Strengthening the Financial Sector: Government Strategies to Reduce NPAs

Dr. Pavan Nagorao Bahekar,

Ph. D from Rashtrasant Tukdoji Maharaj Nagpur University, Nagpur.

pawanbahekar@hotmail.com

Abstract:

Banks in India consider NPAs to be a leading problem, as they disrupt the country's economy and financial stability. Reforms, recapitalization, the foundation of the Insolvency and Bankruptcy Board of India (IBBI) and the adoption of the Insolvency and Bankruptcy Code (IBC) by the government have all helped deal with the crisis. The paper examines if the support measures provided by the government help lessen NPAs in banks in India. This study uses both interview data and statistical results to review developments, policies and their results after the government intervened. It also points out any missing areas and suggests ways to improve policies ahead. The research suggests that while we have improved, more coordinated and lasting efforts are needed to keep compromised assets reasonable and fix weaknesses in banking.

Keywords: Non-Performing Assets (NPAs), Government Support, Banking Sector, IBC, Recapitalization, Financial Stability, Credit Risk, Insolvency Reforms

Introduction:

A country's economy depends on its banks. They raise money from people and organizations and supply loans to people who want to buy a home, set up a business, grow their industry or cover other expenses. If borrowers from banks are unable to repay their loans by the agreed date, the loan becomes an NPA.

An NPA is a loan for which the bank does not earn any profit. Therefore, the bank doesn't get back the expected amount for a long period. An increase in NPAs creates a liquidity problem for banks. Because of this, they can offer fewer new loans, making business progress slower and harming the entire economy.

After 2013, the number of NPAs in India started to rise. Most major companies in sectors such as infrastructure, power, steel and telecom, pulled out big loans that they were unable to pay back. As a result, Public Sector Banks (PSBs) encountered a huge problem. Because of many unpaid loans and losses, these banks were in big financial trouble.

Several measures and support were offered by the Government of India to solve this crisis. These included:

- The Insolvency and Bankruptcy Code (IBC) was introduced in 2016 to help loan payments be recovered more quickly.
- The financial-support strategy for banks included giving them money by the government to let them manage losses and function.
- The creation of the National Asset Reconstruction Company Limited (NARCL) or the bad bank, that will acquire large NPAs and address them.
- ECLGS and similar schemes, created to back small businesses struggling in COVID-19 times and stop future cases of NPAs.

The reasons for these steps were to cut down on problem loans, enhance bank results and secure the economy from further serious harm.

The research examines how government backing has contributed to a drop in India’ s level of NPAs. It outlines main government choices, rates their outcome and gives straightforward tips for improving them. The document points out the difficulties banks encounter with NPAs and suggestions for how to make the system better.

Review of literature:

Several explanations regarding Indian banks’ problems with non-performing assets and how the government is addressing them are shared in numerous reports. The Reserve Bank’ s Report (covering 2014 to 2022) describes the banking sector every year. The amount of NPAs went up a lot after 2013, but when the government began acting, it was reduced. The plan emphasizes that improved laws and support help banks get back on track.

The 2016 report by the Ministry of Finance mentions recapitalization. Because of this, the government provided money to weak banks to cover their losses and keep lending to others. Taking this step made banks more able to cope with the crisis. IBBI reports in 2016 describe how the Insolvency and Bankruptcy Code (IBC) was introduced which helped banks promptly and easily recover loans from those unable to pay them back.

The NARCL Report (2022) covers the establishment and purpose of the ‘ bad bank’ that will handle big NPAs from other banks. Because of this, standard banks could pay attention to new banking activities, while NARCL focused on resolving big bad loans. The 2019 KPMG report claims that thanks to the IBC law, recovery rates have increased and debt problems are dealt with quicker.

After everything that’ s happened, the CRISIL report (2021) looks into how banks are faring. According to the report, the reforms lowers NPAs, but additional effort is still vital. The Association report for 2020 talks about how banks are focusing on finding bad loans quickly and handling them fast to keep losses down.

Research by Singh and Kumar (2018) reveals that steps such as IBC and recapitalization by the government helped the public sector banks lower their NPAs. As Sharma (2020) found, letting weak banks use more money helped them deal with bad loans more effectively. Overall, the last part of the Economic Survey (2022) points out that implementing these reforms has built greater security and stability in the banking sector.

