GE-International Journal of Management Research
Vol. 5, Issue 2, February 2017 **Impact Factor- 5.779**
ISSN(O): 2321-1709, ISSN(P): 2394-4226

Website: www.aarf.asia **Email :** editor@aarf.asia , editoraarf@gmail.com

NPA: WHAT LEVEL OF GNPA IS THE TOLERABLE LIMIT FOR BANK?

Prof. Amrit Lal Ghosh

Department of Business Administration, JN School of Management Studies,

Assam university, Silchar-788011, Assam, India.

ABSTRACT

Non Performing Assets (NPA) more specifically Gross Non Performing Assets (GNPA) of public sector banks are increasing over the years. Every time reports are coming – NPA/GNPA of banks are very high and are rising, but nowhere it is said that the banks must keep NPA below this much limit or to bring down the NPA below that limit. The endeavour of the researcher in this instant study is to analyse the impact of NPA on the earning capability of banks and to find out a tolerable limit of NPA for banks.The study shows through appropriate analysis that 2% GNPA will be the carrying limit of the banks and in this level the banks may not suffer much to handle the GNPA.

Key Words: NPA, GNPA, Asset Quality, Tolerable Limit, Bank, Bad Asset.

Introduction

NPA (Non Performing Asset) in banking sector is a great problem in the country today. The Reserve Bank of India, the Govt., Chairmen of banks and the sensible citizen of the country – all are highly concerned about the increasing NPA of the public sector banks and also in some of large private sector banks of the country. Within one year, i.e. from September 2015 to September 2016, the GNPA (Gross NPA) increased in many fold. For example, GNPA of SBI during this period increased from 4.15% to 7.14%[1], in absolute figure the same was RS. 56,834 crores and Rs. 1,05,783 crores respectively in the same quarter of the two years, i.e. of the second quarter of 2015 & 2016[2]. For ICICI bank the Gross NPA increase from Rs. 15,858 crores in the quarter ending Sept'2015 to Rs. 32,178[3] crores in one year later, i.e. on the quarter ending Sept'2016. In percentage, the GNPA increased from 3.77% to 6.82%[3] over the same period of the two years. These facts show that assets quality of banks are deteriorating at an alarming rate and the same is to be checked immediately. (Increasing NPA/GNPA, which is also termed as bad assets, indicates deterioration of assets quality of banks).

In this backdrop our questions are— who are the beneficiaries from these NPAs (unpaid amount of loan)? At whose cost they are getting the benefit out of the NPAs? What '**%**'(percentage) of NPA is tolerable for bank? Whether it is prudent and correct for some bank to show increase in profit while GNPA is also increasing at analarming rate?

As to the answer of the first question, i.e. who are the beneficiaries form these NPAs? Apparently, the defaulter loanee is the beneficiary. But our apprehension is that under the veil there are also other beneficiaries like the influential person, the dealing person, the sanctioning authorities etc. If it is not so then the recovery of the defaulted amount would have been much easierand the burden of NPAs over banks would haven much more lower. The RBI has to take urgent step to unearth the same with the help of researcher(s) and must take stringent measures to save the country from the probable economic collapse.

At whose cost NPA holders (mostly the will-full loan defaulters) are getting benefit? The answer is beyond doubt that at the cost of the common people for whose money the banks are the custodian. More NPA means less interest given on deposit and more interest charged on the advances given. Also low profitability of the bank associated with the poor quality of the assets, which is the indicator of the poor health of the bank. RBI and the Govt. must take steps to safeguard the interest of the common people and also to protect the health of the banks. Here also independent researcher(s) may contribute a lot if used properly by the RBI and the Government.

In this present discourse, endeavour of the researcher is to put forward some fundamental analysis for determining some tolerable limit of GNPA for banks in particular and the entire financial sector in general, Because, without knowing the tolerable limit of GNPA, it will be very difficult for banks to control the increasing GNPA.

Conceptual Discussion:The term NPA (Non Performing Asset) is a loan or advance where interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan, and the interest and the principal amount remain unpaid in respect of an Overdraft/Cash Credit etc[4].

