Chapter - I

Introduction
INTRODUCTION

Banking Industry in India has traversed innumerable twists and turns. It has braved many challenges, weathered many storms, withstood many onslaughts and has emerged as a dynamic and vibrant industry. The secret of the industry's success lies in its ability to adapt to changes in an effective manner. Whether it is class banking or mass banking, whether private ownership or public sector status, whether state of administered interest rate regime or state of operational freedom, whether bound by antiquated manual process or a scenario witnessing unleashing of technological advancement, it has stood the test of time and triumphed above all industries.

Banking sector has been the hub of the financial sector and is the most important institutional and functional vehicle for economic transformation. It is an indispensable medium in everyday transactions of millions of people. Banks in our country have been playing their role as growth facilitators and the banking sector has undergone far-reaching changes in the post liberalization period. The objective of banking sector reforms initiated in the present period is to make the banking system both viable and effective. It, however, needs to be pointed out that the reform measures introduced in the post-liberalization period have in no way compromised with the goal of extending credit to agriculture and other priority sectors.

Financial sector consists of banking sector, insurance sector, capital market, money market, the government securities market, the intermediaries, the systems and procedures and the regulators. Financial sector plays an important role in mobilization and allocation of resources. The central bank of the country plays an important role in the reformation of the financial sector. The reforms in the financial sector usually aim at removing the rigidities and improving the stability and operational efficiency of the entire sector. Banking sector is the most important constituent of the financial sector. The monetary policy of the Reserve Bank of India gets transmitted to the entire economy through the banking system. Therefore, a strong and vibrant banking sector is pre-requisite for any reforms.

The agenda of the Report of the Committee on Financial Sector Reforms, further strengthening the banking sector, came into force in March 1993, and banks found it hard to present a respectable balance sheet. At least 24 of the 28 banks had shown this difficulty. This was the result of the RBI directive to all banks to identify
their non-performing assets effective from March 1992 and to stop charging interest on them. At that time nearly Rs.25000 Crores of bank credit was Non-performing. Banks had been asked to step-up recovery efforts and bring down overdues. The perennial problem of overdues is due to certain fundamental short comings in our legal system.

Many of the bank advances are secured by a charge of hypothecation on the assets of the borrower. Hypothecation can hardly be called a charge as it does not find a place in any statute. Hypothecation has been interpreted to mean a floating charge on the movables whose possession remains with the borrower. The charge crystallizes on the bank recalling the entire dues. Banks are the only institutions which lend money for working capital purposes; which are secured by a charge of hypothecation on the stock in trade of the firm. The borrower freely uses the stock for running of the business activity, the value changes almost daily and the bank is supplied monthly stock statements against which the drawing power is fixed. The bank takes hypothecation agreement whereby the borrower virtually agrees that the stock is the property of the bank to be used for liquidation of the dues at any time the bank chooses to do so. But all this is only on paper and does not have any legal backing as the rights, duties and responsibilities of the hypothecator (borrower) or the hypothecatee (bank) are not defined anywhere. Courts do not recognize the bank’s right to either attach the stock or sell them, in spite of the clauses in the agreement executed by the borrower.

Even after 60 years of independence, India does not have a law which protects the bank when they lend money on a hypothecation charge. The State Financial Corporations are empowered under Sec.25 of the SFC Act 1951 to take possession of assets of defaulting units without court intervention and to sell them at auction to realize their dues. The Co-operative Banks are also similarly protected. But the banks which lend to various sectors including those under Government sponsored schemes have to approach the court for sale of the hypothecated securities. The Narasimham Committee suggested the formation of a special tribunal for bank cases which could expedite the process. But nothing concrete has mobilized in this matter. What is needed to improve the recovery percentage and make bank assets performing is the enactment of a statute which defines a hypothecation charge and also gives the bank a right to seize hypothecated goods without court intervention and for its sale through public auction. Further any
transfer of hypothecated goods (including vehicles/machineries) by the borrower to any other person should be made to attract criminal charges of cheating and defrauding. This legal backing for a bank advance would definitely give more teeth to banks in their recovery efforts and substantially reduce overdues. The major bottlenecks in the existing legal system are discussed below.

**Time Barred Debts**

The law of limitation restricts the legal enforceability of a debt to three years from the date of its demand. To keep the debt alive, the borrowers have to execute an acknowledgement or fresh documents. To keep alive their advances banks have two options before them:

i. To file a suit for recovery or

ii. To obtain an acknowledgement of debt.

The former option is easy and involves only handing over the documents to the advocate for filing a suit. The process entails an additional cost but it saves the skin of the bank manager for having protected the bank’s interest.

The latter course obviously helps the borrower in buying more time for repayment, but the banker has to run around to get the signatures of all the borrowers, a difficult and thankless task. If the law of limitation is altered to include an amendment that bank debts should be excluded from its purview or the period extended up to say 10 years, the strain on the bankers to keep their debts alive would reduce considerably. They would be able to pursue more rigorous recovery processes, without resorting to litigation. In some states where the Revenue Recovery Act (RR Act) is in existence, bank debts for agricultural purposes can be brought under it and the District Collectors can take the responsibility of recovering the dues. Bank advances brought under the RR Act can be kept alive only if debt acknowledgements are taken; otherwise the debt gets time barred. To ensure that the RR Act proved a boon than a bane to banks, an amendment should be made to exclude RR debts from the purview of the law of limitation. Further all the States which have not so far enacted the Act should do so urgently and bring under it all bank loans extended to priority sector. This would help banks to recover the loans.
Execution of Decrees

Banks are today saddled with countless court decrees. A decree is nothing but a court order which recognizes the right of the holder (the bank) to take steps to recover the dues from the judgment debtors (the borrowers). For quite long, banks were contended with filing suits against the borrower and getting decrees. Execution of these decrees never figured prominently in the bank's priorities. With the result the dues remained unrecovered and the decrees became useless. It is only bank decrees that remain so-unexecuted. One of the reasons is the absence of any bank machinery to probe the debtor's assets, get details and then file an execution petition. In many cases the judgment debtors remain untraceable and the banks do not have any investigative procedure for tracing them or their assets. An offshoot of this would be the appointment of recovery agents on a commission basis to undertake recovery. Banks would only stand to gain. The bank advocates should also be included in this process as now an advocates' responsibility is passed on to the bank after the decree is passed to determine the debtor's assets.

