CHAPTER – III

Management of Non Performing Assets

MANAGEMENT OF NON PERFORMING ASSETS

3.1 Introduction

The Non Performing Assets (NPA) concept was first introduced in India by the Reserve Bank of India (RBI) with effect from 01-04-1992 and certain norms, popularly known as Prudential Norms, were issued as to the methods of NPA identification, asset classification, provisioning and income recognition. The accrual concept of accounting convention has also been followed without reckoning the amount actually realized. As long as expected income is realized from an asset, it is treated as a "Performing Asset" and as a "Non Performing Asset" when it fails to generate income or deliver value on due date.

3.2 Meaning of NPA

When the loans and advances made by a bank or financial institution turn-out non-productive and non-rewarding, they become Non Performing Assets (NPAs). According to Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002: *NPA is an asset or account of a borrower, which has been classified by a bank or financial institution as Substandard asset, Doubtful or Loss asset, in accordance with the guidelines relating to assets classification issued by the RBI.*

3.3 Review of Literature

Keeping in view of the importance of managing NPAs effectively in the process of reducing NPAs and growth of a bank as well as economic development of a country, large number of studies have been carried out by academicians, professionals, both in India and abroad on the concept, types, impact, reasons and measures for NPAs and certain guidelines for recover in NPAs.

Toor, N. S. (1994) analyzed that poor recovery management leads to reduction in yield on advances, reduced productivity, loss in the credibility and put determined impact on the policies of the banks.

Pati, A. P. (1999) conducted a study on Indian commercial banks and particularly of public sector banks, identified the growing NPA as the key factor

that affecting the profitability and viability of the banks and he also suggested some measures to improve recovery mechanism, improving credit management, the Asset Reconstruction Fund option, writing off debt, new initiatives, etc.

Ranjan, Rajiv et. al (2003) attempted an empirical approach to the analysis of commercial banks' non-performing loans (NPLs) in the Indian context and suggest that the terms of credit variables have significant effect on the banks' non-performing loans in the presence of bank size induced risk preferences and macroeconomic shocks.

Reddy, Ramakrishna et. al (2004) have identified the impact of NPAs on different financial parameters viz, ROA, ROE, CAR, banks profitability, etc., and identified the NPAs are not just a problem for the banks, they are bad for the economy. They have given some guidelines for the effective management of NPAs like early warning signals for incipient sickness, close monitoring, rehabilitation of deserving units, etc.

R. K., Raul (2004) attempted to study the nature and consequential affect of the NPAs on the banking sector and concluded that an appropriate set of substantial financial sector regulation clarity including changes in tax laws in imperative for the banking system to get rid off NPAs.

Yeoele, Arun (2004) stated the "successful management pre-supposes that the right type and right amount of credit is given to the right type of client". He concluded, it is essential to enforce the Securitization Act with more stringent provisions to realize the securities and personal assets of the defaulters.

Kaur, Harpreet et. al (2004) focused the problem of NPAs in PSBs and concluded the total elimination of NPAs is not possible but can be minimized, for which it is always wise to follow proper policy for appraisal, supervision and follow-up of advances to avoid NPAs.

Sharma, Meena (2005) has examined and find the NPAs affect a negative impact on the profitability, productivity, achievement of capital adequacy level, funds deployment and mobilization policy, credibility of the banking system and overall economy and suggested the government should not use PSBs as a vehicle to achieve its political objectives by lending to unviable projects, announcing loan

melas and loan waiver schemes, etc.

Shiralashetu, A. S. et. al (2006) have analyzed bank-wise and sector-wise gross and net NPAs of the scheduled commercial banks and find the problems of NPAs are more in the PSBs compared to private and foreign banks in India. Similarly the problems of NPA are more in non-priority sector than priority and public sector. They concluded that the banks in India must apply the principles of financial management to solve the problems of NPA.

G. Naik, Janardan (2006) pointed out on the problem of NPAs management in the banking sector and he concluded the Govt. of India has to set ARCs to manage NPAs to face the challenges before the banking sector.

