TAKING A RELOOK INTO THE DECISION MAKING PROCESS IN INDIAN BANKING SECTOR WITH RESPECT TO NON-PERFORMING ASSET MANAGEMENT

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Introduction

Economic decisions are the future course of actions for any economic activity having a definite outcome in the socio-economic aspects of the country. Economic decisions are taken by the management considering the economic situations, prevailing risk factor, socio-political aspects as well as business environment. There is a psychological aspect in the decision making process, taking into account the behavioral aspect of the socio-economic parameters. Every economic decision has a multiple alternatives for sorting out the solution. It requires reformation in the existing practices and processes of decision making in the economy. The purpose of the present paper is to throw light on the Advance (loan) Management Processes with special references to NPA management processes practiced in Indian Banking System. Indian Banks have been suffering from unprecedented rise in NPA (Non-Performing Asset) and decline of asset quality. The major banks in the public sector have suffered losses in the last quarter of 2015. The banking sector's asset quality woes further worsened in the last one year, with gross non-performing asset (GNPA) ratio inching to 4.45% as on March 15, 2016, as compared to 4.1% in March 2014, according to the latest data released by the Reserve Bank of India (RBI). Stressed assets ratio, which is GNPA plus restructured standard advances for the system, stood at 10.9%, as at the end of March, 2015 as compared to 10% in March, 2014 and 10.7% in September 2014.

In the present paper we will focus on the NPA management procedure and practices, as well as we examine the decision making process in this regard. We will try to show whether a change can be introduced in the existing practices to make an improvement in the scenario of NPA (Non-Performing Asset) management. The economic, social, financial and psychological aspects can also be examined in this exercise.

Economic Decisions and Its Relevance for the Economy

The act of deciding on matters relating to the economy is economic decisions. Economic decision making is routinely conducted by economic advisors, heads of major central banks and business leaders and can have profound effects on economy. Economic decisions are the future course of actions for any economic activity having a definite outcome in the socio-economic aspects of the country. Economic decisions are taken by the authorities considering the economic situations, prevailing risk factor and socio-political aspects as well as business environment.

Decision Making Process in a typical macroeconomic problem consisting of 7 major steps:

Identifying the problem. This is one of the most important steps in decision making as all the other steps in the process depend on the nature of the problem. What you do about it depends on your diagnosis of the problem. This step in decision
making is, however, complicated by the fact that often what seems to be the problem is not really the problem, but rather its symptom. For example, if workers in a company are restricting output to an artificially established sub-optimal level, the problem may really be a defective incentive scheme, or apprehension in their mind that if they produced more, the job will be retimed and standard revised. In defining the problem, the manager has, therefore, to be a diagnostican who should look for the problem underlying the apparent symptoms.

Analyzing the problem. Once the problem has been correctly diagnosed, the next logical step in decision making process is to analyze it. The most important aspect of problem analysis is to find the “limiting factor”, or the “critical factor”. This is the factor in the situation that must be changed or removed in order to make the problem-solving decision that will result in the accomplishment of the desired goal. The ability of the manager to locate these limiting or strategic factors in the problem situation is crucial to his success in finding the optimal solution to the problem.

Another element in analyzing the problem is to find the nature of the decision involved in it. Non-programmed decisions are needed in situations where problems are ill-structured. These are critical decisions that commit the enterprise for a long time into the future, and vitally affect its future effectiveness.

Developing Alternatives Solutions. This is also an aspect of search process involved in decision making. There is not a single problem which cannot be solved in more than one way. If a decision maker finds that there is one and only one solution to the problem, it means that he has not searched for alternative solutions. But this process cannot be unending due to limitations of time and cost. Once the manager is satisfied that he has found enough alternatives, he may put a stop to his search process, and start on the next step of weighing the alternative solutions against one another.

