Recovery Management Process of Indian Commercial Banks - A Special Reference to Non-Performing Assets

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Abstract

The best indicator of the measure of the health of the banking industry in a country is its volume of Non-Performing Assets (NPAs). The increasing number of NPAs in commercial banks is a major concern in India. The best solution to reduce the volume of NPAs depends on good management of recovery mechanisms. The present context of research focuses on the recovery mechanism of NPAs with three important legal measures. Most of the cases are being negotiated and monitored through Lok Adalats in order to reduce the burden of those assets which cease to generate revenue. In addition to this, there is Debt Recovery Tribunals mechanism (DRTs), which focuses on diminishing the balance of NPAs. However, the third measure includes Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act (SARFAESI Act), which allows banks to curb NPAs. The entire study is based on secondary data and SPSS is used to analyze the data. The study revealed that there is a statistically significant difference between the number of cases referred to the recovery mechanisms and the amount recovered through various recovery channels.

Keywords: NPAs, Recovery Mechanism, DRT, Lok Adalats, SARFAESI Act

Introduction

The Indian banking industry plays a major role in the growth and development of the country's economy.

A good percentage of the shares in the banking sector contributes to the GDP of India. But the volume of NPAs is increasing day by day. So, the financial performance of the banking industry is hampered because of the large volume of non-performing assets (NPAs), as it indicates the profitability and income growth of the banks. The high percentage of NPAs is due to the target-oriented approach by banks, ineffective supervision, improper management of loan accounts, wilful defaulters, unwanted disbursal of loans, and finally, improper recovery mechanisms. According to the Reserve Bank of India (RBI), term loans on which interest or instalment of principal remain unpaid or overdue for more than 90 days from the end of a particular quarter is called a non-performing asset. NPAs create an unfavorable impact on liquidity, profitability, and solvency of banks. But the recovery of bad loans from borrowers, and the management of NPAs, bringing them to a sizeable level, are a challenge for the banks. Thus, the increasing volume of NPAs has an adverse effect not only on the banks, but also the economy as a whole.

An asset that fails to generate income for the banks is called a non-performing asset. The banks should develop proper credit appraisal processes rather than trying to recover an asset after it becomes an NPA. Private sector banks are more financially viable than public sector banks. At present, the RBI has enacted and enforced several recovery mechanisms. Hence, to reduce the volume of NPAs, bad loans are to be recovered in time and managed properly. The three major instruments of the recovery channel are discussed further.

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Debt Recovery Tribunals (DRTs)

The Debt Recovery Tribunals (DRTs) and Debt Recovery Appellate Tribunals (DRAT) come under the arrangements of the DRT Act for the substratum of Tribunals, for expeditious repayment and recuperation of obligations on behalf of banks and financial institutions, and matters associated with the law. The DRT has been enabled to settle the applications documented by the borrower/mortgagor against the activity of the Secured Creditor commenced under the Securitization Act. The Debt Recovery Tribunals have been set up in India under an Act of Parliament (Act 51 of 1993) for expedient and bother-free recuperation of obligations for banks and monetary organizations by the Regime of India. The DRT is likewise the appellate expert for requests recorded against the procedures commenced by lenders under SARFAESI Act 2002.

Lok Adalats

Lok Adalats were established in India by the Legal Services Authorities Act, 1987. Lok Adalats are a non-adversarial framework, whereby demo courts (called Lok Adalats) are held by the State Authority, District Authority, Supreme Court Legal Services Committee, High Court Local Services Committee, or Taluk Legal Services Committee. Debt Recovery Tribunals have been approved to frame the Lok Adalats to settle on cases of NPAs worth a sum of Rs. 10 lakhs. This is only the tip of the iceberg. The framework is by all accounts increasingly compelling in its recuperation of credits by a moment's judgment on the cases alluded to. Lok Adalats have been useful, for the most part, in recovery of low-level credits.

SARFAESI Act

The SARFAESI Act was framed on 17 December 2002 based on the suggestions of the (a) Committee on Banking Sector Changes (Narasimham Committee Report II), and (b) Restructuring of Impotent Public Sector Banks (Verma Committee). This act fixates on expeditious recuperation of defaulting credits and ways to abate the expanding quantum of non-performing assets of budgetary substructures and banks. The arrangements of the act potentiate the banks and financial establishments to acknowledge long-haul resources, oversee issues of liquidity and resource risk inconsistencies, and amend recuperation by practicing forces to take guardianship of securities, sell them, and diminish non-performing assets by implementing measures for recovery or remaking.