Rajesham and ***Rajender K.*** (2007) have attempted to focus on the causes and consequences of NPAs, scenario of NPAs at global level and analyze sector-wise and bank group-wise NPAs in Indian SCBs. They find that the NPAs have negative impact on the productivity, achievement of capital adequacy level, funds deployment and mobilization policy, credibility of the banking system and overall economy and concluded that a strong political basis will only be able to find satisfactory solution to the problem of mounting level of NPAs.

3.4 RBI Guidelines for NPA Recognition

RBI has issued guidelines in respect of recognition of NPAs time to time. A summary of these guidelines is given below:

Table 3.1: Summarized RBI Guidelines for NPAs Recognition

Loans and Advances	Guidelines Applicable from 31-03-2001*	Guidelines Applicable from 31-03-2004
Term loan interest and / or installment remains over due for more than	180 days	90 days
Overdraft / Cash Credit A/C	Remains out of order**	Remains out of order**
Bills purchased and discounted remains overdue for more than	180 days	90 days
Agricultural loan interest and / or installment remains overdue for	Two harvest seasons but not exceeding two and half years	Two harvest seasons but not exceeding two and half years
Other accounts – any amount to be received remains overdue for more than	180 days	90 days

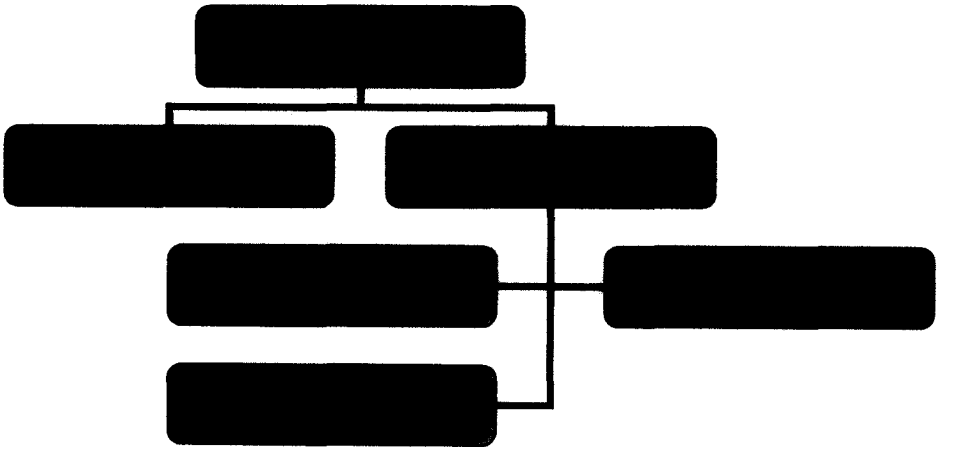
* Prior to 31-03-2001 NPAs were to be reckoned on *"past due"* basis. As per these guidelines if the amount remained *"past due"* for more than two quarters, it would be considered as NPA. When the advance remains outstanding for 30 days beyond the due date it is *"past due"* according to the RBI clarification issued in December 1992.

** *"Out of order"* means the outstanding balance in the Overdraft / Cash Credit Account which remains continuously in excess of the sanctioned limit for 6 months. If the outstanding balance in principal OD/CC is less than the sanctioned limit but there is no credit balance for 6 months or the balance is not enough to cover interest debited in the period, then also such account is taken as *"out of order"*

It may be noted that the criteria for NPA recognition has become stricter over the years. RBI reports that these stricter guidelines due to improvements in the payment and settlement systems, recovery climate and up gradation of technology in the banking system, etc.

