CHAPTER THREE

REVIEW OF LITURATURE

• Research Studies in India
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RESEARCH STUDIES IN INDIA

Banking in our country and its system of credit delivery were being viewed almost exclusively as an instrument of social change, concern surfaced in the Tandon Committee (1973)\(^1\) about a proper quality wise grading of advance portfolio. Income recognition as a criterion was not thought of. The committee recommended slotting of borrowal accounts into four bands as (a) excellent (b) good (c) average and (d) unsatisfactory/ bad and doubtful.

This was followed by the Chore Committee (1980)\(^2\) which also recognized the need for close watch on the quality of the loans portfolio, and this concern is reflected in its emphasis on regular annual review of all borrowal accounts with credit limits of over Rs. 10 lakhs. It was the recommendation of Pendharkar Committee (1981)\(^3\) implemented in 1984, that recognized the need for classifying advances into different categories to index the overall quality of assets portfolio. This was the starting point for the introduction of the health coding system of categorising bank loan portfolio by Reserve Bank of India (RBI) in 1985. The eight-band concept of health coding of advances accounts for health code 1 to 8 was followed in 1989 by a circular\(^4\) from the RBI to banks, specifying the need to refine the practice of charging the interest on loans and advances by banks on new prudential criteria in line with international practices by ceasing to charge interest on non-performing advances. Accordingly, banks were advised to refrain from charging interest on borrowal accounts falling in health code 6 to 8 (Suit filed; decreed, bad and doubtful and loss accounts) but to continue charging interest on accounts in health code 4 and 5 accounts of 4 selective basis.

The above health code system was modified subsequently, from the accounting year 1990-91 stipulating that banks should not charge interest on accounts in health code 5 but charge interest on selective basis in accounts falling under health code 4 depending on the availability of security and the perception of banks about the individual accounts. In sum, a system a transparency and prudential norms was prevalent even prior to 1992-93, specifying non-recognition of interest income in accounts, which had crossed the sickness stage to the recalled category upto bad and doubtful category.
To elaborate, interest was charged though not recovered, whereas provisioning also was based on bank's perception about security and prospects of recovery, even after recalling the advances. The health code system, therefore, had non-performance hidden in its layers.

As new norms to define the implementation of Narasimham Committee, the above objective norms and desperate accounting practices were given up, replaced by objective and more scientific criteria based on prudential norms of income recognition, asset classification, provisioning and capital adequacy. The committee submitted its report in November 1991 and its findings are by now rather well known.

On the basis of the same the RBI issued detailed guidelines and instructions to banks in April 1992. Subsequently, following representations from different banks on a number of issues, the RBI constituted a working group under the chairmanship of Shri S.S. Tarapore, Deputy Governor, RBI, to examine the various aspects of the prudential norms. Based on the recommendations of the working group, the RBI issued further guidelines/ clarifications in December 1992. In the same way, two more circulars were issued in March 1993 and April 1994.

Satyanarayana K. (1993) in his study has suggested that, despite all the hiccups, income recognition and provisioning are absolutely essential steps for Indian banking system though delayed for long by the RBI. The RBI perhaps is trying to compensate the delay by pushing it in haste.

The Narsimham Committee had studied the problems faced by banks in India in a detailed and practical manner and its recommendations were more or less an organic package. It was desired by the committee that for the success of the proposed reforms, a proper sequencing is essential like success in controlling fiscal deficit for successful deregulation of interest rates. For the problem with banks, asset reconstruction was a key ingredient of the package along with instituting capital adequacy, establishing prudential norms, with a good supervisory machinery, to be implemented in a properly sequenced and
phased manner over the next three to four years. Of these, except for the proposal for setting up an Asset Reconstruction Fund (ARF), the other recommendations had already been proposed by some committee or the other. The proposal for setting up Special Recovery Tribunals was already made by the Tiwari Committee\(^7\). More than a year before the Narasimham Committee submitted its recommendations, the Governor, RBI had called for setting up of Special Tribunals to settle large claims of commercial banks. He also added that these tribunals should settle the claims in six months to one year as against eight to ten years taken by courts\(^8\). The special tribunals are yet to be operationalised while the recommendation for Asset Reconstruction Fund has been given the go.

M. Narasimham himself made the observations in this regard "However the reform of accounting practices and introduction of prudential norms and provisioning would have a much greater impact and effectiveness, if the books of the banks were cleaned up before this exercise was undertaken. This was the rationale for committee's recommendation with respect to an Asset Reconstruction Fund (ARF) but, unfortunately, there has been no movement in this direction. The RBI has made out some arguments against ARF, which to our mind are not convincing. The proposal for setting up of ARF together with the recommendation of setting up special recovery tribunals was meant to wipe the slate clean and the put the onus on bank management for conducting the affairs of the banks in the manner calculated to enhance the efficiency, productivity and in the final analysis, profitability. It is a matter of regret that the ARF proposal has not been accepted"\(^9\).