Weighing Alternative Solutions. The various consequences associated with each available alternative solution should be analyzed, and then various alternatives compared against one another, or against a decision criterion, such as a desired rate of return, sales volume, etc. Every alternative solution has favorable as well as unfavorable consequences. For example, one of the alternative solutions to cut costs may be to install a computer, but it may create industrial relations problems. Another alternative may be to cut down inventory but it may involve the possibility of running out of inventory when the supplies are delayed. All the favorable and unfavorable consequences of every alternative solution to various parts of the organization should be analyzed before they can be compared against one another.

Choosing the Best alternative. After the evaluation of available alternative solutions to the problem, the next step in the process of decision making is the selection of the best solution. This is done by comparing each alternative solution with one another in terms of predetermined objectives. The criterion of decision is one or more objectives which are sought to be attained. In selecting the alternative that satisfies a predetermined objective, the decision maker may find that it is prejudicial to the attainment of some other objective.

Implementing and verifying the decision. Effectiveness of decision in achieving the desired goals depends on its implementation. Best decisions are futile if not implemented effectively. It is entirely possible that a “good” decision may be hurt by poor implementation. In this sense, implementation may be more important than the actual activity of choosing the alternative. Difficulties in implementing a decision often
arise when it requires significant changes in methods of work, interpersonal and group relations, and so forth. In such cases, organization should be prepared to accommodate change before implementing the decisions.

In this paper we are going to show the decision making mechanism that are being followed due to the unprecedented price in NPA for the Indian Banks particularly in the public sectors. In the process we will throw light on the Advance (loan) Management Processes with special references to NPA management processes practiced in Indian Banking System. Indian Banks have been suffering from unprecedented rise in NPA (Non-Performing Asset) and decline of asset quality. The major banks in the public sector have suffered losses in the quarter ending in December 2015. The banking sector's asset quality woes further worsened in the last one year, with gross non-performing asset (GNPA) ratio inching to 4.45% as on March 15 this year, as compared to 4.1% in March 2014, according to the latest data released by the Reserve Bank of India (RBI). Stressed assets ratio, which is GNPA plus restructured standard advances for the system, stood at 10.9 per cent, as at the end of March, 2015 as compared to 10% in March, 2014 and 10.7% in September 2014.

**What is a Non-Performing Asset?**

According to RBI’s decision *Non-performing asset (NPA)* is defined as a credit facility in respect of which the interest and instalment of bond finance principal has remained ‘past due’ for a specified period of time. NPA is used by financial institutions that refer to the loans that are in risk of default. Once the borrower has failed to make interest or principle 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.

With a view to moving towards international best practices and to ensure greater precision, it has been decided to adopt the ‘90 days’ overdue’ norm for identification of NPA, from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, a non-performing asset (NPA) is a loan or an advance where:

- Interest and/or installment of principal remain overdue for a period of more than 91 days in respect of a term loan,
- The account remains ‘out of order’ for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes.
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.
- Non submission of Stock Statements for 3 Continuous Quarters in case of Cash Credit Facility.
- No active transactions in the account (Cash Credit/Over Draft/EPC/PCFC) for more than 91 days.

Non-performing assets can be categorized into the following three categories.
based on the period for which the asset has remained non-performing and the reliability of the dues:

1. Sub-standard assets: This kind of asset is one which has been classified as NPA for a period not exceeding 12 months. Sub-standard asset is the asset in which bank have to maintain 15% of its reserves.

2. Doubtful Assets: This kind of asset is one which has remained NPA for a period exceeding 12 months.

3. Loss assets: where loss has been identified by the bank, internal or external auditor or central bank inspectors. But the amount has not been written off, wholly or partly. Hence, all those assets which cannot be recovered are called as Loss Assets.

Reasons for non-performing assets: a general outlook

NPAs result from “Bad Loans” or defaults. Default, in the financial jargon, is the failure to meet financial obligations, say non-payment of a loan installment. These loans can occur due to the following reasons:

- Unethical banking operations /Abnormalities in the bank lending practices
- Incremental component (due to internal bank management, like credit policy, terms of credit, etc...)
- Macroeconomic obstacles and unfavorable situations (such as environmental reasons, business cycle, etc...)