Loan Melas

Mercifully, the loan melas which had vitiated the natural bank lending processes during 1983-86 is now a thing of the past. Banks have now been advised not to disburse credit through loan melas. Bank credit is precious and is not to be frittered away for unproductive purposes. Banks should lend only to borrowers who have the capacity and inclination to repay the dues. Applications should be carefully scrutinized and considered only on merits. As political pressure has lessened, bankers should be able, over a period of time, to direct their lending to areas where it is needed and consequently be put to productive uses.

Credit Appraisal

The credit appraisal processes in banks need to be overhauled, to ensure that optimum credit is given. Working capital advances which form a major percentage are often assessed cursorily, without considering the Tandon and Chore committee norms. A borrower with good deposits gets credit limits often in excess of his/her requirements while it is curtailed in other cases. Both practices lead to sickness, the first out of diversion, the second out of non-completion of the working capital cycle.
Credit appraisal in banks, even today, lacks professionalism. The amount of bank credit locked up in sick units bear testimony to this fact.

Unless the gravity of the problem is understood and tackled urgently, it could subvert the financial liberalization initiated by the government and put the clock back for the economic reforms of the country. Therefore, Indian financial sector reforms are guided by two reports viz., the Report of the Committee on Financial Sector Reforms (1991) and the Report of the Committee on Banking Sector Reforms (1998) under the Chairmanship of Shri M. Narasimham. The agenda of the report of the Committee on Banking Sector Reforms has further strengthened the banking system in India. The report suggested for,

i) further improvement of the capital adequacy.
ii) introduction of risk measurement and management in banks.
iii) greater autonomy for public sector banks
iv) introduction of best corporate governance practices.
v) Adoption of modern technology

One of the important recommendations of this committee is to reduce further the high level of NPAs in commercial banks as a means of strengthening the institutional setup. The thrust here was mainly on efficiency and productivity in banks. Non-Performing Assets is defined as an advance where interest and/or instalment of principal remains overdue for a period of more than 90 days. An asset is considered as Non-Performing Assets when:

i. Interest and/or installment of principal remains overdue for a period of more than 90 days in respect of a term loan.
ii. The account remains out of order for a period of more than 90 days, in respect of overdraft/cash credit (OD/CC).
iii. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
iv. Interest and/or instalment of principal remains overdue for two harvest seasons, in respect of short term and one harvest season for long term crop agricultural loans in the case of advance granted for agricultural purposes.
v. Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.
In the present context, all types of banking institutions, irrespective of commercial, rural or co-operative banks are greatly concerned about the nature of assets because the NPAs are culminating into banking crisis and have a huge effect on liquidity and profitability of the banks. NPAs have reached dangerous level and require major operation to set right the position. The banking industry is saddled with more and more NPAs every year and unless the NPA menace is curbed with an iron hand, the banking industry itself will become the biggest NPA and its existence will be shaken. Thus, it is all the more important in the present scenario, to manage the non-performing assets for the solvency and survival of the banks.

Managing NPAs should be pro-active function than a reactive response. As management of NPA has direct bearing on the bottom lines of banks, it needs highly focused and professional approach.

REVIEW OF LITERATURE

In a study conducted by Demirgkc-kunt and Huizinga (DKH), the international cross-section study about banking performance was conducted more in terms of standardized measures such as interest spread and bank profitability. This is the most recent and certainly most comprehensive ever, cross country study of variations in bank performance, using two performance indicators separately regressed on a set of explanatory variables, i.e. interest spread (used as an efficiency indicator) and bank profitability.

Baiju S. and Gabriel Simon Thattil, highlighted the magnitude of NPAs in commercial banking sector of India taking the current position of scheduled commercial bank. They had graded all the four categories of commercial banks i.e. SBI and its associates, nationalized banks, other scheduled commercial banks and foreign banks, in very good, good, bad and worst group on the basis of NPAs and capital adequacy and they suggested that purpose based lending, should be undertaken and a strong banking culture ought to be developed.

In a study conducted by Bhaskar Rao, it was observed that the strengthening of the internal factors is important in NPA Management to focus on assessment, provisioning, recovery and prevention of fresh NPAs. Kalyan Debanath conducted the study on the importance of management of NPA. The author compared health code system (HCS) and Asset Classification System (ACS) and stressed the
portfolio concept of managing non-performing assets.\(^7\) Rajendra Singh in his study mainly considered the significance of the securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI ACT, 2002). He observed that with the enactment of this landmark Act, borrowers will no longer be able to take banks lightly and simply walk away with scarce public money.\(^8\) Sivaloganathan studied the rapid growth of non-performing assets which affect operational efficiency of banks. The author recommended that conversion of NPAs into PAs is most important.\(^9\) Noronha conducted the study on NPA, its theoretical framework and various measures for prevention of NPAs. He observed the necessity of the proper management to curb the NPA menace.\(^10\) Kaveri has thrown light upon the DRTs and Lok-Adalats. He has emphasized the necessity of training and educating the DRTs, banks and borrowers.\(^11\)

Roy Chowdhury discussed how the high NPAs are eroding the strength of banking system in India. He argued that an entry barrier be created for those promoters who have contributed to the creation of any NPA with a bank or financial institution.\(^12\)

