# Chapter-1
# Introductory

# Chapter-1
# Introductory

## 1. Introduction:

The banking system in India being the dominant segment of financial sector, accounts for a major portion of fund flow. They are the vehicle for monetary policy signals, credit channel and facilitator of payment system. The deepening and widening of the financial markets, growing disintermediation process, adoption of modern technology, rising customer expectation, innovative financial services and scheme supplement with suitable credit delivery mechanism and challenges for which banks would be required to reorient their organizational structure and modify their strategies (Chaudhary and Sharma, 2011)[1]. The commercial banks are highly sensitive organization open to public security and as such, they must continuously ensure their profitability, which is essential for their growth and viability as also for infusing public confident. The profitability is the most important indicator of overall financial performance. The level of efficiency, productivity and cost effectiveness is reflected through the bank's profit which can be considered as a composite index of the bank's performance in its various areas of operation (Angadi and Devraj, 1983)[2]. Therefore, commercial banks at the present juncture have to ensure a balance between social banking and profitability and earn a fair return to justify their

---

[1] Chaudhary, K. and Sharma, M. (2011) "Performance of Indian Public Sector Banks and Private Sector Banks: A Comparative Study", *International Journal of Innovation, Management and Technology*, - 2 (3), ( June).

[2] Angadi, V.B. and Devraj, V. J. (1983) "Productivity and Profitability of Banks in India", *Economic and Political Weekly*, - 18 (48), (November)

existence. Hence, the importance of efficiency has assumed a critical significance for the viability of commercial banks in the liberalized era particularly in the backward regions of the country. The success of the commercial banks to maintain a healthy profit growth not only depends on the hardening of interest rate owes its origin to reduction in operational expenses but also rests on improvement in their assets quality.

The non-performing asset (NPA) has emerged since over a decade as an alarming threat to the banking industry in our country sending distressing signals on the sustainability and endurability of the affected banks. The positive results of banking sector reforms by the Government of India and RBI in terms of Narasimham committee reports in this contemporary period have been neutralized by the ill effects of this surging threat (Shajahan, 1998)[3]. The efficiency of a bank is not always reflected only by the size of its balance sheet but also the level of return on its assets. The NPAs do not generate interest income for banks but at the same time banks are required to provide provisions for NPAs from their current profits. The NPAs have destructive impact on the return on assets in the following ways (Prasad and Veena, 2011)[4].

- The interest income of banks reduced; it is to be accounted only on receipt basis.
- The current profits of the banks are eroded because of the providing of doubtful debts and writing it off as bad debts and it limits the recycling funds.
- The capital adequacy ratio is disturbed and cost of capital will go up.

---

[3] Shajahan, K.M. (1998) "Non-Performing Assets of Banks; Have They Really Declined? And on Whose Account", *Economic and Political Weekly*, (March-21), pp – 671

[4] Prasad, B.V.G and Veena, D. (2011) "NPAs in Indian Banking Sector-Trends and Issues" *Journal of Banking Financial Service & Insurance Research*, The Journal of Sri Krishna Research & Educational Consortium, retrieved from http://www.skirec.com. (visited on 12/3/12) International e-Journal, 1(9) (December)

- The economic value addition (EVA) by banks gets upset because EVA is equal to the net operating profit minus cost of capital.