Literature Review

The authors have studied various literatures from research journals and articles, which are outlined as follows.

Patel (2000) highlighted the problem of bad loans and the growing level of non-performing assets in commercial banks in the post-reform period. It was observed that effective lending practices should be adopted by banks and supervisory authorities. Along with this, corporate entities should be made more accountable by following more stringent disclosure, transparency practices, guidelines, and principles. Efficient legal machinery, and the large number of Debt Recovery Tribunals and Credit Information Bureau in banks can prove effective in quick recoveries of dues. Sharma (2005) observed that a more essential step to resolving the NPA problem is the timeliness of measures as it would save the system from greater damage, obviating serious macroeconomic costs. In the post-liberalization period, various measures and recovery mechanisms were initiated in the Indian banking system. The problems of increasing NPAs cannot be eliminated in banking. However, by means of proactive and reactive measures it can be controlled. Effective risk assessment, credit evaluation, and monitoring techniques are proactive measures, while various recovery measures that include Asset Reconstruction Companies (ARCs), Debt Recovery Tribunals (DRTs), Lok Adalats, SARFAESI Act, and so on, are reactive measures. The SARFAESI Act 2002 allows banks and other financial institutions to recover NPA accounts without the intervention of the Court. Banana and Chepuri (2016) examined the financial soundness of banks with respect to various recovery channels and came to the conclusion that the SARFAESI Act is more efficient in managing and controlling NPAs than the others.

Bose (2005) mentioned that while there have been several schemes in the past to facilitate the recovery of NPAs, they are not satisfactory in terms of reducing the volume of NPAs. It was hoped that the establishment of the SARFAESI Act would help banks in their effort to

reduce and recover money from NPAs. But due to certain limitations, the act is creating apprehension among banks and financial institutions. In order to take full advantage of the SARFAESI Act, the root cause of NPAs, which were evident in the system, may have to be addressed first. Shaardha and Jain (2016) analyzed that public sector banks are found to be more effective in regulating and controlling the process of NPA under the SARFAESI Act 2002. Siraj and Pillai (2012) opined that the SARFAESI Act provided much-needed momentum for NPA management in banks. Swain et al. (2017) revealed in his study that the SARFAESI Act recovery mechanism played a pivotal role in mitigating NPAs, due to which the level of NPAs in commercial banks in India has been transformed.

Joshi (2003) conducted a study on 'Analysis of NPAs of IFCL Ltd'. The study revealed that the viability and profitability of the Development of Financial Institutions are directly affected by the quality and performance of advances. Kavitha et al. (2019) study investigated the impact of NPAs on the profitability of scheduled commercial banks in India for the past ten years, from 2007-2008 to 2016-2017. By applying various statistical and research tools, the study identified the variables affecting the profitability of the banking sector. There is a growing trend of NPAs in scheduled commercial banks in India. Salunkhe et al. (2013) stressed that banks should maintain a low level of NPAs, which could have a significance impact on its profitability, both in the short and long run. Hence, they suggested that the banking system should adopt an effective recovery process under the efficient guidance of the concerned authorities or regulating governing bodies. Singh (2013) opined that profitability can only be increased if NPAs are being monitored and evaluated continuously over a period of time.

Objectives of the Study

The current research investigated various recovery channels for NPAs and examined several cases, referred to recovery channels, in terms of recovery. In addition to this, the objective of the study is to analyze the percentage of recovery amounts involved in the recovery of NPAs by commercial banks. Further, the study analyzes and compares the effectiveness of recovery channels such as DRTs, Lok Adalats, and SARFAESI Act.

Hypothesis of the Study

Ho1: There is no statistically significant difference in the cases referred to various recovery channels.

Ho2: There is no mean difference with respect to the percentage of amount recovered among various sources of recovery mechanisms.

Problem of the Study

NPAs are reducing the growth of income and the bank's profit percentage. So, the financial sustainability of the banking industry remains a question in Indian banking history. Hence, to solve the problem of NPAs, bad loans should be recovered.

