Chapter-2
The Review of Literature

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The previous chapter has drawn the blueprint of the entire study and has covered the research problems, the significance of the study, background of the study area, methodology adopted, objectives set and hypotheses framed, the study period considered etc. There have been huge empirical literature and narrative on the magnitude and causes of NPAs in Indian banking sector. In a work of this line, these studies and literature need to be tinted. Hence, the present chapter is an attempt to review the related literature on asset quality and non performing assets of scheduled commercial banks both in India and abroad. The purpose of this chapter is to find out and establish the gap of the present study.

1. Introduction:

The asset quality and banks efficiency are affected by local economic slowdowns as observed by notable studies in abroad. In Indian scenario, the asset portfolio of commercial banks has improved quite impressively over the period in the liberalized era. 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. The major determinants of profitability and productivity of banks in present era was higher degree of establishment expenses, more exposure of banks towards lending activities and the level of NPAs. The containment of NPAs through proper management is a challenge as agreed by the notable studies. A brief review of these literatures and recommendations of various committees' on banking sector is highlighted in the following paragraphs to underline the importance of the study.

2. Studies in Abroad:

There exists some cross country studies on financial health and asset quality of banks. The recessions cause banking crisis studied by Hardy and Pazarbasioglu (1999)[1] and Kaminsky and Reinhert (1999)[2]. Gambera (2000)[3] used a bivariate VAR technique and found that firm income and state annual product have significant influence on bank loan quality in US. Meyer and Yeager (2001)[4] found that the loan quality of local banks in U.S. is affected by

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[1] Hardy, D.C. and Pazarbasioglu (1999) "Determinants and Leading Indicators of Banking Crisis: Further Evidence", Washington D.C, *IMF Staff Papers*, 46(3)

[2] Kaminsky, G.L. and Reinhert, E.S. (1999) "The Twin Crisis: The Causes of Banking and Balance of Payment Problems", *American Economic Review*, 89, Retrieved from http://home.gwu.edu/graciela (Visited on 16/5/2010)

[3] Gambera, M. (2000) "Simple Forecasts of Bank Loan Quality in the Business Cycles": Emerging Issues Series, *Federal Reserve Bank of Chicago*, pp,1-31

[4] Meyer, A.P. and Yeager, T.J. (2001) "Are Small Rural Banks Vulnerable to Local Economic Downturns Federal Reserve Bank of St Louis" *Working Paper*, pp-1-28

local economic slowdowns. Salas and Saurina (2002) [5] established the significant role of economic slump in increasing loan problem in Spanish banks. Shu (2002)[6] observed that bad loans as a proportion to total loans of banks decrease with high economic growth in Hong Kong. Sylvanus and Abayomi (2001)[7] observed financial reform started in August 1987 in Nigeria with the deregulation of interest rates. Since then, far-reaching policy measures including the chartering of new banks, reform of the capital market and a move from direct to indirect monetary controls have been undertaken. The bank insolvency, high inflation and excessively high interest rates have become common phenomena in the economy.

Uesugi (2003)[8] observed that during periods of tight money in the U.S., firms with relatively large cash balances tended to extend trade credit, thus, favoring firms against who credit rationing was said to be applied. It also found that monetary policy shock changes the ratio of bank loans to total short-term debt. Kasuya (2003)[9] studied on NPAs of Japanese banks. He found that Japanese banks were also holding a large amount of non-performing assets in the inter-war period. The experiences of Japan in the inter-war period may provide useful lessons for the problem of today's Japanese banks. The paper has also considered that what affects the non-performing assets of the Japanese banks had on the financial intermediation

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[5] Salas and Saurina, J. (2002) "Credit Risk In Two Institutional Regimes: Spanish Commercial and Saving Banks", *Journal of Financial Services Research*, 22(3):203-224

[6] Shu, C. (2002) "The Impact of Macro Economic Environment on the Asset Quality of Hong Kong's Banking Sector", *Hong Kong Monetary Authority*, Retrieved from http://www.bis.org/pub/. (Visited on, 12-06-2010).

[7] Sylvanus, I. I. and Abayomi, A. A.(2001)"Financial Sector Reforms, Macroeconomic Instability and the Order of Economic Liberalization: The Evidence from Nigeria". *AERC Research Paper* 112, *African Economic Research Consortium*, P.O. Box 62882, Nairobi, Kenya, (November)

[8] Uesugi,L. (2003) "Maximizing Value of Non-performing Assets. Forum for Asian Insolvency Reform", *Research Institute of Economy, Trade and Industry,* Seoul, Korea (10 – 11 November)

[9] Kasuya, M. (2003) "Non-Performing Assets of Banks and Financial Intermediation: Experiences of Japan in the Inter-War Period", *Discussion Paper Series from Research Institute for Economics & Business Administration,* Kobe University.