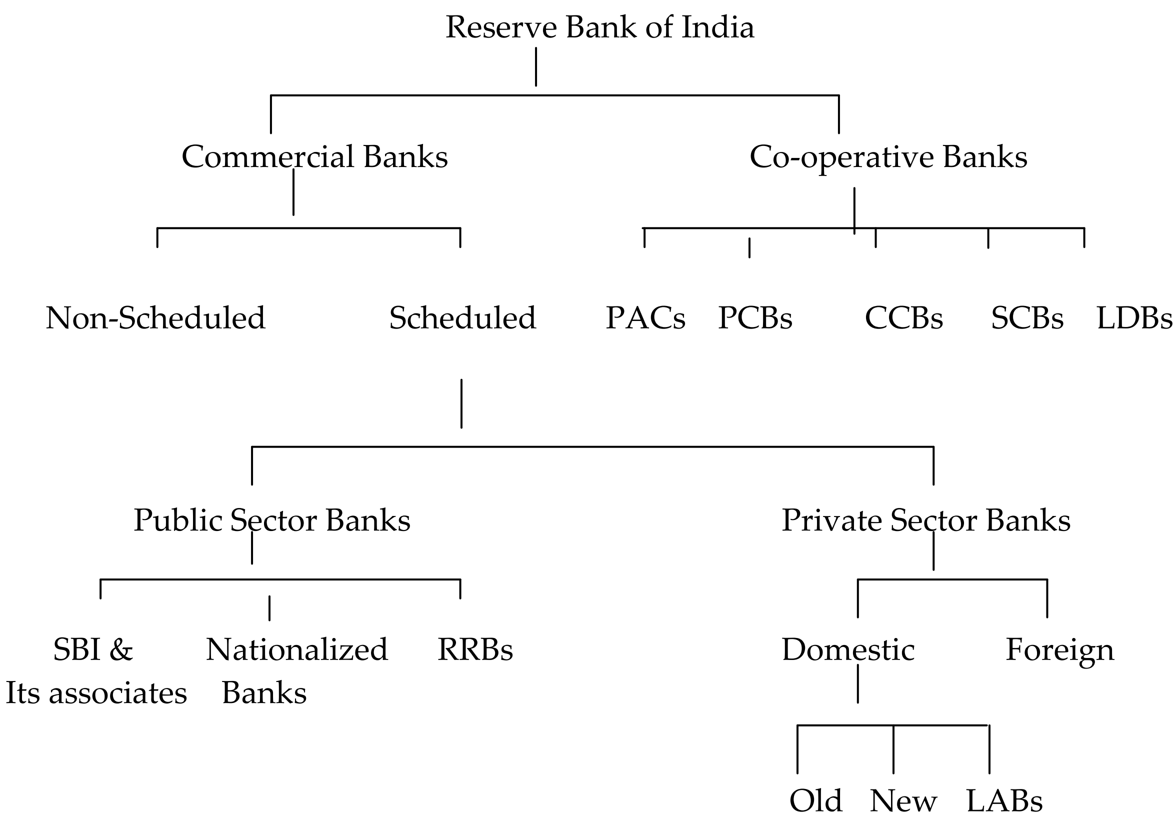
Despite various correctional steps administered to solve this problem, concrete results are escaping. It is a sweeping and all pervasive virus confronted universally on banking and financial institutions. The severity of the problem is however acutely suffered by nationalized banks, followed by the State Bank of India (SBI) group, and the all India Financial Institutions. The asset quality of banks, however, has improved in recent year and is reflected in the decline in their gross and net NPA ratios. A survey of 77 commercial banks finds that their aggregate gross NPA has declined by 1.2 per cent in 2006-07 over 2005-06. The gross NPA as percentage of loans and advances has declined from 2.39 per cent in 2009-10 to 2.25 per cent in 2010-11. Incidentally, in absolute term, the net NPA of Scheduled Commercial Banks (SCBs) increased to Rs. 41,813 crores in 2010-11 from 38,723 crores in 2009-10. The total amount recovered through Lok Adalat, DRTs and SARFAEST Act is Rs. 151 crores, Rs. 3930 crores and Rs. 11,561 crores respectively in 2010-11. This scenario frontages the emerging question as to whether the quality of assets of commercial banks in the area under study is up to the desired extent. How are the banks managing the NPAs? These issues need to be addressed. The present work is an attempt on this issue keeping in view the prudential norms and asset classification, and global trends in financial liberalization of the economy.

## 2. Relevant Concepts:

### 2.1. Scheduled Commercial Banks (SCBs):

Commercial banks are comprised of scheduled and non-scheduled banks. Scheduled banks are those commercial banks which are included in the second schedule of the Reserve Bank of India Act, 1934. The banking sector is dominated by SCBs which accounted about 95 per cent of banking operation. It includes Public Sector Banks (PSBs) namely SBI and its seven subsidiaries, 19 Nationalized Banks (NBs) and 196 Regional Rural Banks (RRBs). The present institutional set-up of Indian commercial banking is presented in figure 1.0

**Figure 1.0**




**Notes:**
PACs ; Primary Agricultural Credit Societies
PCBs ; Primary Co-op. Banks.
CCBs ; Central Co-op. Banks.
SCBs ; State Co–op. Banks.
LDBs ; Land Development Banks.
LABs ; Local Area Banks.
RRBs ; Regional Rural Banks.

