

Management of Non-performing Assets of Commercial Banks: The Evidence from Indian Banking Sector

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Abstract

Non performing assets (NPAs) of the Indian banking system are now comparable to several advanced economies and significantly lower than several economies in the Asian region. RBI rates reduction in NPAs as one of the major achievements of the Indian banking sector in recent year. But still the Indian banking sector is facing a serious problem of mounting quantum of NPAs. The commercial banks in India in general suffer a tendency to minimize their NPA figures. There is the practice of 'ever-greening' of advances through understated techniques. The earning capacity and profitability of banks has been adversely affected by the high level of NPAs. The reduction of NPAs in banks is posing the biggest challenges in the Indian economy. The present paper is a modest attempt to diagnose the management of NPAs of commercial banks in India. Finally, it has identified some of the lacunas for large quantum of NPAs of banks and proposed strategies for tackling the unbridled virus of commercial banks.

Keywords: Non performing assets, Indian Bank, foreign Bank, Commercial Bank, Assest Classification.

JEL Classification: G21

Introduction

The non-performing assets (NPAs) of banks is a brought forward legacy accumulated over the past decades. It is not wrong to have pursued social goals, but this does not justify relegating banking goals and fiscal discipline to the background. But despite this extravagance the malaise remained invisible to the public eyes due to the practice of not following transparent accounting standards, but keeping the balance sheets vague. In the milieu of the complex changes when the dilemma of bank's NPA was gradually recognised for the first time at its peak velocity during 1992-93, there was resultant uproar and confusion. As the problems in large magnitude exploded unexpectedly commercial banks were unable to analyze and make a realistic or complete assessment of the prevailing situation. The partial perceptions and hasty judgments led to a policy of ad-hoc-ism, which characterised the approach of the authorities during the last two-decades towards finding solutions to banking ailments and dismantling recovery impediments. Repeated correctional efforts were executed, but positive results were evading. The problem was challenging a positive solution.

The level of NPAs of the Indian banking system are now comparable to several advanced economies and significantly lower than several economies in the Asian region. RBI rates reduction in NPAs as one of the major achievements of the Indian banking sector in recent year. But still the Indian banking sector is facing a serious problem of mounting quantum of NPAs which are to the tune of Rs. 31,424crores in March 2009. The earning capacity and profitability of many banks and financial institutions has been adversely affected by the high level

of NPAs. The reduction of NPAs in banks is posing the biggest challenges in Indian economy. It affects the liquidity, profitability and equity. The gross NPAs in Indian banking sector have declined sharply close to 3.0 per cent and the net NPAs of the banking sector are now at close to one per cent and the gap between the gross and net NPAs has narrowed over the years. The recovery of dues is also more than the fresh slippages.

The decline in NPAs is particularly significant as income recognition, asset classification and provisioning norms were tightened over the years. For instance, banks are now following 90-day delinquency norm as against 180-day earlier. An asset is now treated as doubtful if it remains unpaid for more than 120 days instead of 180 days earlier. The banks are also required to make general provisioning (0.40 per cent) for standard advances, barring banks direct advances to agricultural and small and medium sector. The general provisioning requirement is 1.0 per cent for certain sensitive sectors.

According to Reserve Bank of India, improved profitability, underpinned by robust macro-economic environment and upturn in interest rate cycle, has enabled banks to reduce the backlog of NPAs. Although asset quality in the banking system has improved considerably over the years, commercial banks need to guard against any deterioration of credit quality, particularly in the wake of significant expansion of credit. RBI feels that banks need to have a comprehensive system in which the process of risk monitoring is combined with proper risk assessment. This would entail creation and maintenance of an appropriate data base on risk assessment and credit extended, which would be required to be updated periodically. With this backdrop, an attempt has been made in this paper to examine the management of NPAs by commercial banks in Indian context.

Studies Reviewed

There exist some cross country studies on asset quality and NPAs of commercial banks. Shu (2002) observed that bad loans as a proportion to total loans of banks decrease with high economic growth in Hong Kong. Gambera (2000) used a bivariate VAR technique and found that firm income and state annual product have significant influence on bank loan quality in US. Recently some studies investigated the feedback effect from the banks to the real economy. Marcucci and Quagliariello (2005) validated the cyclicity of write-offs to total loans for

Italian banks. Hoggarth, Sorensen and Zicchino (2005) observed cyclicity of aggregate write-offs in UK banks. Baboucek and Jancar (2005) found no corroboration of the cyclicity of NPAs but conform pro-cyclicity for banks in Czech economy. Codjia (2010) observed that NPAs are loans that a bank believes it may not recover from a borrower. Evaluation of NPAs is an important business practice because it helps top leadership gauge the company's credit risk levels.