in the inter-war period. In addition, it analyzes economic meanings of those effects. The study inferred that the prompt action in required collection and required redemption of non-performing assets might be effective in the recovery of financial intermediation. Chan, Greenbaum and Thakor (2004)[10] explained the recent decline in bank asset quality using the notion of information reusability. Banks are viewed as information processors; they exist because of their advantage in extracting the surplus associated with the reusability of borrower-specific information. It is shown that a bank's incentive to screen loan applicants, and hence maintain the quality of its assets, depends on the surplus this screening can produce, which in turn depends on information reusability. Two recent changes in banks' operating environment are increased competition and greater temporal volatility in borrower credit risks. The former has directly reduced banks' informational surplus while the latter has impaired information reusability. Recently some studies investigated the feedback effect from the banks to the real economy. Marcucci and Quagliariello (2005)[11] validated the cyclicality of write-offs to total loans for Italian banks. Hoggarth, Sorensen and Zicchino (2005)[12] observed cyclicality of aggregate write-offs in UK banks. Baboucek and Jancar (2005)[13] found no corroboration of the cyclicality of NPAs but conform pro-cyclicality for banks in Czech economy. Chaudhuri (2007)[14] analyzed the methods adopted by China to clear out the backlog of NPAs. The study

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[10] Chan, Y., Greenbaum S.I. and Thakor, A.V.(2004) " Information Reusability, Competition and Bank Asset Quality", *RePEc: wpa: wuwpfi: 0411049*.

[11] Marcucci, J. and Quagliariello, M. (2005) "Is Bank Portfolio Riski-ness Pro-cyclical? Evidence from Italy Using A Vector Auto-regression", University of York, *Discussion Papers in Economics*, Retrieved from ,http://www.york.ac.uk/depts/econ .(visited on 12-2-2010).

[12] Hoggarth, G., Sorensen, S. and Zicchino, L. (2005) "Stress Tests of UK Banks Using a VAR Approach", *Bank of England Working Paper*, Sickness in Small Scale Industries; Problems and Prospect. No. 282, pp,1-44

[13] Baboucek, I. and Jancer, M. (2005) "A VAR Analysis of the Effects of Macroeconomic Shocks to the Quality of the Aggregate Loan Portfolio of the Czech Banking Sector", *Czexh National Bank Working Paper Series*, pp- 1-68.

[14] Chaudhuri, T.D. (2007) *"Management of NPAs in China"* in Chaudhuri (ed) Management of NPAs, ICFAI University Press, Hyderabad.

observed that recapitalization, sale of NPAs to AMCs, merger, corporatization, adoption of risk management techniques etc followed by the banking system of china to contain the NPAs. Kithiniji (2010)[15] found that the requirement by Basle II might have enabled commercial banks to control their level of NPLs thus reducing banks credit risk in Kenya. Thus on an average, profits of the banking industry increased 2004-2008. However, profitability of the commercial banks fluctuated during the period but on average increased marginally during the period. The amount of credit extended to customers was relatively high but assumed a downward trend during the period. Codjia (2010)[16] observed that NPAs are loans that a bank believes it may not recover from a borrower. The evaluation of NPAs is an important business practice because it helps top leadership gauge the company's credit risk levels. Siddiqui, Malik and Ali (2012)[17] studied about impact of interest rate volatility on Non-Performing Loans in Pakistan and found that volatility in borrowing cost may lead to unpredictability of inflows and outflows for the borrower who may pocket something extra in case of lower interest rates on one side or reach to the levels of un-affordability on the other side leading to defaults and ultimately contributing to the non-performing loan portfolios of the lenders having devastating implications on the economy. Based on this concept, this study is conducted focusing Pakistan where non-performing loans are increasing at an uncontrollable pace.

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[15] Kithiniji, A.M. (2010) "Credit Risk Management and Profitability of Commercial Banks In Kenya". School of Business, University of Nairobi, Nairobi – Kenya. Retrieved from- akithinji@yahoo.com or akithinji@uonbi.ac.ke.(visited on 2-9-2011).

[16] Codjia,M. (2010) "About Non-Performing Assets in Commercial Banks", Retrieved from, http://www.ehow.com/facts-6807007-Nonperformingassets commercial banks.html#ixzz 19VvXzPUK (visited on 11th August 2010)

[17] Siddiqui,S., Malik,S.K. and Ali,Z.S. (2012) "Impact of Interest Rate Volatility on Non-Performing Loans in Pakistan".*International Research Journal of Finance and Economics*, Issue 84.

3. Studies in Indian Context:

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 hereunder to pinpoint the study gap. Rangarajan (1991)[18] pointed out that improving the quality of loan assets is the true test of improved efficiency of banking system. The Narasimham Committee (1991)[19] identified the weakness of banking sector and recommended provision for capital adequacy; liberalization of interest rate; reduction in SLR rehabilitation of PSBs by the government; introduction of prudential norms relating to income recognition, asset classification and provisioning; easy norms for entry of foreign bank. The committee also suggested for directed credit programme to channelize credit to priority sector. Ramala and Nagi (1994)[20] suggested proper end-use of loans to the entrepreneurs that could only ensure economic development of the area and the country as a whole. Goldstein (1996)[21] in his study on capital norms of banking sector argued that developing countries, with few exceptions, have not set national capital standard much above the Basle minimum norms and their banks have not held actual capital much above that for banks in countries with significantly more stable operating environments. To evolve an efficient and competitive financial system, RBI constituted a working group under the chairmanship of S. H. Khan (1997)[22].The Khan working group recommended a general provision on standard assets of a minimum of 0.25 per cent from the year ending March 31,

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[18] Rangarajan,C.(1991) "Banking Development Since 1947"; Achievement and Challenges", "*Financial System In India*", Volume - II.