Narayanan quantified the word NPA as credit risk. He discussed in detail about the process of slippage from PA (Performing Assets) to NPA and how the banker has to act on these slippage signals. He suggested that informal/non-technical credit investigation and monitoring of the loan accounts right from the beginning is very important to reduce the NPA.\(^13\)

Sudhakar discussed about the Basel Committee for Banking Supervision (BCBS). He studied three important concepts of the credit risk involved in the NPA. The paper suggested, RBI should adopt a consultative approach.\(^14\) Venkata Ramana Reddy analyzed an overview of restructuring of debts and its difficulties. The paper highlighted the Corporate Debt Restructuring (CDR) system. He felt that the success of the CDR system depends on the terms and conditions of CDR Package offered by the Corporates.\(^15\) Shiralshetu and Akash analysed bank-wise, sector-wise NPAs, gross and net non-performing assets to total assets and advances. They suggested that Banks in India must apply principles of financial management to solve the problems of the mounting NPAs.\(^16\)

Ramakrishnaiah, Saraswaty and Sudhakar Chetty in their paper focused on the strategy of reduction of magnitude of NPA with reference to Andhra Bank. The authors concluded highlighting the importance of efforts to avoid the
convergence of new NPAs. Bagchi emphasized in his paper about the RBI guidelines on the upgradation of NPA accounts. The paper stressed on essentials of timely counseling, restructuring/rescheduling of loans.

K.C. Tomba Singh, discussed NPAs with respect to RRBs in India. He suggested the importance of early identification of problem loans, advantages of SARFAESI ACT, 2002, and credit audit to prevent the NPAs in RRBs. V.M. Patel in his study felt that, legal measures are more important to reduce NPAs. NPA, from the point of view of International Standard was also studied. The author suggested the importance of SWOT Analysis Method for management of NPAs.

R. Amutha studied the magnitude of NPAs taking into account the current position of Public Sector Banks. Reasons for rising NPAs and the Preventive and Curative measures to control the NPAs are discussed. The paper highlighted the avoidance of NPAs at initial stage with the help of rigorous and appropriate credit appraisal mechanisms.

K.J. Taori suggested in his paper to avoid delays relating to suit filed cases. Functions of DRTs and their SWOT analysis are highlighted. N.K. Dash focused on how NPA management is practiced in Urban Co-operative Banks Ltd.

Mohammed Farook and Charanjit Singh in their research paper discussed the study undertaken under C.H. Bhabha Scholarship and Fellowship award, 2005 scheme of Indian Bank's Association. The purpose and importance of the study is to satisfy the present need to evaluate the existing system of recovery of dues and the paper suggested a most suitable mechanism/system which creates a marked difference in realization of dues to avoid lengthy process in realizing the defaulted overdues.

Prasum Kumar Das and B.G. Barla in their study have felt the need for special emphasis on investment credit in agriculture and its diversification. The authors studied the existing credit delivery system, impact of Information and Communication Technology (ICT) and IT Enabled Services (ITES) on opening new horizons in credit flow to agriculture by the Commercial Banks in India.

K.C. Sharma observed in his study the confusion on parallel proceedings under SARFAESI ACT and DRT amendment Act, 2004. He felt that SARFAESI Act is an additional and improved remedy for the management of NPAs.

Sunil Pevekar and Ashvine Kr. Sharma in their article interestingly noted that even a small percentage decrease in NPAs can lead to healthier bottom lines for the bank which take into consideration the role of Public Relation (PR).
Chunnmar John Mathew in his study has noted that the SARFAESI Act is the weapon to overcome the NPA problems. Varughese K. John and Thomas Philip in their study did observe that recovery through DRTs is not an effective tool to reduce bulk of the NPAs in the banking sector. Ajay Govil in his study discussed about the recovery management, steps to be taken to turn around the loss making branches and the whole hearted support of staff at all levels. S. Bhaskar Gopal in his study emphasized on comprehensive check of the Family Partition Deeds, Ancestral Properties, Physical Verification of Properties offered as primary or collateral security for loans. Shankar in his paper discussed the gravity of the problem in management of NPA is Credit Appraisal especially in the working capital advances. Sardar N. S. Gujral in his study compared the NPA menace with the chronic health decease and suggested various measures to tackle NPA effectively. G. R. K. Murthy in his paper discussed the right alternative for arresting the overdues. He highlighted the importance of compromise settlement for recovery of NPA dues. Chowdhar Prasad in his paper discussed about the importance of ARCs and SARFAESI Act, 2002 to recover the NPA. R. K. Raul in his paper assessed the role of Asset Reconstruction Company (ARC) and Securization Act, 2002. The author observed the accounting aspect of the NPA and Tax implication.

TCG Nambodiri in his paper identified basic points a banker has to keep in mind while appraising a credit proposal. 5Cs i.e. Character, Capital, Capacity, Conditions and Collateral or 6Ms i.e. Man(Management), Money, Machine, Material, Market and Men(Workers and Employees) and 7Ps i.e. The product, Project, purposes, Place, By people, Policies and Profit are the important basic pointers to handle the credit proposal effectively. Kshitej Dua and Karn Gupta discussed the credit information companies, agencies and so on. They highlighted that, managing credit risk is a much more forward looking approach and is mainly concerned with managing the quality of credit portfolio before default has taken place.

