CHAPTER - I

INTRODUCTION

A country’s development can be achieved only through economic growth which is dependent on the prevailing financial system. The role played by the adopted ‘Financial System’ is crucial and it intermediates between the flow of funds belonging to those who save a part of their income and those who invest in productive assets. The major function of the financial system is provision of money and monetary assets for the production of goods and services\(^1\). A strong financial system is crucial to fulfill the objective of strengthening the real economy and for its healthy and orderly growth.

Financial system is a complex, well-integrated set of sub-systems of Financial Institutions, Markets, Instruments and Services which facilitates the transfer and allocation of funds, efficiently and effectively. The formal financial system consists of four segments or components namely – (1) Financial Institutions, (2) Financial Markets, (3) Financial Instruments and (4) Financial Services. These constitute the financial system and act as a conduit for the transfer of financial resources from net savers to net borrowers i.e. from those who spend less than they earn to those who earn more than they spend.

Financial Institutions are intermediaries that mobilize savings and facilitate the allocation of funds from surplus units to deficit unit in an efficient manner. Good financial institutions are vital to the functioning of an economy. If finance were to be described as the articulatory systems of the economy, financial institutions are its brain. They make decisions that tell scarce capital where to go and ensure that it is used most efficiently. The process of financial intermediaries support increasing the capital accumulation though the institutionalization of savings and investment and as such, fosters economic growth. The gains to the real sector of the economy therefore depend on how effectively the financial sector performs this basic function of financial intermediation.

The major function of the financial system is the provision of money and monetary facilities for the production of goods and services. Efficient and sound financial system of a country plays an important role in nation’s economic development\(^2\). The financial system performs the basic economic function of intermediation essentially through the following four transformation mechanisms:

- Liability-asset transformation i.e. accepting deposits as a liability and converting them into assets such as loans.
- Size transformation i.e. providing large loans on the basis of assorted large medium and small deposits.

- Maturity transformation i.e. offering savers deposits according to their liability preferences while providing borrowers with loans of required maturities and

- Risk transformation i.e. distributing risks through diversification which substantially reduces risks for savers, which would prevail while lending directly in the absence of financial intermediaries.

The financial systems of most developing countries are characterized by co-existence and co-operation between the formal and informal financial sectors. The Indian financial system can also be broadly classified into formal (organized) financial system and informal (unorganized) financial system.

In India, the financial sector comprises of banking and non-banking financial institutions. Banking institutions simply accept the long term deposits from the public and then lend to the borrowing community. Banking institutions are creators and purveyors of credit. While the liabilities of banks are part of the money supply, this may not be true of non-banking financial institutions. There is no hard and fast rule to distinguish between banking and non-banking institutions.

The banking system is the heart of the financial system. The Indian financial system comprises of a large number of commercial and cooperative banks and specialized developmental banks for industry, agriculture, external trade and housing, social security institutions, collective investment institutions, etc.
A developing country faces many problems like poverty, scarcity of capital, lack of entrepreneurship, etc. There is a high dependence on agriculture and at the same time agriculture is not modernized and the means of transport is underdeveloped. There are inter-regional and inter-sectoral disparities. There is also unequal distribution of wealth.

Banks play a very useful and dynamic role in the economic life of every modern state. They are important constituents of the money market and their demand deposits serve as money in the modern community. Banks can work as catalytic agents of growth by following the right kind of policies in their working, depending upon the socio-economic conditions prevailing in a country. It is realized that since banks have the required investment potentiality, they can make a significant contribution in eradicating poverty, unemployment and they can bring about progressive reduction in inter-regional, inter-state and inter-sectoral disparities through rapid expansion of banking services.

Banking system is also referred to as a system provided by the bank which offers cash management services for customers, reporting the transactions of their accounts and portfolios throughout the day. The banking system in India should not only be hassle free but also be able to meet the new challenges posed by the technology and any other external and internal factors. For the past three decades, India’s banking system has had several outstanding achievements to its credit. The

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Banks are the main participants of the financial system in India. Although deregulation and liberalization in the banking sector have resulted in enhanced efficiency and systematic resilience, they have also raised legitimate concerns with regard to the quality of customer services provided by banks\(^4\). The Banking sector offers several facilities and opportunities to their customers. All the banks safeguard the money and valuables and provide loans, credit and payment services, such as checking accounts, money orders and cashier’s cheques. The banks also offer investment and insurance products. As a variety of models for cooperation and integration among finance industries have emerged, some of the traditional distinctions between banks, insurance companies and securities firms have diminished. In spite of these changes, banks continue to maintain and perform their primary role - accepting deposits and lending funds from these deposits.

