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NONPERFORMING ASSETS AND ITS IMPACT ON INDIAN PUBLIC SECTOR BANKS

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ABSTRACT

The problem of nonperforming assets is deep and global. But, the magnitude of this problem is un-doughtily very high in the developing countries like India. The economic reforms initiated by the Government of India to match the speed of global economic challenge cannot be achieved without the complete and strategic overhaul of Indian banking and financial sector. The speedy growing problem of NPAs is threatening banks existence, shrinking their profitability and affecting the economy in general. Mismatch of financial liability largely depend on the ability of banks and financial institutions, how they are managing various risks in their business. High NPAs reflects the state of nation's health of industry and trade. For better economic future of the nation, potential changes are must to tackle the NPAs problem with effective judiciary, polity and the bureaucracy. Thus it became important to make entire banking and financial sector vibrant and competitive. In Indian banking and financial sector, public sector banks are worst affected followed by private sector banks, and the foreign banks. The paper provides strategic overview of the problem and deals with understanding the concept of NPAs; it also highlights its magnitude, real causes behind growing and managing NPAs in Indian PSBs. In last suggests mechanisms to handle the problem basing on experiences from past with concluding remarks.

KEYWORDS: SCBs; PSBs; Bad loans, Assets; NPA; RBI; GOI; AUCA; SARFAESI; OD; CC; EVA; ROI.

INTRODUCTION

Managing bad loans and keeping them at the lowest level has become a key word for the banking industry in recent years. NPAs reflect the performance of banks and its failure adversely affects their financial health and paralyzed the economy in long run. 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. A strong banking sector is important for flourishing economy. In India as well as globally banks had registered rapid credit growth which is partly blamed for the slippage. Besides, a hardening of interest rates has also resulted in a rise in bad debts. The global most calamitous problem for commercial banks in recent times is spiraling nonperforming assets which are affecting their viability and solvency and thus ultimately posing challenge to their survival. The mounting solvency crises of financial systems, like American savings and loans crises in the 1980s, the Nordic banking and financial crises at the binging of 1990s, the banking sector problems in Japan and turkey and recent USA subprime crises, been consequences of accumulation of problem loans overtime. NPAs in Indian banking system came into existence consequent to introduction of prudential and potential accounting norms. However, non performing loans did exist even before and its proportion to gross advances was highest to 23.5 percent in March 31, 1994. The best improvement in India's banking history was that its ratio fell from 9 per cent in FY03 to 2.4 per cent in FY08. It is like a two edge swards from one side it cut the banks survival and from other side it cut the economic growth of the respective nation. It is also a kind of mirror which reflects the health of the nation's trade, industry, and exposes the week implementation of the banking norms and fraudulent business culture.

Indian banks with enormous amounts of bad loans are in pathetic health and witnessed a sharp jump in their gross NPAs. It is also found that at international level Indian banks are among the banks that have higher percentage of NPAs. Comparatively competitive banks in countries like China are healthier and in better position economically and industrially than Indian banks due to effective policy and efficient approach and control. Generally world class banks do not have NPAs of over 2 percent of the total portfolio. After the global financial turmoil in 2008, Indian banks begin the year with a lurking fear that their non performing assets would go up with their portfolios coming under severe stress. Further, due to corrupt practice, political nepotism and favoritism banks extended a large number of loans to the priority sector which became matter of sorry. Among bank groups, the new tech-savvy private banks have the lowest NPAs followed by foreign banks, old private banks and public sector banks. With holistic view for smooth financial health and functioning, strategic measures both macro and micro levels are required by the government. For the noble economic cause, to control if cannot eliminate NPAs the RBI has taken numerous measures in conjunction with the government which resulted substantial decline in level of NPAs in Indian banking system and bought it down to all time low of 2.3 percent in 2008 but due to recession and other global complexities it has increases to 3 per cent in 2011and expected to touch 4 per cent of the total assets. According to RBI data, the growth rate of bad loans in 2011-12 first-half at 25.5 per cent was more than triple the average growth rate of 7.4 per cent in the same period in 2006-12. In absolute terms, bad loans of banks increased to Rs 100,000 crore mark in September 2011 quarter and remain a cause of concern in the December 2011 quarter as well and is expected to touch Rs. 150000 mark by the end second quarter of 2012. Desperately the Government is ensuring that the targets of Gross NPAs, set by the PSBs in their 'Statement of Intent on Annual Goals' are such that they strive to contain the level of their Gross NPAs within acceptable limits.

2. Objective and Methodology:

Banking and financial sector are wheel of fortune and play important role in the development of nations economy. It is a core fact that developed banking and financial system reflects the strength and growth of nation's economy. The main objective of this paper is to scientifically identify and examine the emerging trends of NPA's and their major causes, to assess the impact of NPA's in general and to analyze the impact of SARFAESI Act implemented with amendment. The study is based on the secondary data collected from various RBI annual reports, books, journals, research paper and published national and international document.