Harpreet Kaur and J. S. Pasricha in their article opined that total elimination of NPAs is not possible in banking business owing to externalities but their incidence can be minimized. Sangeetha Arora and Shubpreet Kaur in their article discussed that, it is essential on the part of the banks to pay adequate attention to quality of lending so that credit expansion could be on sustainable basis.
building upon higher profitability while ensuring financial stability. They also analysed seven key indicators of financial performance like Return on assets (ROA), Capital Risk Weighted ratio, NPA to net advances, Business per employee, NPA level, Net profitability of banks and Off-balance sheet operations of scheduled commercial banks.40

**G.R.K Murthy** in his paper observed that credit monitoring, rehabilitation of sick units and effective management of civil litigation help a branch in arresting the NPAs.41

**J.S.R Sastry** conducted a study and focused that work culture, planning systems and procedures, are important for the Indian Banks to come upto the International standards.42 **Khasnobis** in his paper observed that 20% of borrowers are responsible for 80% of value of impaired assets and achieving speedy recycling of assets; conducive legal environments are important to tackle the NPAs effectively.43

**C.Hari Vithal Rao** in his study discussed the role of compromise in NPA management.44 **Rajendra Singh** in his paper suggested legal action for recovery of banks dues.45 **C.Hari Vithal Rao** in his paper discussed the Lok Adalat’s action plan to settle the dues in NPA management.46 **Rashid Jilani** conducted a study which revealed that NPAs constitute a real economic cost to the nation.47 **Rajendra Kakker** in his paper discussed the role of Asset Reconstruction Companies in managing the NPAs.48

**T.P.Karunanandan** in his paper discussed that transparency has helped the banks in developing a sense of self-discipline and self-appraisal about their strengths and weaknesses to a great extent at all levels.49 **Banambar Sahoo** in his paper discussed rating model for effective supervision of the bank/branches.50 **Sanjai J.Bhayani** in his paper observed the effect of Securitization Act on Central Bank of India with the point of view that NPA is an international problem.51 **R.N.Khadam** in his paper observed state wise NPAs of Urban Co-operative Banks and their best performances.52

**Hemalatha Joshi** in her paper discussed the impact and effect of present prudential regulations of NPA on the economy.53 **V.Gopala Krishna and Phani Ratna Surampudi** in their article focused on clarity in determining the nature of security interest in SARFAESI Act, 2002 to avoid resistance from the borrower at the enforcement stage.54
J.Rajesh Chowdary and B.H.Venkateshwara Rao in their article focused on identifying various measures such as personal touch with borrowers, professionalism in credit appraisal, common documentation, re-phasing of loans, rehabilitation of the potentially viable units, acquisition of sick units by healthy units, compromise proposals, filing suits, approaching debt recovery tribunals effective utilization of securitization act and credit information bureau to monitor and control NPAs effectively.\textsuperscript{55} Sandip K.Bhatt in his paper focused on risk associated with the routine business of banks and relationship between NPA and Provisioning on the basis of type of assets.\textsuperscript{56} Nirbhoy Lodh in his paper discussed credit management with regard to profitability.\textsuperscript{57} P.Malayadri and S.Sirisha in their article discussed the reflections of the NPAs and application of scarce capital and credit funds for unproductive use. They suggested that reduction of NPAs in banking sector should be treated as a national priority, to make the Indian Banking System stronger and geared to meet the challenges of globalization.\textsuperscript{58} Kalyan Mukherjee in his paper discussed Asset Management’s success story of Andhra Bank. He explained various measures adopted by the Andhra Bank to reduce their NPA level to the barest minimum.\textsuperscript{59} Sanjay Kumar Arora and Rajat Khater in their paper observed the importance of comprehensive appraisal of credit system, post-sanction follow-up, merging of sick units with a healthy one, periodical review of performance of NPAs and legal audit.\textsuperscript{60} G.Sudarshana Reddy in his article discussed that the growth of NPAs is mainly due to external and internal factors. To reduce the NPAs SARFAESI Act, 2002 works as a weapon to the bank manager and the Act will improve the bank’s strength.\textsuperscript{61} Gayathri Nayak in her article, discussed mainly about the housing loan sector with NPA bug of the banks, especially the State Bank of India.\textsuperscript{62} S.V.Naik in his paper highlighted that the value of NPAs is not an indicator of loss assets which will have different proportion on NPAs of different banks at different times.\textsuperscript{63} Andreas A Jobst in his paper developed a comparative statistical model of optimal security design in loan securitization.\textsuperscript{64} K.J.Taori in his paper discussed non-conventional measures in management of NPA.\textsuperscript{65} K.J.Taori observes in another study that SBI action plans are very attractive in reducing the NPAs.\textsuperscript{66} B.K.Jha and Jai Shankar Shukla in their article have discussed major findings and recommendations of the Narasimham Committee, and comparative study of NPAs of Scheduled Commercial Banks.\textsuperscript{67} B.Samal in his paper identified various phases
of banking industry, and suggested that it is necessary to take precaution not only for reducing the present NPAs but also to avoid future NPAs.\textsuperscript{68}

Jhanwar Lal Chhimpa in his paper discussed combination of modern tools of risk management and experience maturity in a lending banker are important to minimize inflow of future NPAs.\textsuperscript{69} B.Krishna Reddy, V.Mallikarjuna and P.Viswanath made an empirical study on the issue of non-performing asset management of the Public Sector Banks in Cuddapah district. They carried out the cost-benefit analysis and stressed the need for balance between social and commercial objectives.\textsuperscript{70} Rajendra Kakker in his article focused on NPA management through Asset Reconstruction Companies\textsuperscript{71} C.Vijayachandra Kumar in his paper highlighted that assured repayment structure is very important in management of NPAs.\textsuperscript{72} Jin-Li Hue, Yang Li and Yung-Ho Chiu in their study derived a theoretical model to predict the relation between non-performing loan ratios and government shareholdings.\textsuperscript{73} Manoj N.J.Monteiro and Anathan B.R. in their article observed that risk from NPL’s mainly arises when the external economic environment worsens during economic depressions.\textsuperscript{74}

Jeelam Basha, discussed on the analysis of NPAs of Tungabhadra Grameena Bank and studied the impact of NPAs on the return and risk.\textsuperscript{75} Another researcher Ramakrishna G.Hegde analysed the impact of NPAs on cost and profitability of the Kanara District Central Co-operative Bank Limited.\textsuperscript{76}

