CHAPTER II
LITERATURE REVIEW

2.1 INTRODUCTION

Post economic reforms in 1990's the Banking and financial system in India had considered it imperative to accept international standard of accounting system, procedures and financial reporting. This being major procedural shift, initially, it resulted into huge Non-Performing Assets and the need for adequate capitalising of the Banking system was viewed necessary. This apart the credit risk management, market risk management and operational risk management had to be put in place for finding an Indian Banking system at par with global practices. Therefore, this research work concerning Non-Performing Assets and Capital Adequacy had to find comprehensive coverage that began with prudential norms involving income recognition, assets classification, provisioning as also capital adequacy in terms of Basel I, Basel II and Basel III norms. A better justice to this research work can be done if entire literature accessed from above referred purpose is segregated for review into two major disciplines viz.

(I) Peripheral Issues
(II) Focal Issues

(I) Peripheral Issues such as introduction of prudential norms and its implication

2.2 Dr. Gnati Subrahmanyam

In her article titled “Capital Adequacy Norms aggravated Bank's Regulatory Burden” deals with the capital structure and its role in the Indian Banking and financial system emerged immediately after considering agenda for economic reform by the Government in early 90's. The author has evaluated very analytically the implications of cost factors relevant to funding of capital. The nitty-gritty of Banks allocation of fund for parking with regulators as a reserve on one hand and deployment of balance fund for business activities on other hand mix the whole exercise of risk assessment as very complex. The author has painted the capital as king considering its importance in offering security and safety to attract business fund from other source at a cheaper or judicious cost. However the same author is painting the capital as burden since the cost of such capital and its adequate

volume implicates interest rate offer able to depositors or interest rate chargeable from borrowers. Thus with such interpretation, the perception of risk weight age vis. a vis. capital requirement is well brought out and well addressed in concluding caveats of the article.

2.3 Dr. N.P. Kurup

As per his article titled "M. Narasimham Committee: Two Years After " has considered up front, the obtaining status after two years of Narasimham Committee recommendations and its implications. Amongst other things, the author has effectively brought out developments in respects of setting up of Recovery Tribunals to improve both liquidity and profitability. This apart author also addresses the prospects of Bank tapping capital market for raising capital after having cleaned balance sheet structure through adopting modalities of transparency in the financial statement reporting system. Need for adopting practices of transparent international accounting standard is emphasised. Author has also observed then undecided status and hang over of abortive proposal in respect of assets reconstruction fund as opined by Dr. Rangrajan of RBI. The issue of overcoming bad debts was then left to strategy of Banks after implementation of prudential norms.

2.4 N.K. Bakshi

In his article titled "Infusion of Capital in Banks through Public Issues" touched upon very elementary composition of capital structure in Bank with particular preference to Basel norms. It was between 1990 and 1995 that prudential norms, its implications and compliance gave many shock to PSB's in pursuit of achieving stipulated quantum of capital. Income recognition, assets classification and provisioning of NPA's make Bank balance sheet more transparent and more attractive to tap capital market. As per author it was in 1995 and thereafter that tapping capital market through the launch of public issues, would help Banks not only raise capital muscle by levying hefty premium but also in the process demonstrated capital adequacy against risk weighted loans. This exercise complies with capital adequacy requirements as per RBI stipulated Basel norms as also growth in tier I of core capital creates headroom for raising supplementary capital in case

---


of need if business prospect demand one. Table showing break up of core and supplementary capital as pasted by the author is attached for perusal.

**Capital of the Bank (8%)**

<table>
<thead>
<tr>
<th>Core Capital (4%)</th>
<th>Supplementary Capital (4%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Tier I)</td>
<td>(Tier II)</td>
</tr>
<tr>
<td>* Paid Up Share Capital</td>
<td>*Undisclosed Reserves</td>
</tr>
<tr>
<td>* Disclosed Reserves</td>
<td>*Asset Revaluation Reserve</td>
</tr>
<tr>
<td>- Share Premium</td>
<td>*General Loan Loss Reserve</td>
</tr>
<tr>
<td>- Retained Profit</td>
<td>*Hybrid (Debt / Equity) Capital</td>
</tr>
<tr>
<td>- General Reserves</td>
<td>*Subordinated Term Debt</td>
</tr>
<tr>
<td>- Legal Reserves</td>
<td></td>
</tr>
</tbody>
</table>

2.5 V. T. Godse, K. C. Chakrabarty4

In his article titled "Risk Management" the author himself being prudent Banker in large size PSB’s, has close look at risk management in general and types of credit risk and its tools operative in the financial system in particular. The author has broadly confined risk perception to 3 different Banking areas viz. credit risk, market risk and capital risk. The author outlines backdrop of credit growth in a post Nationalisation era and subsequent need for compliance prudential norms in the 90's which uncovered the concept of credit risk management and place the same in the sharper focus of the Bank management. Besides importance of prudent credit appraisal, proper credit delivery implications of interest rates and its market determination find automatic linkage with market risks. Under market risk, the author covers the financial operative system and its relevance with currency exchange rate besides swings and volatility in commodity markets vis. a vis. hedging through forward contracts etc. clearly dominate the area of market risk. This has to be factored in while making an overall risk assessment. The author has also quoted reference of BCCI, Barings and Daiwa etc to project associated capital risk. Author is opinion that cost of capital and its prospects of perceive threats should be made a part of overall risk management.