3. What is Non Performing Assets in Indian Context?

As per Para 2.1 of the RBIs master circular dated 01-07-2005 An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. It is also known as non- productive assets (NPAS), non-performing loans and constitute integral part of Bank's operations. It means NPA an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI. An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement systems, recovery climate, up-gradation of technology in the banking system, etc., it was decided to dispense with 'past due' concept, with effect from March 31, 2001. Accordingly, as from that date, a Non performing asset (NPA) shell be an advance where

- interest and /or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan,
- the account remains 'out of order' for a period of more than 180 days, in respect of an overdraft/ cash Credit(OD/CC)
- the bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,
- interest and/ or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
- any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days overdue' norm for identification of NPAs, form the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, a non-performing asset (NPA) shell be a loan or an advance where;

- interest and /or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan,
- the account remains 'out of order for a period of more than 90 days, in respect of an overdraft/ cash Credit(OD/CC), (as according to guidelines "an account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/ drawing power. In case where the outstanding balance in the principal operating account is less than the sanctioned limit/ drawing power, but there are no credits continuously for six months as on the date of balance sheet or credits are not enough to cover the interest debited during the same period, these account should be treated as 'out of order').

- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted, *(as according to guidelines "any amount due to the bank under any credit facility is overdue if it is not paid on that date fixed by the bank")*.
- interest and/ or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
- any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

4. Income Recognition and Asset Classification:

In line with the international practices and as per the recommendations made by the committee on the financial system the RBI has introduced in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks so as to move towards greater consistency and transparency in the published accounts and to reflect a true picture of financial position of banks on the basis of their booking the income on actual basis than the accrual basis add also to classify assets according to the level of risk attached to them (R. Kanan).

4.1. Income Recognition: the policy for income recognition is based on the record of recovery rather than on any subjective considerations. In the line with international best practices, income from NPA is not to be recognized on accrual basis but is booked on income policy only when it is actually received. Likewise, the classification of assets of banks has to be done on the basis of objective criteria which would ensure a uniform and consistent application of the norms. Also, the provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realizable value thereof. Therefore the banks should not charge and take to income account interest on any NPA component of finance income on the leased assets, (as according to guidelines "Interest on advances against term deposits, NSCs, IVPs, KVPs and life policies may be taken to income account on the due date, provided adequate margin is available in the accounts. Fees and commissions earned by the banks as a result of renegotiation or rescheduling of outstanding debts should be recognized on the accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit. If government guaranteed advances become NPAs, the interest on such advances should not be taken to income account unless the interest has been realized").

4.2. Reversal of Income: if advances, generally including bills purchased and discounted, due to any circumstances become an NPA as at close of any year, the interest accrued and credited to income account in the corresponding previous year, should be reversed or provided for. This is applicable to government guaranteed accounts also. Apart from this, uncollected fees, commissions and other income that due to any circumstances have accrued in NPAs during past periods should be reversed or provided for.

4.3. Leased Assets: According to 'Guidance Note on Accounting for Leases' issued by the (ICAI), the net lease rentals or the unrealized finance charge on the leased assets which are accrued and credited to income account before the assets become non performing, should be reversed or provided for in the current accounting period.

4.4. Appropriation of Recovery in NPAs: Interest realized on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/additional credit facilities sanctioned to the borrower. But in the absence of a clear agreement banks have a right to adopt an accounting principle and exercise the appropriation of recoveries in a uniform and consistent manner.

4.5 Assets Classification: To avoid errors Banks classify non-performing assets into the following three categories generally based on the period for which the asset has remained non-performing

4.6. Sub-Standard Assets: with effect from 31st March 2005, a substandard assets is one, which has remained NPA for a period less than or equal to 12 months. In such cases, the current net worth of the borrower / guarantor or the current market value of the security charged is not enough to ensure recovery of dues to the banks in full. Such an asset has well-defined credit weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the bank will sustain some loss, if deficiencies are not corrected

4.8. Doubtful Assets: with effect from 31st March 2005, an asset is called as doubtful if it has remained in the substandard category for more than 12 months. a loan classified as doubtful has all the weakness inherent in assets that were classified as sub standard, with the added characteristic that the weakness make collection or liquidation in full-on the basis of currently known facts, conditions and values-highly questionable and improbable.

4.9. Loss Asset: Assets in general on which losses have been identified by the bank or internal or external auditors or the Reserve Bank India inspection but the amount has not been written off fully. There are separate guidelines for projects under implementation which are based on the achievement of financial closure and the date of approval of the project financing.

4.10. Restructured Assets: According to Central Bank guidelines for restructured assets. A restructured item is defined as one in which the original contractual terms have been modified to provide concessions of interest, principal or term for reasons related to the financial difficulties of a customer. A fully secured standard asset can be restructured by re-schedulement of principal repayments and/ or the interest element, but must be separately disclosed as a restructured asset. The amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved. Similar guidelines apply to sub-standard assets. The sub-standard accounts which have been subjected to restructuring, whether in respect of principal installment or interest amount are eligible to be upgraded to the standard category only after the specified period, i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due, subject to satisfactory performance during the period. To protect banking system and to minimize hanging risk Central Bank has devised a corporate debt restructuring system through institutional mechanism for the restructuring of corporate debt.