Chang, Ching-Cheng in their paper studied that loans are the major output provided by banks, but they are a risky output as there is always an ex ante risk for a loan to finally become non-performing. Non-performing loans (NPLs) can be treated as undesirable outputs or costs to a bank which will decrease the bank’s performance.\textsuperscript{77}

The two study districts namely, Dakshina kannada and Udupi are the well developed districts of Karnataka state in terms of Education, Banking, Health, Transportation and communication. Besides, the districts have the unique distinction of being the birth place of four major Nationalised Banks viz: Canara Bank, Vijaya Bank, Corporation Bank, Syndicate Bank and one leading private sector bank viz Karnataka Bank Ltd. Both the districts also have always been better banked districts. Though plenty of studies have been undertaken on different aspects of Non-Performing assets in the different banks in different parts of the country and also in
the state of Karnataka, there is lack of research work done on the Management of Non-Performing Assets in commercial Banks.

The above literature review refers to the studies conducted at all the types of banks at the state and national level. The available literature has failed in its attempt to highlight the Management of Non-Performing Assets in Commercial banks from two dimensions i.e. both from the branch managers as well as defaulters view point. It is pertinent to point out here that so far, there has not been any in-depth two dimensional study conducted on the Management of Non-Performing Assets in these two districts relating to Commercial banks in particular. Hence, to bridge this research gap the present study is undertaken. Thus, the present study is a modest but an earnest attempt in that direction and it hopes to remedy, albeit, in a humble way, the lacunae identified. It differs from the earlier studies relating to Non-Performing Assets in terms of its objectives, nature, scope, coverage, Act and the period of study.

STATEMENT OF THE RESEARCH PROBLEM

NPAs are a serious strain on the profitability of banks as they cannot book income on such accounts and their funding costs and provision requirements are a charge on their profit. The rise in NPAs raises transaction costs. It is painful to note that about 80 percent of the NPAs is from the defaulters who have borrowed one crore rupees and above. The external factors like raw materials shortage, price escalation, power shortage, industrial recession, excess capacities and natural calamities like flood, famine and accidents have contributed to the mounting NPAs. Besides this, the internal factors responsible for NPAs include business failure, inefficient management, strained labour relations, and inappropriate technology and product obsolescence. Regarding agricultural loan, the important reasons leading to overdues are social expenses, failure of crops, low productivity, scarcity of electricity and lack of proper market for agricultural produces. Hence, for success of the reform process, the effective management of NPAs portfolio assumes great importance. Total elimination of NPA is not possible in banking business owing to externalities but their incidents can be minimized. NPAs in banks affect their liquidity, profitability and equity.

After nationalization, commercial banks in India have been directed to provide loans to the priority sector at concessional rate of interest and participate in
government sponsored schemes by providing loan facilities at a subsidized rate of interest without insisting on collateral security. The resultant feature is the non-performing assets. The Narasimham committee recommended reduction of gross NPAs to 5% by 2000, 3% by 2002 and net NPAs to 3.0 percent by 2000 and to 0.0 percent by 2002. The non-performing assets of the Commercial Banks have been on the increase due to lack of proper credit appraisal, directed and target based lending under government sponsored schemes, lending to priority sector at a concessional rate of interest without having adequate collateral security, political interference, wilful defaults, lack of timely and adequate finance, proper follow-up of credit by the bank personnel, and lack of adequate recovery measures undertaken by the bank personnel. Hence, this has prompted research scholar to undertake study on NPAs and their management in Commercial Banks.

George S. Moore in his famous book, “The Banker’s Life” opines that any well-run bank must have losses, but they should be kept within bounds. He also says that many people think that successful bankers never make a bad loan, but the truth is that nobody has ever made a living or performed a service for his/her society by betting on sure things. Hence, bad loans and NPAs though inevitable, should be kept within bounds in the interest of the banks.

An important decision of the Reserve Bank of India was to bring the banking industry under prudential norms with regard to Capital adequacy, Income recognition and Asset classification which are fundamental to the preservation of the strength and stability of the banking system. Provisioning norms and containing the level of NPAs have become a priority issue for bank management in recent times and the strength, efficiency and profitability of the banks will be based on their ability to contain their NPAs. Thus greater attention has to be paid by the banks in this direction.

With the mounting NPAs, profitability of banks is adversely affected in two ways. To elaborate, the loss of interest and at times principal amount are the most obvious losses. In addition, banks spend considerable money and time to recover the same.

Therefore, this study has been carried out to understand the issues of NPA to study the management of NPAs in commercial banks, banking development in Dakshina Kannada and Udupi districts, and to suggest various recovery measures to improve the efficiency of banks in respect of NPAs.
International Comparison of NPA position

As against the NPA position of banks in India, it is pertinent and useful to find out how Indian banks compare internationally. Two problems are encountered while attempting such a comparison, one is the comparability of the asset classification and provisioning norms, and the other is the availability of the data. According to the World bank report, in the year 2003-04 only 605 banks out of top 1000 banks have disclosed the levels of their NPAs. The non-disclosure was most apparent in German banking system where only 4 out of 82 banks gave figures of NPAs.

The actual level of non-performing assets of banks in India is around $ 40 billion, much higher than the government’s own estimate of $16.7 billion, (about 11 percent of all outstanding loan). According to the managing director (Asia Pacific) of Ernst and Young’s financial solution practice, Mr. Jack Rodman (Economic times, 26 November 2002 and Business India, December 9-22, 2002, p. 87), “We believe that India’s NPAs figure are higher than what was officially quoted, since the accounting norms here are less stringent than those of the developed economics. He further explains that accounting norms of Indian banks often allow a grace period of 180 days after the due date before a loan is declared non-performing, while the norm in developed countries is a 90-day grace period. However despite this, considering India’s GDP of around $470 billion NPAs were around 8 percent of the GDP, while the equivalent figure for Japan was around 28 percent and for Malaysia 42 percent. Individual bank-wise, the highest disclosed NPAs apart from Turkiye Halk Bankasi at 48.80 percent were from Philippines National Bank at 46.60 percent and First Bank of Nigeria at 40.87 percent.