Rationale of the Study

The high volume of NPAs has become troubling. It is not only affecting the liquidity, but also the profitability and solvency of commercial banks in India. Hence, the sanctioning of new credit may be a difficult task for banks. So, there is a requirement for proper management recovery channels to reduce the volume of NPAs to a manageable level. The present study tries to find out the key role of recovery channels and their effectiveness in managing NPA levels.

Limitations of the Study

The study is based on secondary data, and primary study is not taken into consideration. Further, the study is limited to only ten years, from 2009-2010 to 2018-2019. The study has only included three recovery channels, whereas other recovery channels are ignored.

Research Methodology

Data has been collected from secondary sources like the RBI website, research articles, and journals. Data in a ten-year time period (2010-2019) has been used for analysis. The one-way ANOVA t-test has been used to test the hypothesis through the SPSS package. In addition to this, data has been analyzed by using descriptive statistics, and finally, multiple comparisons have been made to produce a more accurate and valid hypothesis. The technique of one-way ANOVA is being applied, which studies the mean difference among various recovery mechanisms.

Results and Discussion

Table 1: Number of Referred Cases of NPA's

Year	DRT	LOK ADALATS	SARFAESI ACT
2009-2010	6,019	7,78,833	78,366
2010-2011	12,872	6,16,018	1,18,642
2011-2012	13,365	4,76,073	1,40,991
2012-2013	13,408	8,40,691	1,90,537
2013-2014	28,258	16,36,957	1,94,707
2014-2015	22,004	29,58,313	1,75,355
2015-2016	24,537	44,56,634	1,73,582
2016-2017	32,418	35,55,678	1,99,352
2017-2018	29,551	33,17,897	91,330
2018-2019	52,175	40,80,947	2,48,312

Source: Off-site returns, RBI (2010-2019)
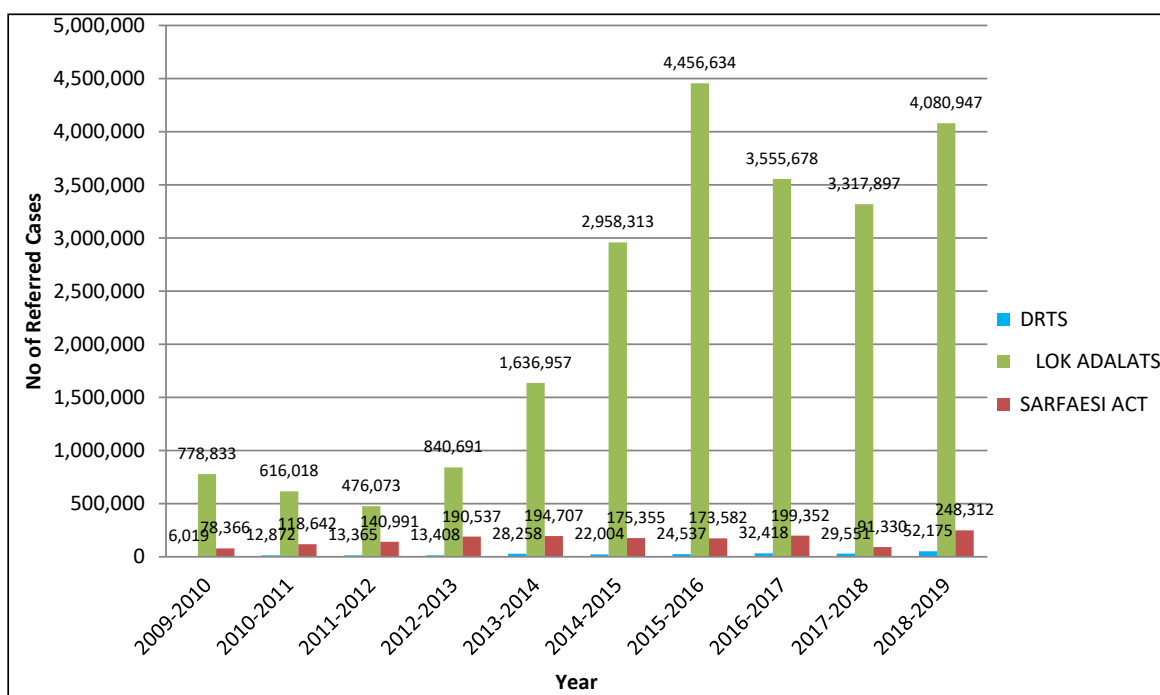
Graph 1: Number of Referred Cases through Recovery Channels

It is clear from Graph 1 that the number of cases referred through Lok Adalats is more in comparison to other recovery channels. The data shows that in the year 2015-16 the number of cases referred through Lok Adalats is 44,56,634, which is the highest.