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

[20] Ramala, K.S. and Nagi, K.S. (1994) "New Trends in Indian Industries", *Chugh Publications, Allahabad,* (2).

[21] Goldstein, M. (1996) "The Case for an International Banking Standard", Washington, D.C., *Institute for International Economics.*

2000, setting up a Asset -Liability Management (ALM) system and set up internal ALM at the top management level to oversee its implementation. RBI had constituted Debt Recovery Tribunals (DRT) working group (1998)[23] to review the functioning of DRTs. The working group recommended certain legislative amendments regarding the recovery of debts due to the Banks and financial institutions and measures to improve the functioning of DRTs.

In order to improve further soundness of Indian banking system Narasimham Committee (1998)[24] submitted its report in April 1998 and in conformity with the committee recommendations RBI announced a package of measures in October 1998. The report has emphasized on increasing the minimum capital adequacy ratio from 8 per cent to 9 per cent by March 31, 2000; recognizing the market risks and prescribing the risk weight for Govt./approved securities by March 31, 2000; providing 100 per cent risk weight for foreign exchange and gold open limits from the year ended March 31, 1999; moving towards tighter asset classification; income recognition and provisioning norms; introduction of formal ALM system with effect from April-1, 1999 and further enhancing transparency in accounting and disclosure practices.

EPW Research Foundation Group examined the dynamic credit policy (1999)[25] and suggested that against the prevailing backdrop of output, price and monetary trends, the credit policy has to be decisively expansionary. Verma Committee (1999)[26] identifying three weak banks, viz. Indian Banks, United Commercial banks and United Bank of India, viewed that in the long run privatization is good option for restructuring weak banks. The committee recommended the measures to clean the balance sheet with large NPA by

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[23] Report of *the Working Group to Review the Functioning of DRTs* (Chairman; N.B. Desh Pande), (August,1998)

[24] Govt. of India (1998), "*Report on Banking Sector Reforms"* (Narasimham Committee-II) Ministry of Finance, (April).

[25] EPW Research Foundation: (1999) "High Cost of Funds Forces Industrial Slowdown". *Economic & Political Weekly*, (August,10).

[26] RBI (1999) "*Report on the Working Group on Restructuring of Weak Public Sector Banks".* (Chairman ; M.S. Verma) [Verma Committee].

creating Asset Reconstruction Fund (ARF), to introduce Voluntary Retirement Fund (VRF) enabling banks to reduce excess manpower and to establish Financial Restructuring Authority. Taori (2000) [27] 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 Bhattacharya (2002)[28].

In order to root out the bank's NPA problem, Banmali (2001)[29] suggested a multi-frontal attack to the problem involving all the concerns 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)[30], Harpreet and Parricha (2004)[31], Ramkrishna and Bhargavi (2004)[32] etc agreed that the asset quality of commercial banks has improved considerably due to reform package. Ranjan and Dhal (2003)[33] established that the terms of credit variables have significant effect on the banks' non-performing loans (NPL) in the presence of bank size induced risk preferences and macroeconomic shocks. Moreover, alternative measures of bank size could give rise to differential impact on bank's NPL. In regard to terms of credit variables, changes in the cost of credit in terms of

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[27] Taori, K. J. (2000). "Management of NPAs in Public Sector Banks" *Banking Finance, (August), PP*, 98-11

[28] Bhattacharya,K.M. (2001) "Management of Non- Performing Advances in *Journal of Accounting and Finance*", (Oct"ober 2001- March 2002). PP, 58-69.

[29] Banmali, O. P. (2001) "Life line of Banking; New RBI formula for NPA Recovery". *IBA Bulletin* (January) PP, - 23-25.

[30] Ranjan, R. and Dhal, S.C. (2003) "Non-Performing Loans and Terms of Credit of Public Sector Banks in India": An Empirical Assessment, *RBI Occasional Papers,* 24 (3).

[31] Harpreet, K. and Parricha, J.S. (2004) "Management of NPAs of Public Sector Banks", *The Indian Journal of Commerce*, 57(2):14-21

[32] Ramkrishna, R.G. and Bhargavi, T.S. (2004) "An Appraisal of Indian Banking from NPA Perspective: Management of NPAs in Indian Scheduled Commercial Banks", *Journal of Accounting and Finance,* 18(1)

[33] Ranjan,R. and Dhal,C.S. (2003) "Non-Performing Loans and Terms of Credit of Public Sector Banks in India: An Empirical Assessment". *Reserve Bank of India Occasional Papers*. 24-(3), (Winter).

expectation of higher interest rate induce to rise in NPAs. On the other hand, factors like horizon of maturity of credit, better credit culture, favorable macroeconomic and business conditions lead to lowering of NPAs. Shanmugam and Das (2004)[34] observed that the efficiency of raising interest margin is time invariant while the efficiencies of raising other outputs-non-interest income, investments and credits are time varying. The reform period witnessed a relatively high efficiency for augmenting investments, which is consistent with economic growth objective of the reform measures. However, there are still larger gaps between the actual and potential performances of banks.