Had the proposal for ARF been accepted, the problem of Non-Performing Assets management would have acquired an entirely different character. The discussion paper for Finance Minister’s meeting with Chief Executives of Public Sector Banks and Trade Unions prepared by the Ministry of Finance held out the contrary view that the banks which originated the credit should retain the responsibility for such recovery\(^10\), while recognizing at the same time that, "there is no easy solution to the problem of enhancing recovery on existing bad advances."\(^11\)
Policy level thinking on this issue can best be summarized in the words of Dr. C. Rangarajan, Governor, RBI, in a paper presented by him in January 1991. He stated that "It is responsibility of the banking institutions to maintain the quality of their credit portfolio. Directed credit, per se, does not lead to Non-Performing Assets; banks have a choice of borrowers. There is evidence to show that the proportion of Non-Performing Assets among banks ... can be efficiently used in monitoring accounts and improving the overall quality of loan assets."

More than two years later, in a speech delivered on October 18, 1993, he stated: "As regards NPAs, so long as these sterile assets remain on the books, it will be difficult for banks to raise their profitability to the desired level. The drawback of a centralized nationwide Asset Reconstruction Fund (ARF) in the Indian environment is the lack of geographic reach for a new institution to a large country, such as India, as well as concerns that releasing commercial banks from their recovery obligations would weaken them. This could also encourage such accounts themselves going sick. In addition, there is the issue of how to finance the capital shortfall, created by cutting down an even greater part of the assets portfolio than is required by the minimum provisioning requirements. No single solution can resolve the problem of NPAs. We have opted to go in for a decentralized approach, under which workout units are created in each bank. Individual banks will have to take a range of initiatives taking into account the circumstances specific to them.

Sinha R. P. (Feb 1995) in his paper "Management of non-performing Assets - The Only Imperative" held IRAC norms and provisioning requirement responsible for huge losses posted by nationalised bank in 1992-93 and 1993-94. Public Sector Banks in India in a bid to perform social banking requirements did not bother to improve their equity or profitability. It would, therefore, be imperative for these banks to take effective measures to reduce their NPAs to the maximum possible extent. Further, he discussed objectives of Non-Performing Assets, management and methods, which could be considered for achieving such objectives. He believed that such methods are only indicative and by no means exhaustive. He was of the view that in
present scenario, NPAs are at the core of the financial problems of the banks and hence ceaseless efforts have to be made to improve recovery rate. Advances, which are not NPAs but are on the threshold, should be given special attention because they might turn into Non-Performing Assets sooner or later. Finally he concluded that banks have to be alert as regard the new lendings and have to constantly upgrade their evolution skills and systems in order to successfully manage their assets 14.

Shivpuje C. R. and Kaveri V. S. (1997) in their book titled "Management of Non-Performing Advances" have made an effort to identify the perception of branch managers, bank officers, borrowers, civil judges, legal practitioners etc. on the recovery matters and on effectiveness of various recovery measures. On the basis of case studies conducted on various borrowers, firms the authors tried to identify the present status of borrowal account, reasons for NPAs and also the deficiencies in bank operations. Finally they concluded that with wide banking network and declining credit deposit rate the profitability of Public Sector Banks, is decreasing day by day. In view of greater emphasis being put on profitability in recent times it is essential to keep the cost related to lending low. For this purpose the banks are required to ensure operational efficiency. The systems and procedures associated with the lending needs a fresh look in order to be able to offer efficient services 15.

Jalan Bimal (Dec. 1998) while delivering the inaugural address to the bank economists on “Towards a more Vibrant Banking System” expressed his views on various aspects of NPAs in PSBs in India. He stated,"A key issue relates to banking sector is Non-Performing Assets (NPAs). The amount of gross and net NPAs have been on the rise, although the rate of their growth has been below the overall rate of expansion of advances. Apart from absolute size, the distribution of Non-Performing Assets is skewed across banks. Still a large number of Public Sector Banks have net Non-Performing Assets ranging between 10 to 20 percent of net advances. The Narasimham Committee has underlined the need to reduce the average level of net NPAs for all banks to 3 percent by 2002 and to zero for banks with international presence. I think this is an important requirement for our banking system and
is crucial to maintain the viability of the system in future. A two pronged strategy identified by the Committee viz., to reduce the backlog NPAs and improving the management efficiency and stricter enforcement of prudential norms have to be acted upon to deal with this challenge" 16.