## 2.2. Concept of Non-Performing Assets (NPAs):

An asset is classified as NPA if due in the form of principal and interest are not paid by the borrower for a period of 180 days. With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days' overdue norm for identification of NPAs, from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, an NPA shall be a loan or an advance where;

- Interest and / or installment of principal remain overdue for a period of more than 90 days in respect of a term loan.
- The account remains 'out of order' in respect of an overdraft / cash credit.
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest and / or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

As per Narasimham Committee recommendations all advances and loans are classified into two categories ie, performing assets and non-performing assets. Generally an asset became NPA when it ceases to generate income for the bank. When a borrower fails to repay the installment of principal and interest within the first quarter, it becomes non-performing in the next quarter (GoI, 1991)[5]. If the past due amount of advance remains outstanding for the second quarter, it becomes non-performing in the third quarter and the past due amount remaining un-recovered for the last quarter the amount would be classified as NPA for the whole year. However, it may so happen that a past due amount remaining non-performing in first quarter or second quarter may become performing in the next quarter. It is thus required to compute and report the

[5] Govt. of India (1991), *"Report on Banking Sector Reforms"*, (Narasimham Committee-II), Ministry of Finance

segregated amount of NPA for each quarter and then assign specified percentage for provisioning in accounts. The committee on Financial System (GoI, 1992)[6] holds that a proper system of income recognition and provisioning is fundamental to the preservation of strength and stability of banking system. An NPA would thus be considered as an advance where as on the balance sheet date:

- In respect of term loans, interest remains past due when it remains outstanding 30 days beyond the due date for a period of more than 180 days;
- In respect of overdraft and cash credits, accounts remain out of order for a period of more than 180 days;
- In respect of bills purchased and discounted, the bill remains overdue and unpaid for a period of more than 180 days.
- In respect of other accounts, any amount to be received remains past due when it remains outstanding 30 days beyond the due date for a period of more than 180 days.

**2.3. Asset Classification of Banks:**

The banks are required to classify their advances into the following four broad groups: (a) Standard Assets, (b) Sub-standard Assets, (c) Doubtful Assets and (d) Loss Assets. This classification should be done only after taking into consideration the degree of well defined credit weaknesses and the extent of dependence on the collateral security for realization of dues.

[6] Govt. of India.(1992), "*Report of the Committee on Financial System (1991)* (Narasimham Committee)", Ministry of Finance, P-54

(A) Standard Assets: The standards assets are those assets, which do not pose any problem and also do not carry more than normal risk attached to the business. These are not NPAs.

(B) Sub-Standard Assets: The sub-standard assets are those assets, which have been classified as NPAs for a period not exceeding 24 months form 31st March 1992 and onwards, for a period not exceeding 18 months from 31st March 2001 and onwards, and for a period not exceeding 12 months from March 31st, 2005 and onwards. In such cases, the security available to the bank is inadequate to ensure the full recovery of bank dues and there is a distinct possibility that the bank will suffer some loss, if deficiencies are not corrected.

(C) Doubtful Assets: The doubtful assets are those assets, which have remained NPAs for a period exceeding 24 months from 31st March 1992 and onwards, for a period exceeding 18 months by 31st March, 2001 and onwards, and for a period exceeding 12 months from March 31st, 2005 and onwards. These assets are so weak that their collection on liquidation in full is considered highly improbable.

(D) Loss Assets: The loss assets are those assets, which have been identified by the bank or internal auditors or RBI inspection, but the amount has not been written off wholly. These assets are considered as not collectible and therefore, must be written off even though there may be a remote possibility of recovery of some amount.

An asset is considered to have gone bad when the borrower has defaulted on principal and interest repayments for more than two quarters or 180 days. Globally this cut off has been set at 90 days and RBI is trying to implement the same (RBI, 2001)[7]. With effect from April 2004, an asset will become NPA if a borrower fails to pay interest for 90 days. With effect from March 31, 2005 banks

[7] RBI Tightens NPA Recognition Norm, The Economic Times, (November ,2001).

will have to classify assets as 'doubtful', if they remained under the sub-standard category for 12 months (currently at 18 months). To help banks to overcome extra provisioning a minimum of 20 per cent per year is allowed over four years. The banks may, however, go for an aggressive provisioning with an immediate effect. In order to push lending to the infrastructure loans, the RBI are in favour of relaxation of the asset classification norms for this sector (Dey, 2008)[8]. The asset classification norms relate to the period in which banks classify their loans and advances as standard or performing assets or non-performing. This move has been triggered by the fear that several gas-based power projects in the South are likely to turn into non-performing assets on bank books. For classifying an infrastructure project in the performing category, it is not only essential for the customer to service the interest payments but also ensure that the commercial production has also kicked off. The central bank had earlier already extended the period for NPA classification from six months to one year. However, the banks under the aegis of the Indian Banks' Association (IBA) have represented to RBI to increase the time for classification of such loans into NPA. In a related development, RBI is now in favour of relaxing the norms for external commercial borrowing (ECB). The sources said even as the relaxation has been postponed due to inflationary concerns. The government may even relax the norm for foreign currency borrowing to be used for rupee expenditure.