Raul (2004)[35] 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. Kumar (2004)[36] viewed that Indian banking sector is facing a serious problem of NPA. The extent of NPA is comparatively higher in PSBs. In order to improve the efficiency and profitability, the NPA has to be scheduled. Although various steps have been taken by government to reduce the NPAs, it is impossible to have zero percentage NPAs, but at least Indian banks can try competing with foreign banks to maintain international standard. Bidani (2004) [37] observed that NPAs could wreck a bank's profitability both through a loss of interest income and write-off the principal loan amount. It tackles the subject in its entirety, starting from the stage of

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[34] Shanmugam,K.R. and Das,A. (2004) "Efficiency of Indian Commercial Banks During The Reform Period", *Applied Financial Economics*, Retrieved from, http://www.tandf.co.uk/journals. (visited on 12-03-2010).

[35] Raul, R.K. (2004) "Menace and ARCs: An Assessment In Indian Context", *The Management Accountant*, June, pp, 471-476

[36] Kumar,B.S.(2004) "Non Performing Assets in Indian Banks", Retrieved from http//www.indianbanks/confg/drtyiu/. (visited on 12-03-2010).

[37] Bidani, S.N. (2004) *"Managing Non-Performing Assets in Banks"*, Vision Books, New Delhi

their identification till the recovery of dues in such accounts. Ghosh (2006)[38] 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)[39] 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 on the causes and consequences of NPAs of commercial banks, by Rajesham and Rajender (2007)[40], concluded that a strong political will only be able to find satisfactory solution to the problem of mounting NPAs.

Sinha (2007)[41] highlighted that in the pre-financial sector reform period, Indian commercial banks operated under a system of financial repression, whereby their lending activities were subjected to a variety of regulatory controls. Given the scenario, risk management got little emphasis in the commercial banking sector. This however, changed drastically during the reform period following the introduction of prudential operational guidelines and of modern supervisory practices. Under the circumstances, his paper made a comparative study of the asset quality profile of the Indian commercial banks for the reform period using the stochastic frontier approach. The paper also analyzed the impact of factors such as bank operating efficiency, capital adequacy, ownership and bank size on the asset quality of the observed commercial banks. The study found that operating profit ratio and capital adequacy are two important determinants of asset

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[38] Ghosh, S. (2006) "NPA Management in District Central Co-operative Banks", *The Management Accountant,* 41(2): 355-360.

[39] Rajender, K. and Suresh, S. (2007) "Management of NPAs in Indian Banking- A Case of State Bank of Hyderabad", *The Management Accountant,* (September).

[40] Rajesham, C. and Rajender, K. ((2007)"Management of NPAs in Indian Scheduled Commercial Banks", *The Chartered Accountant of India,* (June).

[41] Sinha, R.P. (2007) "Asset Quality Profile of Indian Commercial Banks: A Stochastic Frontier Approach", *The ICFAI Journal of Financial Risk Management*, 4(3): 24-36, (September).

quality. However, the effect of size and ownership are found to be statistically insignificant. Saha (2007)[42] articulated management of non-performing loans and advances and observed that with remarkable rise of Indian economy and related complexities, the financial landscape of the country, especially on the asset build up side, is likely to undergo substantial changes in future.

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 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. Bhaumik and Piesse (2008)[43] 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. Ahmed (2008)[44] examined NPAs of PSBs in Indian milieu. He observed that PSBs have been committed towards the reduction and management of NPAs. The quality of asset portfolio has improved quite impressively over the period. 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. In the wake of the deterioration in the overall economic climate, Singh and Singh (2009)[45]

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[42] Saha, G. (2007) "Management of Non-Performing Loans and Advances", *The Chartered Accountant*, June, pp-1949-1952.

[43] Bhaumik S. K. and Piesse, J. (2008) "Does Lending Behaviour of Banks in Emerging Economies Vary by Ownership? Evidence from the Indian Banking Sector", *Economic Systems*, 32 (2).

[44] Ahmed, J.U. (2008). "*Non Performing Assets of Public Sector Banks in India: An Analytic Study*", International Conference on Recent Development on Economics, Finance and Accounting and Econometrics, 8-12 September, Serial Publications, New Delhi.

[45]Singh,N.T. and Singh,T.J. (2009) Recovery Performance of RRBs: A Case Study of Manipur Rural Bank, *Journal of Accounting and Finance,* 23((1):66-(74), (March).

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. Lele (2009)[46] 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. Akhan (2009)[47] 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 fully compliance with the prudential norms of RBI help to control NPA.

Aggarwal and Mittal (2012)[48] found that NPA involves the necessity of provisions, any increase in which bring down the overall profitability of banks; it is the indicator of banking health in a country. All the Indian banks are facing hard time managing their NPA. The magnitude of NPA was comparatively higher in public sectors banks compared to private banks under study but now, they have managed the number at lower end. ICICI bank still do have higher NPA figure Compared to PSBs under study. Siraj and Pillai (2012)[49] studied on the Performance of NPA of Indian Banking during Post Millennium Period and found that NPA is a virus affecting banking sector. It affects liquidity and profitability, in addition posing threat on quality of asset and survival of banks. This study explored movement of

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[46] Lele, A. (2009) "16 Govt Banks Miss NPA Target" *Business Standard,* (June 29).

