

Understanding NPA – Borrowers' Perspective

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Abstract

The rise of Non-Performing Assets (NPAs) in the Micro, Small, and Medium Enterprises (MSME) sector has become increasingly prevalent, posing significant challenges to both financial institutions and the broader economy. This research delves deep into the intricate dynamics surrounding NPAs within MSMEs, with a particular focus on the intricate interplay between financial practices, borrower behaviour, and regulatory frameworks. The study sheds light on the numerous hurdles that MSME borrowers encounter in meeting their loan obligations through comprehensive analysis, underscoring the imperative for empathetic and targeted support. It examines how borrower behaviour influences loan defaults, underscoring the need for tailored financial education programs, flexible repayment options, and transparent communication. Additionally, the paper puts forth novel policy recommendations, including early warning systems, industry-specific guidance, and expanded loan guarantee schemes, all with the aim of reducing NPAs and fostering sustainable growth within the MSME sector. This research offers invaluable insights into the intricate landscape of NPAs by bridging the gap between financial institutions, regulatory authorities, and MSME entrepreneurs, paving the way for more effective strategies, supportive policies, and a resilient MSME ecosystem.

Introduction

NPA, an acronym for "non-performing assets," is a term commonly utilized within the financial sector, particularly in the banking and lending industry. It pertains to an asset, often in the form of a loan or advance, that ceases to generate income for a financial institution due to the borrower's failure to meet the agreed-upon repayment terms at the loan's approval. In simpler terms, NPAs encompass loans that have not been repaid in a timely manner, thereby posing a risk to the financial well-being of the lending institution.

To categorize an asset as an NPA, financial institutions typically establish specific criteria and timetables for loan repayments. If a borrower falls behind on scheduled payments for more than 90 days from the due date, as per the classification prescribed by the Reserve Bank of India (RBI), the asset is labelled as distressed. This classification holds paramount importance for regulatory compliance and financial reporting, aiding financial institutions in evaluating the quality of their asset portfolios.

The core objective of this study is to gain insights into the behaviour of MSME (Micro, Small, and Medium Enterprises) borrowers affiliated with PSU (Public Sector Undertaking) Banks. Borrower defaults are typically not deliberate, as they often result

from severe financial hardships, business failures, challenges in managing multiple equated monthly instalments (EMIs), and limited financial literacy, among other factors. Conversely, there exists a segment of borrowers who frequently default on loans with PSU banks, showcasing habitual non-repayment behaviour. The study delves into the behaviour patterns of these specific borrowers, which have contributed significantly to the substantial volume of NPAs held by PSU Banks.

Problem Statement

In recent years, the rising trend of non-performing assets (NPAs) in the Micro, Small and Medium Enterprises (MSME) sector has become a major concern for financial institutions, policymakers, and the broader economic landscape. Although NPAs are typically assessed from the financial institution's perspective, there are significant gaps in understanding the borrower's perspective in this dynamic. This study aims to address this gap by investigating the management of NPAs and the challenges faced by MSME borrowers in meeting their loan obligations.

Research Objectives:

- To evaluate the prevailing trends in NPAs within the MSME sector, specifically for loans not exceeding Rs 50 Lakhs.
- To gain an understanding of the obstacles encountered by MSME borrowers in effectively managing NPAs.
- To scrutinize the role played by financial institutions in the prevention of NPAs.
- To analyse the behavioural patterns exhibited by borrowers with NPAs.
- To formulate policy recommendations aimed at reinforcing the financial resilience of MSMEs.
- To make a meaningful contribution to the existing body of knowledge concerning NPA management.

Literature Review

The issue of Non-Performing Assets (NPAs) remains a significant challenge within the banking and financial sectors, and its effective handling is paramount for the stability and overall well-being of financial institutions and the broader economy. In this analysis, we delve into the evolution of regulatory frameworks, revenue recognition practices, asset categorization, provisioning rules, and the classification of NPAs. A pivotal development, the shift to the '90 days overdue' norm for identifying NPAs, is also examined. Notably, the Committee on Financial System, led by Shri M. Narasimham, played a pivotal role in shaping the regulatory framework for NPA management. The recommendations of this committee led to the Reserve Bank of India gradually implementing prudential criteria for income recognition, asset categorization, and provisioning for bank advances. This phased implementation was aimed at accurately representing a bank's true financial position on its balance sheet.

This alteration aligns with the global standard for NPA recognition and has notably enhanced transparency in risk assessment and management for banks¹. The policy pertaining to income recognition is a critical component of NPA management and has undergone a transformation towards greater objectivity, placing more reliance on records of recovery rather than subjective assessments. This shift was instrumental in ensuring that income recognition accurately reflects the health of Banks' loan portfolios¹.