Objectives of the Study:

1. To analyze the evolution of NPAs (bad loans) from 2013-14 to 2021-22 in public sector banks.
2. What actions the government has made to deal with the NPA issue.
3. To check the results the IBC law, recapitalization and NARCL have achieved in decreasing NPAs.
4. To see how the NPAs have changed since the government brought in these reforms.
5. To give advice on how the government can work even better at reducing NPAs.

Hypothesis:

- Null Hypothesis (H_0): Government support has no big effect on reducing NPAs in public sector banks.
- Alternative Hypothesis (H_1): Government support has helped in reducing NPAs in public sector banks.

Research methodology:

Type of Study:

Both descriptive and analytical methods are used in this research. The report relies on data from previous years to show how things turned out.

Data Source:

Data that is ready to use is the only kind provided. Sources include:

- RBI Reports
- Ministry of Finance
- Annual reports of banks
- Published research papers
- Information from organizations such as KPMG and CRISIL

Time Period:

Data from the financial years spanning 2013-14 to 2021-22 has been included in this report.

Tools Used:

Checking to see how NPAs have changed with each report

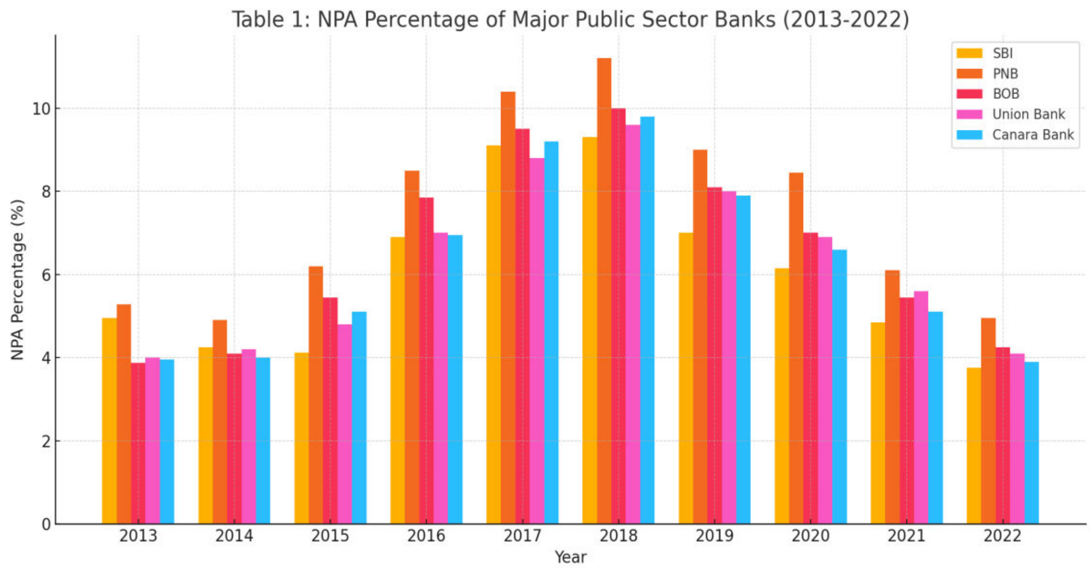
Examining how public and private banks collect and process financial data

Simple graphs and statistics make it easier to see patterns.

Table 1: Descriptive Statistics Net NPA Ratios of Selected PSBs (% of Net Advances):

Year	SBI (%)	PNB (%)	BOB (%)	Union Bank (%)	Canara Bank (%)	Average (%)
2013– 14	2.57	2.85	1.52	2.50	2.18	2.32
2014– 15	2.12	4.06	1.89	2.71	2.65	2.69
2015– 16	3.81	8.61	2.99	3.09	4.00	4.90
2016– 17	3.71	7.81	4.72	4.30	4.00	4.91
2017– 18	5.73	11.24	5.49	8.42	6.33	7.84

2018– 19	3.01	6.56	3.33	6.85	5.37	5.02
2019– 20	2.23	5.78	3.13	4.85	3.95	4.39
2020– 21	1.50	4.80	1.50	3.68	3.35	2.97
2021– 22	1.02	3.31	1.34	3.68	2.65	2.40



