such as machinery, immovable property, bonds, shares and policies. The sole intention of the bank is to earn something in cash from the consumers in terms of interest rates, while getting back the same loan amount as principal in stated time duration. So, the loan amount along with interests if remain unpaid or overdue, will be declared as NPA. The three letters “NPA” strike terror in banking sector and business circle today. NPA is short form of “Non Performing Asset”. The accumulation of huge

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non-performing assets in financial institutions has assumed great importance. The depth of the problem of bad debts was first realized only in early 1990s. Non-Performing Assets are popularly known as NPA. All those assets which generate periodical income are called as Performing Assets (PA), while all those assets which do not generate periodical income are called as Non- Performing Assets (NPA). If the customers do not repay principal amount and interest for a certain period of time then such loans become non-performing assets (NPA). Thus non-performing assets are basically non-performing loans. In India, the time frame given for classifying the asset as NPA is 180 days as compared to 45 days to 90 days of international norms. Nonperforming assets are footnoted on the balance sheet. Gross NPA reflects the quality of the loans made by banks and net NPA shows the actual burden of banks. Now it is increasingly evident that the major defaulters are the big borrowers coming from the non-priority sector. The banks and financial institutions have to take the initiative to reduce NPAs in a time bound strategic approach.

NPA is a classification used by financial institutions that refer to loans that are in jeopardy of default. Once the borrower has failed to make interest or principal payments for 90 days the loan is considered to be a non-performing asset. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. Troublesome pressure from the economy can lead to a sharp increase in non-performing loans and often results in massive write-downs.

Non –performing asset means an asset or account of borrower, which has been classified by bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the direction or guidelines relating to assets classification issued by RBI. An amount due under any credit facility is treated as “past due” when it is not been paid within 30 days from the due date. Due to the improvement in the payment and settlement system, recovery climate, up gradation of technology in the banking system etc., it was decided to dispenseith “past due” concept with effect from March 31, 2001. Accordingly as from that date, a non performing asset shall be an advance where:

- 1) Interest and/or installment of principal remain overdue for a period of more than 180 days in respect of a term loan.

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- 2) The account remains 'out of order' for a period of more than 180 days, in respect of an amount Overdraft/ Cash Credit (OD/CC),
- 3) The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,
- 4) Interest and /or principal remains overdue for two harvest season but for a period not exceeding tow half years in case of an advance granted for agricultural purpose and
- 5) Any amount to be received remains overdue for a period of more than 180 days in respect of other account.

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt '90 days overdue' norms for identification of NPAs from the year ending March 31, 2004, a non-performing asset shall be a loan or an advance where:

- 1) Interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,
- 2) The account remains 'out of order' for a period of more than 90 days, in respect of an amount Overdraft/ Cash Credit (OD/CC),
- 3) The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- 4) The installment of principal or interest thereon remains overdue for two crop seasons for short duration crops.
- 5) The installment of principal or interest thereon remains overdue for one crop season for long duration crops.
- 6) The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.
- 7) In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

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Banks should classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.

LITERATURE REVIEW

Singh's study (2009)¹, "Development Banking in India", analyzes the role of financial intermediaries which cater to the credit needs of the industrial sector of our economy.

Singh (2009)² et al. revealed that the wrong project appraisal, follow-up and monitoring system of Haryana Financial Corporation is responsible for cost overrun. Although the Management of HFC claimed that increase in over dues was primarily due to inadequate management of units, shortage of power, raw material and labour problems. Further the authors hinted that in order to improve the recovery performance, should make an in-depth review of default portfolio, reason for default should be analyzed on case to case basis and appropriate recovery strategies should be adopted in order to recover the maximum amount at the same time. As preventive measure, HFC should follow sound project appraisal, follow up and monitoring system. They also suggested that IDBI as an apex banking institution should make use of some more ratios in order to have a complete picture of performance of SFCs. Finally they summed up that HFC has emerged as a huge organisation over the time. HFC has extended its business operations and thereby had contributed significantly to the process of industrialization in Haryana through various schemes. Development of small-scale industries and backward areas had been accorded top priority. They evaluated that HFC's operational performance was commendable. However, its financial performance has not been satisfactory. Various ratios used in the present study show an overall decline in the performance. It appeared that HFC had tried to maintain the pace of sanctioning and disbursing financial assistance at the cost of financial performance. These costs doubt on the effectiveness of the financial support. There was a need for a

¹ Singh, Prabhu N, "Role of Development Banks in a Planned Economy", Vikas Publishing House, Delhi, 2009.