**3. Research Problem:**

The NPAs of commercial banks is a brought forward legacy accumulated over the past decades, when prudent norms of banking were unoccupied relaxing by

[8] Dey, A. (2008) "RBI May Relax NPA Norms for Infra Loans", *Business Standard*, Mumbai (April, 26), 3:25

the radiance of security provided by government ownership. It is not mistaken 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 chaos 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. It was not realised that the root of the problem of NPAs was centered particularly in the economy of the country. The un-preparedness and structural weakness of our banking system to act to the emerging scenario and de-risk itself to the challenges thrown by the new order, trying to switch over to globalization were only aggravating the crisis. 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 (Saha, 2007)[9]. Repeated correctional efforts were executed, but positive results were evading. The problem was challenging a positive solution to the banking sector in India.

Although the level of NPA of the Indian banking system is now comparable to several advanced economies due to RBI rates reduction, still commercial banks have attributed to a huge quantum of NPAs. The gross NPA of the SCBs amounted to Rs. 97,922 crores for 2010-11. The net NPAs of public sector banks in absolute term increased to Rs. 36,071 crores in 2010-11 from Rs. 29,375 crores in

---

[9]Saha, G. (2007) "Management of Non-Performing Loans and Advances", *The Chartered Accountant*, ( June)

2009-10. The gross NPAs of PSBs in 2010-11 stood at Rs. 74,614 crores compared to Rs. 59,926 crores in 2009-10 and Rs. 17,435 crores in 1999-00 (RBI, 2010-11)[10]. 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 priority sector added up a large proportion about 46.4 per cent (Rs.21, 184 crores) of total NPAs in March 1998 and swelled to 51.8 per cent (Rs.46, 068 crores) in March 2011. The NPAs in the priority sector increased by 4.1 per cent during 2011 (47.7 per cent in the previous year) mainly due to increase in NPAs in the agriculture sector. In the non-priority sector, the same has been reduced to 48.2 per cent (Rs.42, 950 crores) in March 2011, from 52.3 per cent (Rs.39,045 crores) in March 2010. The higher NPAs in priority sector advances have pushed up the overall proportion of NPAs by three to four percent. Although the commercial banks in general have succeeded in reducing NPAs, or loans defaulted by borrowers, the private sector banks, the new generation private sector banks, especially, have witnessed an increase over the years. The gross NPAs of 26 private sector banks have decreased to 2.25 per cent (Rs. 18,240 crores) in 2010-11 from 2.74 per cent (Rs.17,639 crores) in 2009-10.

Further, 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. It has been reported that the banking industry has under-estimated it’s NPAs 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-

---

[10] RBI (2010-11) Trend and Progress of Banking in India.

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 (RBI, 2006)[11].

There was a variation in the level of loan loss provisioning actually held by the bank and the level required to be made due to the wrong classification of NPAs. This practice can be logically explained as a desperate attempt on the part of the bankers, whenever adequate current earnings were not available to meet provisioning obligations. Driven to extreme anxiety and impelled by the desire not to accept defeat, they have chosen to mislead and claim compliance with the provisioning norms, without actually providing. This shows that the problem has swelled to graver dimensions.

The NPAs of commercial banks has direct impact on the profitability, productivity, liquidity and equity of banks and finally influence the outlook of the banks towards credit delivery and credit expansion. The gravity of the situation may be revealed by the facts that return on assets (ROA),the most telling measure of banks performance, was 0.96 for PSBs as against 1.74 for foreign banks and 1.43 for private sector banks in 2010-11 (RBI, 2011)[12]. Further, net profit or spread ratio (the difference between interest earned and interest paid) usually considered as true measure of core operation of banking sector turned up trumps. The spread as percent of volume of business was 3.52 per cent for PSBs while the same for foreign banks was 5.0 per cent and 4.0 per cent for private sector banks in 2010-11. The SCBs experienced a declining ratio of operating profit to total asset which has been declined to 1.2 per cent in March

---

[11] RBI (2006*) "Reserve Bank of India Master Circular* "– Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances, RBI No. 2006-07/31

[12] RBI Circular (2011) "*Prudential Norms for Capital Adequacy*" – Risk Weight for Educational Loans, RBI/2010-2011/226.