In Indian milieu, there have been large empirical literatures on the causes of NPAs in Indian banking sector. However some studies relating to NPAs are mentioned to pinpoint the importance of the study. Rangarajan (1991) pointed out that improving the quality of loan assets is the true test of improved efficiency of banking system. Taori (2000) dealt with the NPA management of banks and stated that surest way of containing NPAs is to prevent their occurrences. He suggested proper risk management, strong and effective credit monitoring, co-operative working relationship between banks and borrowers etc should be tenets of NPA management policy. The similar opinion has been echoed in more recent work by Battacharya (2002). In order to root out the NPA problem, Banmali (2001) suggested a multi-frontal attack to the problem involving all the concern's staff members in the field up to the grass root level as well as in the controlling points. A number of studies viz, Ranjan and Dhal (2003), Harpreet and Parricha (2004), Ramkrishna and Bhargavi (2004), Singh (2007) etc agreed that the asset quality of commercial banks has improved considerably due to reform package. Raul (2004) suggested that an appropriate set of substantial financial sector regulation clarity including changes in tax laws is imperative for the banking system to get rid off NPAs as well as QIBs to look forward to the investment opportunity. Ghosh (2006) studied the management of NPAs with reference to Mugberia Central Co-operative Banks and Tamluk Ghatal Central Co-operative Bank Ltd. They found that these banks were not successful in restricting the level of NPAs and suggested for changing the character from NPAs to Performing Assets. Rajender and Suresh (2007) in a case study examined the quality of loan assets of Indian banking and suggested some of the practical strategies to make Indian banks more viable by managing the level of NPAs. An assessment of the causes and consequences of NPAs of commercial banks, by Rajesham and Rajender (2007), concluded that a strong political will only be able to find satisfactory solution to the problem of mounting NPAs.

Bhaumik and Piesse (2008) in their study indicated that allocation of assets between risk-free government securities and risky credit is affected by past allocation patterns, risk averseness of banks, regulations regarding treatment of NPAs, and ability of banks to recover doubtful credit. In the wake of the deterioration in the overall economic climate, Lele (2009) observed that out of 27 PSBs, 16 entities, including State Bank of India, reported higher level of gross NPAs than the target set for the year-ended March 2009, according to data available with the finance ministry. Singh and Singh (2009) in their paper examined the recovery performance of Manipur Rural Bank. The study observed that the repayment of loans mainly depends on proper utilization of the loan amount, supply of quality assets, generation of sufficient income from schemes, availability of infrastructural and marketing facilities, willingness to repay, continuous supervision and follow-up visits etc. Akhan (2009) attempted to study the NPA Management of NBFC in India during 2002-2007 and suggested that pre-sanctioned scrutiny and post sanctioned supervision, effective recovery steps and full compliance with the prudential norms of RBI help to control NPAs.

From the review of earlier studies, it is revealed that not many studies are based exclusively on the management of NPAs of banks. Most of the studies relate to the quality of bank assets and loan portfolio. However, studies relating to the NPAs of commercial banks remained un-researched in the study area.

Objectives of the Study

The objective of the proposed study is to examine the management of NPAs of the commercial banks in Indian context. The specific objectives are as under-

1. To study the asset portfolio and, nature and growth of NPA of commercial bank groups in India.
2. To study the recovery and provisions of NPAs of commercial banks over the years.
3. To suggest strategies for better management of NPAs of banks on the basis of the analysis.

For this purpose group-wise scheduled commercial banks operating in India viz, PSBs, private sector banks and foreign banks, have been considered. An attempt has also been made for cross-section analysis of NPAs of bank groups. The relevant data have been collected from secondary sources only. The sources of secondary

data are financial statements compiled by the banks, RBI Bulletins, Report on Trend and Progress of Banking in India, Report on Currency and Finance, RBI Annual Reports and various surveys. The statistical and financial techniques have been used to examine the management of NPAs of banks.

Magnitude of NPAs of Commercial Banks in India

Commercial banks in India in general suffer a tendency to minimize their NPA figures. There is the practice of 'ever-greening' of advances through understated techniques. It has been reported that the banking industry has underestimated its non-performing assets by whopping Rs. 3,862.1 crores as on March 1997. The industry is also estimated to have under-provided to the extent of Rs 1,412.29 crores. The nationalized banks along-with the State Bank of India and its associate banks have underestimated their NPAs by Rs 3,029.29 crores. Such deception of NPA statistics is executed through various ways. Among these, non-identification of NPAs as per stipulated guidelines eg, 'sub-standard' assets classified as 'standard', wrong classification of NPAs eg, classifying a 'loss' asset as a 'doubtful' or 'doubtful' asset as a 'sub-standard' asset, avoiding prudential norms etc.

Thus, the high level of NPAs is prevalent to the Indian financial sector and reflects country's poor bankruptcy laws. The gross NPA of the banking system amounted to Rs. 60,841 crores for 2000-01, a little over 16 per cent of the total assets of nationalized banks. During 2001-02 nationalized banks have recorded a collective growth of 130 per cent in net profits besides fresh NPAs added during the year more than double of those added in the previous fiscal. The gross NPAs of scheduled commercial banks in absolute term raised to Rs. 68,226 crores in March 2009 from Rs. 50,519 crores in March 2006 but percentage share to total advances declined from 3.5 per cent to 2.4 per cent. The net NPAs of banks in 2008-09 stood at Rs. 31,424 crores compared to Rs. 24,730 crores in 2007-08 and Rs. 17,435 crores in 1999-00. This has been largely possible because of the huge provisioning that most of these banks could make as a result of growth in treasury income and, therefore profits. The Table 1 exhibiting net NPA as a percentage of net advances reveals that though NPAs maintained a declined trend across all segments of banking sector but PSBs are clearly worse off as compared to private and foreign banks. The reasons of

decline of NPAs to total assets may be attributed to change in the composition of assets in favour of investment in government and other approved securities and the banks unwillingness or inability to assume higher exposure to small and medium enterprises.

