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An analysis of NPAs in priority and non-priority sectors with respect to public sector banks in India

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Abstract
Rising NPAs is one of the major concerns for banking system in India. It reflects the performance of banks and affected the whole economy. The financial health of the banking sector can be assessed by the level of NPAs in the banks. NPAs affect the asset quality, credit risk and efficiency in the allocation of resources to productive sectors. The earning capacity and profitability of many banks and financial institutions had been adversely affected by the high level of NPAs. The Indian banking sector is facing a serious problem of Non-Performing Assets. The Govt. of India and Reserve Bank of India has initiated various measures to control the growing level of NPAs. Priority Sector Lending (PSL) refers to those sectors of the economy which may not get timely and adequate credit in the absence of this special dispensation. Non-Priority Sector lending (NPSL) is the sector towards which financial institutions are always ready to lend credit. This sector is still attracts finance every time. It covers all the remaining sectors which are other than PSL. This paper intended to explore a brief comparison between priority and non-priority sectors NPAs and also examined whether there is a significant impact of priority sector NPAs and Non-priority sector NPAs on total NPAs of Public Sector Banks (PSBs) in India and find out the effect of gross advances on total NPAs of PSBs. This study conducted on secondary data. The period of the study is 10 years i.e., from 2008 to 2017. Statistical tools like percentage, mean, standard deviation, correlation, t-test have been used to analyse the data.

Keywords: Public sector banks, priority sector, non-priority sector, non-performing assets (NPAs), gross NPAs, Net NPAs

1. Introduction

Banking system plays a pivotal role in the development of a nation’s economy. The performance of the economy is positively and directly related to the functioning of banks. The key players in the development of the economy are commercial banks in general and public sector banks in particular. The prevalence of Non-Performing Assets (NPAs) has become a serious threat to the banking sector. The NPA is an important indicator to assess the financial health of the banking sector and financial statements would display an incorrect picture of the financial status of the bank. Therefore, strict requirements have been laid by RBI regarding recognition of Non-Performing Assets. As per Reserve Bank of India with effect from March 31, 2004 a Non Performing Asset (NPA) is a loan or an advance where;

a) Interest and/or instalment of principal remains overdue for a period of more than 90 days in respect of a term loan.
b) The account remains ‘out of order’ for a period of more than 90 days, in respect of an over Draft/Cash Credit.
c) The bill remains overdue for a period of more than 90 days in case of bills purchased and discounted.
d) Interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two and a half years in the case of an advance granted for agricultural purpose.
e) Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

Banks are lending money to various sectors of economy which comprises of both priority and non priority sectors under the RBI‟s guidelines.

The priority sectors include the sectors which require special attention for the development and for the disbursement of adequate credit such as agriculture, education, micro and small enterprise, social Infrastructure, renewable energy, housing and others. Sectors other than the priority sectors of economy as above are fall under non-priority sectors.

The targets and sub-targets set under priority sector lending for all scheduled commercial banks operating in India are furnished below

categories	scheduled commercial banks in India
Total Priority Sector	40 percent of Adjusted Net Bank Credit [ANBC defined in sub paragraph (iii)] or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.
Agriculture	18 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher. Within the 18 percent target for agriculture, a target of 8 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher is prescribed for Small and Marginal Farmers, to be achieved in a phased manner *i.e.*, 7 percent by March 2016 and 8 percent by March 2017.
Micro Enterprises	7.5 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher to be achieved in a phased manner i.e. 7 percent by March 2016 and 7.5 percent by March 2017.
Advances to Weaker Sections	10 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.

Source: RBI (https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=985)

2. Review of Literature

In relation to non-performing assets management in banks a brief review of literature has been made on the basis of available sources such as Journals, articles, Newspaper, research reports etc.

Uppal (2009) [2] investigation presumes that priority sector advances of all the banking groups are rising. In spite of increasing advances, Indian banks have not achieved some targets fixed by Indian banks are facing many problems like low profitability, high NPAs, transaction cost, etc. due to Lending to priority sector. It is required to find out answers for these issues otherwise growth of the Indian banks will halt.

Dr. G Nagarajan, N. Sathyanarayana, Ali Asif, (2013) [4] studied the relationship between recovery and NPA. Researchers found that the main reason of the NPA is writing off defective loans and bad loans are higher in case of PSL in comparison of Non-PSL.

ShabbirNajmi, MujooRachna, (2013) studied the relationship between private and public banks NPA. They were concluded that NPA of public banks as compared to private sector banks is high because PSL of public banks is higher than private banks.