3.5 RBI Guidelines for NPA Classification and Provisioning

Chart 3.1: NPA Classification



RBI guidelines for NPA Classification and Provisioning are summarized below:

Table 3.2: Summarized RBI Guidelines for NPAs Classification and Provisioning

Classification of NPAs	Guidelines for Classification prior to 31-03-2001	Guidelines for Classification from 31-03-2001	Provisioning Norms
Sub-standard Assets	NPAs for a period less than or equal to 2 years	NPAs for a period less than or equal to 18 months	10% of outstanding principal + entire outstanding interest
Doubtful Assets (Note 1)	NPAs for a period exceeding 2 years	NPAs for a period exceeding 18 months	For advances not covered by realizable securities – provide at 100% of advances. For advances covered by realizable securities provide at: - 20% of advances, if doubtful for below 1 year - 30% of advances, if doubtful for 1-3 years - 50% of advances, if doubtful for 3 & above 3 yea rs
Loss Assets	Identified as lost by the bank or auditors or by RBI on inspection	Identified as lost by the bank or auditors or by RBI on inspection	Write-off entire asset or provide at 100%
Standard Assets	Which are not NPAs, but has business risks	Which are not NPAs, but has business risks	A minimum of 0.25% on "Global Portfolio" but not on "Domestic Portfolio"

[Note 1: With effect from 31-03-2005, the period exceeding 12 months, which is internationally accepted norm, has come into force.]

The following table (Table 3.3) shows Classification of Loan Assets of Scheduled Commercial Banks (Bank Group-wise).

Table 3.3: Classification of Non-Performing Assets (Bank Group-wise) (As at end-March)

Bank Group/ Year	Standard Assets		Sub-standard Assets		Doubtful Assets		Loss Assets		Total NPAs		Total Advances
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount
1	2	3	4	5	6	7	8	9	10	11	12
Scheduled Commercial Banks											
1998	3,01,881	85.6	17,428	4.9	27,146	7.7	6,242	1.8	50,815	14.4	3,52,696
1999	3,40,714	85.3	19,926	5.0	31,350	7.8	7,444	1.9	58,722	14.7	3,99,436
2000	4,14,917	87.2	19,594	4.1	33,688	7.1	7,558	1.6	60,841	12.8	4,75,758
2001	4,94,716	88.6	18,206	3.3	37,756	6.8	8,001	1.4	63,963	11.4	5,58,679
2002	6,09,972	89.6	21,382	3.1	41,201	6.0	8,370	1.2	70,953	10.4	6,80,925
2003	7,09,260	91.2	20,078	2.6	39,731	5.1	8,971	1.1	68,780	8.8	7,78,040
2004	8,37,130	92.9	21,026	2.3	36,247	4	7,625	0.9	64,898	7.2	9,02,027
2005	10,93,523	94.9	14,016	1.2	37,763	3.3	7,382	0.6	59,161	5.1	11,52,684
2006	14,99,431	96.7	14,826	1	30,105	2	7,016	0.4	51,947	3.3	15,51,378
2007	19,61,87	97.5	20,010	1.0	24,408	1.2	6,215	0.3	50,633	2.5	20,12,510
Public Sector Banks											
1998	2,39,318	84.0	14,463	5.1	25,819	9.1	5,371	1.9	45,653	16.0	2,84,971
1999	2,73,618	84.1	16,033	4.9	29,252	9.0	6,425	2.0	51,710	15.9	3,25,328
2000	3,26,783	86.0	16,361	4.3	30,535	8.0	6,398	1.7	53,294	14.0	3,80,077
2001	3,87,360	87.6	14,745	3.3	33,485	7.6	6,544	1.5	54,774	12.4	4,42,134
2002	4,52,862	88.9	15,788	3.1	33,658	6.6	7,061	1.4	56,507	11.1	5,09,369
2003	5,23,724	90.6	14,909	2.6	32,340	5.6	6,840	1.1	54,089	9.4	5,77,813
2004	6,10,435	92.2	16,909	2.5	28,756	4.4	5,876	0.9	51,541	7.8	6,61,975
2005	8,30,029	94.6	11,068	1.3	30,779	3.5	5,929	0.7	47,796	5.4	8,77,825
2006	10,92, 607	96.2	11,453	1	25,028	2.2	5,636	0.5	42,117	3.7	11,34,724
2007	14,25,5 19	97.3	14,275	1.0	19,873	1.4	4,826	0.3	38,974	2.7	14,64,493

(Amount in Rs. crore)

Contd...

