Non Performing loans in BRICS Countries

Narasimha Murty Indrakanti, Sridevi V

Abstract: ***After 2008 most of the BRICS countries witnessed sharp decline in the growth. The reasons could be due to high inflation, regulatory and policy risks causing significant financial and operating stress across Steel, Textile, Infrastructure, Telecom sectors. There is a significant importance of BRICS counties in the global economy, but in past few years they are grappled with budget deficits, anemic growth rising unemployment and high rise of Non-performing assets. As per our review it is clear that there is a steep increase of NPAs in BRICS countries which adversely impacted banks by reducing their profits, decrease in lending and increase in provisioning impacted the economy. Some of the reasons are, majority of these financial institutions were not having holistic regulatory framework and early warning mechanism to assess the business conditions. Besides weak credit appraisal mechanisms and not having the timely investigation mechanism for analyzing the intent and business rational of default borrowers led to more NPAs. Non-performing assets were highly impacted by the macro-economic parameters of Capital adequacy ratio; NPAs to loans and Year wise provisioning for the loans were taken into consideration to analyze the NPAs status across BRICS countries. Banks need to identify the willful defaulter and genuine business failure and these cases should be treated in a different manner.***

In most of the developed countries bulk of the banks keep provisioning for any expected NPAs and these damages are written off at an initial stage and their balance sheets carry very little NPAs. Besides the recovery measures are also stringent for foreclosure of loans.

Keywords: non-performing asset (NPA), BRICS, GDP, Provisions to loan ratio, bank capital to asset ratio

I.INTRODUCTION

Non-performing loans is not a novel phenomenon around the world, but a significant increase in loans year after year in the economy is a matter of great concern. The present working manuscript is an effort to survey the method of transfer of such distressed loans in different economies vis-à-vis India and also explores the reasons for increase.

The Brics concept was coined by Jim O'Neill, chairman of Goldman Sachs Asset Management in the year 2001. It was believed by many that these 5 emerging economies i.e., Brazil, Russia, India, China and South Africa would dominate the 21st century. The concept became popular as a cluster representing emerging economies, however a group of critics always criticized the concept. Another reason attributing to the dawn of the concept and this was followed by Goldman Sachs shuttered its BRICS investment fund after years of losses.

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NPA is described as a credit facility in respect of installment and/ orinterest of principal has remained 'past due' for a detailed period. The description of NPAs has changed over time. As stated by the Narasimham Committee Report in 1991, the resources for that the interest remains due for a period of 4 quarters must be deliberated as NPAs. Consequently, this period was reduced, and from March 1995 onwards the assets for that the interest remains unpaid for 90 days were deliberated as NPAs. Banks are essential to classify non-performing assets into 3types i.e. Doubtful Assets, Sub-Standard Assets, &Loss Assets based on the period for that the asset has remained non-performing and the reliability of the dues. The raise of NPAs will have direct influence on the profitability of the banks, decline in the lending and the banks need to increase provisions and write off the loans effects overall economy. The NPAs ratio in BRICS countries is alarming especially in Russia, India and South Africa when compared to China and Brazil. Non-performing loans are the indicator of Bank's performance any adverse will have significant impact on the economy. If the NPAs are increasing it will result in reduction of credit, lowers the deposit interest rates. This may encourage genuine borrowers also to avoid paying the loans. All these factors effects negative balance of trade leads to inflation, un-employment and leads to unrest in the society. The motivation of the survey to recognize the various factors impacting the NPAs across BRICS countries.

II. REVIEW OF LITERATURE

Kamiar Mohaddes, Midehi Raissi and Anke Webber (2016) states that High nonperforming loans are a drag on banks profitability and might also adversely affect economic activity on various ways. Empirical evidence proposes that economic activity is the major driver of Non-performing loans ratios

Role and Beck, Et AL 2013: Says that the average bank asset quality has deteriorated and a sharp decline is witnessed due to global economic recession. According to the authors real GDP growth is considered as the main drive of NPA ratios. Additional featurescouldnegatively affect asset quality in countries with particular vulnerabilities. The authors found that in counties with wide spread currency mismatches; exchange rate depreciation is associated with lower bank asset quality. Their experimental study results indicate that growth in NP loan is systematically connected to a drop-in share prices. These influences are found to be economically &statistically important.