Resulting Problems from NPA

NPAs not only reveal the bank’s account books, but also badly crash the national economy. Following are some of the effects of NPAs:

- Depositors do not get suitable returns and many times may lose their deposits. Banks may begin charging higher interest rates on some products to reimburse Non-performing loan losses
- Bad loans are siphoned of from good projects to bad ones. Hence, the economy suffers due to loss of good projects and failure of bad investments.
- When bank do not get loan repayment or interest payments, liquidity problems may arise.
- Bank shareholders are badly affected

Worldwide economic recession emerged after the banks suffered in USA following the Subprime crisis: A situation of inadequate decision making

Here we will explain a situation where inadequate untimely decisions may lead to series of economic crisis as it happened in USA. Many banks lost their money and they did not have the economic resources to advance further in the running organization, who needed money and up-and-coming enterprises. The United States (U.S.) subprime mortgage crisis was a nationwide banking emergency that coincided with the U.S. recession of December 2007 – June 2009. It was triggered by a large decline in home prices after the collapse of a housing bubble, leading to mortgage delinquencies and foreclosures and the devaluation of housing-related securities. Declines in residential investment preceded the recession and were followed by reductions in household spending and then business investment. Spending reductions were more significant in areas with a combination of high household debt and larger housing price declines. The expansion of household debt was financed with mortgage-
backed securities (MBS) and collateralized debt obligations (CDO), which initially offered attractive rates of return due to the higher interest rates on the mortgages; however, the lower credit quality ultimately caused massive defaults. While elements of the crisis first became more visible during 2007, several major financial institutions collapsed in September 2008, with significant disruption in the flow of credit to businesses and consumers and the onset of a severe global recession.

There were many causes of the crisis, with economists assigning different levels of blame to financial institutions, regulators, credit agencies, government housing policies, and consumers, among others. A proximate cause was the rise in subprime lending. The percentage of substandard quality subprime mortgages originated during a given year rose from the historical 8% or lower range to approximately 20% from 2004 to 2006, with much higher ratios in some parts of the U.S. A high percentage of these subprime mortgages, over 80% in 2006 for example, were adjustable-rate mortgages. These two changes were part of a broader trend of lowered lending standards and higher-risk mortgage products. The indebtedness among the U.S. household increased with the ratio of debt to disposable personal income rising from 77% in 1990 to 127% at the end of 2007, much of this debt increase was mortgage-related.

Thus, the economic crisis in a matured economy like USA arose due to the flaws in the decision making process of banks and controlling authorities.

**Anatomy of NPA Management Led Crisis in India**

The decision making process and its inadequacies give rise to various situations which are not conducive to economic growth and its smooth functioning. The subprime crisis in America made a situation of lot of economic maladjustments resulting in economic recession which has plagued the world economy for a protracted cycle. The economic recession in the global scenario has its effect from subprime crisis which resulted in collapse of many banking institutions, lack of demand in many countries and resulted in unemployment and decline of output. In recent months in India the economic scenario has been poor in various sectors such as coal, power, and infrastructure projects. Here the industrial crisis has led to NPA in various banks. We will quote following news items to understand the unabated problem of NPA in Indian banking system signifying lack of timely initiative and proper decision in control of NPA, both on the part of the regulatory authorities as well as on the part of the bankers.

Bad loans at public sector banks have increased to Rs 2.67 lakh crore at the end of March 2015 from Rs 2.16 lakh crore a year ago, minister of state for finance Jayant Sinha informed Parliament on Tuesday. "NPAs of (PSU) banks for the system as a hole is increasing continuously," he said in a written reply to the Rajya Sabha. “Gross NPA ratio of the public sector banks (PSBs) increased to 5.43% at the end of March 2015 as compared to 4.72% a year ago”, he said.

Replying on another question, Sinha said "The government, RBI and the PSBs are all concerned with timely recovery of NPAs as it affects their profitability and capital adequacy."