Old Private Sector Banks											
1998	22,786	89.1	1,402	5.5	1,068	4.2	324	1.3	2,794	10.9	25,580
1999	25,195	86.9	1,920	6.6	1,463	5.0	401	1.4	3,784	13.1	28,979
2000	31,447	88.8	1,577	4.5	2,061	5.8	347	1.0	3,986	11.3	35,433
2001	35,166	88.7	1,622	4.1	2,449	6.2	413	1.0	4,484	11.3	39,650
2002	39,262	89.0	1,834	4.2	2,668	6.1	348	0.8	4,850	11.0	44,112
2003	46,761	91.1	1,474	2.9	2,772	5.4	321	0.6	4,567	8.9	51,328
2004	53,516	92.4	1,161	2	2,727	4.7	504	0.9	4,392	7.6	57,908
2005	66,212	94	784	1.1	2,868	4	549	0.8	4,201	6	70,413
2006	81,414	95.6	710	0.8	2,551	3	479	0.6	3,740	4.4	85,154
2007	91,903	96.9	760	0.8	1,783	1.9	425	0.4	2,969	3.1	94,872
New Private Sector Banks											
1998	10,781	96.5	365	3.3	9	0.1	19	0.2	392	3.5	11,173
1999	13,199	93.8	737	5.2	128	0.9	6	0.0	871	6.2	14,070
2000	21,870	95.9	560	2.5	294	1.3	92	0.4	946	4.2	22,816
2001	29,905	94.9	963	3.1	620	2.0	11	0.0	1,594	5.1	31,499
2002	70,010	91.2	2,904	3.8	3,871	4.9	41	0.0	6,816	8.8	76,826
2003	87,487	92.3	2,700	2.9	3,675	3.9	856	0.9	7,231	7.6	94,718
2004	1,13,560	95	1,966	1.6	3,665	3	321	0.3	5,952	5	1, 19,512
2005	1,22,577	96.2	1,449	1.1	3,061	2.4	334	0.3	4,844	3.8	1,27,421
2006	2,28,504	98.3	1,717	0.7	1,855	0.8	460	0.2	4,032	1.8	2,32,536
2007	3,19,002	98.1	3,608	1.1	2,147	0.7	516	0.2	6,271	1.9	3,25,273
Foreign Banks											
1998	28,996	93.6	1,198	3.9	250	0.8	528	1.7	1,976	6.4	30,972
1999	28,702	92.4	1,238	4.0	507	1.6	612	2.0	2,357	7.6	31,059
2000	34,817	93.0	1,096	2.9	798	2.1	721	1.9	2,615	7.0	37,432
2001	42,285	93.1	876	1.9	1,202	2.6	1,033	2.3	3,111	6.9	45,396
2002	47,838	94.5	856	1.7	1,004	2.0	920	1.8	2,780	5.5	50,618
2003	51,288	94.7	995	1.8	944	1.7	954	1.8	2,893	5.3	54,181
2004	59,619	95.1	990	1.6	1,099	1.8	924	1.5	3,013	4.8	62,632
2005	74,705	97	715	1	1,035	1.3	570	0.7	2,320	3	77,025
2006	96,907	98	946	1	670	0.7	441	0.5	2,057	2	98,965
2007	1,25,453	98.1	1,367	1.1	605	0.5	447	0.3	2,419	1.9	1,27,872

Source: Report on Trend and Progress of Banking India, India

3.6 Reasons for Assets becoming NPAs

A few prominent reasons for assets becoming NPAs are as under:

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

3.7 Impact of NPAs on Banking Operations

NPAs have the following impacts in the banking operations:

- Bank's profitability is affected adversely because of provisioning for Doubtful Assets / writing off of Loss Assets. Besides provisioning, banks are also required to meet the cost of funding these unproductive assets.
- The interest income of the banks will fall as interest is to be accounted only on receipt basis.
- NPAs reduce earning capacity of assets. Return on Assets (ROA) also gets affected. NPAs carry risk weights of 100% (to the extent it is uncovered). Hence, they block capital for maintaining capital adequacy.
- As NPAs do not earn any income, they adversely affect Capital Adequacy Ratio (CAR).
- Cost of Capital will go up.
- Assets and Liability mismatch will widen.
- Economic Value Addition (EVA) by banks gets upset, because EVA is

equal to Net Operating Profit minus Cost of Capital.