GNPA(Gross Non Performing Asset) is the total Not Performing Assets of the bank/ organisation. For the purpose of the study, NPA and GNPA is often used without much specification for common purpose. However, for specific purpose specific reference is made.

NNPA (Net Non Performing Asset) is = GNPA- Provisions. i.e. NNPA = GNPA – Provisions.

Impact of NPA on Bank/Financial Institution

When an asset becomes non-performing i.e. NPA, then the banks are incurring losses from two fronts. One, the assets quality of the bank gets deteriorated, that is bad assets of the organisation increases.More GNPA means more bad assets of the bank which indicates low level of good assets of the bank.The other—income of the bank decreases. Bank incurs financial losses from two aspects. First, the bank is not able to earn any income/ interest from the NPA and second, the entire amount of loan advanced is often not possible to recover.Moreover, to collect loan amount from the defaulter, bank has to pay litigation fees, commission for recovery agents if recovered through recovery agents, sale of NPAs at lower price in auction, in the process both time and money is lost by the bank.

Apart from these, the goodwill of the bank is also lost due to high NPA. Market price of share of the bank falls in the market. Confidence of the people over the bank is affected. To protect the goodwill and the confidence of the people over the bank, bank sometimes hide NPAs and does not want to go for litigation. At the same time, it is neither the main purpose of the bank, nor does the bank have specialisation to go for legal litigation.Some wilful defaulters take advantage of the same and willingly do not pay the amount due to bank.

Some bank managers, to protect their image, promotion etc. do not show the correct picture of NPA and hide the same under the veil of restructuring etc. which is a serious issue for the bank.

Research Methodology for the Study

The study is aiming to find out the level of tolerance for banks so far NPA (more specifically GNPA) is concern. How much GNPA a bank can carry, along with its normal course of business, without sacrificing its profitability, its principal amount, its goodwill and above all its precious time and costly resources? That is why NPA tolerance level of bank is to be analysed and determined.

For the purpose of the study and the analysis, the required rate of interest for bank, if NPA is ‘0’ (zero) is taken as 8%, 9% and 11%, depending on the low interest, moderate interest and high interest rate regime respectively (this is taken observing the recent market trend). Loss of principal amount due from NPA account is determined from the empirical evidences. Thereafter, the interest rate need to be earned by bank along with increase of NPA from the range of ‘0% – 10%’ is calculated to show that how much extra rate of interest a bank needs to earn over and above its required rate of interest at the different levels of NPA.

Interest rate spread for bank(s) is observed from the existing market rate and the same is compared with the excess interest rate needs to be earned by the bank to protect its capital plus interest or to keep its assets intact. The NPA level,up to which a bank canearn excess interest, is the tolerance level of NPA for the bank. It is observed from the market home loan interest rate that different banks are charging different interest rate for home loan, interest rate difference across the banks is about 1%.

What % of NPA is tolerable for bank?

From the existing reports and the literatures it is often found that when some banks are reporting Gross Non Performing Asset (GNPA) at 3% - 4% then it is said that the NPA /non-performing assets are alarmingly very high. When the GNPA is reported at 6% - 8% then also it is said that the percentage of bad assets are very high and alarming. Now the million dollar question is – How much NPA, more specifically gross NPA (GNPA)is high and how much is tolerable for banks. That is, how much GNPA a bank (financial institutions) can tolerate without putting its financial health into a risky zone. What will be the threshold limit of GNPA beyond which it will be termed as high GNPA for bank/financial institution? It is quite logical that after giving loan some exigencies may arise for some of the loanee members and the entire amount of loan advanced may not be collected along with interest. Hence, NPA is inevitable. But how much NPA? How much GNPA (actual or Gross NPA) a bank or financial institution can carry without feeling burden on it? Right now there is no such standard or parameter available. Our analysis show that up to 2% GNPA (Gross NPA)a bank may able to tolerate without much stress. Of course, up to 1% GNPA is found to be normal for most of the banks, which can be managed by banks easily.Up to 2% of GNPA may be tolerable for banks and banks can bear the burden of loss for the same, (bank must be cautious and must start taking care from this level). 3% to below 4% level of GNPA of any bank or financial institution may be termed as high level of non-performing assets, bank will start facing difficulties from this point, and bank must take special care to recover the loan advanced from the defaulters. At the 4% or above level of GNPA, which is very high and alarming level of bad assets, a bank will not be able to earn the needed excess rate of interest to meet its requirement to safe-guard its earnings and capital, in this era of stiff competition.