5. Magnitude of NPAs in India:

A critical look through the existing statistics on the movement of NPAs of public sector banks, private sector banks, foreign banks, and all scheduled commercial banks will help to determent the extent to which they are standing with regard to NPAs. The table number 1 to 5 highlights the magnitude of NPAs in Indian banking industry which is alarming. Swelling NPAs should be considered as a serious crisis in

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absolute terms, it is a high bread financial cancer in nation economic health. The rising level of NPAs in banks is a matter of great concern not only for public but also for the government. Bank credit is a mirror to the economic development of the nation and any shadow of NPAs will reduce the reflection of its economic development. With growing awareness of risk management and fear of financial loss both government and banks are taking corrective measures to contain NPAs which by enlarge resulted positively. The problem of NPA is universal not only limited to Indian banks, irrespectively whether the countries are developing, developed or poor. However, the degree of NPAs and its impact varies from country to country and economy to economy. Develop countries with large resources and effective controls have least NPAs in comparison to developing and poor countries.

6. Banks Group Wise Classification of Loan Assets of Scheduled Commercial banks- 2006-2011 as on 31 March 2011 *(Amount in crore)*

Public Sector Banks: Table.5.1

Bank Group / Years	Doubtful assets (amount)	Doubtful (%Share)	Loss Assets (amount)	Loss Assets (%share)	Gross NPAs (amount)	Gross NPAs (%share)	Total Advances
2006	24804	2.3	5180	0.5	41378	3.9	1070872
2007	19944	1.5	4510	0.3	38602	2.8	1373777
2008	19167	1.1	3712	0.2	39749	2.3	1696333
2009	20715	1.0	3803	0.2	44039	2.1	2103763
2010	24685	1.0	4928	0.2	57301	2.3	2519331
2011	31919	1.0	5514	0.2	71047	2.3	3079804
2012	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**

Source: *Statistical table relating to banks in India, Page Number 101, 2010-2011*

Private Sector Banks: Table.6.2

Bank Group / Years	Doubtful assets (amount)	Doubtful (%Share)	Loss Assets (amount)	Loss Assets (%share)	Gross NPAs (amount)	Gross NPAs (%share)	Total Advances
2006	4438	1.5	940	0.3	7774	2.6	303793
2007	3930	1.0	941	0.2	9239	2.4	391869
2008	4452	0.9	1244	0.3	12976	2.7	472345
2009	5017	1.0	1345	0.3	16888	3.2	519655
2010	6542	1.1	2166	0.4	17384	3.0	584591
2011	10735	1.5	2839	0.4	17972	2.5	732310
2012	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**

Source: *Statistical table relating to banks in India, Page number 101, 2010-2011*

Foreign Banks: Table.6. 3

Bank Group / Years	Doubtful assets (amount)	Doubtful (%Share)	Loss Assets (amount)	Loss Assets (%share)	Gross NPAs (amount)	Gross NPAs (%share)	Total Advances
2006	698	0.7	446	0.5	2090	2.1	98862
2007	631	0.5	454	0.4	2452	1.9	127867
2008	768	0.5	387	0.2	3118	1.9	162999
2009	1004	0.6	416	0.2	7294	4.3	169714
2010	1441	0.9	757	0.5	7128	4.3	167439
2011	2113	1.1	1087	0.5	5065	2.5	199321
2012	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**

Source: *Statistical table relating to banks in India, Page Number 101, 2010-2011*

All Scheduled Commercial Banks: Table. 6.4

Bank Group / Years	Doubtful assets (amount)	Doubtful (%Share)	Loss Assets (amount)	Loss Assets (%share)	Gross NPAs (amount)	Gross NPAs (%share)	Total Advances
2006	29940	2.0	6565	0.4	51242	3.5	1473527
2007	24505	1.3	5905	0.3	50293	2.7	1893513
2008	24386	1.0	5343	0.2	55842	2.4	2331678
2009	26736	1.0	5564	0.2	68220	2.4	2793133
2010	32668	1.0	7850	0.2	81813	2.5	3271361
2011	44767	1.1	9440	0.2	94084	2.3	4011435
2012	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**

Source: *Statistical table relating to banks in India, Page Number 101, 2010-2011*

Table.6. 5: Composition of NPAs of Public Sector Banks - 2002 to 2011(Amount in crore) as on March 31, 2011 (Nationalized Banks & State Bank of India & its Associates):