Table 2: Output of One Way-ANOVA of Number of Cases Referred through Recovery Channels

Recovery Channel					
	Sum of Squares (SS)	df	Mean Square (MS)	F	Sig.
Between Groups	31763319189784.470	2	15881659594892.234	19.550	.000*
Within Groups	21933704167507.400	27	812359413611.385		
Total	53697023357291.870	29			

Source: Results are calculated by SPSS

Note:* Statistically significant at 5% level of significance

Table 2 shows that the p-value is 0.000, which is less than 0.05 at a 5% level of significance. Hence, the null hypothesis (H1) is rejected and the alternative hypothesis is accepted. So, it is proved that there is a statistical significant difference among the recovery channels in terms of cases referred to. So, the RBI should take corrective measures to address the increasing number of cases referred by the banks. This action should be given priority to safeguard the credibility of banks.

Table 3: Multiple Comparisons

	Mean Difference	Standard Error	t-Value	p-Value	Hypothesis
DRT	2248343.4	489164.7639	4.5569993	0.0002[*]	Reject H1
Lok Adalat					
SARFAESI Act	137656.7	12581.12804	8.396684175	0.0007[*]	Reject H1
DRT					
LokAdalat	2267377.778	503788.8608	4.275675665	0.0004[*]	Reject H1
SARFAESI Act					

Source: Results are calculated SPSS

NB: *Statistically significant at 5% level of significance

Table 3 shows that the mean difference is significant at 5% level of significance. There is a statistically significant difference between groups as shown by the one-way ANOVA test. The table further reveals that the null hypothesis is rejected, as p-value is less than 0.05 in all the cases, which implies that there is a statistically significant difference in the number of cases referred to DRTs, Lok Adalats, and SARFAESI Act.

Graph 2 shows that the percentage of the amount recovered through the SARFAESI Act is more in comparison to other recovery channels. The data shows that in the year 2010-11 the percentage was highest, at 37.78%, and in the year 2018-19 it was 14.49%.

Table 4: Percentage of Amount Recovered through Various Channels

Year	LOK ADALATS	DRTs	SARFAESI ACT
2009-2010	1.55	31.98	29.96
2010-2011	2.87	27.89	37.78
2011-2012	11.76	17.01	28.61
2012-2013	6.06	14.19	27.17
2013-2014	6.03	9.58	25.79
2014-2015	3.18	6.97	16.33
2015-2016	4.48	9.18	16.45
2016-2017	6.37	10.22	18.32
2017-2018	3.94	5.40	24.84
2018-2019	5.26	3.45	14.49

Source: Off-site returns, RBI and IBBI (2010-2019)

