EVALUATION OF VARIOUS TECHNIQUES USED BY THE PUBLIC SECTOR BANKS FOR THE MANAGEMENT OF NON PERFORMING ASSETS (NPAs)

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ABSTRACT

The banks and financial institutions in India have made significant contributions to almost all the sectors of the Indian economy such as agriculture, industries of all categories and sizes, trade, employment and infrastructure. The ever-increasing trends in deposits and credits speak the volumes for the performance of Indian banks. However, the NPAs in the credit portfolios of the banks and financial institutions have become thorn in the flesh during the last one decade or so. NPAs have not only affected the profitability and productivity of the banks and financial institutions, but also put a stigma on the image of Indian banking and a drain on the very value system of the society. According to an estimate the NPAs have risen to an alarming level of more than Rs. 1, 00,000 crore in year 2000. The Reserve Bank of India and the Government of India took number of measures from time to time like One Time Settlement Scheme (OTS), Debt Recovery Tribunals (DRTs), Lok Adalats, etc. to stem the rot, but fell short of the desired results and high expectations of the concerned people in particular and society in general.

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INTRODUCTION:

The most calamitous problem being faced by commercial banks all over the world in recent times is spiraling non-performing assets (NPAs). They are affecting their viability and solvency. NPAs adversely influence lending activity of banks as non recovery of loan installments and interest on the loan portfolio negates the effectiveness of credit dispensation process. Non recovery of loans also hurt the profitability of banks. Besides, banks with high level of NPAs have to carry more own funds by way of capital and create reserves and provisions and to provide cushion for the loan losses. NPAs, thus, make two pronged attack on the bottom lines of commercial banks: one, interest applied on such assets is not taken into account because such interest is to be taken into account only on its realisation, two, banks have to make provisions for NPAs from the income earned by them on performing assets. Persistently high level of NPAs make banks and financial institutions fragile leading ultimately to their failure. This shakes confidence both of domestic and global investors in the banking system.

Thus, managing bad loans and keeping them at the lowest possible level is critical and need of the hour for banks. An NPA level of over five percent is indicator of poor quality of loan portfolio. With growing competition and shrinking spreads, banks should strive to keep NPAs much below the level of ten percent to make net earnings necessary for their survival and growth. Under the new RBI monitoring system a bank's performance has become crucially dependent on the recognition of income and non performing assets[1]. Before discussing how to manage loans in commercial banks, it would be pertinent to comprehend the concept of NPAs and examine factors contributing to the emergence of NPAs in the loan portfolio of banks.

MEANING OF NPA:

The principal objectives of commercial banking operations are to generate profits and contribute to growth process of the country. The technique that commercial banks adopt to fulfill these objectives has a direct bearing on their assets and liabilities. Banks always strive to adopt an appropriate operational approach with a view to maintain liquidity and profitability of their assets. But there are many assets in the banking system, where there is an imbalance between the liquidity and profitability. Such assets are known as non performing assets, for instance, term loan, overdraft, cash credit account, government securities, etc. The amount to be received from these assets remains unpaid or remains overdue. The government securities, bonds and debentures of corporations can also be included in non performing assets, if interest is not received regularly from them and if still there are some recoverable arrears. In other words, an asset will become non-performing asset, if it does not generate income to the bank.

An asset is classified as non-performing asset if dues in the form of principal and interest are not paid by the borrower for a period of 180 days. However, with effect from March 2004, default status would be given to a borrower if dues are not paid for 90 days. If any advance or credit facilities granted by banks to a borrower becomes non-performing, then the banks will have to treat all the credit facilities granted to that borrower as non performing without having any regard to the fact that there may still exist certain credit advances having performing status.