During 2014-15, according to him, the public sector banks have recovered Rs 41,236 crore as compared to Rs 33,698 crore in the previous fiscal.

The recovery mechanism in the form of debt recovery tribunals (DRTs), Board for Industrial and Financial Reconstruction (BIFR), Central Registry of Securitization
Asset Reconstruction and Security Interest of India (CERSAI) and Central Repository of Information of Large Credits (CRILC) are already in existence, he said.

He also added that RBI further released guidelines for early recognition of financial distress, prompt steps for resolution suggesting various steps with specific timelines for implementation of corrective action.

Sinha said that RBI has also introduced flexible structuring of long terms project loans to infrastructure and core industries which takes into account the lifecycle of the project for the purpose of repayment.

Another News item gives the performance of the Indian banks in 2016.

Bad loans at Indian banks have jumped an unprecedented 30% in the third quarter and things are likely to get worse.

This follows an official review last quarter by Reserve Bank of India governor Raghuram Rajan, when India’s banking regulator started a bank-by-bank review of stressed accounts. For all the past few years of growth and reform, banks in India have continued rolling over troubled loans or restructured them to make terms favorable to borrowers. Rajan has set banks a March 2017 deadline to clean up their balance sheets and treat some troubled loan accounts as bad and make provisions for them by the end of this March. The aim is that the clean-up, which started in the December quarter, will restore the health of banks, revive lending and, in turn, boost economic growth.

But there’s still time for that.

According to a report by Credit Suisse, bad loans are likely to move up further to 6.6% of loans by Mar 2016 as most banks have deferred the impact over two quarters. The provision coverage—having enough capital in the bank to provide for any bad loans—has also slipped to 43%. Meaning, only 43% of the loans are provided for. At state-owned banks the unprovided non-performing assets (NPAs) are now 30–75% of their capital and un-provided problem loans (loans which are in trouble and could turn into NPAs) even higher at 65–200%, the report said. (Once a borrower has failed to make interest or principal payments for 90 days, the loan is considered to be a non-performing asset or NPA.)

That’s a huge number.

“As was our concern, the RBI audit revealed significant under-recognition of NPAs. However based on our analysis full recognition is yet to happen,” the report said.

According to Credit Suisse there are a few reasons why there continues to be an under-recognition of NPAs—

- Post the audit there’s been an increase in divergences in classifying stressed corporate loans as non-performing loans. (A loan on which a debtor has not made the scheduled payment within its allotted time of 90 days is called a non-performing loan or NPL. A NPL is usually in default or close to being in default. Once a loan becomes a NPL, the chances of it being repaid are usually slim.)

- So far still only 10–20% of steel loans are impaired for most banks. This number could easily go up as steel has been a highly stressed sector because of the global commodity slowdown.

- The majority of “House of Debt” groups’ stress is still neither NPL or restructured. (House of Debt is a Credit Suisse report where it evaluated top 10 Indian corporates, including companies owned by several billionaires such as Anil Ambani, Anil Agarwal, Gautam Adani amongst others, and found that a steep growth in
borrowings had stretched the financials of these companies. Many of those loans are yet to be restructured or declared as NPLs.)

- Loan growth to stress sectors (power, steel) continues to be high.

What this also means is that capital requirements of the banks will be large given weak core profitability and high under-provisioning. The former is due to the fact that operating performance at banks that lend to corporates, especially the state-owned banks, has deteriorated. Most have been unable to grow their loan books in the past nine months and with net interest margins under pressure, pre-provision profitability has weakened further. With the need to increase provisioning for loans even as P&Ls weakened (11 banks reported losses), recap needs for the state-owned banks have gone up more and they are likely to need $34 billion to $53 billion of capital, the report estimated.”

Thus, we see delay in the change in decisions in controlling the banks have made the situation much more badly deepening the crisis. Timely action would have saved the situation and would not make the impact so high. In spite of government’s repeated declaration there was delay in reforming the laws, institutions which control the bank activities.