Bank Insolvency: Bad luck, Bad policy or Bad Banking by Gerard Caprio Jr. and Daniela Klingbiel (1996): Bank insolvencies are become progressively common. These failures are systemic; they might drain a country's institutional, financial, and policy resources-resulting in large losses, misallocated resources and slower growth. The authors observe the reason and effects of sixty-eight episodes

of insolvency, their effects and how governments have responded. According to the authors both macro-economic and micro economic features have figured in bank crisis and built on the criterion developed by them, several governments have responded well and others did not. It is suggested by them that to manage insolvencies, policy makers should progress a regulatory system, which permits banks to respond more robustly to shocks and ensure suitableoversight &management. The other reason stated was that bankers are not frequently planned for shocks suggest that they have not had the incentive to do so.

Non-performing loans and terms of credit of public sector banks in India: An experimental assessment by Rajiv Ranjan (2003): The experimental study estimates as to how banks non-performing loans have affectedby 3 main sets of financial &economicfeatures, i.e., bank size induced risk preferences,terms of credit, and macro-economic shocks. According to them the credit variables have important influence on banks non-performing loans in existence of macro-economic shocks &bank size induced risk preferences. In addition, alternative measures the size of bank might give rise to differential influence of banks non-performing loans regarding terms of credit variables, variations in credit cost regarding expectation of higher interest rate induce increase in NPAs. On other hand, features such asfavorable macroeconomic, better credit culture, horizon of credit maturity, and business conditions lead to lowering of NPAs. Business cycles might have disparity implications presenting to disparity response of lenders & borrowers.

Non-performing loans in CESEE: macroeconomic & determinants performance: working paper prepared by NirKleing, 2013, IMF: The paper investigates loans in central and South-Eastern Europe (CESEE) by looking at macroeconomic indicators &bank level data during 1998-2011. The manuscript discovers that level of nonperforming loans might be attributed to bank specific factors&macroeconomic conditions. Among the economic determinants, exchange rate depreciation, higher unemployment rate, and higher inflation contribute to higher Non-performing loans. The influence of equity to asset ratio and return on equity are negatively connected to Non-performing loans.

III. OBJECTIVE OF THE STUDY

The primary objective of survey to compare the trends of non-performing loans in BRICS economies. The secondary objective is to study the potential solutions to address the above problem statement.

2.2Statement of the Problem

BRICS as a cluster is keen on building upon initiatives it has so far taken to improve the economy. But its member-nations are facing huge challenges like Non-performing assets (NPAs) inadequate capital, unemployment, high inflation, low return on investment, lack of strong regulatory mechanisms etc. To understand the nature of NPA and its influencers we evaluated variables like the country's GDP, Trade Balance, Bank provision to loans, Inflation rate of the country, External Debt, Unemployment Rate, Return on Assets, Capital Adequacy of the country etc. to build the model on the significance of these factors on the NPAs.

2.3Limitations of the study

The study does not cover the policy implications of major sectors leading to Non-performing loans in BRICS.

2.4Research Design

The design of research utilized to carry out this survey will be descriptive examinationdue to it deals with Statistical information &the major goal of the report is to define the trends affecting the Non-performing loans.

2.5Sources of Data

The data composed is secondary in nature. The data sources for this manuscript contain the literature published by Reserve Bank of India, World bank, BIS, various magazines dealing with presentresearch papers & banking scenario.

2.6BRICS

BRIC nations were playing a visible role in shaping the global economic policies and regulations. These countries put together having 40% of the global population and nearly 25% of global GDP. As per Goldman Sachs the BRICS countries are expected to signify 47% of GDP by 2050.