Kannan K. (Dec. 1998) in his article entitled "Whose Non-Performing Assets is it anyway?" stated that the emphasis so far should be only on identification and quantification of NPAs rather than ways to reduce and upgrade them. In broader perspective the term Non-Performing Assets is a reflection of the productivity of the unit, firm, industry or nation where this asset is idling. Hence Non-Performing Assets is a result of an environment which prevents it from performing up to expected levels. The increased incidence of vigilance inquires in commercial banks have created such a fear psychosis amongst bankers that they have turned risk averse rather than risk takers. The easiest way to curtail NPAs is to remove the assets from the balance sheet and not to create new assets. He was of the view that NPAs are nothing but a reflection of the health of the economy. If the economy is doing well and if all its sectors are doing well, bank NPAs will also show an improvement. Finally he reiterated on need to change the outlook towards Non-Performing Assets. The banks having high NPAs will not lead the economy anywhere. Unless all section of the society addresses themselves to this problem and help in creating a healthy environment, banks alone will not able to make any appreciable dent into the problem of Non-Performing Assets 17.

Sarda D P. (Dec 1998) in his paper entitled, " Strategies for Reducing Non-Performing Assets " believed that with the adoption of guidelines issued by RBI on income recognition, assets classification and provisioning, banks are now fully vigilant about the quality of their loan assets and several steps are being taken by them to reduce NPAs. However, risk attached to lending cannot be completely eliminated. He emphasised that each bank should have a "Loan Recovery Policy" giving details of the strategies to be adopted for recovery of dues. This policy should be placed before the board for approval. Proper monitoring of the policy is equally necessary. Further he discussed few measures for reducing Non-Performing Assets and suggested some steps to
banks to ensure fast disposal of their claims. He was of the view that it is not possible always to revive a sick unit or enter into a reasonable settlement with the borrower. Filing of civil suit should be considered as last resort for recovery of loan. If a reasonable settlement is possible even after filing the court case, compromise may be made with the knowledge of the court. Finally he concludes that there are various techniques for reducing NPAs, if one technique fails while dealing with a particular NPAs, bank may have to try with other technique.

Taori K. J. (May 1999) in his paper, "Non-Performing Assets Management: Non-Conventional Vehicles" expressed need for preventing slippage of healthy accounts by formation of Non-Performing Assets management policy emphasizing on tackling potential Non-Performing Assets accounts effectively through an in built process/ mechanism of structured intervention. The focus of the policy must be on measures to be taken by bank at pre-Non-Performing Assets stage, viz., to identify danger signals, to diagnose the maladies and to take corrective steps in potential Non-Performing Assets accounts in consultation with controlling authorities. He further discussed various measures for recovery used by banks and their effectiveness. He firmly believed that information management would be of immense use in this respect. Under information management, information regarding willful defaulters to Public Sector Banks is made available. Finally he concluded that in addition to the time tested measures for stepping up the recoveries, several other non-conventional measures were also taken in the recent past, viz. micro level budgeting, review of top NPA accounts, opening of recovery branches, creation of recovery cells, mergers and acquisitions, which proved very effective in management of NPAs.

Rao C. Hari Vithal (May 1999) in his paper "Non-Performing Assets: Recovery Made Easy" expressed great concern over mounting NPAs in PSBs and wanted major operation to set the position right. He found two remedial measures very effective e.g. Lok Adalats; And 'Pay your dues today and avail of loan tomorrow Scheme'. The former deals with the legal recourse, where continuous efforts and intensive follow-up are required on the part of bank
official. The later makes the borrower after repaying the dues become eligible to borrow from banks for the next installment, which otherwise was denied to them as they were termed as defaulters. On the basis of practical analysis done by the author, it has been found that officers interaction with the borrowers both performing and non-performing is very poor. If the officer do not meet the borrower periodically, they tend to forget the bank and thereby their repayment liability to the bank also. In the opinion of the author, regular interaction of bank officers with borrowers will, along with reduction of NPAs also pave way for opportunities to meet the problem borrowers too. He expressed effectiveness in reducing NPAs of bureau of recovery services established in Hyderabad, comprising of a group of seasoned retired bank officials. This bureau is liaison with agencies like service cell to convene Lok Adalats and create a platform for various banks to participate. Finally he hoped that the bureau established in Hyderabad would, necessarily come in handy for all PSBs to achieve the desired levels of reduction in the NPAs and thereby increase their profitability.