Commercial banks have come to play a significant role in the development of countries. The two basic functions of commercial banks are: mobilization of the savings of the people and disbursement of credit according to direction. The world over, banking system is the focal point in the financial set-up of any developing country. In India too economic development has evolved around the banking system\(^5\).

1.1 NEED FOR THE BANKS

Before the establishment of banks, the financial activities were handled by money lenders and individuals. At that time the interest rates were very high. The interest rate charged by them is higher than the interest charged by other banking institutions. Again there was no security of public savings and no uniformity regarding loans. So as to overcome such problems the organized banking sector was established, which was fully regulated by the government. The organized banking sector works within the financial system to provide loans, accept deposits and provide other services to their customers. While banks play a critical role in financial intermediation and in the creation of money, banking’s primary focus is the satisfaction of customers’ needs. The following functions of the bank explain the need of the bank and its importance:

- To provide the security to the savings of customers.
- To control the supply of money and credit.
- To encourage public confidence in the working of the financial system, increase savings speedily and efficiently.
- To avoid focus of financial powers in the hands of a few individuals and institutions.
- To set equal norms and conditions (i.e. rate of interest, period of lending etc) to all types of customers.

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1.2 A BRIEF HISTORY OF INDIAN BANKING SYSTEM

The first bank in India, called The General Bank of India was established in the year 1786. The East India Company established The Bank of Bengal/Calcutta (1809), Bank of Bombay (1840) and Bank of Madras (1843). The next bank was Bank of Hindustan which was established in 1870. These three individual units (Bank of Calcutta, Bank of Bombay, and Bank of Madras) were called as Presidency Banks. Allahabad Bank which was established in 1865 was for the first time completely run by Indians. Punjab National Bank Ltd. was set up in 1894 with head quarters at Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. In 1921, all presidency banks were amalgamated to 22 from the Imperial Bank of India which was run by European Shareholders. After that the Reserve Bank of India was established in April 1935.

At the time of first phase, the growth of banking sector was very slow. Between 1913 and 1948 there were approximately 1100 small banks in India. To streamline the functioning and activities of commercial banks, the Government of India came up with the Banking Companies Act, 1949 which was later changed to Banking Regulation Act 1949 as per amending Act of 1965 (Act No.23 of 1965). Reserve Bank of India was vested with extensive powers for the supervision of banking in India as a Central Banking Authority.
After independence, Government has taken most important steps in regard of Indian Banking Sector reforms. In 1955, the Imperial Bank of India was nationalized and was given the name “State Bank of India” to act as the principal agent of RBI and to handle banking transactions all over the country. It was established under State Bank of India Act, 1955. Seven banks forming subsidiary of State Bank of India was nationalized in 1960. On 19th July, 1969, major process of nationalization was carried out. At the same time 14 major Indian commercial banks of the country were nationalized. In 1980, another six banks were nationalized, and thus raising the number of nationalized banks to 20. Seven more banks were nationalized with deposits over 200 Crores. Till the year 1980 approximately 80 percent of the banking segment in India was under Government’s ownership. On the suggestions of Narsimhan Committee, the Banking Regulation Act was amended in 1993 and thus the gates for the new private sector banks were opened. Bank is not only playing the role of money lender but also leader of economic development.

The following are the major steps taken by the Government of India to Regulate Banking institutions in the country:

1949 : Enactment of Banking Regulation Act.

1955 : Nationalization of State Bank of India.

1959 : Nationalization of SBI subsidiaries.

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1961 : Insurance cover extended to deposits.
1969 : Nationalisation of 14 major Banks.
1971 : Creation of credit guarantee corporation.
1975 : Creation of regional rural banks.
1980 : Nationalisation of seven banks with deposits over 200 Crores.