In order to avoid the hassles of NPA management in the absence of proper guidance banks have taken recourse to corporate debt restructuring which means they have provided additional loans that has made additional funds again blocked, thus to increase the burden of NPA. Banks have been reeling under pressure due to the rising number of defaults affecting their bottom line. As a result, there is a substantial increase in corporates looking at Corporate Debt Restructuring (CDR) mechanism to streamline their loans. Data available from CDR India shows a steep increase, 187% in number of cases referred to CDR (from 225 to 647), whereas in terms of amount it is more than 370% during the period 2008-09 to 2014-15. Given the unusual increase in cases, the CDR cell notified banks in early 2014 to carry out forensic audits before putting up the corporate case to the CDR for approval. This move was a proactive measure to check the quality and genuineness of companies requiring additional funds for survival. This trend further increased in 2015-16.

According to media reports, around 40% of the loans restructured between 2011 and 2014 turned bad, raising alarms over the cases being put up for the restructuring process. The CDR cell was set up to provide debt ridden companies with flexible repayment terms and an option to turnaround to protect borrowers facing genuine financial difficulty due to factors beyond their control. However, the pace and quantum at which restructuring of loans were being undertaken, implied that restructuring of accounts was being resorted to avoid classification of accounts as NPA and thereby enable lower provisioning in the bank books. According to the recent amendment made by RBI, all restructured assets would be treated and provisioned at par with the NPA accounts. While this may have a negative impact on the bottom line of the banks, it would also help in curbing the misuse of restructuring and CDR mechanism, if any.

An important aspect to consider before approving restructuring is the viability of the business/ project and funds being contributed by the promoters. Project appraisals need to be more diligent and should account for facts and uncertainties surrounding the project. Restructuring proposals often include optimistic industry scenario, unrealistic cash flow analysis, aggressive repayment schedule and date of completion of project. Banks need to consider “window dressed” proposals cautiously and evaluate the
corporate operations with a nip of skepticism to identify the real intent of the borrower. About 91% of the bankers stated that forensic audits should be made mandatory prior to restructuring of loans. Further, 54% of the respondents believed that forensic audit would help in weeding out “willful defaulters” from genuine borrowers and thereby reduce recovery costs/efforts. Additionally, 46% said that forensic audits would assist in rational decision-making for restructuring (early identification of diversion of funds/fraud). According to the recent circular on “Framework for dealing with loan frauds,” RBI has asked banks to undertake investigations before taking a final view on a corporate loan account classified as “Red Flagged Account” based on the existence of early warning signals. It has been observed that independent investigations have assisted banks in identifying the intent of the borrower and willingness to pay their obligations. Banks however, need to ensure that the scope of investigations are well defined and have a comprehensive coverage. Success would also depend on the access to books and records of the borrower.

Ernest and Young hold that forensic audits have revealed potential gaps. Some are listed below: a) Loopholes in adequate screening of promoters/company may have negative impact on the reputation or early identification of red flags – in those cases the appraisal documents are generally filled with positive outlook and futuristic projections which are overstatement. b) Overdependence on certifications provided by third parties such as technical agents, valuers, etc. For example: photo copies are accepted instead of originals. They may be of concocted data. c) Lack of adequate due diligence on the auditors to rule out nexus with borrower company - in many cases, relationships are identified later in forensic audits d) Lack of in-person verification/site visits of key debtors/creditors - in many cases, fictitious customers/suppliers were identified later in forensic audits e) Leaving the decision to appoint or refer verification/valuation agency to the borrower, thereby influencing the outcome f) Borrowers, with an intention to defraud the bankers, often “stage-manage” the verification visits. For example: fictitious movement of goods backed by forged documentation for a sample of transactions are provided for review. g) Trust-based lending, especially in case of multi-lending (consortium advances) – due diligence conducted by other lenders is relied upon within the consortium h) Irregularities around collaterals which includes improper charge creation, unclear title deeds, etc.