Kannan K. (June 1999) in his article “Indian Banking in the New Millennium” stated that the snapshot of bank reforms reflects three dimensions. The first relates to accounting, regulatory and supervisory reforms. The second relates to upgradation of quality of internal management of banks and the third relates to structure and systemic reforms. But the most critical is third dimension; the unfinished agenda involving need for structure and systemic reforms. It requires legal reforms/ modifications in the codified laws and creation of a suitable environment for banks to operate. Regarding Non-Performing Assets management he was of the view that when the Indian economy is passing through a recession, NPAs are bound to go up. Finally he concluded that it is essential to correctly classify the loans and identify the NPAs. After identification, bank should act promptly to recover the dues and simultaneously make generic provision to meet the growing incidence of default.

Rao C. Hari Vithial (June 1999) in his paper titled "Lok Adalat- An effective forum for Non-Performing Assets Reduction" expressed concern over huge
volume of funds of the banks blocked in NPAs. He felt the need to arrest slippage and considered Lok Adalats as a possible panacea to address this problem. He firmly believed that Lok Adalats as a forum through which the disputes among the parties are settled are very effective and expeditious. Finally, giving south Gujrat Zone's experience where Lok Adalats recovered the dues in the Non-Performing Assets substantially, he expressed "Why not we try this method in other regions/zones too for trimming the Non-Performing Assets portfolio?"\textsuperscript{22}

Taori K. J. (July 1999) in his paper entitled "Management of Non-Performing Assets- Strengthening Recoveries Especially Through DRT" made an attempt to analyze the guidelines for legal action, monitoring suits filed and also the contents of the Recovery of Debts due to Banks and Fls Act 1993. He very amicably reviewed the functioning of DRTs and mentioned various constraints due to which the declared objective of DRTs could not be achieved, such as delay in setting up of DRTs, delaying in positioning of presiding officers, lack of infrastructure, delay in position of adequate number of recovery officers, very large number of cases and large geographical jurisdictions. He suggested some measures for improving the efficiency of DRTs like bank should do proper SWOT analysis of each case, recovery application/ petition should be in brief, and suitable control system should be implemented for monitoring the progress of each case.\textsuperscript{23}

Jilani Rashid (1999) while delivering his key note address on" Non-Performing Assets" in National Conference on Financial Sector Reforms held by the Confederation on Indian Industry, amicably addressed the issues related to NPAs in PSBs, prudential norms regarding accounting of loans and causes of NPAs. He viewed that NPAs constitute a real economic cost to the nation and reflect the application of scare capital and credit fund to unproductive useges. The money locked up in NPAs is not available for productive usage and to the extent that banks seek to make provision for NPAs or write them off. Thus, It is charge on the profit. He suggested that banks should charge their productive and diligent customer a higher rate of interest. The NPAs also raises the transaction cost in the system thus denying the diligent credit
customer the benefit of lower rates, which would help them to be more efficient and competitive 24.

Naik S. V. (1999) in his paper entitled "Iceberg of NPAs" stated the Non-Performing Assets position of Indian PSBs and also the effectiveness of various recovery measures like BIFR, Rehabilitation, ARCs, and Recovery Tribunals etc. He stated that NPAs of some banks is higher than their capital and reserve. Even % of Non-Performing Assets to owned funds of some of the top ranking Public Sector Banks is quite high. On the basis of analysis, he finally mentioned that unless very serious corrective actions are initiated by the authorities for external factors and individual banks for internal factors the ice berg of NPAs might get converted into grave situation and result into national crisis as has happened else where in the world 25.

Taori K. J. (Feb 2000) in his paper entitled, "Settlement Advisory Committee (SACs) for tackling Non-Performing Assets in Priority Sector" described present position of NPAs and held slow and inefficient legal system, policy distortions and general slow down in the Indian economy responsible for the massive increase in the gross NPAs. He emphasized on the need to treat reduction of NPAs as a national priority. He was of the view that the share of priority sector Non-Performing Assets is huge in total NPAs of PSBs and they are very high in terms of number of accounts. Hence, these should be tackled through one time measure- Settlement Advisory Committees (SACs). However, the success of the scheme largely depends upon bankers' perception about compromise settlement, refining negotiating skills and reorienting attitudes. Finally, he discussed effectiveness of the scheme to borrower and bank and concluded with that if the scheme used to the best advantage, this will go a long way in reducing chronic NPAs from the bank's books 26.

Rao Katuri Nageswara (April 2000) in her paper "Non-Performing Assets: Ground Realities" compared the position of Non-Performing Assets account before and after implementation of new set of prudential norms during the year 1992. He also discussed reasons for borrowal accounts turned out into Non-Performing Assets alongwith recovery measures like BIFR and DRTs. The
author was of the view that DRTs are more helpful to banks in recovery of NPAs than BIFR as the latter was concerned more with the rehabilitation prospects and labor retrenchment problem. She described management of NPAs as a gigantic problem and emphasised for multi-dimensional strategy. She suggested ways and means for reducing NPAs and touched some Micro as well as Macro level management aspects relating to management of NPAs.