On an aggregate level, Asian NPAs have increased from US $1.5 trillion in the year 2000 to US $2 trillion in 2001, i.e. an increase of 33 percent. This accounts for 29 percent of the total GDP of the Asian countries. “A global slowdown, government hesitancy and inconsistency in dealing with the NPA problem and lender complacency has caused the regions NPA problem to jump” says Ernst and Young’s Asian Non-Performing loan report for 2002. The following table 1.1 shown as Bad debt position of different countries.
Table 1.1
Bad Debt Position of Different Countries during the year 2000-01

<table>
<thead>
<tr>
<th>Country</th>
<th>India</th>
<th>Thailand</th>
<th>Korea</th>
<th>Malaysia</th>
<th>USA</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPA as a percentage to total loans</td>
<td>12.5</td>
<td>45.0</td>
<td>5.4</td>
<td>19.3</td>
<td>2.5</td>
<td>25.0</td>
</tr>
</tbody>
</table>


From the above table 1.1 it reveals that, India’s non-performing assets, though described by former Finance Minister Jaswant Singh, as “Loot and not Debt” (Economic Times, July 23rd, 2002), are not in an uncontrollable state. Even developed countries have NPA problems, but they hardly ever exceed 2-4 percent of advances. In the words of Mr. Rodman, “The spread of the NPA problem is not that widespread but it needs to be tackled in time to avoid choking of the financial system”. Unlike in Japan, the problem is still manageable in India.

OBJECTIVES OF THE STUDY
The present study has been carried out with the following core objectives:

- To study the growth and development of Commercial Banks in Dakshina Kannada and Udupi districts.
- To understand the overall performance of Commercial Banks in the field of deposits, advances and recovery of loans in Dakshina Kannada and Udupi districts.
- To understand the magnitude of NPAs of commercial banks at National level and Regional level in Dakshina Kannada and Udupi districts.
- To analyse the causes for poor recovery of loan and mounting NPAs.
- To offer suggestions having policy implications for the purpose of reducing NPAs by the sample banks in particular and their counterparts working in the state and national level in general.
HYPOTHESES OF THE STUDY

In the light of the above objectives the following important hypotheses have been developed.

I. Percentage of NPAs to total advances of the bank is more in public sector bank compared to private sector bank.

II. Wilful defaulters are the major causes for the NPAs compared to other causes.

III. Recovery of NPAs is the sole responsibility of the branch managers.

IV. There is significant relationship between educational qualification and defaulters attitude towards banks for borrowed loan.

V. Recommendations made by the Narsimham Committee play a vital role in overall performance of recovery of NPAs.

METHODOLOGY AND SAMPLE DESIGN

Research methodology is the means through which desired objectives are sought to be achieved. It involves systematic planning and comprehensive methods. The type of steps to be taken in research depends upon the purpose for which the research is undertaken. The study relating to “The Management of Non-Performing Assets in Commercial Banks- A study in Dakshina Kannada and Udupi districts” is a descriptive and empirical research. Hence, the research efforts were put-forth giving particular attention to the overall research design to meet the research objectives stated earlier.

The study is confined to the two coastal districts viz., Dakshina Kannada (D.K) and Udupi districts of Karnataka State. The erstwhile district of Dakshina Kannada has been considered one of the highly banked districts with a well knit network of 651 branches of commercial banks. Both geographically as well as demographically the district is highly served by commercial banks. Dakshina Kannada and Udupi districts, the cradle of banking industry, have the unique distinction of being the birth place of four major Nationalised Banks like Canara Bank, Vijaya Bank, Corporation Bank, Syndicate Bank and one leading private sector bank viz Karnataka Bank Ltd. Both the districts also have always been a better banked district. Out of this the two banks Syndicate Bank i.e. SB (Public sector bank) and Karnataka Bank Limited i.e. KBL (Private Sector Bank) was selected as sample banks for the study with the permission issued by the head office.
The primary data for the present study was collected from the Branch Managers, official staff, Regional Managers, General Managers and Deputy General Managers of the head office and Defaulters of the sample banks of the study area through personal interview with two different sets of structured questionnaires with a view to eliciting their opinions pertaining to the issues on various aspects of management of Non-Performing Assets. The questionnaire included dichotomous type, ranking type and open ended questions. To ensure comprehensiveness and internal consistency of each questionnaire, an extensive pilot study was conducted. On the basis of the pilot study, necessary modifications were made in the final questionnaire. The primary data was collected between December 2006 and July 2007. Table 1.2 and 1.3 present the sample design of the study. The questionnaires are presented in Appendices.

The study has two dimensions:
1. The Branch Managers and
2. The Defaulters (Defaulted Beneficiaries)

Total branches of the two sample banks Syndicate Bank (SB) and Karnataka Bank Limited (KBL) in D.K. and Udupi districts during the study period 2007-2008 was 189 (53 branches of KBL and 136 branches of SB). Of the total branches, 52 branches of both the banks in both the districts (25 branches of KBL and 27 branches of SB) were selected as samples with the permission issued by the head office of the two sample banks which formed 20 percent of the total branches of SB and almost 50 percent of the total branches of KBL in both the districts. The branches were represented by their Branch managers. The researcher has travelled through the length and breadth of both the districts for the purpose of collecting information from sample branch managers of the banks in the two districts of D.K. and Udupi.