² Singh, Satya Prakash, Arora Asha and Anand, Manoj "Haryana Financial Corporation: An analysis of performance", Economic Times, Jan. 12, 2009.

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more scientific project appraisal and follow up, management information and control system.

Jain (2010)³ in his study looked at the total performance of various institutions, financing agencies, using secondary data only. The study reveals that the assistance to small-scale industrial sector has been grossly inadequate. Secondly, the agencies have developed a preference of investing their funds in the medium and large-scale units and the bigger ones among the small-scale units.

Khan (2010)⁴ et al. stated that the SFC's were created with one of the aims of assist small entrepreneurs in particulars with loans so that they could start new small units in various parts of the state. Secondly, SFC's should penetrate in the developing and backward areas to assist in their industrial development that is precisely what Maharashtra State Financial Corporation has done. Since 80 percent of all its assistance number wise and 70 percent value wise has been within its jurisdiction. They also stressed that regularity of making recoveries by the Corporation concerned is the surest sign of the stability and profitability of the unit. They cited various remedial measures to improve the functioning of sick units. In the end they stated that co-ordination between banks, sister financial institutions, electricity board and other allied organization is necessary for the overall improvement of the State Financial Corporation.

Baisya (2010)⁵ has analyzed the functioning of Assam Financial Corporation bringing out the areas that could be affected for financing industrial growth in the State. He has observed that the Corporation has crossed a wide range of about 18 categories of industries and the entire procedure followed by the Corporation before sanctioning a

³ Jain, S.C., "Institutional Finance to Small-Scale Industries in U.P. since 1956" submitted to Agra University, Agra 2010.

⁴ Khan, Telya and Homi, J.H., "SFCs Service of Small Sector", the Bankar, Vol. XXXVII, Jan., 2010, pp. 13-15.

⁵ Baisya, K.N., "State Financing for Industrial Growth and Assam Financial Corporation", Lok Udyog, Vol. XIX, No. 9, Dec., 2010, pp. 31-37.

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loan, take too much of time which brings negative results and very purpose of sanctioning loans get effected.

Definition of NPAs

A debt obligation where the borrower has not paid any previously agreed upon interest and principal repayments to the designated lender for an extended period of time. The nonperforming asset is therefore not yielding any income to the lender in the form of principal and interest payments. For example, a mortgage in default would be considered non-performing. After a prolonged period of non-payment, the lender will force the borrower to liquidate any assets that were pledged as part of the debt agreement. If no assets were pledged, the lenders might write-off the asset as a bad debt and then sell it at a discount to a collections agency.

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A non-performing asset (NPA) was defined as a credit facility in respect of which the interest and /or installment of principal has remained 'past due' for a specified period of time. As per latest prudential norms of Reserve Bank of India (RBI) a Non-Performing Asset (NPA) has been defined as "an advance where interest and/or installment of principal remain overdue for a period of more than 90 days".

Out of Order status

An account should be treated as out of order if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as out of order.

Overdue

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

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Leased Assets

The finance charge component of finance income [as defined in 'AS 19 Leases' issued by the Council of the Institute of Chartered Accountants of India (ICAI)] on the leased asset which has accrued and was credited to income account before the asset became nonperforming, and remaining unrealised, should be reversed or provided for in the current accounting period.

Prudential Norms of RBI

In line with the International practices and as per the recommendations made by the Committee on Financial System, under the Chairmanship of Sh. M. Narsihman, the RBI has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for advances portfolio of the banks/FIs so as to move towards greater consistency and transparency in the published accounts.