1.3 BANKING SYSTEM IN INDIA

Indian banking industry has been divided into two parts, organized and unorganized sectors. The organized sector consists of Reserve Bank of India, Commercial Banks and Co-operative Banks and Specialized Financial Institutions (IDBI, ICICI, IFC etc). The unorganized sector, which is not homogeneous, is largely made up of money lenders and indigenous bankers. An outline of the Indian Banking structure may be presented as below:

1. Reserve banks of India.
2. Indian Scheduled Commercial Banks.
   a) State Bank of India and its associate banks.
   b) Twenty nationalized banks.
   c) Regional rural banks.
   d) Other scheduled commercial banks.
3. Foreign Banks.
5. Co-operative banks.
1.4 RESERVE BANK OF INDIA

The Indian banking system has the Reserve Bank of India (RBI) at the apex. It is the nerve centre of the Indian monetary system. The Reserve Bank of India is a central bank and was established in 1st April, 1935 in accordance with the provisions of Reserve Bank of India act 1934. The central office of RBI is located at Mumbai since inception. Though originally the Reserve Bank of India was privately owned, since nationalization in 1949, RBI is fully owned by the Government of India.

RBI is governed by a central board (headed by a governor) appointed by the central Government of India. RBI has 22 regional offices across India. The reserve bank of India was nationalized in the year 1949. The general superintendence and direction of the bank is entrusted to central board of directors of 20 members, the Governor and four deputy Governors, one Governmental official from the ministry of Finance, ten nominated directors by the Government to give representation to important elements in the economic life of the country and the four nominated directors by the Central Government to represent the four local boards with the headquarters at Mumbai, Kolkata, Chennai and New Delhi. Local Board consists of five members each appointed by Central Government for a term of four years to represent territorial and economic interests and the interests of cooperative and indigenous banks.

The bank was constituted for the need of following:
- To regulate the issues of banknotes.
- To maintain reserves with a view to securing monetary stability.
- To operate the credit and currency system of the country to its advantage.

With economic growth assuming a new urgency since independence, the range of the Reserve Bank’s functions has steadily widened. It could also have supervisory powers, to ensure that banks and other financial institutions do not behave recklessly or fraudulently\(^8\). The bank now performs a variety of developmental and promotional functions, which, at one time, were regarded as outside the normal scope of central banking. The RBI’s broad approach to financial inclusion has been aimed at ‘connecting people with the banking system and enabling them to access the payment system at not higher dispensations’. The Reserve bank was asked to promote banking habit, extend banking facilities to rural and semi-urban areas and establish and promote new specialized financing agencies.

### 1.5 SCHEDULED COMMERCIAL BANKS

The commercial banking structure in India consists of scheduled commercial banks and unscheduled banks.

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Scheduled Banks in India constitute those banks which have been included in the second schedule of RBI act 1934. RBI in turn includes only those banks in this schedule which satisfy the criteria laid down vide section 42(6a) of the Act. “Scheduled banks in India” means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (subsidiary banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under section 3 of the Banking companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980) or any other bank being a bank included in the Second Schedule to the Reserve bank of India Act, 1934 (2 of 1934), but does not include a co-operative bank”. For the purpose of assessment of performance of banks, the Reserve Bank of India categorises the banks as public sector banks, old private sector banks, new private sector banks and foreign banks, i.e. private sector, public sector, and foreign banks come under the umbrella of scheduled commercial banks. “Unscheduled Bank in India” means a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949), which is not a scheduled bank”.

The following are the Scheduled Commercial Banks in India (Public Sector):

1. Allahabad Bank
2. Andhra Bank
3. Bank of Baroda
4. Bank of India
5. Bank of Maharashtra
6. Canara Bank
7. Central Bank of India
8. Corporation Bank
9. Dena Bank
10. Indian Bank
11. Indian Overseas Bank
12. Oriental Bank of Commerce
13. Punjab and Sindh Bank
14. Punjab National Bank
15. Syndicate Bank
16. UCO Bank
17. Union Bank of India
18. United Bank of India
19. Vijaya Bank
20. State Bank of India
21. State Bank of Bikaner & Jaipur
22. State Bank of Hyderabad
23. State Bank of Indore
24. State Bank of Mysore
25. State Bank of Patiala
26. State Bank of Sourashtra
27. State Bank of Travancore

The following are the Scheduled Commercial Banks in India (Private Sector):