With regard to Branch managers as respondents, the study is mainly empirical in nature with the objective being, to find out the branch managers’ attitudes and efforts with respect to recovery of loan from the Defaulters of bank, pre-appraisal and post-disbursement follow-up conducted by them, Appraisal of Recovery performance, Recovery measures, Legal actions taken by the branch managers of the banks in the study region. Interviews and discussions were held
with the branch managers, credit officers and the senior staff of the banks with the help of a separate pre-structured questionnaire designed for that purpose.

Of the total defaulters, a sample of 237 defaulters: who have not paid their dues within 90 days and come under NPA category of both the banks put together in both the districts i.e. 102 defaulters from KBL and 135 defaulters from SB and approached by the branch managers for repayment of the overdues during the year 2005-2006 as per the official records of the sample banks in both the districts was selected. Because of the confident nature of NPA accounts branch managers have not given exact number of defaulters of their branches. Therefore, due to time, distance and resource constraints and confidential nature of accounts only 237 defaulters have been selected as sample respondents and it works out on an average of 3-5 defaulters in each branch of sample banks.

In the case of Defaulters also, the study is empirical in nature. Interviews were held with the defaulters with the help of a separate prestructured questionnaire designed for that purpose to find out their Knowledge/Awareness about the procedures and formalities of loan borrowed and NPAs, Credit facilities availed by the Defaulters, Reasons for non-repayment of Debts/Over dues, Defaulters response to Compromise proposal, Defaulters opinions about Branch managers, Defaulters Opinions about the Legal action taken against them by the branch managers.

Informal discussions with the defaulters and family members of the defaulters were also held on various aspects such as the nature of problems faced by them in respect to repayment of their overdues, attitude of Wilful defaulters in understanding the reasons that caused default to give a new dimension to the issue of management of NPAs.

These defaulters were selected on the basis of judgment sampling method. While selecting the sample defaulters and branches equal representation was given to different taluks of the districts. However, care was taken to see that the sample chosen is a decent representation of the defaulters. The researcher has also taken care to see that the respondents represent age, literacy, income and occupation under study. The addresses of these sample defaulters have been collected from the sample branch managers records. They include Small business, Agriculture, SSI, Non-SSI, Government employees, workers, helpers, SHGs, and Other type of loan defaulters.

The Primary data collected from the sample respondents on various aspects of NPAs has been organized in the tabular form. Such organized data has been
analysed with the help of different statistical tools like average, percentage etc. for easy understanding of the data and for drawing meaningful conclusions. The statistical analysis has been carried out in two parts. The advanced statistical analysis has been carried out with the help of chi-square analysis ($x^2$), factor analysis and discriminate analysis. All the responses have been converted to the numerical form and entered into computer using MS Excel Software. Each questionnaire was entered into separate data file. Later the data was imparted into the software.

Along with the primary data, secondary data have been utilised from books, journals and reports by visiting Libraries, Institutes of Bank Management, Management Institutes and Socio Economic Institutes have been collected and incorporated wherever they are necessary to substantiate the primary data. The proceedings of the Seminars, Conferences, Workshops and Symposia have been utilized.

This thesis is titled "The Management of Non-Performing Assets in Commercial Banks - A study in Dakshina Kannada and Udupi districts". In the study, the researcher has attempted to understand as to how far the branch managers involve themselves in creating awareness among defaulters to repay their overdues other than legal action, giving repayment education and promoting and protecting the bank’s liquidity and profitability positions by adopting the guidelines issued by the concerned higher authorities.

In addition to this, the opinions, perceptions and awareness of the sample defaulters and the problems faced by the defaulters regarding their NPAs in the banks have been analysed.
Table 1.2
SAMPLE DESIGN
District-wise and Taluk wise distribution of Sample Branch Managers of banks in Dakshina Kannada and Udupi Districts

<table>
<thead>
<tr>
<th>Name of the bank</th>
<th>Dakshina Kannada District</th>
<th>Udupi District</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mangalore</td>
<td>Puttur</td>
<td>Belthangady</td>
</tr>
<tr>
<td>No.of Branches</td>
<td>Percent age</td>
<td>No.of Branches</td>
<td>Percent age</td>
</tr>
<tr>
<td>Syndicate Bank</td>
<td>5</td>
<td>18.53</td>
<td>3</td>
</tr>
<tr>
<td>Karnataka Bank Ltd</td>
<td>7</td>
<td>28.0</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>23.07</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Survey Data
Table 1.3
SAMPLE DESIGN
District wise and Taluk-wise distribution of the sample Defaulters of NPAs
in Dakshina Kannada and Udupi Districts

| Name of the bank       | Dakshina Kannada District | | | | Udupi District | | | | Total |
|------------------------|---------------------------|---|---|---|---|---|---|---|---|---|
|                        | Mangalore | Puttur | Belthangady | Bantwal | Sullia | Udupi | Kundapura | Karkala | No.of Defaul ters | Percent age |
| Syndicate Bank         | 25        | 18.51  | 15         | 11.11   | 20     | 14.81  | 20     | 14.81   | 10  | 7.40  | 20    | 14.81   | 15  | 11.11   | 10  | 7.40  | 135 (100.0) |
| Karnataka Bank Ltd     | 35        | 34.31  | 10         | 9.8     | 5      | 4.9    | 20     | 19.6    | 10  | 9.8   | 12    | 11.76   | 5   | 4.90    | 5   | 4.90  | 102 (100.0) |
| Total                  | 60        | 25.32  | 25         | 10.55   | 25     | 10.55  | 40     | 16.87   | 20  | 8.43  | 32    | 13.5    | 20  | 8.43    | 15  | 6.34  | 237 (100.0) |

Source: Survey Data
SCOPE OF THE STUDY

NPA is of recent origin with effect from the introduction of prudential norms on income recognition, asset classification and provisioning in commercial banks during 1992-93. The coverage of the study period is from 1998 to 2008. Out of total four major Public sector banks and one leading private sector bank, the study is confined to Syndicate Bank, a Public sector bank and Karnataka Bank Limited, Private sector bank hailing from Dakshina Kannada and Udupi districts. Therefore, the study covers the following aspects.