A country's financial system is either bank dominated or market based. A significant increase in non-performing loans will have an adverse influence oneconomic & financial stability of a nation if they are bank based economies. BRICS as a sample which represents emerging economies are considered for the study where each country is very different both in terms of their resources and demographics as well, this cluster may not help us to conclude as there is no unified voice and a coordinated action about challenges, the data compiled may give a perspective of what is happening to different emerging economies on the non-performing loans segment.

2.7Brazil

The economic outlook has improved for the recession-hit economies of Brazil and Russia. Brazil was downgraded by Fitch in May 2016. The country's adverse debt profile, fiscal pressure and ongoing recession in addition to weak commodity prices and tightening of market conditions. Corporate leverage has improved during the past 5 years and the firms in the country stand out for their higher interest costs &higher leverage. However, the bank's profitability indicators are still relatively high despite higher funding prices and high provision for loans losses. Banks in the country have higher provisions for loan losses, capital ratios remain well above regulatory minimum and banks continue to rely on domestic funding sources. The overall Non-performing loans ratio remains low at about 3.5%, the increase is observed due to customer and corporate loans, agricultural loans, overdraft loans & credit cards.

2.8Russia

Russia has undergone severe monetary crisis after the market reforms in the country. The economy continually declined from 2011 to 2015 and for the same period the investments dropped from 102. to -9.9. The industrial production was down from 5.1 to -0.8 and the public debt increased from 9.0 to 13.2.

The inflation increased from 6.1 to 12.9 and the trade balance was down from 197 billion to 149 billion. Additionally, exports reduced from +31.3 to -31.3. Central bank initiated few proposals like reducing the interest rates, however due to falling of oil prices had a deep impact on the economy. Due to these factors, there is an increase of NPA up to 9.15%. However, in 2016 there was an increased industrial output of 1.3% which may not be sufficient to stabilize the economy.

2.9India

India is the fastest growing economy in various sectors like IT, Transport, Telecom, Insurance, Real estate and other services industry. GDP annual Growth Rate in India averaged 6.12% from 1951 until 2017, reaching an all-time high of 11.40% in the first quarter of 2010 and a record low of -5.20% in fourth quarter of 1979. The reasons could be due to global challenges and recent the demonetization reduced the currency circulation which slowed down few sectors. Recently Indian Government promulgated the Banking regulation ordinance and added couple of sections to Banking regulation act of 1949 under this government has issued an order authorizing RBI to give directions to the banks. But this may have an adverse impact on the commercial banks for taking any decisions taken by banks. There should be more accountability functioning and processes for executive / legislative and judicial functions.
As per the RBI the NPAs from 1993 to 1998 shows that the situation in these years was far more critical. The figures speak for themselves, Total NPAs :23.2% (1993); 24.8 (1994) 19.4 (1995), 18% (1996) 17.8 (1997) and 16% (1998). As per the recent RBI's Financial stability report, stating that in the last five years there is a substantial increasing trends in frauds in the Financial services sector and the value of loss increased by 72% i.e. from 9750 crores to 16770 crores.

2.10China

The country has made notable progress globally. Despite growth, Chinese corporate profitability is witnessing a decline in the past five years. According to Global financial report, the reasons for this decline is due to years of easy credit and overinvestment as well as declining investment income, falling margins, cyclical factors, and lower asset turnover.

Real estate, mining and steel firms are among the most highly indebted and least profitable in china. Chinese firm's debt/EBITDA has more than doubled since 2010. Increasing corporate stress will be mirrored in stressed assets of banks. Reported problem loans amount to 6% of GDP or 5.5% of bank loans. The authorities are also working to decrease excess capability in inefficient industries &increase the health of corporate sector.