1. Bank of Rajasthan Limited
2. Bank of Madura Ltd.
3. Bharat Overseas Bank Ltd.
4. Bareilly Corporation Bank Ltd.
5. Catholic Syrian Bank Limited
6. City Union Bank Limited
7. Dhanalakshmi Bank Limited
8. The Banaras State Bank Ltd
9. The Federal Bank Limited
10. Ganesh Bank of Kurundwad Limited
11. ING Vysya Bank Limited
13. Karnataka Bank Limited
14. Karur Vysya Bank Limited
15. Lakshmi Vilas Bank Limited
16. Lord Krishna Bank Limited
17. Nainital Bank Limited
18. Ratnakar Bank Limited
19. Sangli Bank Limited
20. SBI Commercial and International Bank Ltd
21. South Indian Bank Limited
22. Tamilnad Mercantile Bank Limited
23. United Western Bank Ltd
24. The Nedungadi Bank Ltd
25. Development Credit Bank Limited

The following are the Scheduled Commercial Banks in India (Foreign):

1. ABN-Amro Bank N.V.
2. Abu-Dhabi Commercial Bank Ltd
3. American Express Bank, Ltd
4. ANZ Grindlays Bank Ltd
5. Arab Bangladesh Bank Ltd
6. Bank International Indonesia
7. Bank of America NT & SA
8. Bank of Bahrain and Kuwiat BSC
9. Bank of Ceylon
10. Banque Nationale Deparis / BNP Paribas
11. Barclays Bank PLC
12. Chase Manhatton Bank
13. Chinazrust Commercial Bank
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<td>14</td>
<td>Chohung Bank</td>
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<td>15</td>
<td>Citibank NA</td>
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<td>16</td>
<td>Commercial Bank of Korea Ltd.</td>
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<td>17</td>
<td>Commerz Bank A.G.</td>
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<td>Credit Agrcole Indosuez/Calyon Bank</td>
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<td>Dredner Bank A.G.</td>
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<td>Fuji Bank Ltd./ Mizuholorgation Bank Ltd.</td>
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<td>Hong Kong Bank / HSBC Ltd.</td>
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<td>Mashreq Bank PSC</td>
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<td>28</td>
<td>Oman International Bank SAOG</td>
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<td>29</td>
<td>Over-Sea Chinese Banking Corporation Limited</td>
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<td>Societe General</td>
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<td>State Bank of Mauritius Ltd.</td>
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35. Sumitomo Bank Ltd.
36. The Bank of Nova Scotia
37. The Bank of Tokyo-Mitsubishi UFJ LTD
38. The British Bank of Middle East
39. The Development Bank of Singapore Ltd. / DBS Bank
40. The Sakura Bank Ltd.
41. The Sanwa Bank Ltd. / UFJ Bank Limited
42. Toronto-Domonion Bank
43. Bank Museat International SAOG
44. Morgan Guaranty Trust Co., of New York
45. K.B.C. Bank N.V.
46. Antwerp Diamond Bank N.V.
47. Shinhan Bank

Since inception, the RBI has been guiding, monitoring, regulating, controlling and promoting the destiny of the financial system in India. The commercial banks help the economic development of a country by faithfully following the monetary policy of the central bank i.e. RBI. They represent the focal point of monetary policy of the central bank. In fact, the central bank depends upon the commercial banks for the success of its monetary policy in keeping with the requirements of a developing economy.
The banking system is an integral part of the financial sector of our country. India has a long and cheque red history of financial intermediation, particularly Commercial Banking. At the beginning of the 20th Century, India had insurance companies, (both life and general) and a functional stock exchange. Even before the setting up of the Reserve Bank of India in 1935, the country had market for money, Government securities and foreign exchange. The financial system was, however, characterized by paucity of funds and instruments, limited number of players and lack of depth and openness. It was primarily a back based system.

1.6 ROLE OF BANKS IN INDIAN ECONOMY

Banking is an important segment of the tertiary sector and acts as a backbone of economic progress. Banks play a very useful and dynamic role in the economic life of every modern state. They are important constituents of the money market and their demand deposits serve as money in the modern community\(^9\). The banks render vital services to the masses belonging to the various sectors of the economy like Agriculture, industry whether small scale large scale\(^10\).