2010 from 2.04 per cent in March 2005. The same for foreign banks have been increased from 3.16 per cent to 4.32 per cent (RBI, 2009-10)[13].

In short, soaring level of NPAs in banks and financial institutions are a cause of worry to the public as bank credit is the catalyst to the economic growth and any bottleneck in the smooth flow of credit is bound to create adverse effect on economic development due to mounting NPAs (Sinha, 2006)[14]. The management is seriously concerned about the growing NPA menace, which is taking its toll on efficiency and profitability. The NPA is a 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.

Thus, NPAs have been the most troublesome problem faced by banks. 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 (DRT's), 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), lokadalats etc to arrest unbridled virus of non-performing assets of commercial banks. With a view to provide an additional option and developing a healthy secondary market for NPAs, the guideline relating to sale/ purchase of NPAs were issued in July 2005

---

[13] RBI, Report on the Trend and Progress of Banking in India, (2009-10).

[14]Sinha, R.P. (2006) *"Asset Quality and Bank Efficiency: A Non-Parametric Approach"*, Kumar, C. V (Edn.) Advances in Business and Finance Studies, ICFAI University Press, III:1-20

covering the procedure for purchase/ sale of NPAs by banks valuation aspects, prudential norms. The guideline were partly modified in May 2007 whereby it was stipulated that atleast 10 per cent of the estimated cash flows should be realised in the first year and atleast 5 per cent in each half year thereafter subject to full recovery within three years.

However, commercial banks are yet to solve the dilemma. This needs to be remedied. Thus, it is pertinent to examine the asset quality and NPAs of SCBs in the present global competitive scenario. An investigation in respect of NPAs of banks is therefore likely to be highly related academic issue particularly in a backward region. It is the matter of the above sorts that have prompted us to undertake the proposed study viz, Management of NPAs of scheduled commercial banks in Barak Valley comprised of three districts of south Assam.

**4. The Background of the Study Area:**

The Barak valley is the southernmost part of Assam covers an extensive area of 6922 sq. kms in 4 sub-divisions of three districts (Cachar, Karimganj and Hailakandi) of south Assam[15]. It is bounded on the north by the district of North Cachar Hills and Meghalaya state and west by Tripura and Bangladesh, on the east by Manipur and Mizoram and on the south-east by Mizoram. The economy of the valley had been a periphery to the economic mainstream of Bengal during the British rule. The partition of the country in the wake of independence and the consequent emergence of East Pakistan (now Bangladesh) not only had shattered the traditional cheapest and quickest lines of transport and communication but also had snapped the age old channels of trade, commerce and transactions. The

[15]Govt. of Assam (2010) "*Statistical Hand book*", Directorate of Economics and Statistics, Guwahati, Assam.

post independence phase did not adequately compensate the valley for all the loss inflicted on it by partition.

The valley is characterized by thickly populated area with density of 360 persons per sq. km and urban population comprises about 9 per cent of total population. The work participation rate in the valley is 8.6 per cent which is much lower than the national average 25.7 per cent. The valley is agrarian biased. About 49 per cent of the geographical area is under agriculture and 36.9 per cent are under forest[16]. The number of existing industries (factories and SSI) in the valley constituted about 8 per cent[17] of the total number of industries state Assam during the period 1998-2009. The district industries centres (DICs) are imparting training to the rural artisans in trade, leatherwork, tailoring, bamboo work, carpentry etc. There were only two Industrial Training Institute (ITIs), one is at Srikona, Cachar district and another is at Karimganj district catering specialized training to the entrepreneurs of the valley[18]. The valley has 7.2 per cent[19] of the road ways and 19.8 per cent[20] of the railway network of the state Assam. 55 per cent of the total villages are electrified in the valley while 65 per cent in Assam[21]. The institutional finance is essential for economic development of any area. But unfortunately, the rate of growth of flow of institutional finance in the valley has not shown significant rise. Table-1.0 shows district wise number of bank branches operating in Barak valley of Assam.

---

[16] Office of the *Joint Director of Agriculture*, South Assam Zone, Silchar.

[17] Calculated on the basis of data obtained from *Directorate Economics and Statistics and District Industries Centres* of the area under study

[18] Superintendent, *Industrial Training Institute*, Karimganj, Assam.