As per the RBI guidelines, the policy of income recognition should be objective and based on actual recovery rather than on any subjective considerations. Likewise, the classification of assets has to be done on the basis of objective criteria which would ensure a uniform and consistent

application of the norms. Also, the provisioning should be made on the basis of classification of assets based on the period for which asset has remained non-performing and the availability of security and the realisable value thereof.

Banks are urged to ensure that while granting loans and advances, realistic repayment schedules may be fixed on the basis of cash flows with borrowers. This would go a long way to facilitate prompt repayment by the borrowers and thus improve the record of recovery in advances. As per the advice and guidelines of the SIDBI, the Banks/FIs are required to classify their assets, further, into the following categories based on the period for which the asset has remained non-performing and the reliability of the dues:

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- a) Standard Assets
- b) Substandard Assets
- c) Doubtful Assets
- d) Loss Assets

Standard Assets

A standard asset is a performing asset. Standard assets are the ones in which the bank is receiving interest as well as the principal amount of the loan regularly from the customer. Here it is also very important that in this case the arrears of interest and the principal amount of loan do not exceed 90 days at the end of financial year. If an asset fails to be in category of standard asset that is amount due more than 90 days then it is NPA. Such assets carry a normal risk. So, no special provisions are required for Standard Assets.

Substandard Assets

With effect from 31 March 2005, A Substandard Asset is one which has remained NPA for a period more than or equal to 180 days. In such cases the current net worth of the borrower/guarantor or the current market value of the security charged is not enough to ensure recovery of the dues of the banks in full. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks/FIs will sustain some loss, if deficiencies are not corrected.

Doubtful Assets

With effect from March 31, 2005, A Doubtful Asset is one, which has remained NPA for a period exceeding 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently known facts, conditions and values highly questionable and improbable.

Loss Assets

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A Loss Asset is one where loss has been identified by the bank or internal/external auditors or the RBI inspection but the amount has not been written off wholly. In other words such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

Guidelines for Classification of Assets

Classification of assets into the aforesaid categories should be done taking into account the degree of well-defined credit weakness and the extent of dependence on collateral security for realisation of dues.

Provisioning Norms

The bank management and statutory auditors are primarily responsible for making adequate provisions for any diminution in the value of loan assets, investments or other assets. The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines.

In conformity with the prudential norms, provisions should be made on the NPAs on the basis of classification of assets, taking into account the time lag between an account becoming doubtful of recovery, the realisation of the security and the erosion over time in the value of security.

Type of Assets		Provisions
1.	Standard Assets	0.25 % for all type of Standard Advances
2.	Sub-Standard Assets	10 % for all type of Standard Advances
3.	Doubtful Assets	

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	- Up to one Year	100 % of Unsecured Advances and 20 % of Secured Advances
	- One to three year	100 % of Unsecured Advances and 30 % of Secured Advances
	- More than three year	100 % of Unsecured Advances and 100 % of Secured Advances
4.	Loss assets	100 % of Unsecured Advances and 100 % of Secured Advances

Provisioning norms, on the basis of classification of assets, as per the RBI Guidelines dated 31st March 2001 are as follows:

Provisioning Norms for Standard Assets

As per the RBI guidelines, from the year ending 31st March 2000, the banks should make a general provision of a maximum of 0.25 percent on standard assets on global loan portfolio basis. This provision should not be reckoned for arriving at net NPAs. Further this provision should not be netted from gross advances but be shown separately as “Contingent Provisions against Standard Assets” under “Other Liabilities and Provisions”, in the balance sheet of the bank/FI. Revised provisioning norms for SFCs are as following:

Account category	Existing Norms for SFCs		Revised Provisioning norms w.e.f. March 31.2010	
	Sub-category	Provisioning requirements	Sub-category	Provisioning requirements
Standard	-	0.25%	-	0.25%

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assets					
Sub-standard Assets	-	10%	-	10%	
Doubtful Assets	Outstanding loan amount doubtful of recovery for period		Doubtful Assets	Secured Portion	Unsecured Portion
	(a) up to 3 years	25%	DA-1 (up to 1 year old)	20%	100%
	(b) above 3 years	50%	DA-2 (more than 1 year and up to 3 years old)	30%	100%
			DA-3 (more than 3 years old)	100%	100%
Loss Assets		100%	100%		

Provisioning Norms for Substandard Assets

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A general provision of 10 percent on total outstanding assets in the substandard category should be made without making any allowance for guarantee cover and securities available.