Public Sector Banks	Priority Sector (amount)	Priority Sector (%)	Non-priority Sector (amount)	Non-priority Sector (%)	Public Sector (amount)	Public Sector (%)	Total
2002	25150	46.21	28371	52.13	902	1.66	54423
2003	24938	47.23	26781	50.72	1087	2.06	52807
2004	23840	47.54	25698	51.24	610	1.22	50148
2005	23397	49.05	23849	50.00	450	0.94	47696
2006	22374	54.07	18664	45.11	341	0.82	41378
2007	22954	59.46	15158	39.27	490	1.27	38602
2008	25287	63.62	14163	35.63	299	0.75	39749
2009	24318	55.21	19251	43.71	474	1.08	44042
2010	30848	53.83	25929	45.25	524	0.91	57301
2011	41245	58.05	29524	41.56	278	0.39	71047
2012	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**

***Source**: Off-site returns (domestic & provisional) of banks, Department of Banking Supervision, RBI**, Statistical table relating to banks in India**,* Page number 102, *2010-2011*,

The problem of NBAs (bad loans, write-offs and restructured assets) in India is quite fascinating especially in the Indian public sector banks and are result of multiple factors like political nepotism favoritism, mismanagement, willful default, diversion of funds and siphoning off of funds, delay in project completion, asset quality, changes in industrial policy, in addition the volatile interest rate regime which also have important role in it and ultimately multiply the burden on banks. World Bank with holistic view has warned Indian banks and financial institutions on their high NPAs and the future risks of suffering losses if interest rate starts rising. The problem became important and drawn attention from several quarters when public sector debt rose to 90 per cent of GDP, the World Bank said in its development policy review report titled 'India-Sustaining Reform, Reducing Poverty'.

During past fiscal years, NPAs amounted to Rs 66,000 crore whereas non-performing assets (NPAs) of over Rs 77,000 crore were written off .Of the written-off accounts, around 50 per cent will be in AUCA (assets under collection accounts).If we add this figures to the NPAs figures, it will account for 16.3 per cent of GDP which is enough to fund 200 world-class airports in the country or fund the entire Golden Quadrilateral highway project by four times" (Arcil 2006). Further, in 2008, the government announced an Rs 65,000 crore farm loan-waiver scheme and *additional contribution in 2011-12* waiver of 4,000 crore for weavers. It is expected that bad assets might grow by Rs 60,000-Rs Rs 65,000 crore, according to a report in (*Mint 14 March 2012).* According to a Macquarie report, agri-loans contributed 44 percent to the incremental non-performing loans in 2011. Credit to agriculture climbed by 6.3 percent in January 2012, down from 21.5 percent the previous year, Further data to check for bank exposures to risky assets in underperforming sectors like textiles, power, metals, and real estate, and discovered the amount involved could be as high as Rs 9,00,000 crore, according to Reserve Bank of India data.

In order to control financial cancer RBI has taken numerous effective measures in conjunction with the government and implemented various rules and regulations on assessment and recovery due to which the asset quality of Indian banks has shown substantial improvement. However, effective implementation of rules and regulations is the potential key to reverse this trend. With improved industrial policy, environment and growing opportunities banks are tactfully and efficiently managing to recover substantial amounts of NPAs. In recent years, particularly after economic reforms, all the scheduled commercial banks registered decline in proportion of gross NPAs to gross advances as also of net advances. In fact, the securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARAESH) Act and other steps taken by GOI and RBI provided a significant impetus to banks to ensure sustained recovery and menu of options to reduce level of NPAs (RBIs Annual Report). An improved industrial climate with cooperative industrial policies also contributed a lot to this state of affairs. By the effect of liberalization and globalization foreign banks got an ample opportunity to expand their business in India. In initial phase of their business operating in India they do not seem to be as serious in sanctioning and monitoring advances as they are at present. However, study reveals that the problem of NPAs in highest among the public sector banks. Among banks groups operating in India, the new high tech private sectors banks have the lowest NPAs followed by emerging competitor's foreign banks operating in India, old private banks and public sectors banks

7. Impact of Priority Sector Advances on NPAs in India

For constant and balance growth of the nation there is a need of proper distribution of scant resources including finance. Generally it is considered that 40% of the net bank credit which is sanctioned to priority sectors has led to higher level of NPAs because most of the projects became white elephant and credit to these sectors become sticky. NPAs as percentage of advances to priority sectors have always been lower than those in non priority sector and it is hard and fast fact that advances to these sectors are becoming NPAs. Banks have to give much careful attention to non priority sector lending rather than priority sector as it is the area where the bankers have to be cautious in lending and have to examine the possibilities of loans becoming non-performing. Here the question of regulation, implementation of existing law, moral hazard, adverse selection and credit rationing comes to fore and these issues need proper exposure and awareness and judicious action. This will ultimately explode the commonly held dogma and myth that the problem of NPAs is a result of credit allocation to priority sector.