MANAGEMENT OF NPAS

NPA is not just a problem for banks, they are bad for the economy. The money locked up in NPAs is not available for productive use purpose and to that extent the banks seek to make provisions for NPAs or write them off. It adversely affects their profitability over a long period of time and results in higher rate of interest to their diligent credit customers. Steps taken at the appropriate time may help in avoiding NPAs. Qualitative appraisal, supervision and follow up should be taken up for the present advances to avoid further NPAs. Things have reached a stage where a hard look at some of the basic issues will have to be taken to improve bank general capabilities and to meet the prudential requirements. Reduction of NPAs should be treated as a national priority item to make the Indian banking system more strong, resilient and geared to meet the challenges of globalization. The following are the some measures for reduction of NPAs:-

Rephasement of the Loan - It is necessary to fix repayment schedule for term loan according to the income generating capacity of the unit. If repayment schedule is not fixed properly or a unit is not able to generate expected profit, possibility may be explored in consultation with the borrowers for rephasement of the loan installment. Rephasement of the loan installment should be done only when it is expected to get payment after the rephasement.

Rehabilitation of Potentially Viable Units - It may be encouraged where units are potentially viable and management is reliable. If the rehabilitation programme runs smoothly, it may not be necessary to make provisions even after one year for additional facility provided.

Compromise Proposal - A compromise may be called where borrower agrees to pay a certain amount to the banker with some concession. A large number of compromise proposals are being approved by banks with a view to reduce their NPAs and recycling of funds instead of resorting to legal procedures.

Debt Recovery Tribunals - On the suggestion of the Narasimham Committee, Government had formed Debt Recovery Tribunals (DRTs). In respect of public and private sector banks, the number of cases disposed off by the DRTs as on March 31, 2002 were 13520 involving recovery of Rs. 2,864 crore.

Assets Recovery Branches - Some banks have opened Assets Recovery Branches at critical centres for undertaking bad and doubtful debts. Such assets will be transferred to these recovery branches which have special trained staff with necessary background for recovery.

Staff Training - The success of a bank depends on staff competence in performing certain jobs. The credit officer and the clerk attached shall be trained effectively for the successful implementation of reforms. They will train the other staff members and avoid failures and keep the bank away from committing mistakes.

Staff Incentives for Recovery - Banks are supposed to keep their NPAs at a low level to maintain profitability. Banks should try recovery from hardcore NPAs. This is possible through staff only. With the incentives provided, staff will work with zeal and take special interest to recover the dues by the appropriate method in consultation with their higher authorities.

Encouraging of Loans to Small Borrowers - With the liberalisation of Industrial policy, there was mushroom growth in industrial sector. Many entrepreneurs created industries on paper and deceived the banks. To avoid such incidents, better to go for small advances, where it will be easy to watch the end use of the funds and through proper follow-up, keep the unit viable.

Special Incentives for Prompt Repayers - Special Incentive Scheme should be launched for the borrowers who pay installment regularly. This type of scheme will be essential in rural areas where everybody tries to derive some benefit from banks.

Credit Investigation - Better management information system and credit investigation set up by banks would go a long way in preventing the defaulters of one bank from moving to another bank in the same area. Further, effective and speedy approach shall be adopted for compromise wherever necessary and the settlement should be transparent.

More Powers to Debt Recovery Tribunal - Loans which are above Rs 10 lakhs and became NPA as per prudential norms will be referred to DRT for recovery. They are not in a position to dispose off the cases quickly and many cases are pending with DRTs. In order to avoid delay in the process, DRTs shall be given special powers to dispose off the security of NPA accounts and realise the advances.

Legislative Reforms - The law of Incidence, The Transfer of Property Act, The Sick Industrial Companies Act, The Banking Regulation Act and the Reserve Bank of India Act are the examples of legislation, which are in urgent need of redrafting. Enactment of Securitisation Act 2002 is the latest legislation for reducing the NPAs of banks.

Research Design

The present study was undertaken for knowing the impact of Securitisation Legislation in the management of NPAs in selected financial institutions. To attain this target following banking institutions operating at their local, regional and zonal levels have been approached to provide the requisite data and information. Banks operating at all the three levels include State Bank of India, Oriental Bank of Commerce, Union Bank of India, Allahabad Bank, Bank of Baroda, Canara Bank and Punjab National Bank. Banks operating at two levels include Bank of India, Central Bank of India, Dena Bank, Punjab & Sind Bank, State Bank of Patiala, Syndicate Bank and Vijaya Bank. Banks operating at only one level include Andhra Bank, Bank of Maharastra, Corporation Bank , Indian Bank, Indian Overseas Bank, United Bank of India and UCO Bank.