The Indian financial sector has considerably widened and depends there by on lending strong support to capital accumulation and overall economic growth. And the commercial banks in India constitute the single most important

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component of the Indian Financial System in bringing about the financial intermediation process in India. Within the banking institutions, the role of commercial banks has occupied a new meaning and significance, in view of the changing structure and requirements of a developing economy. The increasing horizon of commercial banks identifies itself with the problems and responsibilities for making banking an instrument for bringing about social and economic transformation of a developing country, Social responsibilities have undergone far-reaching changes. Banks have become the prime movers and pace setters for the achievement of socio-economic objectives of the country. The operations of commercial banks record the economic pulse of economy of almost all countries big or small, rich or poor, socialist or capitalist and they are faced with the problem of regional disparities in economic development.

In modern economy, bankers are to be considered not merely as “dealers in money” but move realistically as the “lenders in development”. Similarly, banks are not just the storehouses of the country’s wealth but are the reservoirs of resources necessary for economic development. Banks are the purveyors of money and credit to the factors of production in every country and thus help in the acceleration of growth\(^\text{11}\). Banks are the pivot of modern commerce; industrial innovations and business expansions become possible through finance provided by banks. Economic Development needs an appropriate monetary policy. But a

well-defined banking is a necessary pre-condition for the effective implementation of the monetary policy\textsuperscript{12}. 

The commercial banks help the agricultural sector in a number of ways. They open a network of branches in rural areas to provide agricultural credit. They also finance agricultural sector for the modernization and mechanization of farms, for the marketing of their products, for providing irrigation facilities, for high yielding seeds and fertilizers\textsuperscript{13}.

The industrial sector is also not away from the help of the commercial banks. They finance the industrial sector in many ways. They provide short term, medium term and long term loans to industry, to secure labour and other factors of production\textsuperscript{14}. In this way, the commercial banks not only help in the industrialization process, but also have a say in the type of economic development which the community would like. This is so because banks prefer only those entrepreneurs whose products are in great demand by the public. In India, Commercial banks grant loans to small scale industries for expansion, modernization and renovation and also provide them with working finance. Besides industrial units, loans are also granted to technocrats, technologists, technicians and entrepreneurs to set-up small scale industrial units. Banks also give finance to promotion of industrial estates for purchase of land and

\begin{footnotesize}
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\item \textsuperscript{12} Somashekar N.T., “Banking”, New Age International, karnataka,2009, p.25
\item \textsuperscript{13} Sha S.G., “Agricultural Finance by Commercial Banks”, Vikas Publications, 1986, p.66.
\end{itemize}
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construction of sheds\textsuperscript{15}. Besides, they underwrite the shares and debentures of large scale industries.

The Commercial banks help in developing both internal and external trade of a country. The banks provide loans to retailers and wholesalers for their inventory. They also help in the movement of goods from one place to another, or between the countries, by providing all types of facilities such as discounting and accepting bills of exchange, providing overdraft facilities, issuing drafts, etc. Moreover, they finance both exports and imports of developing countries, by providing foreign exchange facilities for export of goods. In India, financing of exports by commercial banks have been given top priority. Commercial Banks have refinance facilities against loans granted to this sector. Besides, in order to make available credit at a cheaper rate to this sector, the Reserve bank of India has fixed ceiling on interest rates to be changed from exporters\textsuperscript{16}.

The commercial banks advance credit for the development of employment generating activities in developing countries. They provide loans for the education of young persons studying in Engineering, Medical and other Vocational institutions of higher learning. They advance loans to young entrepreneurs, medical and engineering graduates and other technically trained persons in


establishing their own business. Such loan facilities are provided by a number of Commercial banks in India through various schemes implemented by the Government of India. Thus, the banks not only help in human capital formation but also in increasing entrepreneurial activities in developing countries.

Commercial Banks also facilitate the activation of the Government motive and force for economic development by providing help in arranging finance to the Government through various methods like: direct credit to the Government undertakings and through subscribing public debt and investing money in various Government securities. This process of credit supply enables the Government to implement various schemes of development. The Commercial Banks may also help the Planning Commission to achieve its targets through their coordinated working with the commission by providing credit to the needy in the country side. They help in the balancing of economic development, thereby decentralizing it. Their working also indirectly helps the Government to solve many problems of development, like: shortage of savings, rising prices, unemployment, unbalanced economic development, lack of entrepreneurship etc. The Commercial Banks help the economic development of a country by faithfully following the monetary policy of the Central Bank. They represent the focal point of monetary policy of the Central Bank. In fact, the Central Bank depends upon the Commercial Banks for the success of its monetary policy in tune with the requirements of a developing economy.
Thus, banking is a basic industry, which not only caters to the development of a trade, commerce and industry, but also helps in removing many obstacles in the way of economic development.