NPA management is a multifaceted endeavour that engages various parties, encompassing borrowers, banks, and regulatory authorities. Within this framework, borrowers assume a pivotal position, bearing both moral and financial obligations to ensure the timely and complete repayment of their debts². It is incumbent upon banks to take an active role in enlightening their borrowers regarding the repercussions of failing to meet their loan obligations and the alternative avenues accessible to them should they encounter difficulties in repaying their loans promptly. Additionally, banks should make dedicated efforts to establish well-defined and transparent policies and procedures for NPA management².

Non-performing assets (NPAs) stand as a continuous and significant issue within the Indian banking sector³. The landscape of the Indian banking system has undergone substantial transformations, and amid these changes, NPAs have surfaced as a central issue. Indian banks confront distinctive challenges, such as policy impediments, protracted project clearances, and infrastructure-related obstacles. These challenges persist alongside broader global economic trends and industry-specific factors that contribute to the presence of NPAs.

Credit repayment behaviour refers to a borrower's capacity and willingness to adhere to the predetermined terms and conditions established at the loan's approval. This aspect carries substantial weight for both borrowers and banks, as it directly influences the financial well-being of the borrower and the profitability of the banking institutions⁴.

Extending loans to the MSME sector plays a vital role in fostering economic and social progress. However, this endeavour presents a formidable challenge for financial institutions, primarily due to the heightened information imbalance prevalent in developing economies such as India⁴. This information asymmetry between borrowers and lenders is a universal characteristic in credit markets globally, but it is particularly pronounced within the MSME sector, where crucial data for predicting defaults is frequently insufficiently, inconsistently, and unfairly disclosed by MSMEs.

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Research gap

Although extensive research exists on repayment behaviour and associated topics such as trends in loan repayment among borrowers, a crucial aspect remains unaddressed – the necessity of implementing credit behaviour policies within banking institutions. This literature gap holds specific relevance, especially in the context of Public Sector Undertaking (PSU) Banks, where credit portfolios are overseen at the branch level. The inherent challenges encountered by PSU bank managers, coupled with the intricacies of adhering to regulatory directives, substantially contribute to the complexities entailed in the management of Non-Performing Assets (NPAs) within the Micro, Small, and Medium Enterprises (MSME) sector.

Research Methodology

Research design: The research study is a combination of secondary and primary data consisting of qualitative interviews with Bankers and MSME Borrowers and quantitative surveys targeting MSME NPA borrowers with loans up to Rs 50 lakhs. This approach helped in discovering the linkage between NPA management, recovery strategies and behavioural patterns of borrowers.

Sample Size:

For interview : 3 Seasoned Bankers specialised in MSME lending and 4 MSME borrowers

For survey: The response of respondents (NPA Borrowers) was analysed for further development of research.

Pre-Research survey: A preliminary survey was conducted to know the current understanding of the general public. Received responses from 34 participants and used them to build research questions and objectives.

Conclusion

An escalating apprehension prevails within the Micro, Small, and Medium Enterprises sector (MSME) concerning the issue of Non-Performing Assets (NPA). This concern extends beyond its implications for businesses and financial institutions, as it unveils the intricate interplay between borrower behaviour, financial institution practices, and the legal and regulatory framework. This research centered its attention on this matter, with a specific focus on MSME entrepreneurs and their challenges in meeting loan repayment obligations. The discoveries underscore the imperative to gain a comprehensive understanding of their predicaments and devise tailored solutions. Both financial institutions and the regulatory framework they operate under play pivotal roles in effectively addressing these challenges.

In response to these challenges and with the aim of enhancing transparency within this sector, the RBI has formulated policies and frameworks. While these policies represent a step in the right direction, there is still room for improvement, and the establishment of new policies can contribute to a more comprehensive approach to NPA management. Here are some recommendations for new RBI policies pertaining to NPAs:

- The RBI can mandate financial institutions to offer comprehensive financial literacy programs to all MSME borrowers.
- The RBI can initiate the development of a centralized database where banks and other financial institutions can exchange information regarding borrowers' credit behaviour.
- The RBI should establish unambiguous criteria for ethical debt collection practices. Banks should refrain from employing coercive or unethical recovery methods and instead maintain a respectful and supportive rapport with borrowers.

Future Scope

In future, we would like to develop an app that will give borrowers relevant information regarding the consequences of NPA, in a gamified manner

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