Arora Usha (April 2000) in her paper titled "Non-Performing Assets Management in the Indian Environment" strongly believed that effective management of Non-Performing Assets has assumed paramount importance because in the present context where the process of deregulation has brought the interplay of market forces into much sharper focus, profit and profitability have emerged as the most important parameters of performance. Higher level of NPAs is the singular reason for not realizing the full profit potential of the banks. She further described current scenario of NPAs and threw light on factors, which contributed in making Non-Performing Assets situation so critical in India. She observed that currently employed actions for reducing NPAs are not effective and suggested that in managing NPAs, one of the most important aspects is the need to curb incidence of NPAs among new loans sanctioned/granted by branches. She felt that there is urgent need to change legal system for recovery of bank dues. Speedy trail of suit-filed cases and execution is the need of the hour. Finally, the author concluded that in the long run, only better credit management in terms of appraising and monitoring of loan assets can solve the Non-Performing Assets problem and this will only enable banks in maintaining the pre-eminent position in the globalised setup.

Taori K. J. (June 2000) in his paper "Problems and Issues relating to Management of NPAs of Banks in India" raised various issues regarding problem and management of NPAs of banks in India. He believed that level of NPAs as most crucial factor, which governs the performance of banks, is health of its credit portfolio. He emphasised on the need to reduce NPAs in banking sector as a national priority if we want to make the Indian banking system more strong and resilient. He considered directed priority sector lending as main reason for high NPAs. Further he discussed various
measures like settlement advisory committee, ARCs, BIFR, DRTs and legal resources for reducing NPAs. Finally, he strongly stated that the surest way of containing NPAs is to prevent their occurrence. But to manage effectively the existing NPAs, the banks must adopt a structural Non-Performing Assets management policy for guidance of operating functionaries.

Reddy B. Ramachandra, Reddy S. Vijayulu and Sukunthla B. (Sept. 2001) in their study titled "Management of Non-Performing Assets in Public Sector Banks" examined the growth and dimension of NPAs in PSBs including their causes and the effectiveness of various recovery measures adopted by PSBs in India. They viewed that total elimination of NPAs is not possible in banking business owing to eternities but their incidence can be minimized. It is always wise to follow proper policy for appraisal, supervision and following of advances to avoid NPAs. Special recovery cells may be set up at regional/ zonal level and also the compromise proposals must be settled effectively and efficiently. They also viewed that unless the willful defaulters, who have the means to repay, are compelled to do so with the threat of social exposure, confiscation of properties and imprisonment, the NPAs can not be recovered.

The problem of NPAs is related to several internal and external factors confronting the borrowers (Muniappan, 2002). The internal factors are diversion of funds for expansion/diversification/ modernisation, taking up new projects, helping/promoting associate concerns, time/cost overruns during the project implementation stage, business (product, marketing, etc.) failure, inefficient management, strained labour relations, inappropriate technology/technical problems, product obsolescence, etc., while external factors are recession, non-payment in other countries, inputs/power shortage, price escalation, accidents and natural calamities. In the Indian context, Rajaraman and Vasishtha (2002) in an empirical study provided evidence of significant bivariate relationship between an operating inefficiency indicator and the problem loans of public sector banks. In a similar manner, largely from lenders' perspective, Das and Ghosh (2003) empirically examined non-performing loans of India's public sector banks in terms of various indicators.
such as asset size, credit growth and macroeconomic condition, and operating efficiency indicators \(^{31}\).

Maji Santi Gopal and Dey Soma (Mar. 2003) in their paper “Management of NPAs in Urban Co-operative Banks – A case study of the Khatra People’s Co-operative bank Ltd.” observed that in the context of global competition, it is a paramount task for the banks to manage their NPAs more efficiently so that they can change their character from non-performing to performing assets. They made an attempt to analyse amount-wise, age-wise, loan head-wise and sector-wise classification of NPAs and to identify the factors responsible for the growth of NPAs in the bank under study. Lastly they suggested certain steps to reduce NPAs like formulation of ‘loan recovery policy’, Interaction with borrowers at regular intervals, Preparation of list of defaulters and affixing it on the notice board of bank, organizing recovery camps, compromise with borrowers after making a proper distinction between willful defaulters and the borrowers defaulting in repayment due to circumstances beyond their control \(^{32}\).