[47] Akhan, J.A. (2009) "Non-Performing Assets Management of Non-Banking Financial Companies: An Introspection" *The Management Accountant*, (February).

[48] Aggarwal, S. and Mittal, P. (2012) "Non-Performing Assets: Comparative Position of Public and Private Sector Banks in India", '*International Journal of Business and Management Tomorrow*' 2.(I) January). I

[49] Siraj, K.K. and Pillai. S.P. (2012) "A Study on the Performance of Non-Performing Assets (NPAs) of Indian Banking during Post Millennium Period", *International Journal of Business and Management Tomorrow*.2 (3), (March).

various NPA indicators; Gross NPA, Net NPA, Additions to NPA, Reductions to NPA and Provisions towards NPA and compare it with Total Advances and Total Deposits of banks. It concluded that NPA still remains a major threat and the incremental component explained through additions to NPA poses a great question mark on efficiency of credit risk management of banks in India.

Siraj and Pillai (2011)[50] studied about the performance of Indian SCBs before and after global financial crisis (2007-09) and the results of the study indicated the vulnerability of SCB to the financial crisis. Various indicators that reflect efficiency of banks were affected during the financial crisis. A notable result is the financial stability of public sector banks and increased susceptibility of private sector and foreign banks during financial crisis. Patidar and Kataria (2012)[51] analyzed the NPAs of priority sector landing and found that there is a significant impact of priority sector lending on total NPA of Public Sector banks, whereas in case of Private Sector Banks, there was no significant impact of priority sector lending on total NPA of Banks. It also showed that there is significant difference between NPA of SBI & Associates, Old Private Banks and New Private Banks with the NPA of Nationalized Banks, the benchmark category.

Prasad and Veena (2011)[52] found that, the best indicator for the health of the banking industry in a country is its level of Non-performing assets (NPAs). Reduced NPAs generally gives the impression that banks have strengthened

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[50] Siraj, K. K. and Pillai. S.P. (2011) "Asset Quality and Profitability of Indian Scheduled Commercial Banks during Global Financial Crisis", *International Research Journal of Finance and Economics'*.(80), Retrievedfrom,http://www.internationalresearchjournaloffinanceand economics.com (Date of visit: 1/01/12).

[51] Patidar,S. and Kataria, A. (2012) "Analysis of NPA in Priority Sector Landing: A Comparative Study Between Public Sector Banks and Private Sector Banks of India". *BAUDDHIK.*,3 (1), (Jan-April)

[52] Prasad, B.V.G. and Veena, D. (2011) "NPAs in Indian Banking Sector-Trends & Issues" , "*Journal of Banking Financial Service & Insurance Research*", The Journal of Sri Krishna Research & Educational Consortium, Retrieved from http://www.skirec.com., 1 (9) (December), (Date of visit: 10/01/12).

their credit appraisal processes over the years and growth in NPAs involves the necessity of provisions, which bring down the overall profitability of banks. The Indian banking sector is facing a serious problem of NPA. The magnitude of NPA is comparatively higher in public sectors banks. To improve the efficiency and profitability of banks the NPA need to be reduced and controlled.

Kaur and Singh (2011)[53] suggested high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The problem of NPAs is not only affecting the banks but also the whole economy. The Indian banking sector is facing a serious problem of NPAs. The extent of NPAs is comparatively higher in public sectors banks. To improve the efficiency and profitability, the NPAs have to be scheduled. Various steps have been taken by government to reduce the NPAs. It is highly impossible to have zero percentage NPAs. But at least Indian banks can try competing with foreign banks to maintain international standard. The problem of losses and lower profitability of NPAs and liability mismatch in banks and financial sector depend on how various risks are managed in their business. Ghosh and Ghosh (2011)[54] established that NPA is an important parameter in the analysis of financial performance of a bank as it results in decreasing margin and higher provisioning requirement for doubtful debts. Various banks from different categories together provide advances to different sectors like agricultural, SSI, priority sector, public sector and others. These advances require pre-sanctioning appraisal and post-disbursement control to contain increasing non-performing assets in the Indian Banking Sector. The reduction of non-performing asset is necessary to

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[53] Kaur,K. and Singh,B. (2011) "Non-Performing Assets of Public And Private Sector Banks ; A Comparative Study", Sajmmr: '*South Asian Journal of Marketing & Management Research'*.(3) (December) Retrieved from http://www.saarj.com. (Accessed on 12/03/12)

[54] Ghosh,D. and Ghosh,S. (2011) "Management Of Non-Performing Assets In Public Sector Banks: Evidence From India", *International Conference on Management* (ICM 2011) Proceeding.

improve profitability of banks and comply with the capital adequacy norms as per the Basel Accord.