8. Impact of NPAs on Banking Operations in India:

Nonperforming assets of banks are hurdles in economic growth and development of the respective nations and breed multiple challenges for present and future. Every aspect of life, business and other events are judged by their performance and ultimate result. Thus, the size of the banks and its balance sheet is not only the criteria to judge the efficiency, effectiveness and performance but also the level of return on its assets. The NPAs generally do not generate interest income for banks but at the same time they are bound to provide provisions for NPAs from their current profits and are major cause of concern. Further it has following deep impact on the return on assets.

- The general interest income of banks will decline and will be accounted only on receipt basis.
- Due to decline in interest income banks profitability get affected adversely because of the providing of doubtful debts and consequent to writing it off as bad debts.
- Return on investments (ROI) gets reduced more than NPAs.
- The capital adequacy ratio gets disturbed due to inclusion of NPAs into its calculation.
- Due to uncertainty in return, high risk and NPAs the cost of capital will go up.
- Due to NPAs, assets and liability mismatch will increase. The economic value addition (EVA) by banks gets disturb, it is because EVA is equal to the net operating profit minus cost of capital and thus, it reduces recycling of the funds.

Due to all these above factors the PSBs are over burdened with bulging NPAs which results in declined income and higher provisioning for doubtful debts and further reduce their profit margin.

9 Major Causes of NPAs in Indian Public Sector Banks:

A strong banking sector is paramount important for a flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. In the era of globalization Indian banking system is facing challenges of an open economy system with having experience of operation in closed economy. On one side socially protected environment ensured that banks don’t require developing sophisticated treasury operations and Asset Liability management skills and on the other hand a combination of directed lending and social banking relegated profitability and competitiveness to the background. The net result was unsustainable NPAs and consequently a higher effective cost of banking services (Anurag). Generally it is found that the directed loans system under which commercial banks are bound to prescribed percentage of their credit (40%) to priority sectors as one of the main causes of NPAs into banking sector. As of today a good percent of Gross NPAs are locked up in 'hard-core' doubtful and loss assets, accumulated over the years. Generally it is noted that lack of strict prudential norms are not the major problem in India but the legal complexities and time consuming nature of asset disposal proposal, negligence and postponement of existing problem in order to show higher earnings, Manipulation of debtors by using political influence.

9.1. Macro Perspective behind NPAs Causes:

A lot of practical problems have been found in Indian banks, especially in public sector banks. It is a hard truth that loans are given by them to various industrial houses not on commercial considerations and viability of project but on political considerations, affiliations and associations, without making a thorough study of the facts, actual need of the party concerned, its past records, its managerial skills, the prospects of the business in which it was and is engaged, and so on. Thus, due to these reasons many of the loans become NPAs. The loans for economically weak sections of the society and the waiving of the loans to farmers are another dimension of the politicization of bank lending. In fact most of the depositor's hard earned savings has been frittered away by the banks at the instance of greedy parasites, politicians, while the same depositors are being force to pay through taxes to bridge the losses of the bank which cause deep impact on banks operations and of its market status, further leave a negative impression on the payer of the loan who innocently become victim of political manipulation. Poverty elevation programs like IRDP, RREP, SUME, SEPUP, JRY, PMRY etc., failed in meeting their objectives on several parameters. The huge amount of loan sanctioned under these political schemes became totally unrecoverable by banks due to lack of awareness among the masses about their social rights, political manipulation, misuse of funds and non-reliability of target audience of these sections. Loans given by banks are their assets and the quality of these assets was steadily deteriorated due to slack proposal evaluation and the poor repayment. Apart from this there are multiple internal and external reasons for an account becoming NPA.

9.2 Internal factors: Among the internal factors responsible for high level of NPAs in Indian commercial banks, the most important ones have been projects appraisal deficiencies regarding technical feasibility, economic viability and project management deficiencies in regard to implementation, production, labor, and marketing, financial and administrative matters, fund borrowed for one purpose but used in some other, poor recovery, in ability of the corporate to raise capital through the issue of equity or other debt instrument from capital markets, diversion of funds in promoting sister concerns, willful default, siphoning of funds, fraud disputes, management disputes, misappropriation etc.

9.3 External Factor: An important reason for the bulging of NPAs was the 'euphoria' generated with liberalization, a dream of globalization led to huge investment which unfortunately could not be utilized due to hesitant liberalization policies(E.T2000). Dominance of traditional industries in credit portfolios, industrial sickness, labor problems, global economic slowdown as well domestic, sluggish legal system, long legal tangles. Among other external factors, the RBI study noted that non availability of raw materials, power shortage, transport bottlenecks, financial bottlenecks, change in government policy like excise duty changes, Import duty changes etc, natural calamities, industrial sickness, increase in import costs, increase in overhead costs, market saturation, product obsolescence, fall in demand and other similar reasons were responsible for slow and weak performance resulting advances given to them by bank into bad. Ineffective and politically infected legal system is the sole factor contributing to enormously high level of NPAs in Indian Commercial Banks. Antiquated defaulter friendly legal system, extremely slow and dormant judicial system, and extremely dismal record of enforcement machineries have also contributed to a great extent in developing significantly high level of