Note: Figures are calculated by recovered amount to the involved amount in percentage
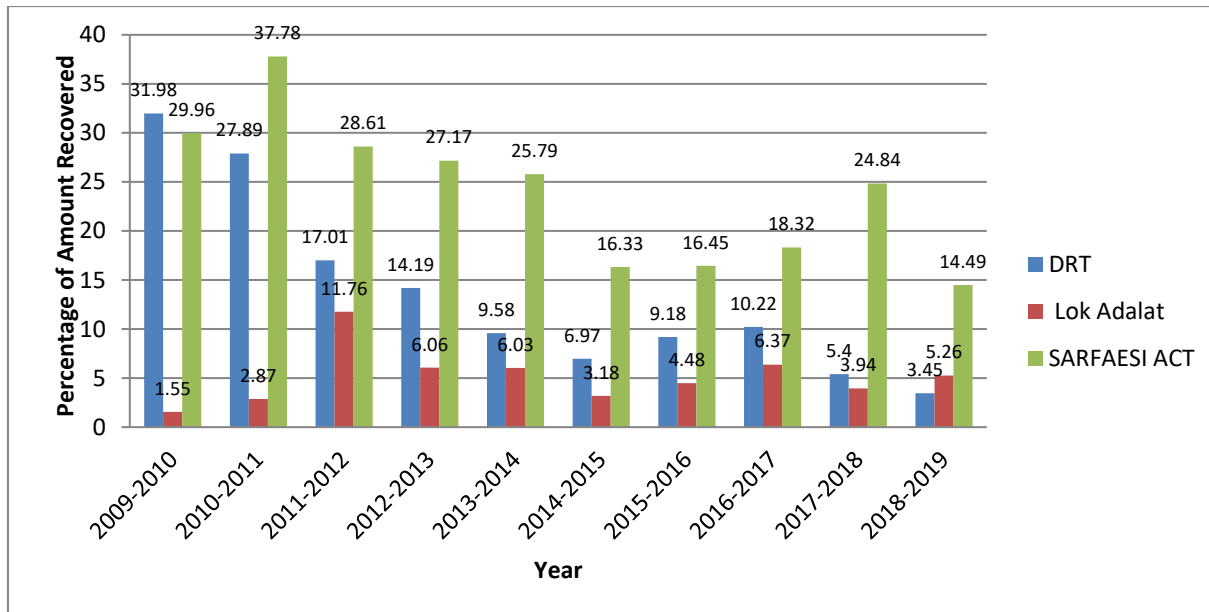
Graph 2: **Percentage of Amount Recovered through Various Channel**

Table 5: **Output of One Way-ANOVA of Percentage of Amount Recovered through Various Channels**

Recovery Channels					
	Sum of Squares (SS)	*df*	*Mean Square (MS)*	*F*	*Sig.*
Between Groups	1778.052	2	889.026	17.328	.000*
Within Groups	1385.239	27	51.305		
Total	3163.291	29			

Source: Results are calculated by SPSS

Note:* Statistically significant at 5% level of significance

Table 5 shows the output of the one-way ANOVA test, where p-value is 0.000, which is less than 0.05 at a 5% level of significance. Hence, the null hypothesis (H2) is rejected and the alternative hypothesis is accepted. So, it is proved that there is a statistically significant difference with respect to the percentage of the amount recovered through various recovery channels.

Table 6: **Multiple Comparisons**

	Mean Difference	*Standard Error*	*t-Value*	*p-Value*	*Hypothesis*
DRT	8.436968492	2.12249297	-2.283786806	0.0150*	Reject H_02
Lok Adalat					
SARFAESI Act	10.38514134	0.654767627	-2.71754885	0.0141*	Reject H_02
DRT					
Lok Adalat	18.82210983	1.467725343	-7.479458557	0.0007*	Reject H_02
SARFAESI Act					

Source: Results are calculated SPSS

NB: *Statistically significant at 5% level of significance

There is enough evidence to believe that there are significant differences between the groups from the ANOVA table. Table 6 shows that the p-value is less than 0.05 in all the three cases. Hence, the null hypothesis (H2) is rejected. There is a statistically significant difference between DRT & Lok Adalats, SARFAESI Act & DRT, and Lok Adalats & SARFAESI Act, with respect to the percentage of recovery channels.

Conclusion

The study concludes that there is mean difference among the number of cases and amount collected under several recovery mechanisms. This implies that the present recovery channels are insufficient to deal with the problems. The analysis shows that the number of cases referred to Lok Adalats is the highest, when compared to the other two recovery channels. In other words, Lok Adalats cannot be confronted in upper courts. Further, as per the guidelines of the RBI, more than Rs. 10 lakh worth of NPAs cannot be recovered through Lok Adalats. The process of trial in DRTs takes a longer time than in others since the cases are being preceded to the respective higher courts. The recovery amount involved in the SARFAESI act is below expectations. Hence, there should be a hybrid or a combined application of recovery channels by the government, and also more effective measures to manage the ballooning amount of NPAs. In addition to this, asset classification, proper credit appraisal system, effective bankers training, proper follow-up, and stringent recovery action are key to recovering the NPAs professionally and systematically, thus achieving financial sustainability of Indian commercial banks.

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