At this level of GNPA bank must consolidate its advances and must take emergency measures to recover the defaulted amount from the defaulters. Following analysis will make the same clear.

Analysis and Interpretation

For the purpose of the study and to make the analysis simple and legible, following assumptions are made:

- Minimum rate of interest required by bank at '0' (zero) level of NPA is assumed as 8% (at low interest rate regime); 9%-10% (at moderate interest rate regime); 11% - 12% (at high interest rate regime), this is the minimum required average interest rate; for different segments/sectorsrate of interest may be different. This required average rate of interest is more or less the average market rate of interest.
- Bank is not getting any income/interest from NPA.
- After giving a loan of Rs. 100 @ r% rate of interest, bank needs at the end of the year, Rs. 100 + r% of 100. e.g. if the rate of interest is 10%, bank needs Rs. 100 + 10% of 100 = Rs. 110 at the end of one year.
- Good advances (total advances – bad loans/NPA) must be charged with high rate of interest so that the capital and the interest earning can be protect, else the bank will face loss(for the purpose of analysis non-interest income is ignored).
- Recovery of principal amount from defaulted loan is assumed to be 60%. (*From empirical evidence and facts it is observed that banks spent about 25% (lower sale/auction price, other expenses etc.) to recover NPAs. In addition to this expenditure, time value of money is there. That is why recovery of loan amount is assumed as 60%. Exact amount of time value of money is not calculated as the time for recovery of bad loan is not certain*).

Table 1: High Interest Rate Regime: Required Average Rate of Interestfor Bank - 11%.

GNPA Level %	Loan Amount Rs.	Amount of NPA Rs.	Good Loan Rs.	Amount Recovered from NPA @ 60% Rs	**At the end of one year money requited Rs.**	Interest to be earned Rs. 7=6-4-5	Rate of Interest to be charged on good loan %	Excess rate of Interest to be charged %	Remarks
1	2	3=GNPA% of 2	4=2-3	5=60% of 3	6^	7=6-4-5	**8=7÷4x100**	**9=8-11%**	10
10	100	10	90	6.0	111	15.00	16.67	5.67	Very High
8	100	8	92	4.8	111	14.20	15.43	4.43	Very High
6	100	6	94	3.6	111	13.40	14.26	3.26	Very High
5	100	5	95	3.0	111	13.00	13.68	2.68	Very High
4	100	4	96	2.4	111	12.60	13.13	2.13	Very High
3	100	3	97	1.8	111	12.20	12.58	1.58	High
2	100	2	98	1.2	111	11.80	12.04	1.04	Tolerable
1	100	1	99	0.60	111	11.40	11.52	0.52	Tolerable
0	100	0	100	0	111	11.00	11	00	Ideal

^ Rs. 100 (loan amount) + 11% of Rs. 100 (required interest) = Rs. 111.

Source: Calculation is made by the researcher.

It is observed from the above table No. 1 that at 2% GNPA, the bank needs to charge about 1% excess interest (precisely 1.04%) from its borrowers. This is tolerable. It is observed that 'Home Loan Interest Rate' across banks varies about 1%. E.g. SBI home loan interest rate is 9.10% - 9.15% whereas for Bank of Baroda the same is 9.25% - 10.25%[5]. Interest rate for home loan of other banks varies in between 9% - 10%. It may be difficult for the banks to charge more than one per cent excess interest from their customer that is why GNPA above 2% to below 4% is a high level of NPA for banks. But if the GNPA level goes above 4% then the banks need to charge more that 2% excess interest, over and above the average required/market interest rate, e.g. if the GNPA is 8% then the banks need to charge excess interest @ 4.43% which is not possible for the banks, in that case the customer will go to the other banks, and the concern bank will lose business. When the GNPA will increase further the requirement to charge excess interest will increase further. Above 4% level of GNPA is really very high GNPA level for banks. Similar observation can be made from table No. 2 & 3 in case of moderate interest rate regime and low interest rate regime respectively.