2.11South Africa

Due to various initiatives of the government, South African banks could establish sophisticated risk management system and corporate governance structure in conducting the business of a bank. Banks have regulated their capital requirements as per the Basel committee on banking supervision. Besides the political transformation and other controls resulted in better controls over the financial services. Although South Africa was remained static in the legal rights index measures and bankruptcy laws but it could resolve insolvency filing and resolution of distressed assets in 2 years when compared to India which is taking around 4.5 years. There was a significant decrease in the NPAs for the last one decade. The total NPAs continued to decrease to a level of 20.9 billion and banks have made significant provisioning to address these challenges

IV. Model Design and Implementation framework Impact of Non-performing loans on economies

India ranks 183rd among 196 countries in terms of loan recovery time and 149th in terms of loan recovery percentage. Bad loans have now shot up by 135 per cent from rupees 261,843 crores in the last 2 years, despite the RBI announcing a host of restructuring schemes. India's poor loan recovery procedure affects its ease of doing business rankings also. As per World Bank's data, India ranks 136th in ease of resolving insolvencies and 130th in ease of doing business 2017. From 2010 onwards among the BRICS countries, Russia, South Africa and India were highest on NPAs to Loans. In majority of cases banks were not able to recover these loans resulting in write off which leads to decrease in the profits of majority of the banks. Due to non-repayment of loans preventing further loans to the new borrowers. This results in increase in the lending rates and discouraging new borrowers from seeking loans thereby affecting the productivity of the economy. Indian government has initiated various recovery agencies like LokAdalats, DRT and SARFAESI for credit recovery, but these agencies were lackluster in recovering the loans. Please refer below the Table 1 below on the insolvency Framework.

Table 1: Insolvency Framework

Economy	Ease of resolving insolvencies	Recovery Rate %	Time (years)	Strength of insolvency of framework index (0=16)
South Africa	50	35.1	2	12.5
Brazil	67	15.8	4	13
China	53	36.9	1.7	11.5
India	136	26	4.3	6
Russia	51	38.6	2	11.5

3. KEY INDICATORS IMPACTING NON-PERFORMING LOANS

CAPITAL ADEQUACY RATIO

This is one of the performance indicator for any banking systems, basing on the available data it is witnessed that there is a gradual fall.
Despite growth, Chinese corporate profitability is witnessing a decline in the past five years. According to Global financial report, the reasons for this decline is due to years of easy credit and overinvestment as well as falling margins, lower asset turnover, cyclical factors, &declining investment income.

Real estate, mining and steel firms are among the least profitable &highly indebted in china. Chinese firm's debt/EBITDA has more than doubled since 2010. Increasing corporate stress is mirrored in stressed assets of banks. Reported problem loans amount to 5.5% of bank loans or 6% of GDP. The authorities are also working to decrease excess capacity in inefficient industries & enhance the health of corporate sector.

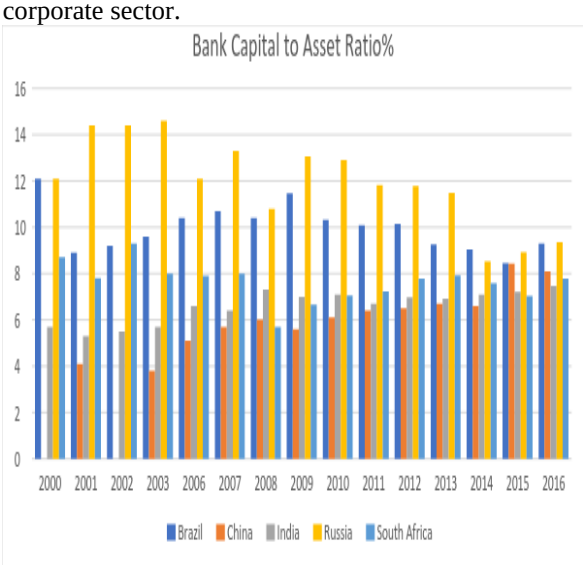

Figure.1. Capital Adequacy across BRICS countries from 2000 to 2016

NPL to loans ratio

NPAs not only deprive banks for further advances and it will not yield interest which has direct impact on the profitability. To address this, banks must set aside some portion their revenue to address the NPAs. The most significant implication of NPA is that the bank might neither debit the loss nor credit the income.