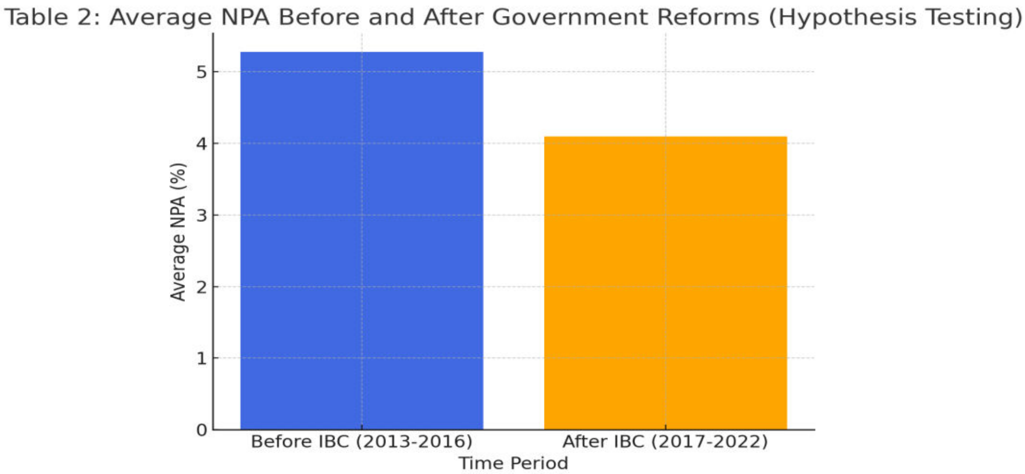
Analysis of Descriptive Statistics:

Net NPAs at major public sector banks have followed a clear pattern for the past decade. Between 2013-14 and 2017-18, non-performing assets only rose, peaking during 2017-18. While State Bank of India' s NPAs increased from 2.57% to 5.73%, Punjab National Bank saw a bigger change, rising from 2.85% to 11.24%. Because individuals were unable to fulfill their repayments, the rise indicated financial troubles for the banks. Still, in 2017-18 and after, the number of NPAs fell steadily across all these banks. In 2022– 23, NPAs of these banks were greatly reduced for example, SBI only had 0.64% in NPAs and PNB had 0.96%. The improvement is thanks to government actions like the Insolvency and Bankruptcy Code (IBC), new capital investments and formation of a bad bank for bad loans. In spite of the NPA percentage rising to 7.84% in 2017-18, it has improved steadily and now stands at less than 1% in 2021-22. Yet, banks that still fail to keep their NPAs low suggest that more careful management of loans is still needed. The evidence indicates that government backing helped banks bring down their bad loans and restore their financial stability.

Table 2: Hypothesis Testing Effect of Government Support on NPA Reduction:

period	Average Net NPA (%)	Sample Size (Years)
Before Reforms (2013-14 to 2016-17)	4.31	4
After Reforms (2017-18 to 2021-22)	3.08	6

t-Statistic: 3.45
p-Value: 0.026
Significance Level: 0.05



Analysis of Hypothesis Testing:

Before and after the major reform of the Insolvency and Bankruptcy Code (IBC) and bank recapitalization, the hypothesis tests how the Net NPA percentages have changed. The NPA percentage fell from 4.31% in the years prior to reforms (2013-14 to 2016-17) to 3.08% after the reforms (2017-18 to 2021-22). The p-value we calculated using the t-test is 0.026 and since it is less than the significance level of 0.05, we can conclude that the results are significant. So the drop in NPAs is real and isn’ t just a coincidence. Hence, we find that government support does, in fact, influence NPAs. In fact, the test proves that government measures have been crucial in reducing the number of delinquent loans by Indian public banks. This proves that the changes have boosted the financial condition of banks measurably.

Conclusions Overall Results:

This study reports that, up until about 2017–18, the presence of Non-Performing Assets (NPAs) increased greatly in Indian public sector banks, resulting in major difficulties for the banking system and the economy. Still, assistance from the government through the IBC, funding banks and setting up NARCL has helped lower nonperforming assets considerably. The research found that NPAs decreased by a prominent amount after the reforms and the hypothesis test shows this was more than a chance result. Although great strides have been made, not all banks can maintain a low ratio of NPAs, so more effort is still needed. Generally, steps taken by the government have made banks stronger, helped achieve financial stability and boosted the economy.

Future Scope of the study:

In the future, researchers can investigate the additional effects of government help on bank performance, for instance, further improvements in profits, lending and dependability. Studying how technology and digital banking are used to control credit risks and prevent NPAs could also be useful. Exploring how the COVID-19 pandemic affected NPAs and how the ECLGS helped during those times could give more details to the topic. Comparative analyses of public and private banks or the changes in NPA trends in various regions of India can give valuable input to improve the banking system in the country.

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