Table 1. Net NPA as Percent of Net Advances

<i>As on March</i>	<i>Public Sector banks</i>	<i>Private Sector banks</i>	<i>Foreign banks</i>	<i>Scheduled Commercial banks</i>
1997	9.2	5.4	1.9	8.1
1998	8.2	5.3	2.3	7.3
1999	8.1	7.4	2.9	7.6
2000	7.4	5.4	2.4	6.8
2001	6.7	5.4	1.9	6.2
2002	5.8	5.7	1.9	5.5
2003	4.5	5.0	1.8	4.4
2004	3.0	2.8	1.5	2.9
2005	2.1	1.9	0.9	2.0
2006	1.3	1.0	0.8	1.2
2007	1.1	1.0	1.0	1.0
2008	0.8	1.2	0.9	1.0
2009	0.7	1.5	1.7	1.1
Covariance	6.92	3.51	0.37	5.44

Source: Report on Trend and Progress of Banking in India 2006-07 and 2008-09

It may not be possible to track exposure to this category as RBI has clubbed the sectoral deployment of credit to small and medium enterprises with large ones. This indicates that with more banks' exposure in respect of volume of business, the magnitude of NPA is increasing that has warranted an efficient management of banks' NPAs. The magnitude of NPAs have a direct impact on

banks' profitability as legally they are not allowed to book income on such accounts and at the same time banks are forced to make provision on such assets as per RBI guidelines.

The Composition of NPAs of Commercial Banks

The problem of high level of NPAs eroding the profitability of banks is not confined to PSBs alone, but it is equally present in the private sector banks and foreign banks too. The problem is multidimensional and unless the same is checked and the NPA level is brought down to the international standards, it is bound to weaken the banking system. A major stumbling block for the banks to reduce their NPAs has been the prevailing legal system in the country. The following paragraphs present asset classification of bank-groups viz., PSBs, private sector banks and foreign banks.

Asset Classification of Public Sector Banks:

The following Table 2 demonstrates the position of NPAs of PSBs during 2000-2009. The table unfolds that the proportion of total NPAs to total advances declined to 2.1 per cent in March 2009 from 14.0 per cent in March 2000. During the same period, the proportion of doubtful assets declined from 8.0 per cent to 1.0 per cent and sub-standard assets from 4.3 per cent to 0.9 per cent. The loss assets however although declined from 1.7 per cent in March 2000 to 0.3 per cent in March 2008, it increased afterwards and reached to 2.0 per cent of advances in March 2009. The rate of decline was significant in case of doubtful assets during the period under consideration. However, the standard assets as per cent of total advances increased to 97.9 per cent in March 2009 from 84.1 per cent in March 2000.

Table 2. Asset Classification of Public Sector Banks during 2000-2009

(Amount Rs .in crores)

<i>Categories.</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>
I. Total Advances	3,80,077 (100)	4,42,137 (100)	5,09,368 (100)	5,77,812 (100)	6,61,975 (100)	8,70,851 (100)	10,70,872 (100)	13,73,777 (100)	16,96,334 (100)	21,03,763 (100)
A. Total standard assets	3,26,783 (84.1)	3,87,360 (86.0)	4,52,862 (88.9)	5,23,724 (90.6)	6,10,435 (92.2)	8,24,253 (94.6)	10,29,493 (96.1)	13,35,175 (97.2)	16,56,585 (97.7)	20,59,725 (97.9)
B. Total NPA	5,3291 (14.0)	54717 (12.3)	56507 (11.1)	54089 (9.4)	51541 (7.8)	46597 (5.4)	41379 (3.9)	38,602 (2.8)	39749 (2.3)	44039 (2.1)

Categories.	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
(a) Sub standard assets	16361 (4.3)	16405 (3.7)	15788 (3.1)	14909 (2.6)	16909 (2.6)	10838 (1.2)	11394 (1.1)	14147 (1.0)	16870 (1.0)	19521 (0.9)
(b) Doubtful assets	30535 (8.0)	31535 (7.1)	33658 (6.6)	32340 (5.6)	28756 (4.3)	29988 (3.4)	24804 (2.3)	19944 (1.5)	19167 (1.1)	20715 (1.0)
(c) Loss assets	6398 (1.7)	6837 (1.50)	7061 (1.4)	6840 (1.2)	5876 (0.9)	5771 (0.7)	5181 (0.5)	4510 (0.3)	3712 (0.2)	3803 (2.0)

Figures in the parenthesis indicate percentage to total advances

Source: Report on Trend and Progress of Banking in India, Various issues

It has been observed that the loss assets are contributing a notable figure to the quantum of NPAs of PSBs, although the rate of NPA reduction was prominent during the period under consideration. A highly warranted step before PSBs is to manage and the fresh accretion of doubtful assets.

Asset Classification of Private Sector Banks

An attempt has been made hereunder to examine the position of NPAs of private sector banks in India. For this purpose both old and new private sector banks together has been considered. The table-3 demonstrates the position of asset classifications of private sector banks during 2004-2009. The table clarifies that the proportion

of total NPAs to total advances declined to 3.2 per cent in March 2009 from 5.8 per cent in March 2004. During the same period, the proportion of doubtful assets declined from 3.6 per cent to 1.0 per cent and loss assets from 0.5 per cent to 0.3 per cent. However, the standard assets as per cent of total advances increased to 96.8 per cent in March 2009 from 94.2 per cent in March 2004. The sub-standard assets are remained as the biggest contributor to total NPAs of private sector banks during the period under consideration. The sub-standard assets to total advances declined from 1.8 per cent in March 2004 to 1.1 per cent in March 2007 and then started to swell up and reached at 2.0 per cent in March 2009.

