NPA MANAGEMENT IN STATE BANK GROUP

SYNOPSIS

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SYNOPSIS

INTRODUCTION

In the first half of the 19th century the East India Company established three banks; the Bank of Bengal in 1809, the Bank of Bombay in 1840 and the Bank of Madras in 1843. These three banks also known as Presidency Banks were independent units and functioned well.

These three banks were amalgamated in 1920 and a new bank, the Imperial Bank of India was established on 27th January 1921. With the passing of the State Bank of India Act in 1955, the undertaking of the Imperial Bank of India was taken over by the newly constituted State Bank of India.

The Reserve Bank which is the Central Bank was created in 1935 by passing Reserve Bank of India Act 1934. In the wake of the Swadeshi Movement, a number of banks with Indian management were established in the country namely, Punjab National Bank Ltd, Bank of India Ltd, Canara Bank Ltd, Indian Bank Ltd, the Bank of Baroda Ltd, the Central Bank of India Ltd.

On July 19, 1969, 14 major banks of the country were nationalized and in 15th April 1980 six more commercial private sector banks were also taken over by the government.

The two watershed events in the post independence phase are the nationalization of banks (1969) and the initiation of the economic reforms (1991).
The objectives of the banking sector reforms had focused to improve the macroeconomic policy framework within which banks operate, to introduce prudential norms, to improve the financial health and competitive position of banks, to build the financial infrastructure relating to supervision, audit technology and legal framework; and to improve the level of managerial competence and quality of human resources.

**STATEMENT OF THE PROBLEM**

Granting of credit for economic activities is the prime duty of banking. Apart from raising resources through fresh deposits, borrowings and recycling of funds received back from borrowers constitute a major part of funding credit dispensation activity. Lending is generally encouraged because it has the effect of funds being transferred from the system to productive purposes, which results into economic growth. However, lending also carries a risk called credit risk, which arises from the failure of borrower.

A strong banking sector is important for flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. Non-performing assets are one of the major concerns for banks in India.

NPAs reflect the performance of banks. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and net-worth of banks and also erodes the value of the asset. The NPA growth involves the necessity of provisions, which reduces the overall profits and shareholders value.

Non-recovery of loans along with interest forms a major hurdle in the process of credit cycle. Thus, these loan losses affect the banks’ profitability on a large scale. Non-performing Assets have emerged since over a decade as an alarming threat to the banking
industry in India sending distressing signals on the sustainability and endurability of the affected banks.

Despite various correctional steps administered to solve and end this problem, concrete results are eluding. It is a sweeping and all pervasive virus confronted universally on banking and financial institutions.

The main problem of the Public Sector Banks at the beginning of 2000 was the increasing level of the Non Performing Assets. The Non Performing Assets of the Public Sector Banks have been increasing regularly year by year. In 1997, the Non Performing Assets were 47,300 crore and it reached 80,246 crore in 2002.

The Non Performing Assets impact drastically to the working of the banks. The efficiency of a bank is not always reflected only by the size of its balance sheet but by the level of return on its assets. Non Performing Assets do not generate interest income for the banks, but at the same time banks are required to make provisions for such Non Performing Assets from their current profits.

A disheartening feature is that a large number of public sector banks have recorded far below the median Return on Assets of 0.4% for 2000-01 in their peer group. Incidentally, the Return on Assets recorded by new private banks and foreign banks ranged from 0.8% to 1% for the same period. An often quoted reason for the decline in profitability of public sector banks is the stock of NPAs which has become a drag on the bank’s profitability. It is to be noted that the stock of NPAs does not add to the income of the bank while at the same time, additional cost is incurred for keeping them on the books.
To help the public sector banks in clearing the old stock of chronic NPAs, RBI had announced ‘one-time non discretionary and non discriminatory compromise settlement schemes’ in 2000 and 2001. Though many banks tried to settle the old NPAs through this transparent route, the response was not to the extent anticipated as the banks had been bogged down by the usual fear psychosis of being averse to settling dues where security was available.