- Carrying NPAs require incurrence of Cost of Capital Adequacy and cost of funds blocked in NPAs. Public Sector Banks are incurring around as high as 11% of their NPAs as operating cost for monitoring and recovering NPAs every year.
- NPAs demoralize the operating staff.
- New branch licenses are not given to the banks where they have high level of NPAs.
- Regulatory and Credit Rating Agencies may not be comfortable with the high level of NPAs of the banks.

3.8 Cost of NPAs

Operating cost of NPAs and total loss due to NPA of Public Sector Banks at the then prevailing bank rates for the years ended as on 31-03-1998 to 31-03-2000 have been shown below. For the purpose of calculation, the level of Gross NPAs has been taken into account over and above the 5% level of NPAs assuming that this is the international standard of NPAs.

Table 3.4: Total Loss due to NPA (Public Sector Banks)

(Rs. in crores)

Year	Total Advances Rs.	Gross NPAs Rs.	Gross NPAs over 5% of Total Advances Rs.	Maintenance Cost @ 11% Rs.	Bank Rate	Opportunity Cost at Bank Rate compounded with quarterly rests Rs.	Total Loss Rs.
(1)	(2)	(3)	(4) [(3)-5% of (2)]	(5) [11% of (4)]	(6)	(7) [% of (4)]	(8) [(5)+(7)
1998	284971	45653	31405	3455	10.5	3430	6885
1999	325328	51710	35444	3899	8.0	2922	6821
2000	380077	53294	34290	3772	8.0	2827	6599

It can be easily observed from the above table that NPAs are directly and indirectly nullifying the efforts of the Public Sector Banks to increase their profitability with huge amount of losses arising out of NPAs.

Table 3.5: Position of Actual Net Worth vis-à-vis Net Worth after accounting for Net NPAs (Public Sector Banks)

(Rs. in crores)

Year	Capital	Reserves	Net Worth	Net NPAs	Actual Net Worth
(1)	(2)	(3)	(4) [(2)+(3)]	(5)	(6) [(4)-(5)]
1999	14406	27447	41853	24211	17642
2000	14234	31819	46053	26188	19865

The above analysis shows that Net NPAs are as high as 57% of Total Net Worth (TNW) of PSBs. If Net NPAs are deducted from the TNW, the TNW (Actual Net Worth) would be reduced to 43% of their existing figure.

3.9 Magnitude of NPAs

After the implementation of Prudential Norms as recommended by the Narasimham Committee, the Gross NPAs of Public Sector Banks increased from about Rs.18,000 crore in 1991-92 (prior to introduction of Prudential Norms) to Rs.39,253 crore as at the end of March 1993 (as a result of introduction of Prudential Norms) and Rs.53,294 at the end of March 2000. Whereas in terms of percentage it declined from 23.2% in 31 March 1993 to 14.0 % by the end of March 2000. In case of Net NPAs it increased from about Rs.17,567 crore in 31 March 1995 to Rs.26,188 crore by the end of March 2000. The Net NPAs as a percentage to net advances came down from 10.7% to 7.42% during the same period.

According to RBI guidelines NPAs are to be viewed as Gross and Net NPAs. When the NPAs are taken at their book values, they are known as Gross NPAs. Net NPAs are Gross NPAs less provisions made for NPAs, balance in interest receivable a/c and claims from ECGC / DIGC but kept in suspense a/c.

The measure of non-performing assets helps us to assess the efficiency in allocation of resources made by banks to productive sectors. The problem of NPAs arise either due to bad management by banks or due to external factors like unanticipated shocks, business cycle and natural calamities *(Caprio and Klingebiel, 1996)*. Several studies have underscored the role of banks' lending

policy and terms of credit, which include cost, maturity and collateral in influencing the movement of non-performing assets of banks *(Reddy, 2004, Mohan 2003, 2004).*