[19] Percentage of roadways is calculated on the basis of data obtained from *District Transport Office.*

[20] Area Manager, *N.F. Railway, Badarpur*, Karimganj, Assam.

[21] Office of the *Electrical Division*, Karimganj, Assam.

**Table - 1.0**

**Banking Network in Barak Valley as on 31- 03- 2009**

| **Commercial Banks** | **Number of Branches** | | | |
|---|---|---|---|---|
| | Cachar | Karimganj | Hailakandi | Total |
| **1. Public Sector Banks** | 51 | 32 | 13 | 96 |
| ***(a) State Bank Group*** | | | | |
| State Bank of India | 10 | 6 | 3 | 19 |
| ***(b) Nationalized Banks*** | 41 | 26 | 10 | 77 |
| (i) United Bank of India | 18 | 16 | 4 | 38 |
| (ii) Allahabad Bank. | 3 | 2 | - | 5 |
| (iii) Punjab National Bank | 3 | 2 | 1 | 6 |
| (iv) Central Bank of India | 7 | 2 | 1 | 10 |
| (v) Indian Bank | 1 | - | - | 1 |
| (vi) Union Bank of India | 1 | 1 | 2 | 4 |
| (vii) Punjab & Sind Bank | 2 | 1 | - | 3 |
| (viii) Bank of Boroda | 2 | 1 | - | 3 |
| (ix) United Commercial Bank | 2 | 1 | 1 | 4 |
| (x) Canara Bank | 1 | - | - | 1 |
| (xi) Vijaya Bank | 1 | - | - | - |
| **2. Regional Rural Bank** | | | | |
| Assam Gramin Vikas Bank | 19 | 17 | 8 | 44 |
| **3. Private Sector Banks** | | | | |
| Federal Bank | 1 | - | - | 1 |
| **4. Co-operative Banks** | 2 | 3 | 3 | 8 |
| **Total** | **73** | **52** | **24** | **149** |

**Source:** *Lead Bank Office, United Bank of India, Silchar, Assam.*

The valley has 12.5 per cent of the total bank branch offices of state Assam. At present, 12 PSBs, 1 RRB, 1 private bank and 2 co-operative banks are operating with a net work of 149 branches (GoA, 2010)[22]. There are 149 numbers of branches of commercial banks operating in the valley. The district Cachar is bestowed with 73 branches (51 PSBs, 19 RRBs 1 private banks and 2 co-operative banks) while the district Karimganj got 52 branches (32 PSBs, 17 RRBs and 3 co-operative banks) and 24 branches (13 PSBs, 8 RRBs and 3 co-operative banks) in

[22] Govt. of Assam (2010) "*Statistical Hand book*", Directorate of Economics and Statistics, Guwahati, Assam.

the district of Hailakandi are taking the care of banking activities. It is also clear that branches of PSBs constitute 64.3 per cent and RRBs constitute about two-third of total existing commercial banks in the districts under study. The valley is economically and industrially backward. Thus, development of an efficient banking network is urgently needed in the direction of industrial and agricultural development for overall development of the districts under study.

**5. Need of the study:**

The problem of NPA in Indian banking sector appears to have subsidized as gross and net NPA ratios are declining, but in quantitative terms there is no significant growth of NPAs made by the banks. The quantum of NPAs has increased notwithstanding the efforts of the bank to reduce them. Incidentally, the mounting NPAs of banks are to the tune of Rs. 51,541 crores in March, 2004 which has increased to Rs. 74,616 crores in March, 2011. Moreover, fresh accretion of NPA has experienced a higher amount than recovery from NPA account during 2010-11. The earning capacity and profitability of commercial banks has been adversely affected by the high quantum of NPAs. The spread as per cent of total assets usually considered as realistic measure of bank's efficiency declined from 2.4 per cent in 2007-08 to 2.0 per cent in 2010-11. Hence, the reduction of NPAs in banks is posing the biggest challenges in the Indian economy. It affects the liquidity, profitability and equity.

How ever, the gross NPAs as per cent to advances in Indian banking sector have declined sharply to close to 2.3 per cent and the net NPA ratio of the banking sector are now at one per cent and the gap between the gross and net NPAs has narrowed over the years (RBI, 2010-11)[23]. The decline in gross NPAs is

[23] RBI (2010-11) *"Report on the Working Group on Restructuring of Weak Public Sector Banks"* (Chairman ; M.S. Verma) [Verma Committee]

particularly significant as income recognition, asset classification and provisioning norms were tightened over the years. For instance, banks now follow 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 revised 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. Apart from this, with no long lasting antidote, banks are looking forward o Asset Reconstruction Companies to sell their NPAs at whatever price they can.