1.7 NON PERFORMING ASSETS (NPAs)

Authentic history of banking tells that it deals with lending and collection of money. However, it followed the basic law of demand and supply where persons having excess money lent to persons who needed it for more productive purposes and were willing to pay a price for this. The operations were limited to the money lender knowing every person he lent money to.

Proper regulation and organization of these activities was necessitated, over a period of time, as the operations began to grow because of increase in the number of clients. Gradually, simple banking transformed itself into commercial banking and the commercial banking itself has undergone numerous changes all over the world, during the last five decades. In the regard, India is not an exception and in fact, the changes that have taken place in India have been far more significant and much more radical in some regards, than elsewhere in the world.

The concept of Non-Performing Assets (NPAs) was introduced for the first time in the Narasimham Committee on “Financial System Reforms” that was tabled in Parliament on December 17th, 1991. The Committee studied the prevailing financial system, identified its short comings and weaknesses and made
with ranging suggestions and recommendations in line with internationally accepted norms. Based on the recommendations of the Committee on “Financial System Reforms”, the RBI evolved prudential norms on Income recognition, Asset classification and Provisioning and issued revised instructions to banks in April 1992. While conveying non-performing category and their anxiety to present rosy picture of their affairs the above instructions to banks also advised them that as per practice followed internationally, income on NPAs is not to be recognized on accrual basis but is to be looked only when it is actually realized because an asset becomes non-performing when it ceases to generate income. The above instructions of RBI have since been implemented by banks from the financial year ended March 1998.

The problem of NPAs is linked to the function of lending money. The lending of money collected from the public, for interest, instead of one’s own money, was the beginning of banking. Though the present day banking does not restrict itself to traditional deposit collection and money lending, encompassing a wide sphere of financial activity, lending still remains the prime activity connected with banking. Most credit needs of the society, for carrying, commercial activities are fulfilled by the banks. The conventional credit from the banking system to the Commercial sector comprises bank loans and advances in the form of term loans, demand loans, cash credit, overdrafts, inland and foreign bills purchased and discounted as well as investments in instruments issued by non-government sector.
Non-performing assets (NPAs) constitute integral part of banks' operations. A bank gives out money upfront and earns income over a time on the promise of a borrower to repay. When loans are not repaid, the bank loses both its income stream, as well as its capital. Lending is always accompanied by the credit risk arising out of the borrower’s default in repaying the money\textsuperscript{17}. The level of non-performing loans is recognized as a critical indicator for assessing banks' credit risk, asset quality and efficiency in allocation of resources to productive sectors. The most calamitous problem facing commercial banks all over the world in recent times is spiraling non-performing assets which are affecting their viability and solvency and thus posing challenge to their ultimate survival. So the problem of NPAs should be nipped in the bud. It is possible only if the check is placed on NPAs from the very beginning.

The major cause for the NPA can be attributed to:

- Improper selection of borrower’s activities
- Weak credit appraisal system
- Industrial problem
- Inefficiency in management of borrower
- Slackness in credit management & monitoring
- Lack of proper follow up by bank
- Recession in the market
- Due to natural calamities and other uncertainties

Banks are ultimately made to finance the losses incurred by constituent industries and businesses. The lack of preparedness and structural weakness of our banking system led to the emerging scenario and trying to switch over to globalization were only aggravating the crisis. The major reason for this situation was that the threat of NPAs was being surveyed and summarized by Reserve Bank of India (RBI) and Government of India with a bird’s eye-view of the banking industry, independent from the rest of the economy.

1.8 SIGNIFICANCE OF THE PRESENT STUDY

There are diversities among banks based on ownership, as among the 28 Public Sector Banks (including IDBI Bank Limited), themselves, between different geographical regions and between different customers using banks credit. Similarly, NPAs concerns of individual banks summarized as a whole and expressed as a mathematical average for the entire bank cannot convey a dependable picture.

NPAs adversely affect lending activity of banks as non-recovery of loan installments as also interest on the loan portfolio negates the effectiveness of credit-dispensation process. Non-recovery of loans also hurts the profitability of banks. Besides, banks with high level of NPAs have to carry more owned 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 realization unlike interest on performing assets which is taken into account on accrual basis; two, banks have to make provisions on NPAs from out of the income earned by them on performing assets.