The magnitude of NPAs has a direct impact on banks profitability as legally they are not allowed to book income on such accounts and at the same time banks are forced to make provision on such assets as per the RBI guidelines. NPAs is an important parameter in the analysis of financial performance of banks.

Gross NPAs are important since they depress the overall yields on the banks' credit portfolio and constrain their ability to operate with lower margins and, in turn, their capacity to lower lending rates.

Loan-loss provisioning and write-offs go to reduce the capital available for further asset creation. Gross NPAs do not, however, disclose the entire picture of the over dues from borrowers. These exclude unpaid interest, including any penal interest, accrued on NPAs and, as a prudential measure, not recognized as income in the banks' financial statements.

A write-off of the NPA involves foregoing of the accrued interest. Hence, the magnitude of such interest dues assumes importance in assessing the likely losses a bank may suffer because of NPAs. Currently, this information is not required to be disclosed in banks’ financial statements.
The tightened RBI norms for reckoning assets as non-performing and for non-recognition of income from such assets (by reducing the minimum period of debt-servicing default from 180 days to 90 days), effective from the quarter ended March 2004, would presumably have resulted in significant additions to NPAs during the Financial Year 2004.

NPAs have a deleterious effect on the return on assets in several ways

- The interest income of banks will fall and it is to be accounted only on receipt basis.
- Banks’ profitability is affected adversely because of the providing of doubtful debts and consequent to writing it off as bad debts.
- Return On Investments (ROI) is reduced.
- The capital adequacy ratio is disturbed as NPAs are entering into its calculation.
- The cost of capital will go up.
- The assets - liability mismatch will widen.
- The Economic Value Addition (EVA) by banks gets upset because EVA is equal to the net operating profit minus cost of capital.
- NPAs require higher provisioning requirements affecting profits and accretion to capital funds and capacity to increase good quality risk assets in future, and
- They limit recycling of funds, set in asset-liability mismatches, etc.

Though RBI has taken number of measures to reduce the level NPAs the result is not up to the expectations.
The high level of NPAs in banks is a matter of grave concern to the public as well as to government since the bank credit is a catalyst to the economic development of the country and any bottleneck in the smooth flow of credit due to the mounting NPAs is bound to create an adverse repercussion for the economy of the country.

In this context, a study on Non-Performing Assets in banks, particularly State Bank Group, is an interesting and useful proposition and hence the present study is envisaged.

OBJECTIVES OF THE STUDY

The present research work entitled “NPA MANAGEMENT IN STATE BANK GROUP” has been done with the following objectives:

1. To present the profile of State Bank of India and its associates with reference to which the present study is made
2. To understand the basic concept of Non Performing Assets, classification of assets, norms for provisions for NPAs and treatment of NPAs of banks in India
3. To study the various mechanisms evolved by Reserve Bank of India to contain Non Performing Assets levels of banks in India
4. To examine the financial performance in relation to NPAs of State Bank Group during the study period and
5. To analyze the Non Performing Assets in State Bank Group
RESEARCH METHODOLOGY

The present research work entitled “NPA MANAGEMENT IN STATE BANK GROUP” is entirely based on secondary data. The secondary data for the study has been collected from the documents of State Bank Group and Reserve Bank of India as available from their respective web sites. Besides, the data has been collated from standard text books of related topic, business dailies and magazines as available online.

In India, there are twenty nationalized banks (including IDBI Bank), State Bank of India and its six subsidiaries under the category of Public Sector Banks as on 31st March 2009. In addition, there are fifteen old Private Sector Banks and seven New Private Sector Banks and 31 Foreign Banks in India as on this date.

The present research work is in the nature of an Analytical Case study. The State Bank Group is considered for this study.

The State Bank of India constituted on 1 July 1955 by passing an Act in parliament in May 1955 and seven former State-associated banks which were taken over by passing the State Bank of India (Subsidiary Banks) Act, 1959 constitute the State Bank Group. Thus, the present study is with reference to the State Bank Group comprising State Bank of India, State Bank of Saurashtra, State Bank of Bikaner and Jaipur (SBBJ), State Bank of Hyderabad (SBH), State Bank of Indore (SBIr), State Bank of Mysore (SBM), State Bank of Patiala (SBP), and State Bank of Travancore (SBT).