NPAs in India. According to RBI study, inability and ineffectiveness of suit filing and recovery measures have resulted in blocking healthy portion of banks funds in unproductive assets. Slow and crawling judiciary results in pending of large number of suits about recoveries. Out of all suit filed cases of Rs 1 crore and above, in 15 banks, only one case reached the logical end. International rating agency FITCHIBCA observed that "the Indian Legal system is sympathetic and prone towards the borrowers and works against the banks' interest. Pannir Selvam Committee of IBA on NPAs clearly stated that it takes decades for courts to decide cases and even after decrees are obtain, execution of decrees are impossible task to held. It became more complex and elongated if matter comes under the purview of the BIFR and AAIFR. The RBI study also reflected that DRT has not been effective and failed to achieve the determined objective. In prevailing Indian work culture it became common practice to delay action or prevent sanction due to frequent flouting rules, not proper awareness of rules, and regulations to concerned authorities and further their interpretation. The long and lasting legal process not only encourages the incidence of NPAs but also prolongs and perpetuates their existence by placing a premium on default. For better growth and development it is important to realize the havoc wrecked by the perennial and willful defaulters on the financial system. Their fraudulent and deliberate acts have raised the cost of credit made bankers more risk averse and squeezed decent small and medium scale enterprise from accessing competitive credit. They have debased the banking system in large and, in the process, penalized the good borrowers. They need to be taken to task.

10. Comparative Study of causes with Other Countries:

The problem of NPA is not only confined to Indian banks but it is universal and embrace develop, developing and poor nations in its iron fold. However, the degree of NPAs and its impact varies from country to country and economy to economy. It is generally found that almost all country in the world have some common and some different causes with close resemblance. Absence of proper bankruptcy laws and inefficient legal procedures in enforcing security rights are the root cause of bad debts in banks universally. Added to these, there are many other reasons why public sector banks have highest level of NPAs. Some of the most important are given as under.

10.1. China: Major causes of problem are: (i) The State Owned Enterprises (SOE's) believe that government will bail them out in case of trouble and thus degradation in all regards is inevitable. (ii) For social cause and undue political pressure government have to keep SOE afloat. , (iii) Banks avoid financing private enterprises, (iv) diabolic and inefficient legal enforcement mechanisms.

10.2. Korea: Major causes of problem are: (i) Selective credit and rigid interest rate control system proves mother of inefficient distribution of funds. (ii) Corrupt and ineffective monitoring system.

10.3. Japan: Major causes of problem are (i) Unwanted support to real estate boom led to bad loans disaster, (ii) Lethargic and inefficient Legal mechanisms, (iii) Accounting system with loop holes,(iv) Dogma of no-bankruptcy doctrine.

10.4. Pakistan: Major causes of problem are (i) Weak and san governance base on zero equity culture with poor lending (ii) Pathetic entrepreneurship with chronic over-capacity and negative competitive advantage,(iv) Loan in under pressure to political heavy weight.

10.5. Thailand: Major causes of problem are (i) Undue favor to debtors,(ii) shabby assessment of foreign exchange risk was considered for liberalized capital and current account borrowing,(iii) Window dress projection of prices and growth in real estate,(iv) bad loans due to high interest rate.

Simply it has to be strictly admitted that no bank in the world can maintain zero NPA because banking and other business, does involve unforeseen risks. Secondly, one of the most important and primary reasons for NPA is the incorrect and corrupt lending decision. In general industries and trade extract major portion of banks lending's, this segment accounted for over 53 per cent of gross bank credit, excluding loans to food procurement agencies of governments (RBI, 2002). Banks relay heavily on this sectors with bleeding results. Till the early 1960s, respected traditional companies of Indian business groups enjoy the bank's lending but now it is not so. With growing economy and small scale industries the economic environment of the nation has tremendously changed and bankers had to learn newer ways of assessment and appraisal. Third, another factor is inexperience and inefficient public sector banks professionals with constant rotation of duties, lack of knowledge and training in lending principles for the loan officers, high bureaucratic interference. Fourth, mollified and untrue demand projection at the beginning of the 90s motivated promoters to take huge project loans and advances to set up Greenfield projects. However, by the end of decade, service industries emerge as the most important contributor to the nations GDP ahead of manufacturing, agriculture. Further saturated public investment and high global overcapacity, in addition with a volatile international market made all segment standstills. Thus many important industrial sectors like textile, steel and chemical came in burden of overcapacity and resulted in reduced cash flow and margin. With anticipation of future loss financial institutions tried debt restructuring as a remedy, and supplied more funds to running projects even became active part of management and also took over the management of some ailing companies. Despite all protective effort good numbers of the mega projects have failed drastically and financial institutions and banks been forced to record the sanctioned investment as non- performing. Last but not the least, introspection and thorough investigation is needed in lending activities (scientific evaluation and assessment of the proposal; perpetual support to the projects especially during the loan period by additional loan or by non fund based activities; and exit decision and modality). Studies in this regard has produced that Indian financial institutions have volatile and ignorant behavior at every stages. In large number of projects loans have been sanctioned because of vested interests. Either due to Promoters-banker nexus or under pressure sanctions due to promoter-politician linkages or combination of all three components. Under these circumstances ignorant and formality monitoring has been done by the bankers especially during post loan disbursal period by neglecting track of the important signals that indicates the health of the loan recipient and in time when much needed monitoring of project progress is required. More often bankers with vested interest provide helping hands to clients in projects financial position feed backs and in many cases they helps in declaring projects sick under existing relevant Indian laws. The Joint Parliament Committee (JPC) investigating the stock market scam has pointed that UTI's present financial scam is a result of favoring and' directing its investment and lending's to dubious private sector promoters and projected this mollified practice in the name of reviving the capital markets'. It seemed that the NPAs of public sector banks are systematic and organized socio- financial crime and not debts'.