Persistently high level of NPAs in loan portfolio of banks makes them fragile, leading ultimately to their failure. This will shake the confidence both of domestic and global investors in the banking system which will have multiplier effect, bringing disaster in the economy. Thus, the most critical condition for bringing about an improvement in the profitability of banks is reduction in the level of NPAs. In fact, it is a pre-condition for the stability of the financial system. The NPA concept presently in vogue was introduced by RBI for implementing in the banks, in the year 1993 based on the recommendations of the committee on the financial system, in line with internationally accepted norms.

With the implementation of the revised norms on asset classification, income recognition and provisioning on NPA’s in the 1993 while are well defined with little scope for different interpretations, many banks went into the red in the first year. Further, the remaining few which had shown marginal profits were also not quite sure as to whether they could be able to sustain the profits in the years to come. Naturally, such a situation shocked not only the banks but also those connected with the banking industry.
In India, the magnitude of the problem of bad debts was first realized only in early 90s, subsequently, following the recommendations of Narasimhan Committee (1991, 1998) and Verma Committee (1999), some steps have been taken to solve the problem of old NPAs. Though concern regarding the reduction of NPAs in the balance sheets of the banks, particularly Public Sector Banks (PSBs) continues to be expressed from every corner, there has hardly been any systematic evaluation of the best way of tackling the problem. There seems to be no unanimity in the proper policies to be followed in resolving this problem. There is also no consistency in the application of NPA norms, ever since these have been recognized.

Today the Indian banking system has undergone significant transformation following financial sector reforms, adopting international best practices. Several prudential, payment, integrating and provisioning norms have been introduced, and these are pressurizing banks to improve efficiency and trim down NPAs to improve the financial health of the banking system. It is among the best in the world because Indian banks are favorable on growth, asset quality and profitability; RBI and Government have made some notable changes in policies and regulations to strengthen the sector. NPA involves the necessity of provisions, any increase in which brings down the overall profitability of banks and it is the indicator of banking health in a country.
It is always important to have periodical assessment in order to have an idea of the impact of different measures designed and implemented for improving the situation. Such evaluation helps in better planning or in improvising the existing mechanisms. Since the nature and magnitude of the problem of NPAs is likely to differ in different types of banks, uniform measures or interventions may not yield expected or same results. Hence, it sometimes necessitates the specific remedies in different situations. This can be done only through periodical study of the problem in different types of banks.

Many such studies have been taken up so far on the management of NPAs. However, the main focus was laid only on identifying causes of NPA’s and extending suggestions in the form of some measures to be taken at micro level, that too specific to some individual banks. Therefore, there is every need to conduct a study on management of NPA’s of Schedule Commercial Banks in both Public and Private Sectors.

In this background, the present study has been attempted to make a comparative study of Public sector and Private sector commercial banks with regard to their NPA situation and management in terms of the operational performance of four banks, two each selected from Public and Private Sectors.

1.9 OBJECTIVES OF THE STUDY

The present study has been taken up with the following objectives:
1. To understand the performance of the public and private sector banks during the last decade.

2. To make a comparative study of the magnitude and dimensions of NPA’s in the Public and private sector banks.

3. To examine the causes for incidence and trends of NPA’s in the public and private sector banks.

4. To examine the recovery measures and strategies followed for reducing the burden of NPAs by the public and private sector banks and

5. To make suitable suggestions for the public and private sector banks to effectively handle the challenge posed by the NPAs.

1.10 HYPOTHESES

1. The financial health and credibility of Banks is not similar in Public and Private sectors.

2. There has been a steady improvement in the management of NPA’s in Banks with considerable variation between the public and private sector banks.

3. The recovery measures are better followed in private sector banks when compared to the public sector banks.

1.11 STUDY DESIGN

The present study is designed to be a narrative study with appropriate analytical discussions presented in tune with the proposed objectives. For the
present purpose, two banks from public sector and two from the private sector have been selected purely considering the bank’s profitability based on the recent performance figures of the banks. In each sector, one bank from the high performing group and the other from the low performing group has been picked up on random basis. Accordingly, State Bank of India and Canara Bank from the public sector, while HDFC Bank and Karur Vysya Bank from the private sector have been selected and performance figures of these four banks have been used for the comparative analysis.