Table 3. Asset Classification of Private Sector Banks during 2004-2009

(Amount in Rs crores)						
Asset Classification	2004	2005	2006	2007	2008	2009
1. Total Advances	1,77,419 (100)	2,25,139 (100)	3,03,794 (100)	3,91,869 (100)	4,72,345 (100)	5,19,656 (100)
A. Standard Assets	1,67,076 (94.2)	2,16,448 (96.1)	2,96,020 (97.2)	3,82,630 (97.6)	4,59,370 (97.3)	5,02,768 (96.8)
B. Total NPAs	10,343 (5.8)	8,691 (3.9)	7774 (2.6)	9240 (2.4)	12,976 (2.7)	16,887 (3.2)
(a) Sub-standard Assets	3,127 (1.8)	2,213 (1.0)	2,396 (0.8)	4,368 (1.1)	7,280 (1.5)	10,526 (2.0)
(b) Doubtful Assets	6,391 (3.6)	5,578 (2.5)	4,438 (1.5)	3,930 (1.0)	4,452 (0.9)	5,017 (1.0)
(c) Loss Assets	825 (0.5)	900 (0.4)	940 (0.3)	941 (0.2)	1,244 (0.3)	1,345 (0.3)

Figures in the parentheses indicate percentage to total advances

Source: DBS Returns (BSA) submitted by respective banks.

Asset Classification of Foreign Banks

The table - 4 exhibits the position of asset classifications of foreign banks operating in India during the period 2004-2009. The table elucidates that the proportion of total NPAs to total advances declined to 1.9 per cent in March 2007 from 4.8 per cent in March 2004 but the year 2009 experienced a high amount of NPAs which evidenced 4.3 per cent of advances. During the same period, the proportion of doubtful assets declined from 1.8 per cent to 0.6 per cent and loss assets from 1.5 per cent to 0.2 per cent. The sub-standard assets declined from 1.6 per cent in March 2004 to 1.2 per cent in March 2007 and

thereafter increased to 3.5 per cent of total advances in March 2009.

However, the quantum and percentage share to total advances of performing assets viz, standard assets has been increased in case of foreign banks. It may be inferred that the foreign banks are doing well in managing their level of NPAs since the new millennium. The fact has been clear from their loan exposure to priority sector (34.3 per cent of net bank credit in March 2009), credit deposit ratio, return on assets, capital adequacy ratio (15.1 per cent in March 2009) etc.

Table 4. Asset Classification of Foreign Banks during 2004-2009

(Amount Rs in crores)

<i>Asset Classification</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>
1. Total Advances	62,632 (100)	75,220 (100)	98,862 (100)	1,27,867 (100)	1,63,000 (100)	1,69,714 (100)
A. Standard Assets	59,619 (95.1)	74,705 (97.0)	96,772 (97.9)	1,25,415 (98.1)	1,59,882 (98.1)	1,62,415 (95.7)
B. Total NPAs	3,013 (4.8)	2,257 (3.0)	2,090 (2.1)	2,452 (1.9)	3,117 (1.9)	7229 (4.3)

Figures in the parentheses indicate percentage to total advances

Source: DBS Returns (BSA) submitted by respective banks.

The above analyses of asset classification of banks suggests that an immediate action is needed in respect of loss assets and sub-standard assets to contain further NPA accumulation although the profile of assets portfolio and the extent of NPAs of commercial banks have improved during 2000-2009. The supervisory strategy of the banks has undergone a change during this period, moving from opacity towards transparency. A positive externality of the reform process has been building up the institutional architecture in terms of market, and creation of enabling environment through technological and legal infrastructure and improving managerial competence etc.

Distribution of Commercial Banks in terms of Ratio of NPAs to Net Advances

A comparative chart of distribution of net NPAs of PSBs vis-à-vis other private sector banks and foreign banks is

presented in table -5. The table reveals that in 2005, 2 out of 28 PSBs had accounted net NPAs of above 5 per cent and below 10 per cent of their advances. While other 19 placed in below 2 per cent and 7 banks were within 2- 5 per cent net NPA category. The position, however, had undergone a sea change in the later period where in all PSBs ie, 27 banks achieved the target of net NPAs less than 2 per cent and none of the PSBs was found within the category of above 2 per cent of net NPAs during 2009. The position of private sector banks in this context is same as there are no banks found in the category of above 2 per cent net NPAs of their advances except only 3 new private banks had NPAs between 2 per cent -5 per cent of its net advances during 2009. During 1995-2007, considerable number of foreign banks attained net NPAs below 2 per cent of their advances. The number of foreign banks which attained below 2 per cent NPA to total advances was 27 in 2007; the number has declined to 24 in 2009.