Subbarao P. Srinivas (Mar. 2003) in his article “Is ‘Securtisation Ordinance’ minimizing NPAs or is improving the profit of PSBs by reducing NPAs?” stated that the level of Non-Performing Assets in the Indian Public Sector Banks is relatively high as compared to international standard of 2%. Measures for controlling NPAs like courts; BIFR and DRTs have not fully succeeded in minimising the NPAs. In this situation Govt. of India has issued the Ordinance namely, The Securtisation and Reconstruction of Financial Assets and Enforcement of Security Interest Bill 2002. This ordinance has removed the main shortcoming of DRTs and vest enormous powers in the Banks/ FIs. He expressed that existing NPAs realization system takes a long time due to heavy backlog of cases pending in courts. Added to this, every decision of a court can be frustrated by numerous appeals that a defaulting borrower can prefer with higher courts. Explaining advantages, he stated that the ordinance empowers the bank/FIs to sell the security to a securitisation or ARC established under the provisions of the ordinance. Finally he concluded that even the ordinance gives enormous powers to Bank/FIs, there are some legal and practical issues in exercising them \(^{33}\).
Singh K. C. Tomba (Dec.2003) in his paper 'Management of Non-Performing Assets in RRBs- A Critical Evaluation" tried to identify the dimension of NPAs in regional rural banks and also identified various reasons for NPAs. He stated that the problem of NPAs has been talked effectively by Public Sector Banks and RRBs by drafting a combination of one or more of various suggestive measures like, enlarging the credit base through careful selection of quality assets, having a appraisal skill through training, vigorous physical, financial and legal follow-up towards Upgradation, restructuring, rehabilitation, forming settlement for compromise and expediting write-off. He also viewed that there is much to learn from the neighbors who, for the past five years, have also suffered with the problem of huge NPAs. Since they reacted faster than India to check the crisis, countries such as Taiwan, Malaysia and Indonesia are now way ahead of us on the learning curve.

In a study, Mohan (2003) observed that lending rates of banks have not come down as much as deposit rates and interest rates on Government bonds. While banks have reduced their prime lending rates (PLRs) to some extent and are also extending sub-PLR loans, effective lending rates continue to remain high. This development has adverse systemic implications, especially in a country like India where interest cost, as a proportion of sales of corporates are much higher as compared to many emerging economies.

Although public sector banks have recorded improvements in profitability, efficiency (in terms of intermediation costs) and asset quality in the 1990s, they continue to have higher interest rate spreads but at the same time earn lower rates of return, reflecting higher operating costs (Mohan, 2004). Consequently, asset quality is weaker so that loan loss provisions continue to be higher. This suggests that, whereas, there is greater scope for enhancing the asset quality of banks, in general, public sector banks, in particular, need to reduce the operating costs further. The tenure of funds provided by banks either as loans or investments depends critically on the overall asset-liability position. An inherent difficulty in this regard is that since deposit liabilities of banks often tend to be of relatively shorter maturity, long-term lending could induce the problem of asset-liability mismatches.
In the seminal study on 'credit policy, systems, and culture', Reddy (2004) raised various critical issues pertaining to credit delivery mechanism of the Indian banking sector. The study focused on the terms of credit such as interest rate charged to various productive activities and borrowers, the approach to risk management, and portfolio management in general. There are three pillars on which India's credit system was based in the past; fixing of prices of credit or interest rate as well as quantum of credit linked with purpose; insisting on collateral; and prescribing the end-use of credit. Interest rate prescription and fixing quantum has, however, been significantly reduced in the recent period. The study also highlighted the issues in security-based or collateralised lending, which need careful examination in the context of growing services sector. Given the fungibility of resources, multiple sources of flow of resources, as well as application of funds, the relevance and feasibility of end-use restrictions on credit need a critical review. Furthermore, in the context of NPAs on account of priority sector lending, it was pointed out that the statistics may or may not confirm this. There may be only a marginal difference in the NPAs of banks' lending to priority sector and the banks lending to private corporate sector. Against this background, the study suggested that given the deficiencies in these areas, it is imperative that banks need to be guided by fairness based on economic and financial decisions rather than system of conventions, if reform has to serve the meaningful purpose. Experience shows that policies of liberalisation, deregulation and enabling environment of comfortable liquidity at a reasonable price do not automatically translate themselves into enhanced credit flow 37.

**RESEARCH STUDIES ABROAD**

In a study of loan losses of US banks, McGoven (1993) argued that 'character' has historically been a paramount factor of credit and a major determinant in the decision to lend money. Banks have suffered loan losses through relaxed lending standards, unguaranteed credits, the influence of the 1980s culture, and the borrowers' perceptions. It was suggested that bankers should make a fairly accurate personality-morale profile assessment of prospective and current borrowers and guarantors. Besides considering
personal interaction, the banker should (i) try to draw some conclusions about staff morale and loyalty, (ii) study the person's personal credit report, (iii) do trade-credit reference checking, (iv) check references from present and former bankers, and (v) determine how the borrower handles stress. In addition, banks can minimise risks by securing the borrower’s guarantee, using Government guaranteed loan programs, and requiring conservative loan-to-value ratios.