Third party agencies such as surveyors, engineers, financial analysts, and other verification agencies, etc. play a critical role in assuring financial information, proposals, work completion status, application of funds, etc. Lenders rely significantly on the inputs issued by such third parties. Reports are made as a routine, with little scrutiny. In some situations, the reports may be drafted under the influence of unscrupulous borrowers. It is therefore important that the selection of such third parties is independent, done in a transparent manner and based on their capability and credentials. In all the above case there is no clear guideline how to control theses irregularities by the decision making authorities.

**Regulatory Mechanisms for Banking: Current Steps by The Authorities**

India is seeing a regulatory disordered and indecisions in the way the Government is addressing the NPA catastrophe. There are clear visible efforts, but the results are not adequate. According to the sources in the authorities a) stricter penal measures for fraudulent borrowers, e.g., restricting access to additional bank borrowing
and restructuring, prompt reporting of cases to law enforcement agencies etc., would act as deterrents and help prevent larger exposures of bad accounts in the banks’ books. b) Widening of the scope of “willful defaulter” ably supported by Securities and Exchange Board of India (SEBI) would assist in restricting defaulting borrowers from accessing the equity and debt markets. The creation of the Central Fraud Registry would benefit banks in obtaining access to critical details of frauds reported by other banks and thereby avoid lending to tainted borrowers. c) The boards of the banks will conduct a detailed scrutiny of the quarterly and annual financial results, review NPA management and reported NPA and provisioning integrity. The new RBI circular on “Framework for dealing with loan frauds” demonstrates its commitment to addressing concerns pertaining to detection, reporting, mitigating and accountability with regards to loan frauds. d) Significant expansion in the role of “Fraud Monitoring Group” (FMG) within the banks is expected based on the circular. Further, importance has also been laid on implementing a strong whistle-blower policy to encourage employees to report concerns. Also, the recent circular around “Strategic Debt Restructuring Scheme” is a firm step by RBI giving strong clutches to the bankers to take-over management control of the defaulters. This would be where they feel the incapability of the borrower company to come out of stress due to operational managerial inefficiencies.

Despite various steps the banks were not enabled to take timely decisions due to gap in the control mechanism. The technological support, man power is not enough to take prompt decisions and timely actions. So the decision making has to be prompt and in time to avoid disaster in the economic scenario. Today banks have a lot of problems for carrying out the NPA, provisioning of bad debts and suffering losses indicated above.

Banks could further take following steps in order to reduce the evils of NPA and a sound balance sheet.

The following initiatives by the regulator were perceived to be the most relevant in improving the NPA crisis situation:

- Strengthening the procedure of appointment of top executives of public sector banks,
- Empowering lead bankers to conduct project appraisals for all the lenders in the consortium set up for sanctioning corporate loans above INR500 crores, 
- Tightening the provisioning norms for restructured loans,
- Expanding the coverage of “willful defaulters”. The decision making process need to be streamlined according to the emerging situation to come out of the catastrophe to avoid further decline in the system.

**Conclusion**

There is a proverb: “a stitch in time saves nine”. In the case of decision making the same thing is applicable. The government and the RBI should take a unified decision in controlling the NPA in the bank. The experience of all regulatory bodies, banks themselves may be taken into consideration before making any long term decision. The major reasons for increase in the NPA and bad assets of the commercial banking system were due to inadequacy of the decision making process and delay in the timely action as it was required in a given situation. The authorities should adapt strategies for a suitable decision making process in the light of the wrong doings and
inadequate functioning of monetary authorities and systems, only then permanent solution in controlling the NPA menace can be arrived at.

References

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Abstract
The article is devoted to the issue of non-performing assets in India banking sector. The main focus is made on the NPA management procedure and practices, as well as the decision making process in this regard is examined. The possible changes in the existing practices directed to the improvement in the scenario of NPA (Non-Performing Asset) management were showed. The economic, social, financial and psychological aspects were also examined.

Keywords: non-performing assets, banking system, decision making, crisis, management