1.12 DATA BASE

The data used in the present analysis is confined to the past one decade (11 years to be exact) from 2001-2002 to 2011-2012. With regard to the study, comparable financial performance of the selected public and private sector banks and data pertaining to the 11 year reference period (2001-2002 to 2011-2012) for analyzing the NPA’s has been considered.

1.13 METHODOLOGY

Collection of required information from secondary sources and primary sources on views and opinions of a sample group of managers and borrowers through formal interviews using structured questionnaires and also through non-formal interviews are the two major components of the methodology adopted in the present study. The data and the information were collected through primary
sources was with an intention to have an opinion polling from the bank officials against the secondary data and the information.


The secondary data were also collected from IBA publications – IBA Bulletin (Monthly) IBA Indian Banking year books, Special Annual Issues and IBA publications on:

- Performance highlights of Public Sector Banks and
- Performance highlights of Private Sector Banks.
Secondary data were also collected from different journals on banking, Economics and Finance; Database of Indian Economy Financial Express, Publications and Websites of Industry Associations (IBA, CII and ASSOCHAM); Publications of Bank Management Institutes (NIBM, IIBF) Annual Reports of Ministry of Finance (Government of India), Publications of World Bank (IBRD); Asian Development Bank (ADB) and Board for International Settlement (BIS).

The primary data comprises of the information elicited through formal and informal interviews with the managers and officials on random cum convenience sample basis from Visakhapatnam city in Andhra Pradesh. The respondents are from the four selected banks of public and private sectors.

Data thus obtained has been analysed in tune with the set objectives of the study bringing out comparison between the public and private sector banks on different parameters. The observations were tabulated to facilitate easy understanding and were supplemented with appropriate graphical presentations. Banks group-wise (all public sector and all private sector) and Bank – wise comparison (between SBI, Canara, HDFC Bank and Karur Vysya banks) has been made to examine the difference existing between them using percentages and other relevant statistics.
1.14 ANALYSIS OF DATA

The data obtained has been analyzed using appropriate statistical measures/techniques like percentages, averages and financial ratios. While analyzing the incidence and trends of NPA’s, usual statistical techniques like percentages and ratios are used. ‘t – test’ and ‘F – test’ were used to determine the significance of difference in averages between public sector and private sector banks and among the four banks studied in the present study. Impact of the Gross NPAs (GNPA) and Net NPAs (NNPA) has been assessed basing on the Correlation Coefficient Values (r). The reference period is from 2001 to 2012 and we have data for these 11 years. Hence, no attempt is made to use regression analysis because of the small number of observations (N=11).

1.15 LIMITATIONS OF THE STUDY

1. Study of the causes and analysis of NPA’s is confined to Public and Private sector banks and the Foreign banks are not taken into consideration.

2. Since the analysis has been restricted to four banks, the inferences may not hold good hundred percent for other banks and also when looked at individual branch level.

3. The percentage and averages as tools of analysis lack absolute accuracy as they are adjusted to the nearest decimal points.
4. Preventive measures which are initiated by the select banks to reduce the NPAs are not available to the researcher, though the statistical figures relating to the same are published by RBI from time to time. At macro level the data is available but at micro level the data is not available.

5. The study considered the impact of NPAs on the exclusive parameter of financial performance of select banks.

1.16 ORGANIZATION OF THE THESIS

The present thesis has been organized in to Six Chapters including the present Chapter. Contents of each Chapter are outlined below:

**Chapter – I:** Presents a brief introduction about banking, need for banks, history of Indian banking, banking system in India, role of banks in Indian economy, NPAs, significance of the present study, objectives of the study, study design and methodology etc.

**Chapter – II:** Comprises of a review of past studies in the area of research i.e. management of NPAs.

**Chapter – III:** Profile of the Selected Banks
Chapter – IV: Presents a detailed account of the concept of NPAs, its impact on banking, remedial measures such as different reforms, different strategies and measures for recovery followed etc.

Chapter – V: Comprises the analysis of data and presentation of the observations. This Chapter is divided into four sections:

Section-1: Financial Performance of Banks during 2001-02 to 2011-12.
Section-2: Status of NPAs during 2001-02 to 2011-12.
Section-3: Management of NPAs.
Section-4: Opinion of the bank officials on NPAs and reaction of the staff in handling Non-performing assets.

Chapter – VI: Presents a summary of findings, conclusions and suggestions for better management of NPAs.