The effectiveness of various measures initiated by GoI and RBI is limited, and banks are still not able to tame the problem of NPAs. According to Reserve Bank of India, improved profitability and health of banks, underpinned by robust macroeconomic environment and upturn in interest rate cycle, has enabled banks to reduce the backlog of NPAs. Although asset quality of banks has improved in percentage terms over the years, commercial banks need to guard against any deterioration of credit quality, particularly in the wake of significant expansion of credit. As the economy poised to grow at a stupendous pace the banks have to play a much larger role in the coming years, this requires a robust framework to deal with NPAs. Hence, in the present cut-throat competition, it is a permanent task for the banks to manage their NPAs more efficiently so that they can change their character from NPAs to performing assets. It is in this context, an in-depth study is warranted to detect this emerging problem of the economy.

**6. Objectives of the Study:**

The objective of the proposed study is to evaluate the Management of NPAs of SCBs operating in Barak valley of Assam. The specific objectives of the study are-

1. To study the nature and growth of NPAs of SCBs operating in the study area.
2. To study the interrelationship between the NPAs and earning capacity of banks over the years.
3. To examine the reasons for assets becoming NPAs of SCBs in the area under study.
4. To suggest strategies for better management of bank NPAs on the basis of the findings.

**7. Hypotheses Framed:**

The following hypotheses are formulated to meet these objectives of the proposed study-

1. The mass social orientation of banks over the years led to insignificant increase in the volume of NPAs.
2. There exists a significant relationship between NPA and profitability of banks over the years.

**8. Research Methodology:**

**8.1. Research Population:**

Research population of the study comprised of all the scheduled commercial banks (mentioned in table-1.0) operating in three districts of the study area. As on March 2009, there are 15 SCBs with 149 numbers of branches catering financial requirements of three districts in the valley. For the purpose of the study of this nature we have considered all SCBs particularly for the analysis of financials of the banks as a whole. However, 40 per cent of the population ie, a total of 60 numbers of branches have been considered for collection of first hand data to assess the procedure adopted by banks to handle with NPA accounts. For this purpose, proportionate sampling method has been followed.

**8.2. Data Collection:**

Both primary and secondary data have been used for the purpose of the study. The sources of secondary data are financial statements compiled by the regional offices of the banks operating in the study area, RBI bulletins, RBI Annual reports, RBI Trend and progress of Banking in India, RBI Report on currency and Finance, Lead Bank statements, Directorate of economics and statistics, various reports, surveys, published and unpublished research papers and dissertations. However for primary data a widely used technique known as survey cum interview method has been used for assessing the work system, recovery system, processing loan applications and other impeding factors associated with the loan portfolio.

**8.3. Variables selected:**

To assess the asset quality of banks in general, we have taken the variables like provisions and contingencies, operating profit, net profit, capital adequacy ratio, advances outstanding, loans recovered. In order to assess the nature of unbridled virus of NPAs in banks, the variables are net and gross NPAs, total sub-standard, doubtful and loss assets, total write off amount during the year, total unrealized interest and amount recovered from bad loans. The variables to analyse loan portfolio of banks includes; advances to agriculture, small industries, weaker section etc. The variables to study the NPAs and earning capacity includes gross NPA to advances, net NPA to advances, net NPA to total assets, operating profits to total assets, spread to assets, net profit to total assets. The general parameters considered for reasons of NPAs are: market failure, willful defaults, poor follow-up and supervision, non-cooperation from banks, poor legal framework, lack of entrepreneurial skills, and diversion of funds. The independent variables for identification of determinants of NPAs in banks are bank specific as well as macro economic factors. This includes priority sector lending, branch expansion, credit deposit ratio, capital adequacy ratio, NPA to total advances etc.