Sergio (1996) in a study of non-performing loans in Italy found evidence that, an increase in the riskiness of loan assets is rooted in a bank’s lending policy adducing to relatively unselective and inadequate assessment of sectoral prospects. Interestingly, this study refuted that business cycle could be a primary reason for banks’ NPLs. The study emphasised that increase in bad debts as a consequence of recession alone is not empirically demonstrated. It was viewed that the bank-firm relationship will thus; prove effective not so much because it overcomes informational asymmetry but because it recoups certain canons of appraisal.

Lis, et. al., (2000) used a simultaneous equation model in which they explained bank loan losses in Spain using a host of indicators, which included GDP growth rate, debt-equity ratios of firms, regulation regime, loan growth, bank branch growth rates, bank size (assets over total size), collateral loans, net interest margin, capital-asset ratio (CAR) and market power of default companies. They found that GDP growth (contemporaneous, as well as one period lag term), bank size, and CAR, had negative effect while loan growth, collateral, net-interest margin, debt-equity, market power, regulation regime and lagged dependent variable had positive effect on problem loans. The effect of branch growth could vary with different lags.

Kent and D’Arcy (2000) while examining the relationship between cyclical lending behaviour of banks in Australia argued that, the potential for banks to experience substantial losses on their loan portfolios increases towards the peak of the expansionary phase of the cycle. However, towards the top of the cycle, banks appear to be relatively healthy - that is, non-performing loans are low and profits are high, reflecting the fact that even the riskiest of borrowers
tend to benefit from buoyant economic conditions. While the risk inherent in banks' lending portfolios peaks at the top of the cycle, this risk tends to be realized during the contractionary phase of the business cycle. At this time, banks' non-performing loans increase, profits decline and substantial losses to capital may become apparent. Eventually, the economy reaches a trough and turns towards a new expansionary phase, as a result the risk of future losses reaches a low point, even though banks may still appear relatively unhealthy at this stage in the cycle.  

Bloem and Gorter (2001) suggested that a more or less predictable level of non-performing loans, though it may vary slightly from year to year, is caused by an inevitable number of 'wrong economic decisions' by individuals and plain bad luck (inclement weather, unexpected price changes for certain products, etc.). Under such circumstances, the holders of loans can make an allowance for a normal share of non-performance in the form of bad loan provisions, or they may spread the risk by taking out insurance. Enterprises may well be able to pass a large portion of these costs to customers in the form of higher prices. For instance, the interest margin applied by financial institutions will include a premium for the risk of non-performance on granted loans.

Bercoff, Giovanniz and Grimardx (2002) using accelerated failure time (AFT) model in their study of Argentina's banking sector's weakness measured by the ratio of non-performing loans to total loans found that both bank specific indicators such as asset growth, the ratio of net worth to net assets, the ratio of operating cost to assets, exposure to peso loans, and institutional characteristics relating to private bank and foreign bank and macroeconomic variables including credit growth, foreign interest rate, reserve adequacy (imports/reserves) and monetary expansion (M2/reserves), besides the tequila effect were reasons behind the banking fragility. Their empirical results suggested that bank size measured by log of assets had a positive effect but asset growth had a negative effect on NPLs. The variables such as operating cost, exposure to peso loans, credit growth, and foreign interest rate had negative effect on NPLs. The macroeconomic variables such as money
multiplier, and reserve adequacy, institutional characteristics and tequila effect had positive influence on NPLs 43.

Carter, Les W., of Nova Southeastern University, (2003) in his dissertation titled, "The credit supply effect on commercial real estate loans in commercial banks" stated that in commercial real estate lending two general theories attempt to address the reasons for default – interest rates or credit supply. The interest rate theory suggests that higher interest rates will reduce the number of borrowers, thereby reducing the defaults. The credit supply theory suggests that when too much credit is available, defaults increases. The significance of this paper is that it will add research on the commercial real estate loan defaults in the commercial banking industry to determine if the credit supply effect is present in commercial banking. Ten hypotheses were tested to explore the relationship between outstanding commercial real estate loans, interest rates, and loan delinquency in commercial banks in the United States. The hypotheses focus on the major relationships affecting non performing loans- the outstanding loan volume, the credit spread, and the Prime rate, the Average Vacancy Rate, and the unemployment Rate. The results indicated that a relationship existed in nine of the ten hypotheses. The study concluded that the credit supply effect exists in commercial banks for commercial real estate loans, and is significantly correlated to delinquency rates 44.