Table 5. Distribution of Banks by Net NPAs to Net Advances

(Number of banks)

Year	Public Sector Banks			Old Pvt. Banks			New Pvt. Banks			Foreign banks			
	Up to 2 %	2 to 5 %	above 5 and up to 10 %	upto 2 %	2 to 5 %	above 5 and up to 10 %	upto 2 %	2 to 5 %	above 5 and up to 10 %	upto 2 %	2 to 5 %	5 to 10%	Above 10%
2005	19	7	2	4	12	4	5	3	1	23	2	2	4
2006	23	5	0	11	7	2	6	2	0	25	0	0	4
2007	27	1	0	15	1	1	7	1	0	27	1	0	1
2008	28	0	0	15	0	0	7	1	0	25	2	1	0
2009	27	0	0	14	0	0	4	3	0	24	6	1	0

Source: RBI, Trend & Progress of Banking in India, various issues.

It could be inferred from the analysis that the PSBs are continuously improving their operations as there is no bank with net NPAs above 5 per cent of their advances during 2009. It is also evident that, by introducing 'net concept', RBI succeeded notably i.e., the number of banks, showed low level of NPAs; however this may not be considered a genuine progress in the context of financial strength of commercial banks as a whole.

Non-Performing Assets and Priority Sector Lending

The sector-wise analysis of NPAs of public sector commercial banks revealed that priority sector added up to a large proportion about 44.5 per cent (Rs.23, 715 crores) of total non-performing advances in March 2000 and swelled to 55.2 per cent (Rs.24, 318 crores) in March 2009. In the non-priority sector, the same has been reduced to 43.7 per cent (Rs.19, 251 crores) in March 2009 from 53.5 per cent (Rs.28, 524 crores) in March 2000. An extremely negligible fraction of NPAs of PSBs are contributed by public sector throughout the period under consideration. The public sector accounted for 2 per cent of total NPA in March 2000 which declined to 1.1 per cent in March 2009.

An analysis relating to the percentage change of NPAs over previous years revealed that the fresh accretion of NPAs in the priority sector is still prevailing. In case of priority sector NPAs, percentage change over previous year becomes positive throughout the period except 2003

to 2008, which again experienced a negative figure of -3.8 in March 2009. However, the accumulation of fresh NPAs in non-priority sector advances has been contained throughout the period except in 2009. The overall fresh accretion of NPAs of PSBs has been controlled which is reflected from the position of percentage change of NPAs over previous years. In March 2000, the same was 3.06 per cent addition over previous year, has appeared a negative figure during 2004-2007. This however started to rise from 2008 onwards and reached to 10.8 per cent over previous year in March 2009. The table - 6 presents the sector-wise NPAs of banks.

The sector wise comparison has been made by employing both linear growth rate (b) and compound growth rate (cgr) of NPAs. The fact has been demonstrated as under-

Growth rate	Priority sector	Non-priority sector	Public sector	Total
.b	924.82	191.3	-18.03	2854.28
Cgr	2.37	-4.86	-1.31	-1.24

The compound growth rate (cgr) of NPAs in priority sector is positive (2.8 per cent). The 'b' and 'cgr' became negative in non-priority sector and public sector. This exposes that the nationalized banks have not considered loan to the priority sector due to fear of further NPAs menace over the years. Moreover, the overall cgr of NPAs during 2000-2009 of PSBs was -1.24 per cent. Thus the non-priority sector is also considerably adding fresh

NPAs over the years. On the other hand, the higher NPAs in priority sector advances have pushed up the overall proportion of NPAs by three to four percent. The reasons of higher proportion of NPAs in priority sector advances may be attributed to; the directed and pre-approval nature

of loans sanctioned under sponsored programmes, lack of effective follow up due to large number of small accounts, non-cost effective legal recovery measures, vitiation of the repayment culture consequent to the loan waiver schemes, willful defaulters and so on.

Table 6. Sector-wise Non-Performing Assets of Public Sector Banks

(Amount Rs. in Crores)

Year (As on March)	Priority Sector		Non-Priority Sector		Public Sector		Total NPA	
	Amount	% change over previous year	Amount	% change over previous year	Amount		Amount	% change over previous year
2000	23715 (44.5)	4.90	28524 (53.5)	3.31	1055 (2.0)	- 29.47	53294 (100)	3.06
2001	24156 (45.4)	1.85	27307 (51.4)	- 4.27	1711 (3.2)	62.08	53174 (100)	- 0.23
2002	25150 (46.2)	4.11	28405 (52.2)	4.02	903 (1.7)	- 47.22	54458 (100)	2.41
2003	24939 (47.2)	- 0.83	26781 (50.7)	- 5.71	1087 (2.1)	20.37	52807 (100)	- 3.03
2004	23841 (47.5)	- 4.40	25698 (51.2)	- 4.04	610 (1.2)	- 43.88	50149 (100)	- 5.03
2005	21926 (48.1)	- 8.03	23249 (51.0)	- 9.53	444 (1.0)	- 27.21	45619 (100)	- 9.03
2006	22374 (54.1)	2.04	18072 (43.7)	- 22.26	341 (2.3)	-23.19	41378 (100)	- 9.29
2007	22954 (59.5)	2.59	15158 (39.3)	-16.12	490 (1.3)	43.69	38602 (100)	-8.70
2008	25287 (63.6)	10.2	14163 (35.6)	-6.6	299 (0.8)	-6.4	39749 (100)	2.6
2009	24318 (55.2)	-3.8	19251 (43.7)	35.9	474 (1.1)	58.5	44043 (100)	10.8

(Figures in the parentheses indicate percentage to total NPAs)

Source: RBI, Report on Trend & Progress of Banking in India, Various issues.