**8.4. Tools and Techniques:**

The statistical and financial techniques have been applied to test the hypotheses of the study. In order to assess the inter relationship between the variables and their interdependency; pearson's correlation coefficient was used. The parametric tests viz, 't' test, has been conducted for analyzing the significance level correlations in appropriate places. The non-parametric test has been used to know the procedures adopted by the bank to handle the NPA accounts. The growth of NPAs along with its components has been tested with the help of compound annual growth rate (CAGR). In order to study the contribution of priority sector lending to NPAs of banks, NPAs of priority, non-priority and public sector has been considered. The correlation matrix analysis was employed to assess the relationship between total advances and total NPAs along with its components. A wide range of ratios has been used as performance indicator which include- capital adequacy ratio, investment, fixed assets, advances to total assets deployed, business (deposits plus advances) per employee, gross NPA ratio, gross NPA to total assets, total standard assets to total outside liabilities, net NPA to total capital and reserve etc. The ratios viz, slippage ratio (ratio of fresh NPA added during the year to standard loan assets at the beginning of the year), NPA accretion ratio (ratio is the total NPA added during the year to total NPA reduce during the year), negotiability ratio (total compromise settlement amount to total NPA compromised) are also used in appropriate place. The opinion of the respondents (branch manager) has been taken based on the rank of the reasons of NPAs (as mentioned in variables selected) from 1$^{st}$ to 6$^{th}$ with regard to the intensity of the parameters. A score of 5, 4,3,2,1 and 0 have been given to ranks 1st , 2nd, 3rd, 4th, 5th and 6th respectively. The frequencies of respondents ranking against each reason in each rank was calculated (by multiplying the corresponding score value) to obtain the total score values. The reason with highest score value is considered as more severe followed by reasons with decreasing order of score values. The appropriate regression model has been fitted on the identified variables to study the determinants of NPAs in banks.

**9. Period of the Study:**

In order to have an in-depth idea on this defensible issue and a systematic prediction, a reasonably suited period of 12 years commencing from 1999-00 to 2010-11 has been considered. The rationale for considering the aforesaid time period is that RBI announced a package of measures following the report of the Narasimham committee (1998)[24] which includes raising the minimum capital adequacy ratio and moving towards tighter asset classification, income recognition and provisioning norms. This has been done to understand the implications of these measures. The different variables in respect of asset quality and management of NPAs of SCBs in the area under consideration at the national context have been compared with during the aforesaid time period.

**10. Display of the Study:**

The present study has covered important aspects of the level of NPAs of SCBs and has displayed in eight chapters. The chapter one *Introductory,* being preparatory in nature presented just now sets forth the parameter of the entire

---

[24] RBI (1998) "*Report of Working Group to Examine the Harmonizing the Role and Operations of DFIs and Banks"* (Chairmen; S.H. Khan), (April).

study in both theoretical and problematic framework highlighted the objectives set and hypotheses framed, methodology adopted for collection of data and techniques used for analysis. Chapter two, *The Review of Literature,* is highlighted the review the related literature on asset quality and non performing assets of scheduled commercial banks both in India and abroad. The chapter-3, *Background of Commercial Banks in India,* presents an analysis of the growth and development of commercial banks on the basis of the selected parameters. It has covered an overview of emergence of commercial banks which would provide the background of the whole study. Conceived with the skeleton of the study, the fourth chapter, *Non-Performing Assets and Capital Adequacy Norms: An Outline* has highlighted the quality of assets, the calculation and accounting aspects of NPAs, capital adequacy of banks which covered prudential norms by commercial banks in respect of income recognition, assets classification etc in the context of financial reform. The *Non-Performing Assets of SCBs in Indian Context,* the content of the chapter fifth attempted to assess position of asset quality and trends of NPAs of commercial banks in the national scenario. Taking the queue from the earlier chapters, the chapter six, *Recovery Measures of Non-Performing Assets of Commercial Banks*, is an attempt to reiterate the measures and relevant guidelines taken by Reserve Bank of India and government of India from time to time to arrest unbridled virus of non-performing assets of commercial banks. The seventh chapter, *Management of Non-Performing Assets of SCBs: The Analysis of Data,* diagnosed the recovery practices of loans and the management of non-performing assets of commercial banks in the area under study in the context of national scenario. The final chapter eight, *Findings and Suggestions,* concluded the entire work, has presented a brief summary of main findings and has offered some workable suggestions for better management of NPAs of banks and thereby improvement of working of the commercial banks operating in the districts under study.

It is expected that this study will remain a decisive piece of document before the relevant authority and also serve as basis for bank executives to frame suitable strategies for NPA management which enable better performance of the commercial banks in other areas correspondent to this.

**11. Limitations of the Study:**

The analysis of the data for the purpose of the study was based on quantitative information. The qualitative aspects of banks have a bearing on the profitability and asset quality has not been incorporated. However, due care has been taken through appropriate analytical tools.

*****