Gramm, Leach, Bliley Laski, John Nelson, Nova Southeastern university, (2003) in their study on “Securities underwriting by commercial banks and others: An analysis of wealth and risk characteristics” looked at the wealth and risk characteristics of commercial banks and other financial institutions following regulatory changes that formerly precluded commercial bank and insurance sector involvement in securities underwriting. Under provisions of the Banking Act of 1933, most commonly referred to as the Glass Steagall Act, a separation of commercial banking and investment-banking activities were instituted. While prior study suggested the increased benefits of diversification may not have been sufficient to overcome the additional risk taken on, this study suggests that in terms of company specific risk as
measured by the Z score, the increased wealth seems to offset the additional risk, if any, incurred. A further examination of these issues, at a point farther down the road would provide the benefit of a more comprehensive view, based on greater and more consistent data availability.\textsuperscript{45}

Cook. Malcom of University of Sydney (Oct.2003) has studied the practice regarding sale of NPAs among commercial banks of Taiwan and Philippines. He pointed that recent moves by locally-operating banks to clear their books of non-performing assets absorbed during the 1997-1998 Asian financial crisis will hopefully re-energize bank lending and local investment. The Philippine government was the only government of the crisis-affected countries not to set up a state-funded asset management corporation during or soon after the Asian financial crisis to buy local banks' non-performing assets and help them stay afloat and begin lending again. The Philippine government even refused to buy up the non-performing loans of state banks like Landbank, directing them instead to seek out willing private sector buyers. Rather, the Philippine government chose to pass a law offering tax incentives to local banks to sell off these non-performing assets while actively encouraging global investment banks to negotiate with local banks over such sales. The passing of the Special Purpose Assets Vehicle (SPAV) law itself was delayed over disputes about whether foreign banks could buy local idle property assets and evade the legal ban on foreign land ownership and whether local banks could participate in consortia bidding to buy their non-performing assets. The eventual passage of the bill and recent transactions under it suggest that Philippine banks may be able to finally clear their books at little cost to the government while offering global investment banks a new avenue to invest in the Philippines.\textsuperscript{46}

Kisero Jaindi (Nov. 2003) in his article "Banks to auction their non-performing assets" stated that 'all non-performing assets in government-controlled banks are to be sold, says a new reform plan sponsored by the World Bank'. This is one a key plank in a comprehensive reform package, supported by a financial sector adjustment credit from the World Bank. It is by
The most ambitious attempt by the government to cede control of the assets it holds in the banking sector. Although the Narc government has put a moratorium on privatisation until after Parliament passes a proposed Privatisation Bill, it has apparently been decided that the planned reforms of the banks proceed without the new law. The aim, according to the terms of reference, is to cause an early exit of the Government from ownership and control of banks. A special unit, to be known as the Bank Restructuring and Privatisation Unit (BRPU), is to be created within the treasury to coordinate the process. It says that turning it around will require extensive work. Thereafter, it is to be quickly privatised by sale of state-owned shares to new multilateral or developmental investors capable of providing good governance and strategic direction to the bank.

Fuentes and Maquieira (1998) undertook an in-depth analysis of loan losses due to the composition of lending by type of contract, volume of lending, cost of credit and default rates in the Chilean credit market. Their empirical analysis examined different variables which may affect loan repayment: (a) limitations on the access to credit; (b) macroeconomic stability; (c) collection technology; (d) bankruptcy code; (e) information sharing; (f) the judicial system; (g) prescreening techniques; and (h) major changes in financial market regulation. They concluded that a satisfactory performance of the Chilean credit market, in terms of loan repayments hinges on a good information sharing system, an advanced collection technology, macroeconomic performance and major changes in the financial market regulation. In another study of Chile, Fuentes and Maquieira (2003) analyzed the effect of legal reforms and institutional changes on credit market development and the low level of unpaid debt in the Chilean banking sector. Using time series data on yearly basis (1960-1997), they concluded that both information sharing and deep financial market liberalization were positively related to the credit market development. They also reported less dependence of unpaid loans with respect to the business cycle compared to interest rate of the Chilean economy.
Jimenez and Saurina (2003) used logit model for analysing the determinants of the probability of default (PD) of bank loans in terms of variables such as collateral, type of lender and bank-borrower relationship while controlling for the other explanatory variables such as size of loan, size of borrower, maturity structure of loans and currency composition of loans. Their empirical results suggested that collateralized loans had a higher PD, loans granted by savings banks were riskier and a close bank-borrower relationship had a positive effect on the willingness to take more risk. At the same time, size of bank loan had a negative effect on default while maturity term of loans, i.e., short-term loans of less than 1-year maturity had a significant positive effect on default.
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