In order to assess the contribution of priority and non priority and public sector advances in the volume of NPAs, we have calculated 'r' between NPAs (a), priority sector advances (b), non-priority sector advances (c) and public sector advances. The results are summarized here under—

Correlations	'r' values	't' value (cal)	't' value (tab.)	
			1 per cent	5 per cent
rab	0.788	3.346	3.355	2.306
rac	0.973	11.263	3.355	2.306
rad	0.312	0.851	3.355	2.306

The analysis explores the existence of positive ‘r’ values between the variables. The correlation co-efficient (0.312) between NPAs and public sector are not statistically significant at 1 per cent and 5 per cent level of significance at 8 degrees of freedom. However, ‘r’ values for NPAs and non-priority sector lending is statistically significant at 1 per cent and 5 per cent level of significance at their respective degrees of freedom. The r value for NPAs and priority sector lending is statistically significant at 1 per cent but not at 5 per cent level of significance. This does not imply that with the increase of priority sector lending, there has been corresponding increase in the volume of NPAs. Thus, it can not be argued that both priority sector and non-priority sector lending are equally responsible for high quantum of NPAs of public sector commercial banks.

Non Performing Assets: Bank Group-wise Comparison

A bank group wise comparison of NPAs commercial banks viz., PSBs, private banks and foreign sector banks are presented in table -7. The table depicts that during the

period 1997-2009, NPAs as percentage of advances has been declining significantly in case of PSBs. It has slipped to 2.1 per cent in March 2009 from 14.0 per cent in March 2000. The foreign banks and private banks witnessed swelling of NPAs both in percentage and absolute term. The same for private banks reduced from 8.2 per cent to 3.2 per cent and for foreign banks 7.2 per cent to 1.9 per cent in March 2008 and thereafter increased to 4.3 per cent in March 2009. The bank group-wise growth of NPAs and advances has been analyzed with the help of compound growth rate (cgr) for the period of 1997 to 2007.

The analysis revealed that the growth of NPAs of PSBs during the period is 20.08 per cent which is 22.45 per cent for private sector banks and 22.19 per cent for foreign banks. One worth noting point in this respect is that the growth of NPAs of PSBs is higher than the growth of advances where as private banks experienced almost a uniform growth rate of both NPAs and advances. This clearly indicates banks’ promising task to maintain international standard of percentage of NPAs. This also implies that the banks are continuously improving their assets portfolio as well as their recovery position.

Table 7. Bank Group Wise Non-Performing Assets during 1997-2009

(Amount in Rs. crores)

Year	Public Sector Banks			Pvt. Sector Banks			Foreign Banks			All Commercial Banks		
	NPAs Rs.	Advances Rs.	NPA as % to ad- vances	NPAs Rs.	Advan- ces Rs.	NPAs as % to ad- vances	NPAs Rs.	Advances Rs.	NPA as % to ad- vances	NPAs Rs	Advances Rs	NPA as % to ad- vanc- es
2000	53291	380077	14.0	4761	58249	8.2	2615	37432	7.0	60841	475758	12.8
2001	54774	442134	12.4	6078	71149	8.5	3111	45396	6.9	63963	558679	11.4
2002	56507	509368	11.1	11667	120883	9.7	2780	50618	5.5	70954	680869	10.4
2003	54089	577812	9.4	13333	144953	9.2	2892	53743	5.4	70314	776508	9.1
2004	51541	661975	7.8	10343	177419	5.8	3013	62632	4.8	64897	902026	7.2
2005	46597	870851	5.4	8691	225139	3.9	2257	75220	3.0	57545	1171210	4.9
2006	41379	1070872	3.9	7774	303794	2.6	1090	98862	2.1	51243	1473528	3.5
2007	38602	1373777	2.8	9240	391869	2.4	2452	127867	1.9	50292	1893512	2.7
2008	39749	1696334	2.3	12976	472345	2.7	3117	163000	1.9	55843	2331677	2.4
2009	44039	2103763	2.1	16887	519656	3.2	7229	169714	4.3	68226	2793132	2.4
.b	3003.0	49094.6	-	856.9	10387.2	-	441.3	42193.8	-	4319.2	63719.8	-
Cgr	20.078	15.288	-	22.24	23.738	-	22.19	12.589	-	7.773	15.972	-

Source: Trend and Progress of Indian Banking, Various Issues & RBI, Statistical Tables Relating to Banks in India, Various Issues.

Recovery and Provisions for Non Performing Assets

The NPA recovery and fresh addition in NPA during 2008-09 may be had from the following table-8. It is clear from the table that the fresh accretion of NPAs is more than the recovery of NPAs in case of commercial banks as a whole. The new private sector and foreign banks have failed to recover NPAs alike other bank groups rather fresh accretion is more than that of the amount recovered from NPAs. The fresh addition in case of PSBs during 2008-09 was Rs 31,338 crores while recovery was Rs 26,771 crores. In case of old private and foreign banks recovery is lower (Rs 1,579 crores and Rs 2,954 crores respectively) than the fresh accretion.