In all 54 bank branches of 21 public sector banks have been included in the study. The performance at national level of the banks under study has been already discussed in previous chapter while various aspects of NPAs and Securitisation Legislation have been enquired from the respondent banks situated in Haryana, Punjab, Delhi, U.P. and Chandigarh.

Techniques Dealing with NPAs - Table 1 was constructed to ascertain the frequency of use of techniques like DRTs, OTS and Securitisation Act for managing the NPAs.

TABLE 1

Frequency of Use of Techniques Dealing with NPAs

Techniques	Frequency of Use				WAS Rank	Summary			
	Never	Sometimes	Always	Total		WAS	Avg.	SD	CV
DRT	4 (7.41)	19 (35.18)	31 (57.41)	54 (100)	2	0.50	2.50	0.63	25.20
OTS	—	33 (61.11)	21 (38.89)	54 (100)	3	0.39	2.39	0.49	20.50
Securitisation Act	—	23 (42.59)	31 (57.41)	54 (100)	1	0.57	2.57	0.49	19.07

Source: Sample Survey

Figures given in parentheses represent percentages

TABLE 1.1

DRT as a Technique to Deal with NPAs

Level	Frequency of Use				Summary			
	Never	Sometimes	Always	Total	WAS	Avg.	SD	CV
Local	4 (14.29)	9 (32.14)	15 (53.57)	28 (100)	0.39	2.39	0.72	30.13
Regional	—	8 (53.33)	7 (46.67)	15 (100)	0.47	2.47	0.50	20.24
Zonal	—	2 (18.18)	9 (81.82)	11 (100)	0.82	2.82	0.39	13.83
Total	4 (7.41)	19 (35.18)	31 (57.41)	54 (100)	0.50	2.50	0.63	25.20

Source: Sample Survey χ^2=7.61(df: 4)

Figures given in parentheses represent percentages

TABLE 1.2

OTS as a Technique to Deal with NPAs

Level	Frequency of Use				Summary			
	Never	Sometimes	Always	Total	WAS	Avg.	SD	CV
Local	—	16 (57.14)	12 (42.86)	28 (100)	0.43	2.43	0.49	20.16
Regional	—	11 (73.33)	4 (26.67)	15 (100)	0.27	2.27	0.44	19.38
Zonal	—	6 (54.55)	5 (45.45)	11 (100)	0.45	2.45	0.50	20.41
Total	—	33 (61.11)	21 (38.89)	54 (100)	0.39	2.39	0.49	20.50

Source: Sample Survey χ^2=1.33(df: 2)

Figures given in parentheses represent percentages

TABLE 1.3

Securitisation Act to deal with NPAs

Level	Frequency of Use				Summary			
	Never	Sometimes	Always	Total	WAS	Avg.	SD	CV
Local	—	11 (39.29)	17 (60.71)	28 (100)	0.57	2.57	0.56	21.79
Regional	—	6 (40.00)	9 (60.00)	15 (100)	0.60	2.60	0.49	18.85
Zonal	—	6 (54.55)	5 (45.45)	11 (100)	0.45	2.45	0.50	20.41
Total	—	23 (42.59)	31 (57.41)	54 (100)	0.57	2.57	0.49	19.07

Source: Sample Survey χ^2=0.82(df:2)

Figures given in parentheses represent percentages

The examination reveals that 'DRT' and 'Securitisation Act' were equally popular for dealing with NPAs as respondents 'always' made their use. The One Time Settlement Scheme (OTS) was used by all the banks in various degrees.

Considering the coefficient of variation, it is lowest for 'Securitisation Act' and highest in case of 'DRT'. It leads us to conclude that respondents are in favour of Securitisation Act in greater degree than other techniques.

The testing of hypotheses under Tables 1.1 to 1.3 for the above techniques to deal with NPAs also led to their acceptances signifying that DRT, OTS and 'Securitisation Act' are used by banks irrespective of their levels of operations.

On the basis of above discussion it may be concluded that all available techniques are being used by the banks to manage the NPAs but Securitisation Act is a more popular tool in this regard.

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