Laveena, Malhotra Meenakshi, (2014) done a study on NPAs and PSL. Researchers have analyzed the NPAs and PSL from 2002 to 2014. They have analyzed the data by various statistical tools like correlation and regression. According to their study the coefficient of determination is 0.887; therefore, about 88.7% of the variation in the gross NPA data is explained by priority sector lending.

Baijal (2015), Goyal, Agrawal and Agrawal (2015) [3] concluded that priority sector lending is a major contributor to NPAs in public and private sector banks.

These studies indicate that there is a significant contribution of priority sector lending towards the NPAs in public sectors banks. In relation to the non-priority sector, there is also a significant relation between both priority and non-priority sector NPAs in contributing to the total NPAs in public sector banks.

3. Objectives

- To find out the significant relation between Gross Advances and priority sector NPAs of Public Sector Banks
- To find the significant relation between Gross Advances and Non Priority Sector NPAs of Public Sector Banks
- To find out the significant relation between Priority sector NPAs and Non Priority Sector NPAs

4. Research Methodology

The present research has been conducted on the basis of secondary data. It has been collected from the RBI website for the period of 10 years, i.e., 2008 to 2017. The statistical tools such as *percentage, mean, standard deviation, correlation, t-test* have been used for the study with the help of the SPSS software package.

5. Data Analysis and Interpretation

Priority Sectors NPAs in Public Sector Banks in India. (Amount in `Billion) As on March 31

Years	Priority Sector		Non-Priority Sector		Public Sector		Total Amount
	Amount	percentage	amount	percentage	Amount	percentage	
2008	248.74	61.48	150.07	37.10	5.74	1.42	404.56
2009	242.01	53.75	205.28	45.59	2.97	.66	450.26
2010	304.96	50.89	291.14	48.58	3.14	.52	599.24
2011	401.86	53.82	342.35	45.85	2.43	0.32	746.64
2012	557.80	47.57	588.26	50.17	26.56	2.27	1172.62
2013	672.76	40.91	960.31	58.39	11.55	0.70	1644.61
2014	798.99	35.16	1472.35	64.79	1.30	0.06	2272.64
2015	966.11	34.69	1815.98	65.21	2.59	0.09	2784.68
2016	1258.09	23.30	4141.48	76.70	34.82	0.64	5399.57
2017	1579.28	21.44	4957.89	82.16	39.41	0.87	6537.17

Sources: RBI (https://rbi.org.in)

This table shows the sector-wise NPAs of public sector banks for ten years from 2008 to 2017. It depicts that the percentage of priority sector NPAs decreased from FY 2008 till FY 2010, and it witnessed fall in FY 2012 and it continued to fall till FY 2017. In case of Non-priority sector NPAs, it continued to fall from FY 2008 to 2009 and it was observed to be stable form FY 2009 to FY 2011 and from FY 2011 onwards it continued to increase substantially from 45.85% in FY 2011 to 82.16% in FY 2017. This result proves a strong relationship between the two variables. It implies that with an increase of priority sector NPAs, there has been a corresponding increase in the total NPAs.

Gross advances and Gross NPAs in Public Sector Banks in India (Amount in Billion) as on March 31.

year	Gross Advances	Gross NPAs	Gross NPA to Gross Advances (%)
2008	18190.74	404.56	2.2
2009	22834.73	450.26	2
2010	27334.58	599.24	2.2
2011	30798.04	746.64	2.4
2012	35503.89	1172.62	3.3
2013	45601.69	1644.61	3.6
2014	52159.2	2272.64	4.4
2015	56167.18	2784.68	5.0
2016	58183.48	5399.57	9.3
2017	76547.00	8956.01	11.7

Source: RBI (https://rbi.org.in)

The above table shows that ratio of gross NPAs to Gross Advances has been improved from 2008 to 2009, but it has shown increasing pattern continuously form 2012 to 2017, which is a matter of serious concern for the banks. However, the amount of gross NPAs in absolute term has been increased continuously for last 10 years except for financial year ended 31st March, 2009.
The following three hypotheses have been framed to study the significance of priority and non priority sector NAPs in contributing to the total advances.

Hypothesis 1
H01: There is no significant relation between Gross Advances to Priority Sector NPAs.

H11: There is a significant relation between Gross Advances to Priority Sector NPAs.

To test the above hypotheses by Pearson Correlation coefficient method and t-test" (paired two sample for means) have been applied, the results of correlation coefficient is 0.9640, which is between +0.75 to +1.0 i.e. there is high degree positive correlation between gross advances and priority sector NPAs. Mean difference between these two variables is 41628.99, SD (Standard Deviation) = 13102.25, N=10 and df (Degree of freedom) =9, t Stat (t calculated) = 7.1044 and P two tail =0.0001, at 95% confidence level, whereas t critical two tail =2.2621, hence null hypothesis is rejected. Therefore there is a significant relation between gross advances and priority sector NPAs.