Table 8. Position of Addition and Recovery from Gross NPAs of Banks

(Amount Rs. in crores)

Commercial Banks	March 2008-09			March 2009
	Addition during the year	Recovered during the year	Written off during the year	
1. Public Sector Banks	31,338	26,771	-	45,156
2. Old Private Banks	2,094	1,579	-	3,072
3. New Private Banks	10,520	6,510	-	13,911
4. Foreign Banks	8,430	2,954	1,514	6,833
Total of Scheduled Commercial Banks	52,382	37,314	1,514	50,486

Source: RBI, Report on Trend and Progress of Banking in India-2008-09, P – 128

The provisioning of NPAs tends to follow a cyclical pattern. The provisioning made during 2008-09 was higher than write-back of excess provisioning during the year. Yet, net NPAs increased during the year due to increase in gross NPAs. The provisions made during the year were higher than write-back of excess provisions for all the bank groups. The outstanding provisions to gross NPA ratio declined in case of all the bank groups

except new private sector banks and foreign banks. The outstanding provisions as per cent of gross NPAs was highest for old private banks (59.0 per cent) followed by new private banks (54.9 per cent), foreign banks (51.2 per cent) and PSBs (49.7 per cent). The provisions for NPAs of banks for 2008-09 are presented in table-9.

Table 9. Provisions for NPAs of Commercial Banks in India

(Amount Rs. in crores)

Provisions for NPAs	Public Sector Banks	Old Private Banks	New Private Banks	Foreign Banks
End - March 2008	21,091	1,719	5,109	1,387
Add: Provision made during the year	11,415	706	7,907	3,099
Less: Write-off excess during the year	10,071	613	5,373	989
End - March 2009	22,435	1,811	7,642	3,498
Outstanding provisions to gross NPAs (%)	49.7	59.0	54.9	51.2

Source: RBI, Report on Trend and Progress of Banking in India-2008-09, P - 130

Measures for Recovery of NPAs

The management is seriously concerned about the growing NPA menace, which is taking its toll on efficiency and profitability. NPAs are serious strain on the profitability because the banks can not book income on such accounts. Further they are required to charge the funding cost and provision requirement to their profits. High level of NPAs adversely affects the financial strength of banks and enforces the government to recapitalize the weak banks from time to time. On the other hand, the banks have failed to conform to stringent international standard. The RBI in this respect proposed prompt corrective action (PCA) mechanism for arresting the menace of NPAs and has introduced various measures like credit risk management models, Compromise Settlement methods, effective use

of debt recovery tribunals (DRTs), Asset Reconstruction Companies (ARC) and Recovery of Debts, Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act-2002, Circulation of information on defaulters, Corporate Debt Restructuring (CDR), Lok Adalats and so on to arrest unbridled virus of NPAs of commercial banks. With a view to provide an additional option and developing a healthy secondary market for NPAs, the guidelines relating to sale/ purchase of NPAs were issued in July 2005 covering the procedure for purchase/ sale of NPAs by banks valuation aspects, prudential norms. The guidelines were partly modified in May 2007 whereby it was stipulated that atleast 10 per cent of the estimated cash flows should be realized in the first year and atleast 5 per cent in each half year thereafter subject to full recovery within three years.

The Performance of Recovery Channels

It is revealed from the above discussion that the various recovery channels have been introduced from time to time for expediting the recovery of bad loans of banks. The following table-10 presents the implications of various recovery channels of NPAs of banks. The table

indicates that among the several channels of recovery available to banks for dealing with bad loans, the debt recovery tribunals (DRTs) and the SARFAESI Act have been the most effective in terms of amount recovered. The total number of cases referred to DRTs during 2006-07 was 4,028 and out of the total amount Rs 9,156 crores involved in the cases, Rs. 3,463 crores has been recovered. Likewise out of the amount Rs. 9058 crores, a sum of Rs. 3,749 crores were recovered in case of referred cases in SARFAEST Act. In the same manner, the total number of cases referred to DRTs during 2008-09 was 4,004 and out of the total amount Rs 4,130 crores involved in the cases, Rs. 3,348 crores has been recovered. Likewise out of the amount Rs. 12,067 crores, a sum of Rs. 3,982 crores were recovered in case of referred cases in SARFAEST Act. The number of cases referred to the Lok Adalats remained the largest but the amount recovered under Lok Adalats and DRTs during 2008-09 was lower than the previous year. The recovery rate has been improved in the case of direct agricultural advances while compared with other priority and non-priority sector NPAs. The rate of recovery in case of direct agricultural advances decreased from 80.1 per cent for the year-ended June 2006 to 75.4 per cent in June 2008 (RBI, 2009).

Table 10. NPA Recovered Through Various Channels

Recovery Channels	(Amount Rs in Crores)								
	No. of cases referred	2005-06		2006-07			2008-09		
		Amount involved	Amount recovered	No. of cases referred	Amount involved	Amount recovered	No. of cases referred	Amount involved	Amount recovered
1. One time Settlement	10,262	772	608	-	-	-	-	-	-
2. Lok Adalats	2,68,090	2,144	265	1,60,368	756	106	5,48,308	4,023	96
3. DRTs	3,534	6,273	4,735	4,028	9,156	3,463	2,004	4,130	3,348
4. SAR-FAEST Act	41,180	8,517	3,363	60,178	9,058	3,749	61,760	12,067	3,982

Sources: RBI, Trend and Progress of Banking in India 2006-07 p- 92, and 2008-09 p 129

The Reserve Bank has so far issued certificate of registration to 12 securitization companies/ reconstruction companies (SCs/ RCs), of which 11 have commenced their operations. At end-June 2009, the book value of total amount of assets acquired by SCs/RCs registered

with the Reserve Bank stood at Rs. 51,542 crores. The security receipts subscribed to by banks amounted to Rs. 9,570 crores. The security receipts redeemed amounted to Rs.2792 crores (RBI, 2009).