Unny (2011)[55] considered about effectiveness of remedies available for banks in a Debt Recovery Tribunal, and originate that, banking in India faces the difficulty of mounting NPA, which is unfavorable for the bank's financial health. Banks have had to wait for very long time in Civil Courts to get cases concerning debt-recovery disposed and recovered. This led to the trapping of crores of rupees in litigation proceedings, which the bank could not re-advance, forcing the Government to establish a Debt Recovery Tribunal (DRT) to assure expeditious recovery proceedings and speedy adjudication of matters concerning debt recovery of banks. Yadab (2011)[56] studied the impact of NPAs on profitability and productivity of PSBs and set up that one fourth credit of total advances was in the form of doubtful asset in the initial year of the nineties and has an adverse impact on profitability of public banks at aggregate or sectoral level indicating high degree of riskiness in credit portfolio and raising question mark on the credit appraisal. The profitability of all PSBs affected at very large extent when NPAs work with other banking strategic variables and also affect productivity and efficiency. Chaudhary and Sharma (2011)[57] observed that increased competition, new information technologies and thereby declining processing costs, the erosion of product and geographic boundaries, and less restrictive governmental regulations have all played a major role for PSBs in India to forcefully compete with private and foreign Banks. The major changes took place in the functioning of banks in India only after liberalization, globalization and privatization.

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[55] Unny, P.M. (2011) "A Study on the Effectiveness of Remedies Available For Banks in a Debt Recovery Tribunal - A Case Study on Ernakulam DRT", *Centre for Public Policy Research*. Door Kerala, India. Retrieved from, http://www.cppr.in/.(Date of visit-5-3-2012)

[56] Yadab,S.M. (2011) "Impact of Non Performing Assets on Profitability and Productivity of Public Sector Banks In India. *AFBE Journal.*4 (1), (June)

[57] 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)

Hosmani and Jagadish (2011)[58] found that there is a slight improvement in the asset quality reflected by decline in the diverse NPA percentage. But even then the quantum of NPAs is alarming with PSBs in India, since NPA being as an important parameter for assessing financial performance of banks, the mounting volume of NPAs will deter the financial health in terms of profitability, liquidity and economies of scale in operation. The bank has to take timely action against degradation of good performing assets. Ahmed (2010)[59] established that the asset quality of commercial banks has been deteriorated due to increasing level of overdues which lead to high level of NPA of banks. It consequently restricts the bank's lending capacity and stands in the way of dilution of funds to developmental activities and hence the socio economic development of the area. Thus, improving the quality of loan assets is the true test of improved efficiency of banking system.

Goyal (2010)[60] made an empirical study on NPAs management of Indian public sector banks and observed that an increase in gross as well as net NPAs in absolute terms and improved asset quality of banks. The public sector banks have managed its assets proficiently. However, it also observes that increased NPA's in the agriculture sector is a matter of great concern. Karunakar, Vasuki and Saravanan (2008)[61] found that the economic reforms would have been remained incomplete without the overhaul of Indian banking sector. The problem of losses and lower profitability of NPA and

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[58] Hosmani,A.P. and Jagadish,H. (2011) "Unearthing The Epidemic of Non-Performing Assets -A Study With Reference To Public Sector Banks In India". ZENITH *International Journal of Multidisciplinary Research* 1 (8), (December)

[59] Ahmed, J. U. (2010) "The Quality of Asset Portfolio and Loan Recovery of Commercial Banks: An Implication in Indian Context". *AIUB Journal of Business and Economics*. 9 (2). (August) pp. 31-52.

[60] Goyal,K. (2010) "Empirical Study Of Non-Performing Assets Management Of Indian Public Sector Banks". *APJRBM.* 1 (1),(October), Sri Krishna International Research& Educational Consortium.

[61] Karunakar,M., Vasuki,K. and Saravanan,S. (2008) "Are Non performing Assets Gloomy or Greedy from Indian Perspective?" *Research Journal of Social Sciences*, 3: 4-12, INSInet Publications.

liability mismatch in banks and financial sector depend on how various risks are managed in their business. The lasting solution to the problem of NPAs can be achieved only with proper credit assessment and risk management mechanism. It is better to avoid NPAs at the market stage of credit consolidation by putting in place of rigorous and appropriate credit appraisal mechanisms.

Reddy (2008) [62] observed that financial sector reform in India has progressed rapidly on aspect like interest rate deregulation, reduction in reserve requirement, barriers to entry, prudential norms and risk-based supervision. But progress on structural-institutional aspect has been much slower and is a cause for concern. Changes required to tackle the NPA problem would have to span the entire gamut of judiciary, polity and the bureaucracy to be truly effective. Sharma (2009)[63] originated that NPAs are adversely affecting banks performance in different manners. Hence, the major thrust of the selected banks should be on reduction of absolute amount of NPAs through aggressive recovery efforts, although both the banks have brought down the level of NPA in comparison to nineties. With the liberalization and growing integration of the Indians financial sector with the international markets, banks have to put in place more effective NPA management techniques. It also established that financial sector reforms initiated in 1991 have improved the position of performing assets of the banks. The strict prudential norms have enforced banks to bring down these levels of NPAs.

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[62] Reddy, K. P. (2008) "A Comparative Study on NPA in India in global context: Similarities Dissimilarities Remedial Measures". CYTL Paper Contest. *Indian Institute of Management,* Ahmedabad.