The ratio of gross non-performing assets (NPAs) to gross advances of all scheduled commercial banks decreased from 14.4 per cent in 1998 to 5.1 per cent in 2005. Bank group-wise analysis shows that across the bank groups there has been a significant reduction in the gross non-performing assets. With respect to public sector banks (State Bank group and nationalized bank group together), NPAs have decreased from 16.0 per cent in 1998 to 5.4 per cent in 2005. In the case of foreign banks group, gross NPAs as a percentage to gross advances, which was the lowest among all the groups at 6.4 per cent in 1998, decreased to 2.9 per cent in 2005. With regard to domestic private sector banks group, gross NPAs decreased from 8.7 per cent to 3.9 per cent during the same period. The ratio of net NPAs to net advances of different bank groups also exhibited similar declining trends during the period from 1998 to 2005. The net NPAs of all scheduled commercial banks declined from 7.3 per cent in 1998 to 2.0 per cent in 2005 (Table 3.6).

The decline in NPAs is more evidenced across bank groups especially since 2003. This reflects on the positive impact of the measures taken by the Reserve Bank towards NPA reduction and specifically due to the enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, ensuring speedier recovery without intervention of courts or tribunal.

The composition of NPAs of public sector banks brings to light certain interesting aspects. It is observed that in 1995 for State Bank group, the share of NPAs was 52.5 per cent for the priority sector, 41.4 per cent for the non-priority sector, and 6.1 per cent for the public sector. These percentages were 47.4 per cent, 51.5 per cent and 1.1 per cent, respectively in 2005. Similarly in the case of nationalized banks also, the NPA composition for non-priority sector has increased, whereas, that for priority sector and public sector, there is a marginal reduction (Table 3.7).

Table 3.6: NPAs of Scheduled Commercial Banks (Bank Group-wise)

(Per cent to Advances)

Year	Public Sector Banks		Foreign Banks		Private Sector Banks		All SCBs	
	Gross NPA	Net NPA	Gross NPA	Net NPA	Gross NPA	Net NPA	Gross NPA	Net NPA
1998	16.0	8.2	6.4	2.2	8.7	5.3	14.4	7.3
1999	15.9	8.1	7.6	2.9	10.8	7.4	14.7	7.6
2000	14.0	7.4	7.0	2.4	8.2	5.4	12.7	6.8
2001	12.4	6.7	6.8	1.8	8.4	5.4	11.4	6.2
2002	11.1	5.8	5.4	1.9	9.6	5.7	10.4	5.5
2003	9.4	4.5	5.3	1.8	8.1	5.0	8.8	4.4
2004	7.8	3.0	4.6	1.5	5.8	2.8	7.2	2.9
2005	5.5	2.0	2.8	0.8	3.7	1.8	5.2	2.0
2006	3.7	1.3	1.9	0.8	2.4	1.0	3.3	1.2
2007	2.7	1.1	1.8	0.7	2.2	1.0	2.5	1.0

Source: Handbook of Statistics on Indian Economy 2004-05 and Report on Trend and Progress of Banking in India .

Table 3.7: Composition of NPAs of Public Sector Banks

(Per cent)

Year	SBI & its Associates			Nationalized Banks		
	Priority Sector	Non-priority Sector	Public Sector	Priority Sector	Non-priority Sector	Public Sector
1995	52.5	41.4	6.1	48.7	49.2	2.0
2000	45.2	51.9	2.8	44.1	54.5	1.5
2001	44.2	49.8	6.0	46.2	52.3	1.5
2002	47.0	50.4	2.6	45.7	53.1	1.2
2003	47.5	49.4	3.1	47.1	51.3	1.6
2004	47.1	51.5	1.5	47.7	51.1	1.1
2005	47.4	51.5	1.1	48.4	50.7	0.9

Source: Statistical Tables Relating to Banks in India, Various issues.

This shows that not only advances to the priority sector are going non-performing, but more than that, non-priority sector lending is the area where the bankers need to cautiously examine the possibilities of loans becoming non-performing. Here the question of moral hazard, adverse selection and credit rationing comes to the fore. This also goes to explode the commonly held myth that the problem of NPAs is caused mainly due to the credit allocation to priority sectors. (Table 3.7).