- Reasons for defaulting the loan.
- Causes for non-performing assets
- Defaulters attitude towards Public Sector Bank and Private Sector Bank and expectations of the defaulters.
- The Effective monitoring of loan accounts and implementation of timely remedial measures to curb NPAs at the branch level.

It is felt that the management of NPAs in banks necessarily includes the views of both branch managers of the sample banks as well as the defaulters of the bank. The study covers awareness of defaulters about the recommendations of the committee on Banking Sector Reforms (Narasimham Committee), Securitization Act, 2002. The study also takes into consideration, the emerging challenges in recovering the NPAs.

This study aims to give a detailed picture of management of NPAs in Dakshina Kannada and Udupi Districts from the point of, branch manager’s views, credit officers views and defaulters views. At the same time, this study does not cover large industrial loans because of time constraints and non-availability of the detailed data and information, both from the industries as well as banks due to confidentiality.

The researcher has made an earnest attempt to study the Role of Branch Managers in Management of NPAs in commercial banks. The study has also been carried out to know the awareness of the Defaulters about NPAs and various NPAs related issues in the study region. Besides, the Public sector bank in the study area is compared with the Private sector bank to determine their performance and effectiveness in management of NPAs. The study also extends further to measure the perceptions of Defaulters with regard to the rules and
regulations of the bank and attitudes of the wilful defaulters towards repayment of 
over dues in the study region. This study also offers suggestions to the branch 
managers of the bank who directly handled the NPAs.

LIMITATIONS OF THE STUDY

It is very relevant to mention the limitations of this study. The survey was 
conducted only in two districts viz., D.K. and Udupi of Karnataka State. 
Although research within a specific area, provides the most reliable data, 
generalization cannot be made unless research conducted in other areas also 
provide similar results.

• Since only two commercial banks hailing from the two districts are 
  studied, this may not lead to formulation of a very reliable line of action.
• The respondents did not easily understand the purpose of the study.
• The branch managers and the defaulters were reluctant to respond frankly 
  to the questions. Hence one time data obtained from respondents through 
  questionnaires may fail to truly depict their exact attitudes. The time 
  constraint, hesitation and lack of willingness on the part of the defaulters 
  to respond to the queries were the major problems in collecting the true 
  information.
• One of the major constraints for this study was non-availability of updated 
  data pertaining to the branches of banks on a uniform basis.

In spite of these limitations, a sincere attempt has been made to arrive at a 
fairly objective, representative conclusion by analysing the data intelligently and 
tactfully. Since the study is confined to management of NPAs of two commercial 
banks hailing from D.K. and Udupi districts, the role of multinational banks, new 
generation banks, DFIs and NBFIs is not covered. Hence this study is only a 
comprehensive and comparative analysis of data relating to management of NPAs 
in commercial banks of the two districts.
CHAPTER LAYOUT

The entire work has been classified into 6 chapters which is presented as follows:

Chapter-I which is an 'introductory chapter', deals with aspects like significance of the concept of NPAs, the problem of NPAs in commercial banks and affirms the need for the present research work. It also deals with technical aspects such as statement of the problem, objectives of the study, hypotheses, methodology. Review of the existing literature, sample design and statistical tools used, Limitations of the study and Layout of the report.

Chapter-II is titled “Non-performing Assets of Commercial Banks – A conceptual framework” and it includes meaning of terminologies like non-performing assets of commercial banks, causes for mounting overdues and NPAs, problems of recovery of loans, non-performing assets, income recognition, assets classification and provisioning norms for assets, Non-performing assets in Commercial Banks and Recovery measures like General Recovery, OTS Recovery, Compromise Recovery, Recovery by task forces and Securitization Act 2002.

Chapter-III on “Banking development in Dakshina Kannada and Udupi districts” deals with functioning aspects like banking development in the districts of Dakshina Kannada and Udupi reflecting the growth and working of commercial banks since their establishment and presents a brief Profile of Dakshina Kannada and Udupi Districts.

Chapter-IV is an analysis of an empirical study and is titled as “Management of Non-Performing Assets (NPAs) in Commercial banks – An analysis of opinions of defaulters” This chapter is devoted to the analysis of the survey data collected from the defaulters (NPAs) of the sample commercial banks Viz. Syndicate Bank and Karnataka Bank Limited. The profile of Defaulters, Credit facilities availed by the Defaulters, Knowledge/Awareness about the procedures and formalities of loan borrowed and NPAs, Reasons for non-repayment of Debts/Over dues, Defaulters response to Compromise proposal, Defaulters opinions about Branch managers, Defaulters Opinions about the Legal action taken against them by the branch managers in the study region are analysed.
Chapter-V is an analysis of an empirical study and is titled as “Management of Non Performing Assets (NPAs) in Commercial banks – An analysis of opinions of Branch managers” This chapter is devoted to the analysis of the survey data collected from the Branch managers/Credit officers’ point of view of the sample commercial banks. Viz. Syndicate Bank (SB) and Karnataka Bank Limited (KBL). This study comprises of Defaulters repayment behavior after taking loan, as well as the branch managers’ attitudes and efforts with respect to collection of loan from the Defaulters and pre-appraisal and post-disbursement follow-up of the banks.

Chapter-VI on Summary of “Findings, suggestions and conclusions” presents a brief summary of the findings of the study followed by the suggestions for improving the operational efficiency of banks with regard to NPAs based on the findings of the study. At the end it presents scope for further research and conclusion.
References