11. Managing NPAs through Securitization:

In the era of globalization the growing volume of Non Performing Assets (NPAs) is a big challenge for banks and financial institution to control. They were experiencing considerable difficulties in recovering loans and enforcement of securities charged to them. A handsome portion of the bank's funds were blocked in non-productive assets/litigation. Until the enactment of Securitization Act, banks/ financial institutions had to enforce their security through court which was very slow and time consuming process. There was also no provision in any of the present law in respect of hypothecation, though hypothecation is one of the major security interest taken by the bank/ financial institution. Keeping NPAs growing complexities in view the GOI passed the Recovery of Debts Due To Banks and Financial Institutions Act, 1993 which was positively welcomed by banking circle. This effort of the government was not enough, and the Act proven ineffective and insufficient to tackle NPA problem in large. To fight the growing financial termite NPAs the Indian banking and financial industry required more power, effective financial regulation and Act. To overcome the hardships faced by the banking industry the GOI decided to bring in the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002. This Act brought tremendous change in India's entire law on the recovery of non-performing loans by banks and financial institutions. In case of any borrower having defaulted in repayment of secured debt or any installment, the Act confers powers on secured creditors to take possession and sell assets kept as security, take over the management of the secured assets of the borrower or appoint any person to manage the secured assets the possession of which has been taken over by the secured creditor. To solve the problem of bad loans, the SARFAESI Act provides for the establishment of ARCs. The 2002 Act aims to regulate securitization, reconstruct financial assets and enforce security interests. Earlier there was no provision for facilitating securitization of financial assets and the power to take possession of securitized assets and selling them off. The (SARFAESI) Act, 2002 enacted at a time when the Indian banking and financial industry was grappling with bad loans and advances which at that time was 14 % of their entire advances in gross terms and net NPAs approximately 7%, which roughly amounted for up to Rs. 650 billion. In April 2004, a Supreme Court ruling on the SARFAESI Act 2003 struck down the provisions requiring the borrower pre deposit 75 percent of the liabilities in case the borrower wants to appeal against the order of attachment of the assets. The SARFAESI Act was amended in 2004, in order to dissuade the borrower from delaying the repayment of the dues and to facilitate the speedy recovery of debt of secured creditors. Though with the help of (SARFAESI) Act 2002 banks succeeded in getting their smaller clients to pay the outstanding loans and advances but the adequacy of (SARFAESI) Act in recovering outstanding dues is doubtful, as evidenced from the recovery amount, the fact that most of the big defaulters have taken consortia loans and before issuing notice the, led bankers has to secure assent by secured creditors representing 75 percent of the outstanding secured debt. Also, the core competence of bankers is to lend and receive money, not to attach assets and fight cases (Economic Times 2002).With a view to ensuring healthy development of the securitization market, the RBI issued draft guidelines on securitization of standard assets on April 4, 2005, financial institutions and non banking companies and for providing an additional option and developing a health secondary market for NPAs, the RBI issued guidelines in July 2005. Further In its endeavor to protect interest of investors in securitized debt, the RBI has unveiled draft regulations on securitization on February 2, 2006. Banks are now confident of a faster recovery of dues, in a land mark judgment by Bombay High Court in May, 2007 possession of secured assets has been made easier. The court has ruled that no notice or hearing needs to be given to a borrower or third party when instance is taken from the chief Judicial Magistrate to take possessions of the secured asset under the securitization Act. (TOI, 3 May 2007). Further with passing time securitization will gain advantage in the banking sector. Thus, among the several channels of recovery available to banks for dealing with bad loans, the debt recovery tribunals (DTR) and the SARFAESI Act have been the most effective in terms of amount recovered.