3.10 Recent Movements in Provisions for Non-performing Assets

Provisioning for non-performing assets tends to follow a cyclical pattern. Although gross NPAs in absolute terms declined, net NPAs increased, reflecting the higher write back of excess provisioning than the fresh provisioning made during the year. This trend was observed across all bank groups, barring new private sector banks and foreign banks. Cumulative provisions at end-March 2007 were, thus, lower than their respective levels a year ago in respect of all bank groups, except new private sector banks and foreign banks. Cumulative provisions as percentage of gross NPAs declined marginally to 56.1 per cent at end-March 2007 from 58.9 per cent at end-March 2006. Bank-group wise, the ratio was the highest for old private sector banks (66.0 per cent), followed by PSBs, foreign banks and new private sector banks.

Despite increase in net NPAs in absolute terms, net NPAs as percentage of net advances declined marginally to 1.0 per cent from 1.2 per cent at end-March 2006. Similar trend in the gross and net NPA ratios was observed for all bank-groups, except new private sector banks, which recorded an increase in the NPA ratios both in gross and net terms.

The net NPAs to net advances ratio was close to 1.0 per cent at end-March 2007 for all bank-groups, except foreign banks (0.7 per cent). Between end-March 2006 and end-March 2007, the net NPA ratio of public sector and old private sector banks declined, while it increased in respect of new private sector banks leading to convergence of net NPA ratio at the bank-group level. The deviation in net NPA ratio at the individual bank level narrowed down significantly during the year. The net NPAs to net advances ratio at end-March 2007 of 75 banks (as against 65 last year) out of 82 (as against 85 last year) was less than 2 per cent. The net NPAs ratio of only two banks was higher than 5 per cent, of which the net NPA ratio of one foreign bank was higher than 10 per cent. During 2006-07, the net NPA ratio of twenty three banks in the public sector and fifteen banks in the private sector improved.

The data on loan asset categories suggest further improvement in the asset quality of SCBs during 2006-07. While the share of standard assets in total

advances increased to 97.5 per cent from 96.7 per cent at end-March 2006, the share of 'sub-standard' loans remained stable at a low level of 1.0 per cent. The share of 'doubtful' and 'loss' categories, however, declined. In these two categories ('loss' and 'doubtful'), NPAs declined in absolute terms as well. More or less similar trend was observed across all bank groups, except new private sector banks and foreign banks in whose case NPAs in all the three categories (sub- standard, doubtful and loss) generally increased. Thus, the asset quality of new private sector banks, though comfortable, showed some signs of weakening.

The consolidated statement of public and private sector banks with respect to sector-wise NPA indicates that the NPAs in the priority sector increased during 2006-07. This was mainly due to increase in NPAs in the agriculture sector, while NPAs in the SSI sector declined. The NPAs in the public sector also increased during the year. However, NPAs in the non-priority sector declined during 2006-07. At the aggregate level, the share of priority sector NPAs was the highest at 54.1 per cent, of which priority sector NPAs other than agriculture and SSIs constitutedalmost a quarter (25.1 per cent) of the total NPAs. The share of non-priority sector NPAs was 44.9 per cent during 2006-07.

3.11 Statistical Calculations

3.11.1 ANOVA to test Bank Group-wise NPA Performance of SCBs

Let us set up the null hypothesis that there is no significant difference between the NPAs of banks group-wise viz., Public Sector Banks, Private Sector Banks and Foreign Banks during the study period 1998 – 2007 as per the Table 3.6, for which the ANOVA test is employed and the results are presented in the Table 3.8A and 3.8B.

At 5% level of significance as per Table 3.8A, the calculated value of 'F' (4.8787) is greater than the table value (3.3541), the null hypothesis is rejected. Hence there is significant difference in the means between the NPAs of banks group-wise.

At 1% level of significance as per Table 3.8B, the calculated value of 'F' (4.8787) is lower than the table value (5.4881), the null hypothesis is accepted.

Hence there is no significant difference in the means between the NPAs of banks group-wise.

The P-value in both of the cases is 0.0155 which denotes that there is no significant difference in the means between the NPAs of banks group-wise up to 1.55% level of significance and there is significant difference in the means between the NPAs of banks group-wise over and above 1.55% level of significance.