In the below table, it will be noticed that there is aimportant increase of NPAs to Loan % among Russia, South Africa, India and China. It is observed that this trend is showing significant raise from 2012.

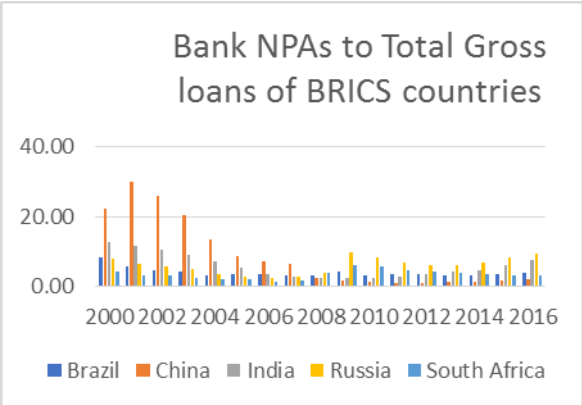

Figure.2. Comparison of NPAs to Total loans % 2000-2016

Provisions loans ration

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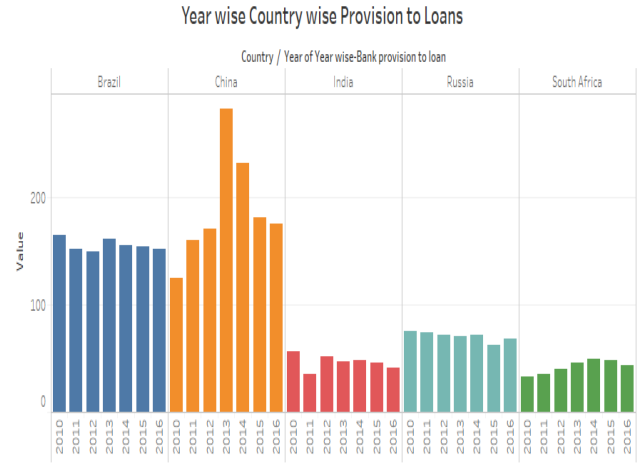

Figure.3. Provision to Loans across BRICS countries from 2000-2016

BRICS as a cluster is keen on its position and various initiatives have been taken regarding the same. One of the latest initiative is introduction of the new development bank co-owned by BRICS countries is to invest in four projects one each in brazil, India, China and South Africa supporting renewable energy ventures.

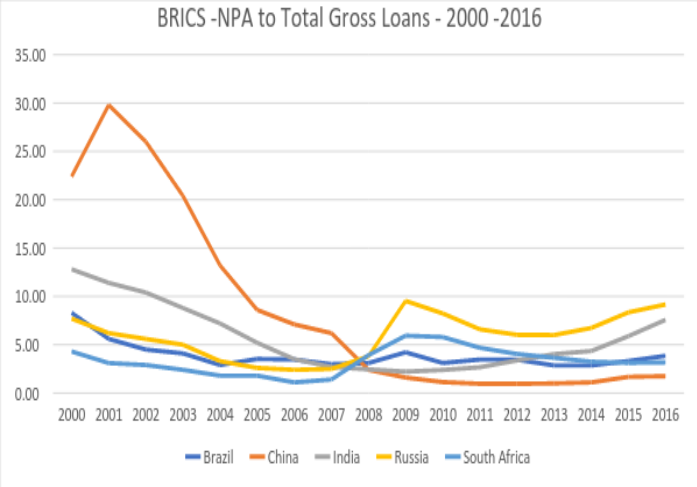

Figure.4. NPAs to Total Gross loans among BRICS countries from 2000-2016

Implementation of critical economic parameters in BRICS countries to reduce Non-performing assets Past ten years the BRICS economy has made a significant contribution which has one-sixth of the global economy, with 40% global population and BRICS were ranked as top ten from the economy perspective. One of the reports from Goldman Sachs states that BRIC countries will represent 47% of global GDP by 2050. Most of the BRICS countries initiated regulatory reforms to improve the fundaments of

macro-economic conditions. These changes help in driving a robust performance despite global financial challenges. Most of the BRICS nations focused on raising the capital, selling the NPAs, institutionalizing the processes across divestments and emphasized on the regulatory mechanism which reflected the overall growth of the economy. The table-2 below shows how these nations are reflecting their implementation of these processes*(1 is lowest and 5 is highest).