12. Findings, Conclusion and Suggestions:

Managing bad loans and controlling them at lowest level has become paramount important for the banking industry in recent years. After independence India has adopted bank based financial system, where banks and financial institutions are major financial intermediaries for commercial sector credit. It is found that NPAs in Indian banking system came into existence consequent to introduction of prudential accounting norms. The impact of NPAs on the Indian economy is not that alarming as witnessed recently in the East African Region, Japan or another part of the globe, viz., Russia, rescission hit America and Europe. However, even reduced level of NPAs of the Indian banks is still higher as compared to developed county standards of around 2 percent warrants continued remedial actions and need strategic measures both at macro and micro levels. Nepotism in project appraisal due to political dearness, and fabricated projections of industrial sector demand, with political recession, have resulted in the default of many loan accounts, resulting in everlasting 'non performing assets' and impacts the accounts of a financial institution in multiple ways. It is needless to mention, that that there is ultimate solution for NBAs, but can develop protective measure to avoid risk. Serious attention required to monitoring of the loans sanctioned by the banks as most bad loans have been due to poor credit monitoring than to poor credit approval. To reduce the level of NPAs in the loan portfolio, comprehensive preventive monitoring mechanism to explore and maintain sound and healthy loan portfolio has to be developed and adopted. The approach to NPA management by the banks has to be multi-pronged, necessitating varied strategies suited to different stages of the passage of credit, every commercial bank has to embark upon strategic plan to prevent or control the occurrence of the NPAs and stoppage of health accounts into bad loans. Existing credit evaluation process is not adequate and focused and staff handling the task is not endowed with much needed skills and expertise. It is therefore, imperative to bring about radical change and a lasting solution to the problem of NPAs can be achieved only by adopting crystal clear policy guidelines in respect of credit appraisal with minute, proper assessment of credit and risk management mechanism along with credit rating of the potential borrower. Based on relevant financial statements with minute scientific investigated appraisal and physical checking of stocks, in this regard the bank must develop suitable and relevant model to assess health and repaying capacity of the credit applicants along with their own risk-rating system to assess the risk of lending. The loan review mechanism is to be adopted as a relevant tool to bring about improvements in the credit administration. Every limit of sanction must have committee to assess the basic formal status.

Exchange of credit information among banks should be developed in positive way to avoid possible NPAs. Branch level measures have to be kept in mind while developing suitable policy guidelines for approval and monitoring. The banking system should be coordinated in such a manner that a defaulter at one place is recognized as a defaulter by the entire system. In view of ineffective, dormant and crawling legal and judicial system bank should adopt strategic compromising time-value of money approach as method of settlement of overdue accounts lying in the Indian courts of low. In general interest income cannot be booked on any assets that have become a NPA, thus required provisioning, further affecting profits. In case of liquidity overhang, the enthusiasm and movement of the banking system to promote lending may compromise on sound asset quality, raising concern about their adverse selection and potential danger of addition to the stock of NPAs. Thus for smooth survival banks must conduct special and compulsory audit on regular basis to avoid chances of borrowers doctoring their accounts to produce negative net worth and seek registration with BIFR so as to avoid / delay legal action. In the era of globalization and prevailing situation it became important that the banking system have to be upgraded and to be equipped with prudential norms to minimize and control if not completely to avoid the problem of NPAs. For speedy recovery of dues and maintenance of effective and robust portfolio, the existing structure deserves to be revamped to make lean, flat, systematic and responsive, equipped with professional staff possessing required negotiating skills, experiences and aptitudes. Study revealed that banks themselves are responsible for containing the factors leading to NPAs. This will necessitates honest organizational restructuring, Qualitative improvement in overall managerial efficiency and skill, technical and lawful up gradation for proper assessment of credit worthiness. It is better to prevent rather than cure, thus have to avoid NPAs at the nascent stage of credit consideration by putting in place of rigorous and appropriate credit appraisal mechanisms. With growing possibilities of NPAs in banking industry, assuming high proportion of total assets requires powerful, efficient, effective and relevant authorities for preventing mounting NPAs to avoid reduction of profitability and liquidity. Bad debts should not be written off it is recoverable by banks. At the outset NPAs are considered to be gloomy as well as greedy to the Indian economy. The study revealed that GOI has already taken number of initiatives in this direction. After economic and structural reforms, to the Indian credit market by empowering financial institutions to recover NPAs there has been substantial decline in level of NPAs in Indian banking system. Though one time settlement scheme, DRTs, CIBIL, and SARFAESI Act 2002 has proven effective tool in solving the problem of NPAs, but lot more have to be done in this regard. Suitable amendments in the Act/Rules should be made to earliest. DRATs can positively function if they have adequate infrastructure and manpower support. Society, government machinery has to be rational and have to realize nation’s development not their personal benefits and gain. For betterment of banking industry there is a need of recapitalization of banks with government aid, positive disposal and writes off of NPAs and increased regulation. All internal arrangements will have to support externally by a proper legal framework where under quick action against a defaulting borrower could be taken. Honesty with cooperation, coordination, and dedication, effective implementation of relevant rules, regulation, speedy courts and Nobel vision can help in controlling NPAs.

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