The 'unsecured exposures' which are identified as 'substandard' would attract additional provision of 10 per cent, i.e., a total of 25 per cent on the outstanding balance. However, in view of certain safeguards such as escrow accounts available in respect of infrastructure lending, infrastructure loan accounts which are classified as sub-standard will attract a provisioning of 20 per cent instead of the aforesaid prescription of 25 per cent. To avail of this benefit of lower provisioning, the banks should have in place an appropriate mechanism to escrow the cash flows and also have a clear and legal first claim on these cash flows. The provisioning requirement for unsecured 'doubtful' assets is 100 per cent. Unsecured exposure is defined as an exposure where the realisable value of the security, as assessed by the bank/approved values/Reserve Bank's inspecting officers, is not more than 10 percent of the outstanding exposure. 'Exposure' shall include all funded and non-funded exposures (including underwriting and similar commitments). 'Security' will mean tangible security properly discharged to the bank and will not include intangible 20 DBOD-MC On IRAC Norms-2011 securities like guarantees (including State government guarantees), comfort letters etc.

In order to enhance transparency and ensure correct reflection of the unsecured advances in Schedule 9 of the banks' balance sheet, it is advised that the following would be applicable from the financial year 2009-10 onwards:

- 1) For determining the amount of unsecured advances for reflecting in schedule 9 of the published balance sheet, the rights, licenses, authorizations, etc., charged to the banks as collateral in respect of projects (including infrastructure projects) financed by them, should not be reckoned as tangible security. Hence such advances shall be reckoned as unsecured.
- 2) However, banks may treat annuities under build-operate-transfer (BOT) model in respect of road / highway projects and toll collection rights, where there are provisions to compensate the project sponsor if a certain level of traffic is not

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achieved, as tangible securities subject to the condition that banks' right to receive annuities and toll collection rights is legally enforceable and irrevocable.

- 3) Banks should also disclose the total amount of advances for which intangible securities such as charge over the rights, licenses, authority, etc. has been taken as also the estimated value of such intangible collateral. The disclosure may be made under a separate head in "Notes to Accounts". This would differentiate such loans from other entirely unsecured loans.

Provisioning Norms for Doubtful Assets

100 percent provisioning be made to the extent to which the advance is not covered by the realizable value of the security to which the bank has a valid recourse and the realizable value is estimated on a realistic basis.

In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 20 percent to 50 percent of the secured portion depending upon the period for which the asset has remained doubtful.

Period for which the advance has remained in 'doubtful' category	Provision requirement (%)
Up to one year	25
One to three years	40
More than three years	100

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With a view to bringing down divergence arising out of difference in assessment of the value of security, in cases of NPAs with balance of Rs. 5 crores and above stock audit at annual intervals by external agencies appointed as per the guidelines approved by the Board would be mandatory in order to enhance the reliability on stock valuation. Collaterals such as immovable properties charged in favour of the bank should be got valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors.

Provisioning Norms for Loss Assets

The entire asset should be written off. If the assets are permitted to remain in the banks for any reason, 100 percent of the outstanding should be provided for.

Causes and Management of NPAs

NPA is a virus affecting banking sector. It affects liquidity and profitability, in addition posing threat on quality of asset and survival of banks. This chapter explain the position of recovery and loans outstanding, causes and management of various NPA indicators; Gross NPA, Net NPA, Gross NPA Coverage ratio, Reductions to NPA and Total Provisions towards NPAs and Loan Portfolio and NPAs of the HFC,PFC and DFC from 2000-2001 to 2009-2010.

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