[63] Sharma, S. (2009) "Non- Performing Assets (NPAs): An Analysis of Causes and Impact,A Comparative study of SBBJ and BOR". *Rajasthan Economic Journal,* 33(1 and 2) (Jan. and July)

Uppal (2009)[64] concluded that PSBs have not achieved the target of 40 per cent while private sector banks have achieved the overall target. No private sector bank could achieve the 10 per cent target by lending to weaker sections. On the other hand, foreign banks have achieved the small scale industries' export credit and overall target. NPAs of public sector banks have increased because of high priority sector advances. Choudhary and Tandon (2010)[65] observed that the banking sector in India has responded very positively in the field of enhancing the role of market forces regarding measures of prudential regulations of accounting, income recognition, provisioning and exposure, reduction of NPA's and up gradation of technology. But at the same time reforms failed to bring banking system at a par with international level and still the Indian banking section is mainly controlled by government as PSB's being leaders in this sphere.

Rajeev and Mahesh (2010)[66] observed that the issue of NPA, the root cause of the recent global financial crisis, has been drawing the attention of the policy makers and academicians alike. The problem of NPAs, which was ignored till recently, has been given considerable attention after liberalization of the financial sector in India. It also shows that public sector banks in India, which function to some extent with welfare motives, have as good a record in reducing NPAs as their counterparts in the private sector. Thomas and Dalia (2011)[67] found that higher capital requirements, by raising banks' marginal cost of funding, lead to higher lending rates. A large number of banks would

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[64] Uppal,R. K. (2009) "Priority Sector Advances: Trends, Issues and Strategies". *Journal of Accounting and Taxation*,1(5), pp. 079-089, (December).

[65] Choudhary, V. and Tandon, S. (2010) "Performance Evaluation of Public Sector Banks In India". APJRBM, *The Journal of Sri Krishna Research & Educational Consortium*, 1 (1),(October), Internationally Indexed & Listed Referred e-Journal.

[66] Rajeev, M. and Mahesh, H. P. (2010) "Banking Sector Reforms and NPA : A Study of Indian Commercial Banks". The Institute for Social and Economic Change, Bangalore.

[67] Thomas, F.C. and Dali,S. H.(2011) "Bank Behaviour in Response to Basel III: A Cross-Country Analysis". *IMF Working Paper*, IMF Institute, International Monetary Fund WP/11/119,(May).

on average need to increase their equity-to-asset ratio by 1.3 percentage points under the Basel III framework. It also seen that banks' responses to the new regulations will vary considerably from one advanced economy to another depending on cross-country variations in banks' net cost of raising equity and the elasticity of loan demand with respect to changes in loan rates.

Herd, Koen, Patnaik and Shah (2011)[68] found that the Indian financial system has changed considerably since the 1990s. Interest rates have been deregulated and new entrants allowed in the banking and the securities business. The Indian equity market has become world class. The new private banks have emerged that are more customer-oriented than the older state-owned banks. Meanwhile, the scale of saving within the economy has expanded considerably, much as in East Asian economies during their high-growth period. This adds to the need for further financial-sector reform. Uppal and Juneja (2011) [69] instituted that old private banks are much profitable and efficient than any other bank groups. The performance of foreign banks is worst during the study period with all the parameters which shows that this bank group is yet not able to make its place in Indian banking Industry and the banking industry in India is still dominated by old private sector banks.

Poongavanam (2011)[70] opined that the banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management. In recent times the banks have become very cautious in extending loans, this is due to mounting NPAs. Therefore, an NPA account

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[68] Herd,R., Koen,V., Patnaik, I. and Shah, A. (2011) "Financial Sector Reform In India: Time For A Second Wave?" *OECD Economics Department Working Papers* No.879, OECD Publishing.

[69] Uppal,R.K. and Juneja,A. (2011) "Performance Evaluation of Scheduled Commercial Banks In India- A Comparative Study". AJRBF: : *Asian Journal of Research in Banking & Finance* . A Journal of Asian Research Consortium. 1 (2).

[70] Poongavanam,S. (2011) "Non Performing Assets: Issues, Causes And Remedial Solution," ASIAN *Journal of Management Research.* Online Open Access publishing platform for Management Research, 2 (1).

not only reduces profitability of banks by provisioning in the profit and loss account, but their carrying cost is also increased which results in excess and avoidable management attention. Apart from this, a high level of NPA also puts strain on a bank's net worth. Considering all the above facts banking industry has to give more importance to NPA and to structure proper remedial solutions.

Pandey and Kaur (2012)[71] studied on NPA in banking sector and found that NPA indicated the credit risk of the banks. Operational efficiency of the banks is affected by the quality of advances which in turn has an impact on the profitability, liquidity and solvency position of the banks. Rajput, Arora and Kaur (2012)[72] established that a mounting level of NPA's in the banking sector can severely affect the economy in many ways. If NPA's are not properly managed, it can cause financial and economic degradation which in turn signals an adverse investment climate. The NPA is an important constraint in the study of financial performance of a bank as it results in declining margin and higher provisioning requirement for doubtful debts. The decline of NPA is essential to improve profitability of banks and fulfill with the capital adequacy norms as per the Basel Accord. For the recovery of NPAs a broad framework has evolved for the management of NPAs under which several options are provided for debt recovery and restructuring.