State bank of India is the largest banking company in India, by almost every parameter - revenues, profits, assets, market capitalization etc. The State Bank Group,
with over 16000 branches, provides a wide range of banking products through its vast network in India and overseas, including products aimed at Non Resident Indians.

The total deposits of the State Bank group as on 31\textsuperscript{st} March 2001 were Rs.312118.45 crore. It is about 30\% of the total deposits of the entire banking system and about 36\% of the total deposits of the Public Sector Banks.

The total advances of the State Bank group as on 31\textsuperscript{st} March 2001 were Rs.150387.82 crore. It is about 29\% of the total advances of the entire banking system and about 36\% of the total advances of the Public Sector Banks.

The gross NPAs of the State Bank group as on 31\textsuperscript{st} March 2001 were Rs.20593 crore. It is about 32\% of the gross NPAs of the entire banking system and about 34\% of the gross NPAs of the Public Sector Banks.

The State Bank group commands about 30\% of the total business of the banking system and is fit for a case study of it, the findings of which could be applicable to the banking industry as a whole.

The study period for the present research work was a nine year period between 31\textsuperscript{st} March 2000 and 31\textsuperscript{st} March 2009.

The data relating to the key parameters to evaluate the NPA management in State Bank Group – Deposits, Borrowings, Advances, Total Assets, Operating Profit, Net Profit, Spread, Total Income, Total Expense, Operating Expense, Gross NPA, classification of Gross NPA, Net NPA, Gross NPAs to Total Assets, Net NPAs to Total Assets, Gross NPAs to Gross Advances, Net NPAs to Net Advances, and Sector wise NPAs have been gathered for the study period from the web sites.
LIMITATIONS OF THE STUDY

The present study is with reference to State Bank Group, the biggest bank group among Public Sector Banks. The status of the NPAs may vary in respect of the Private Sector Banks, Co-operative Banks, or Foreign Banks as they differ in their business reach.

CHAPTER CLASSIFICATION

The present study entitled “NPA MANAGEMENT IN STATE BANK GROUP” is inter-twined into seven Chapters.

This Chapter I, “INTRODUCTION”, starts with the origin and growth of the banking industry in India. It describes the post-liberalization banking sector reforms in India. This Chapter also presents the relevant review of literature, statement of the problem, objectives of the study, research methodology, limitations of the study, and the chapter classification.

Chapter II, “PROFILE”, presents the evolution of SBI and its growth in terms of branches, and ATM services. It also provides the salient features of the business activities of the SBI Group. It also provides a SWOT analysis of the SBI Group.

Chapter III, “NON-PERFORMING ASSETS – THE BASICS” throws light on the concept and classification of Non Performing Assets. It also gives an insight into the main causes for Non Performing Assets. It also accounts for the various factors contributing to NPAs in India.

Chapter IV, “NPA RECOVERY MECHANISMS” is devoted to throw light on the various legislations evolved by the Reserve Bank of India to recover NPAs. The
guidelines in respect of Lok Adalats, Debt Recovery Tribunals, SARFAESI ACT, One-Time Settlement /Compromise Schemes, Corporate Debt Restructuring Mechanism, Asset Reconstruction Companies, and Sale/Purchase of Non Performing Assets have been dealt in detail.

Chapter V, “FINANCIAL PERFORMANCE” makes an attempt to unearth the trends of deposits, borrowings, advances, total assets, total income, total expenses, operating profit, and net profit of the State Bank Group.

Chapter VI, “AN ANALYSIS OF NPAs” throws light on gross NPAs added, provisions for NPAs made during the year and the status of gross NPAs, and net NPAs of the State Bank Group. It presents an analysis of the sector-wise NPAs of the State Bank Group. It also deals with the NPA recovery mechanism adopted by the State Bank Group to contain NPA levels.

Chapter VII, “CONCLUSION”, is a capsule summary of the findings of the study. It also provides viable suggestions for better NPA recovery in banks.