Hypothesis 2
H02: There is no significant relation between Gross Advances and Non Priority Sector NPAs.

H12: There is a significant relation between Gross Advances and Non Priority Sector NPAs.

In this case Pearson Correlation coefficient is 0.90281 i.e. highly positive correlation exist between these two variables. A paired sample "t-test" conducted to test the hypothesis, where Mean difference = 40839.45 and SD =13154.3437, N=10, df =9 t Stat =6.9418, t critical two tail =2.2621, P two tail =0.0001 at 95% confidence level. This result suggests that there is a significant relation between Gross advances and Non Priority sector NPAs.

Hypothesis 3
H03: There is no significant relation between Priority sector NPAs and Non Priority Sector NPAs.

H13: There is a significant relation between Priority Sector NPAs and Non Priority Sector NPAs.

The value of Pearson Correlation coefficient is 0.9684, which suggest that a high degree of positive correlation exists between these two sectors of NPAs Significantly, a paired sample "t-test" conducted, the value of Mean difference between these two variables is 790.01, SD = 1253.982, df =9, t Stat = 1.4086, t critical two tail = 2.2621 and value of P two tail = 0.192 at 95% confidence level. This result suggests that there is significant relation between Priority and Non Priority Sector NPAs.

6. Findings

- The priority sector NPAs of Public sector banks have raised from Rs 248.74 billion at the end of March 2008 to Rs 1579.28billion at the end of March 2017. From 2012 percentages of Priority sector NPAs of public sector banks have been declined.
- The Non-priority sector NPAs of Public sector banks have raised from Rs 150.07 billion at the end of March 2008 to Rs 4957.89 billion at the end of March 2017. From 2012 percentages of Non Priority sector NPAs of public sector banks have been increased.
- There is a definite correlation between the Priority Sector NPAs and total NPAs and a strong relationship between the Non-Priority Sector NPAs and total NPAs.
- Both Priority Sector and Non-Priority Sector NPAs are contributing total NPAs of public sector banks.

A positive association between Gross Advances and total NPAs. Gross advances significantly impact on total NPAs of public sector banks.

7. Causes for NPAs in Priority and non priority sector lending

Here causes are nothing but the problems/issues/challenges in Priority sector and non priority sector lending

1. Ineffective debt recovery mechanism.
2. Banks grant credit to doubtful debtors & in return some unscrupulous bankers get kickbacks from doubtful debtors.
3. Poor legal frameworks for lending & for collecting debts
4. Unduly broad based classification of priority sector without considering economic viability of projects.
5. Govt. interference for political gains through cheap populist schemes.
6. Lack of appropriate mechanism to examine the viability of projects of priority sectors.
7. Lower rates interest charged advances under priority sector lending scheme.

8. Lack of Efficient bank staff to assess the credit needs and working of projects financed under priority sector lending programme.
9. Willful defaults by borrowers are a serious challenge in priority sector lending which leads to creation of NPAs.
10. While lending to priority sector institutional viability is neglected.

8. Conclusion

The non-performing asset is one of the major problems for the Indian banking system. The contribution of priority sector NPAs is more than 50% in total NPAs till 2011. After that it gradually declined. Non-priority sector NPAs however well above 50% after 2011. Non-priority Sector NPAs steadily increased during the period. By the insights of the study, both priority sector and non-priority sector NPAs were showing significant effects on total NPAs of public sector banks. However Non-priority sector NPAs contribution was found to be more than priority sector NPAs of total NPAs. Hence it can be concluded that gross advances also have a significant impact on total NPAs of Indian public sector banks.

On the basis of our observation, we would like to suggest following measures to bring down NPAs level in priority sector lending as well as non priority sector lending.

1. Introducing proper follow up mechanism to monitor the end use of bank credit.
2. The problem of raising NPAs can be solved if proper follow up action is initiated to see that advances taken are used for the purpose for which they are taken only.
3. The Govt. should refrain from populist programmers for political gains without considering viability of the projects.
4. The Govt. priority sector lending should offer preferential treatment to banks which give directed credit in form of reduced Cash Reserve Ratio, Statutory Liquidity Ratio, offering easy rediscounting facilities.
5. Give loan facilities to genuine borrowers. Avoid granting loan facilities to doubtful debtors.
6. Proper training bankers & orientation to borrowers to inculcate required skills manage their projects.
7. Good relation between banker and borrowers should be built, so that borrowers' credit standing & managerial capabilities can be assessed & skill is imparted to them to utilize the credit.
8. Bankers should be given some freedom to select the beneficiaries under in priority sector lending.

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