Kavitha (2012)[73] instituted that credit of total advances was in the form of doubtful assets has an adverse impact on profitability of PSBs at

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71 Pandey,K.V. and Kaur,H. (2012) "NPA In Banking Sector: Some Correlational Evidence." AJRBF: *Asian Journal of Research in Banking & Finance*. A Peer Reviewed International Journal of Asian Research Consortium. 2 (5) (May), Retrieved from http://www.aijsh.org. (Visited on 6-04-2012)

72 Rajput, N., Arora,P. A. and Kaur, B. (2012) "Management of Non-Performing Assets A Study of Indian Public Sector Banks", *International Journal of Management, IT and Engineering*. IJMIE, 2 (4),

73 Kavitha,N. (2012) "The Impact of Non-Performing Assets on The Profitability of Indian Scheduled Commercial Banks: An Empirical Evidence". *International Journal of Research in Commerce & Management,* 3 (1) (January).

comprehensive level representative high degree of riskiness in credit portfolio on the credit appraisal. The profitability of all PSBs affected at very large extent when NPAs work with other banking and also affect productivity and efficiency of the bank groups. The banks directly or indirectly affect trade and industry development.

Bihari (2012)[74] instituted that NPA has emerged since over a decade as an alarming threat to the banking industry in our country sending distressing signals on the sustainability of the banks. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The problem of NPAs is not only affecting the banks but also the whole economy. Dhanabhakyam and Kavitha (2012)[75] observed that bank is a financial intermediary that accepts deposits and channels those deposits into lending activities. Banks are a fundamental component of the financial system, and are also active players in financial markets. Financial performance refers to the achievement of the bank in terms of profitability. The profitability of a bank denotes the efficiency with which a bank deploys its total resources to optimize its net profits and thus serve as an index to the degree of asset utilization and managerial effectiveness. The Indian banking system faces several difficult challenges. The old private sector banks and new private sector banks play a vital role in marketing of new type of deposits and advances schemes.

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[74] Bihari,K.J. (2012) "A Study on NPA Management In Indian Banking Industry". AJRBEM : *Asian Journal of Research in Business Economics & Management*. A Journal of Asian Research Consortium.2 (6) (June)

[75] Dhanabhakyam,M. and Kavitha,M. (2012) "Financial Performance of Selected Public Sector Banks In India". ZENITH *International Journal of Multidisciplinary Research*, 2 (1), (January).

Chaudhry and Singh (2012)[76] found that there is a significant difference in the group-wise asset quality of Indian banks. Nevertheless, reforms have indeed transformed Indian banks into strong, stable and prosperous entities. Indian banking system can now claim that their level of NPAs have registered a declining trend over a period of time and is of international standards, with prudential provisioning, classification. But effective cost management, recovery management, technological intensity of banking, governance and risk management, financial inclusion are the areas, which will have a key bearing on the ability of Indian banks to remain competitive and enhance soundness. In this paradigm, improvement in policy framework, regulatory regime, market-perceptions and indeed, popular sentiments relating to governance in banks need to be on the top of the agenda to serve the society's needs and realities while being in harmony with the global perspective. Chidambaram (2012)[77] studied on Old Private Sector Banks (OPSB) and New Private Sector Banks (NPSB) and instituted that NPSBs fared better than their counterpart OPSBs in terms of profitability, profit per employee, declining NPAs, mounting deposits, increased Return on Assets (RoA) etc. In short, most of the new private sector banks out-performed old private sector banks.

4. Conclusion:

It is clear from the review of studies that the economic reforms have transformed Indian commercial banks into strong, stable and prosperous entities. Indian banking system now claimed that their level of NPAs have registered a declining trend over a period of time and is of international standards, with prudential provisioning, classification. But effective cost

[76] Chaudhary, S. and Singh, S. (2012) "Impact of Reforms on The Asset Quality In Indian Banking", ZENITH *International Journal of Multidisciplinary Research,*2 (1), (January), Retrieved from www.zenithresearch.org.in (Date of visit: 3/4/12).

[77] Chidambaram, N. (2012) "Old Private Sector Banks (OPSB) and New Private Sector Banks (NPSB)", AJRBF: *Asian Journal of Research in Banking and Finance*. 2 (6), Retrieved from http://www.aijsh.org (Date of visit: 13/04/12).

management, recovery management, technological intensity of banking, governance and risk management, financial inclusion, which will have a key bearing on the ability of Indian banks to remain competitive and enhance soundness. In this paradigm, improvement in policy framework, regulatory regime, market-perceptions and indeed, popular sentiments relating to governance in banks need to be on the top of the agenda with the global perspective. This apart not many studies based exclusively on the management of NPAs of SCBs. Most of the studies related to the quality of bank assets and loan portfolio. However, studies relating to the management of NPAs of SCBs remained un-researched in the backward regions of the country. Hence, a study on management of NPAs of banks in the study area will add to the existing literature of commercial banks and expected to fill up the study gap.

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