Major Causes of NPAs in Banks

There are number of factors responsible for increasing size of NPAs of commercial banks. A few prominent reasons for assets becoming NPAs are mentioned as under:

- Poor credit appraisal system.
- Lack of vision/ foresightedness while sanctioning/ reviewing or enhancing credit limits.
- Lack of proper monitoring.
- Reckless advances to achieve the budgetary targets.
- Lack of sincere corporate culture.
- Inadequate legal provisions on foreclosure and bankruptcy.
- Change in economic policies/environment at the macro level.
- Non transparent accounting policy and poor auditing practices.
- Lack of coordination between Banks and their customers.
- Directed / schematic lending to certain sectors.
- The failure on the part of the promoters to bring in their portion of equity from their own sources or public issue due to market turning lukewarm.

Proposed Suggestions and Strategies

Having analyzed various lacunas of accumulation of NPAs in the loan portfolio of PSBs, it may be observed that banks have been committed towards the reduction and management of NPAs. The quality of asset portfolio has improved quite impressively over the period under consideration due to reform measures. In order to survive and compete with private and foreign banks, it is crucial for the PSBs to clean up their balance sheets by increasing the equity capital. However, following suggestions are offered for effective management of NPAs.

1. The timely edifice of loan portfolio is indispensable for effective management of NPAs. Keeping in view the present stipulation of sensitive sector where the instability is escalating gradually, the bank should diversify its services into capital market, consultancy, credit card, housing finance and insurance sector etc.
2. In the wake of expansion regime of credit although the asset quality of banking system has improved considerably, banks need to safeguard against any

deterioration of credit quality. Banks need to have a comprehensive system in which the process of risk monitoring is combined with proper risk assessment.

3. Prevention is better than cure. It has been observed that there is unprecedented rise in fresh accretion NPAs in some banks. Pre-arrangements must be made to contain the fresh accretion. The surest way of containing NPA is to prevent their occurrences. The tenets of this prevention policy lies on-
 - Proper risk management system in banks.
 - Strong and effective credit monitoring.
 - Open and co-operative working relation between banks and borrowers.
4. Internal governing factors of banks are, possibly, responsible for current level of NPAs. The onus, therefore, rests with the banks themselves. The organizational Structuring, Improvement in managerial efficiency, up-gradation of skills for proper assessment of credit worthiness and a change in the banks attitude towards legal action need to be called for.
5. Supervision and follow-up are two sides of the same coin. The regular monitoring makes the borrowers not to divest the funds for purposes other than the purpose for which the loan is sanctioned. Funds should not be sanctioned and released suddenly or immediately rather it required to be done step by step. A personal enquiry may be conducted over the borrowers whose accounts became NPA.
6. Repayment ethics should be inculcated in the minds of the borrowers by optional utilization of various media ie, television, video films, All India radio and press. The incentives could be offered to the regular payers by financing again or providing bonus or disincentives for the willful defaulters in the form of public crime action or adverse publicity in the news papers.
7. The mounting overdue thwarted the banks' lending in the area under study. No effort is made to improve the recovery performance. The local leaders do not encourage the loanee to pay it back rather they give assurance for exemption of loan repayment. Consequently, loan is not recovered in future; it becomes difficult to pay it back due to heavy amount.

Therefore, an immediate action plan in the line of provisions made in the Securitization Act. 2002 is necessary to expedite the recovery position.

8. The credit management implies an ethical responsibility on the part of the lenders to the borrowers to secure their genuine and bonafide interests. Lenders are thus liable to the borrowers to practice clear and transparent policies, to extend need-based finance, to convey timely sanction, and further to effect in-time disbursements. Recovery should be based on pragmatically calculated anticipated cash flows of the borrower concern, while recovery of installments of term loans should be exclusively out of profits and surplus generated and not through recourse to the corpus of working capital of the borrowing concerns.

Concluding Note

The paradigm shift of attitude of financial institutions towards the short term financing has also changed the complexion of scheduled commercial banks. The undeniable fact remains that Indian banking has huge quantum of NPAs by international standard. The NPAs, being an important parameter for assessing financial performance of banks, reduction is necessary to improve the profitability of the banks and comply with capital adequacy norms. The quality appraisal, supervision and proper follow up undoubtedly will assist to solve the problem. In a situation where nature of clientele is bit complicated, the management must ensure that the right amount of credit is given to the right client. The judicial system needs to be restored to have a smooth progress of quick recovery of dues from defaulters. The pre credit and post credit appraisal should be done more objectively. The Banking Secrecy act must be amended to enable the publication of defaulter's names and willful default has to be treated as criminal offence. The mounting NPAs of banks deter their financial health in terms of profitability, liquidity and economics of scale of operation. The bank has to take timely action against degradation of performing assets. The management of NPAs has been an immense task before the bankers because it challenges the banks resistance capacity. The occurrences of NPAs may not be avoidable entirely but they can be managed effectively. The fresh incidence of NPAs should be avoided but not at the cost of fresh deployment of credit.

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