Table 3.8A: ANOVA: Single Factor Significance Level - 5%

SUMMARY

Groups	*Count*	*Sum*	*Average*	*Variance*
Public Sector Banks	10	98.5	9.85	23.554
Private Sector Banks	10	67.9	6.79	9.421
Foreign Banks	10	49.6	4.96	4.5604

ANOVA

Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between Groups	122.08	2	61.041	4.8787	0.0155	3.3541
Within Groups	337.82	27	12.512			
Total	459.9	29				

Table 3.8B: ANOVA: Single Factor Significance Level – 1%

SUMMARY

Groups	*Count*	*Sum*	*Average*	*Variance*
Public Sector Banks	10	98.5	9.85	23.554
Private Sector Banks	10	67.9	6.79	9.421
Foreign Banks	10	49.6	4.96	4.5604

ANOVA

Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between Groups	122.08	2	61.041	4.8787	0.0155	5.4881
Within Groups	337.82	27	12.512			
Total	459.9	29				

3.11.2 ANOVA to test Asset-wise NPA Performance of SCBs

Let us set up the null hypothesis that there is no significant difference in the asset-wise recovery of the NPAs of SCBs viz., Sub-standard Assets, Doubtful Assets and Loss Assets during the study period 1998 – 2007 as per the Table 3.3, for which the ANOVA test is employed and the results are presented in the Table 3.8C.

At 5% and 1% level of significance as per Table 3.8C, the calculated value of 'F' (14.4335) is greater than the table value (3.3541 at 5% and 5.4881 at 1%), the null hypothesis is rejected. Hence there is significance difference in the means of Sub-standard Assets, Doubtful Assets and Loss Assets in recovery of mounting NPAs.

Table 3.8C: ANOVA: Single Factor Significance Level – 5% and 1%

SUMMARY

Groups	*Count*	*Sum*	*Average*	*Variance*
Sub-standard Assets	10	28.5	2.85	2.28722
Doubtful Assets	10	51	5.1	5.66889
Loss Assets	10	11.2	1.12	0.32178

ANOVA

Source of Variation	SS	*df*	*MS*	*F*	*P-value*	*F crit at 5%*	*F crit at 1%*
Between Groups	79.6527	2	39.8263	14.4335	5.5E-05	3.3541	5.4881
Total	154.154	29					

3.12 Observations and Suggestions

The following are the observations and suggestions to improve the effective management of mounting NPAs of scheduled commercial banks:

- The bank should follow different strategies of NPA management, timely construction of loan portfolio. Keeping in view the present condition of the sensitive sector where the volatility is increasing day by day the SCBs should diversify its services into capital market, consultancy, leasing, credit card, housing finance, insurance service, etc.
- As per the guidelines framed by the RBI, the aggregate advances to the

priority sector should constitute 40% of the total net banking credit (NBC), the sub-target in respect of agriculture is 18% of NBC and in respect of weaker section it is 10%.

- The SCBs should implement effective CRM system, Basel-II implementation, improved risk management systems, implementation of new accounting standards, transparency and disclosures, effective cost management, supervision of financial conglomerates and corporate governance to face the competitive global environmental conditions.
- The SCBs has to constitute more legal recovery cells and tribunals, recovery branches, NPA management departments, ARCs, Lok Adalats, fix recovery targets and also share information on known and willful defaulters.
- The SCBs should be free to design and implement their own policies for recovery especially in case of old and unresolved cases falling under the NPA category. According to the RBI an independent settlement advisory committee should be set up, headed by retired judge of High Court to scrutiny and recommend proposals.
- The affected banks should send circulation to informant and defaulters, which will serve as a caution list considering request for new additional credit limits defaulting borrowing units and also file criminal cases in regard to willful defaulters.
- The SCBs are advised that the NPAs should be avoided in initial stages of credit consideration by putting in place appropriate credit appraisal mechanism.
- One of the prime responsibilities of the banks is that the borrower should also realize their role and responsibilities. The banks have to build up awareness in this respect.