Table 2: NPA implementation process across BRICS countries.

Country	Capital Raising (1-5)	Solvency	Mergers (1-5)	Stringent regulator mechanism (1-5)	Divestment (1-5)
Brazil	3	4	2	2	2
Russia	4	2	2	4	2
India	3	4.3	2	3	2
China	3	1.7	2	4	2
South Africa	4	2	2	4	2

V. KEY FINDINGS AND SUGGESTIONS

Though various regulatory bodies and the central banks are taking various measures, the government must adopt following measures to reduce the NPAs.

For better growth and control, governments must make structural changes in the loan process across industries. Each country needs to develop a prototype for the structural transformation which can be measured against the developed nations. Banks must implement data analytics for early warning NPA system which should dwell the hidden NPAs. The table-3 below shows how some of the measures will reduce the NPAs.

Table.3. Measures for reducing the NPAs

S.NO	Suggestion	Details
1	Cleaning of Balance sheet	Banks need to follow a common process and these banks must share the information across banks before approving the loan. Controlling the credit limits for both banks and borrowers and banks need to advocate practical approach in dealing with NPAs
2	Early warning systems	Banks must integrate their entire IT and they should use early warning systems to monitor loan portfolio with skilled resources to resolve any issues related to the credit risk of the borrower.
3	Stringent due diligence	Before approving any loan, banks need to do rigorous due diligence, and there should be a dashboard covering the present exposure of the industry by region-wise. Stringent processes must be laid down while sanctioning the loans, assessing the quality of assets and post sanction credit management.
4	Scrutinizing dispersed funds	Banks need to scrutinize of the funds during the implementation and the lead banks must audit regularly on the performance of the project. At the time of proposal, the Banks need to check the cash flow projections without any gold platting.
5	Sharing of lessons learnt	On a regular intervals banks must share their best practices in handling the loan process and lessons learnt must be shared among the banks
6	Compliance and stricter regulatory controls	Regulatory systems should be having more powers to resolve out of court settlements and banks need to publish top 20 NPAs to the public
7	Appointing skilled professionals	Banks need to appoint insolvency professionals (IP), Forensic auditors and form a committee of creditors to address NPAs at the earliest. The sanctioning authority must be familiar with the local issues and the familiarity and the performance of the industry in the region
8	Effective negotiation among stakeholders	Banks need to negotiate among the stakeholders, primarily the debtors & creditors, to attainat a common method for resolution within 180 days (extendable to 270 days). Banks and regulators need to classify the assets and make necessary provisioning to prevent the NPAs and the willful borrowers must be dealt sternly. Government should not focus on analysis paralysis which hampers the speedy disposal of cases

9	Early disposal of cases	Though banks are keeping the provision for unsecured loans, they also need to refer these cases to the tribunal for early disposal. Strict regulations should be in place to avoid any diversification of funds to unrelated business activities
10	Divestment	Nationalized banks must reduce their share and it should be operated more as a profit oriented service to reduce the NPAs. The regulator must play a more proactive role in prevention with more supervisory oversight on credit management in banks, rather than more regulation.

VI. CONCLUSION

This paper focused on the key indicators impacting the Non-performing loans. The model has chosen the variables like GDP, Trade Balance, and Provision to loans, Unemployment rate and Capital adequacy. As part of research paper we analyzed various critical parameters like capital raising, solvency, mergers, regulatory compliance and divestment and impact on the NPAs.Basing on the multiple regression models it is arrived that the Trade balance, Bank provision to loans, Return on assets and unemployment rate will have an impact in the increase in NPAs.

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