Table 2: Moderate Interest Rate Regime: Required Average Rate of Interest for Bank - 9%.

GNPA Level %	Loan Amount Rs.	Amount of NPA Rs.	Good Loan Rs.	Amount Recovered from NPA @ 60% Rs	**At the end of one year money requited Rs.**	Interest to be earned Rs. 7=6-4-5	Rate of Interest to be charged on good loan %	Excess rate of Interest to be charged %	Remarks
1	2	3=GNPA% of 2	4=2-3	5=60% of 3	6^	7=6-4-5	**8=7÷4x100**	**9=8-9%**	10
10	100	10	90	6.0	109	13.00	14.44	5.44	Very High
8	100	8	92	4.8	109	12.20	13.26	4.26	Very High
6	100	6	94	3.6	109	11.40	12.13	3.13	Very High
5	100	5	95	3.0	109	11.00	11.58	2.58	Very High
4	100	4	96	2.4	109	10.60	11.04	2.04	Very High
3	100	3	97	1.8	109	10.20	10.52	1.52	High
2	100	2	98	1.2	109	9.80	10.00	1	Tolerable
1	100	1	99	0.60	109	9.40	9.49	0.49	Tolerable
0	100	0	100	0	109	9.00	9	00	Ideal

^ Rs. 100 (loan amount) + 9% of Rs. 100 (required interest) = Rs. 109.

Source: Calculation is made by the researcher.

Like table No.1, It is also seen from the above table No. 2 that up to 2% GNPA is tolerable limit, as the required excess interest rate to be charged is 1%. GNPA level above 2% to below 4% shows high level and above 4% level of GNPA is Very high level of GNPA for banks as it will be almost impossible for the concern bank to charge more that 2% excess interest from its customer.

Table 3: Low Interest Rate Regime: Required Average Rate of Interest for Bank - 8%.

GNPA Level %	Loan Amount Rs.	Amount of NPA Rs.	Good Loan Rs.	Amount Recovered from NPA @ 60% Rs	**At the end of one year money requited Rs.**	Interest to be earned Rs. 7=6-4-5	Rate of Interest to be charged on good loan %	Excess rate of Interest to be charged %	Remarks
1	2	3=GNPA% of 2	4=2-3	5=60% of 3	6^	7=6-4-5	**8=7÷4x100**	**9=8-8%**	10
10	100	10	90	6.0	108	12.00	13.33	5.33	Very High
8	100	8	92	4.8	108	11.20	12.17	4.17	Very High
6	100	6	94	3.6	108	10.40	11.06	3.06	Very High
5	100	5	95	3.0	108	10.00	10.53	2.53	Very High
4	100	4	96	2.4	108	9.60	10.00	2.00	V. High*
3	100	3	97	1.8	108	9.20	9.48	1.48	High
2	100	2	98	1.2	108	8.80	8.98	.98	Tolerable
1	100	1	99	0.60	108	8.40	8.48	0.48	Tolerable
0	100	0	100	0	108	8.00	8	00	Ideal

^ Rs. 100 (loan amount) + 8% of Rs. 100 (required interest) = Rs. 108.

* In the threshold of 2% excess interest.

Source: Calculation is made by the researcher.

In the low interest rate regime also the similar observation can be made from the table No. 3. It can be clearly observed from the table that 4% and above level of GNPA is very high for the bank. Up to 2% GNPA is tolerable, and above 2% to below 4% is high level of GNPA for banks.

How to Keep the Gross NPA Under Tolerable Limit

After arriving at a tolerable limit of GNPA, the next task will be to maintain the GNPA within tolerable limit. The importance and the urgency of keeping the Gross NPA under tolerable limit can be well understood form the fact shown in the table No. 4 below:

Table 4: Gross NPA for the Quarter ended

Quarter ended	Rs in crore
Dec' 2015	4,47,602
Mar' 2016	5,90,560
Jun' 2016	6,48,890
Sep' 2016	6,99,854

Source: Business Standard, Dec' 8 2016, p-7

The Gross NPA of the banks of the country increased to Rs. 6,99,854 crore in quarter ended Sept' 2016, which was Rs. 2,52,000 more than the quarter ended Dec'2015. Gross NPA was Rs. 4,47,602 crore on Dec'2015, i.e. one year before. This indicated that within one year year (4 quarters) the Gross NPA increase by about Rs. 2.5 lakh crore. This is really a matter of serious concern. In the banking system where 7 lakh crore are non-performing assets, which are about half of the recently demonetised figure, needs to be addressed urgently and very carefully, else the entire economy of the country may crumble at any point of time.

To keep Gross NPA under tolerable limit RBI as to formulate and adopt strong polity measures so that lapses on the part of the bank/sanctioning officials can be minimised and no wilful defaulter can escape and at the same time no loanee with genuine reason is harassed. A full-fledged research may be undertaken in this respect. However the following suggestive and feasible measures may be adopted in this respect.

- ✓ From empirical evidences it is observed that due to improper monitoring system many loans become NPA. For effective monitoring, independent monitoring team must work at: i. Head office level of the bank concern for loan amount up to Rs. One lakh. ii. For loan above Rs. 1 lakh and up to Rs. 1 crore, RBI Regional Office level monitoring team must monitor the same. iii. For loan above Rs. 1 crore, RBI Head Office level monitoring team must continuously monitor the same. With the help of the 'Information Technology' the monitoring team must monitor the loan continuously and if required must take strong measures to recover/regularise the same.
- ✓ If after taking all probable measures a loan remains NPA after 12 months, then immediately the loan must be sold to the SC/RC through auction. The mark up price must not be less than 75% of the amount due from the loanee. To reduce legal hassles in this respect, an undertaking must be taken from the loanee, at the time of sanctioning loan, stating there in, that in case of default the loan will be sold/transferred to the other company and the purchasing company will recover the loan, the loanee will not have any objection for the same.

Epilogue

From the facts and the figures above it is seen that the bad assets are souring in the banking sector, the Gross NPA is increasing in leaps and bounds in the banks. Our analysis shows that the Gross Non Performing Assets of the banks should not cross 2% limit. Above 2% limit of GNPA bank will start suffering. The loss suffered by the Indian public sector banks in the last few quarters is the evidence of the fact. In the last few quarters, the GNPA of the banks more specifically the Public Sector banks is increasing and the banks are also suffering losses of the same.The regulators and the top management of the concern bank must work hand in hand to solve this menace. The RBI and the concern bank may also take help of the researchers in this respect. The researchers may also carry out future research in the field for the benefit of the country.

Reference

1. SBI profit takes a knock, http://www.telegraphindia. com/1161112/jsp/business/story_118711, retrieved on 12-11-2016.
2. SBI profit drops 35% as bad debts rise, loan growth slows, TNN | Updated: Nov 12, 2016, 12.55 AM IST, http://www.telegraphindia.com

3. ICICI Bank reduces its watch list, Q2 net profit up 2.4%, http://economictimes.indiatimes.com/markets/stocks/news/icici-bank-reduces-its-watch-list-q2-net-profit-up-2-4/articleshow/55304122.cms, Retrieved on 8-11-2016.
4. RBI, Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, July 1, 2015, Annex – 1, p-73.
5. http://www.deal4loans.com/home-loans-interest-rates.php retrieved on 22-11-2016, p-1-2.
6. AnandNupur, (2016), *Pace of bad loan addition comes down,* Business Standard, Dec'8, p-7.