---

Having addressed core risk management concept in credit risk, market risk and capital risk, the author has then talked about available tools to manage such risks in Indian Banking system. In this considered opinion market determined interest rate tool would be proved very effective. However he has observed that despite the concept of prime lending rate (PLR), more than 45% credit being under direct interest rate regime, it reduces the efficiency of the interest rate tool. It seems that large credit portfolio should attract market determined interest rate link with PLR effective risk management tool. The author further says that existing cash credit system operating in Indian Banks is hugely blocking working capital, always causes the need for growth related additional working capital, leaving earlier blocked capital exposed to substantial risk. Therefore in the opinion of the author the cash credit system should be replaced by term loan type of credit delivery system which stipulates mandatory periodical repayment and thus it does not allow liquidity to dry up in the Banking system. The author has further gone on record recommending need for more vibrant secondary market which can play its role to pump in contingent liquidity needs at market determined cost and thus mitigate the market risk of the Bank.

2.6 S. Sambasiva Rao

In his article titled "A Primer for NPA Management" is at very elementary level and is more philosophical than realistic. In the initial coverage, the author has outline definition and exposed only the risk element in any kind of lending. If weight age is given to zero degree scope of recovery of lended money than perhaps the Banks and financial institutions cannot undertake any profitable business. Nevertheless, the author has commented on the social economic obligation of state owned PSB’s and the policy maker and has commented on proposing certain steps for recovery in accounts with willful default has also in the accounts where Government sponsored scheme have triggered NPA's. Amongst other things the author has suggested filing of criminal proceedings against willful defaulter, authorised seizure agencies attach property of relatives and evolve such system under which the promoters cannot become rich when the organisation is deteriorating. The author has also indicated measures in which accountability of professionals like charted accountants should be fixed for either concealing facts in the

balance sheet account or fixing accountability of lawyers for giving convenience legal opinions.

2.7 M. V. Lonkar⁶
In his article titled "Risk Based Supervision and Changing Role of Auditors" in the instant case, the author belongs to the agencies on the other side of the table who is a professional charted accountant and not a Banker. It is therefore that he has different angle of perception to the issue of capital structure and its risk based assets ratio. Purely on theoretical bases sees three trigger points of 9 % or less but more than 6 % or less but more than 3 % as second category and less than 3% as a third category. The author also comment on prospect of chronic sickness which attaches risk to depositors money where suspending licence is a step contemplated or liquidation or merger with other healthier organisation are other steps contemplated. Similarly the author has also focused two triggers for NPA's ratio of 15% and above and less than 15 % but more than 10 %. The other parameters looked into by the author is return on assets which he thinks, is a single trigger point at 0.25%. He has then his own ways of putting in place risk based supervision elements (RBS) which would be a useful tool in all within referred parameters. The RBS approach is introduced with a view to reducing financial sector vulnerability and enhancing financial sector stability. This involves codification and declaration of supervisory objectives and applying supervisory resources to those areas which pose a threat to supervisory objectives. This also involves making an assessment of the existing supervisory process and laying down a road map for making it more risk based. The new approach will be more flexible allowing focus on individual Bank’s situation.

2.8 S.K. Dutta⁷
In such article titled "Credit Risk Management in Banks- Basel Way" has clearly discussed that if the mention method adopted by the Banks of calculating the economic capital and RAROC for evaluating the loan proposal seems to have the dual advantages (1) the pricing loan based on statistically designed model. The premium for the risk can be based on scientific evaluation and can vary from borrower to borrower. The approval or

---


⁷ The Journal of Indian Institute of Banking And Finance, Vol. 75, April 2004
rejection is totally convincing to the management and the customer. There is some value addition in the net worth of Bank vis. a vis. the risk undertaken in lending. (2) The economic capital or risk weighted capital fully reflects the underlying level of risk being undertaken by the Banks for each lending. Such scientific method helps in overcoming the shortcoming the" one- size- fits - all" approach in which risk weighting is 100% for all. Hence, this is the most scientific approach to access how much capital is required by the Bank. The only limitation for this approach is capability, willingness and resources to develop such standard approach. This could well necessitate a degree of housekeeping of the Banks books and developing strong information system and its recording, to build a database and profile of clients and portfolios. These data can then only feed the above discussed models that will allow Banks to measure not only the RAROC but also the regulatory capital required in terms of economic capital. This will then help the Banks to enhance the risk management capabilities and to adopt new approaches to lending as well as risk mitigation techniques.

2.9 Rajendra Singh 8

In his article titled “Empowering Banks for Recovery of Non-Performing Assets (NPAs)” the author had concluded that with the enactment of this Act, it is felt that borrowers will not longer be able to take Banks lightly and simply walk away with scarce public money. The threat of taking over of collateral assets and enforcement of loan covenants has already begun to show positive results. So far NPA recoveries are estimated to be in the range of 20 percent. During the next 3-4 years, the Banks hope to recover 50 to 60 percent NPAs through tough measures.

This Act is an essential pre- requisite for smooth operations. This Act will not only help in improving the financial health of the country but also our mortal fiber as a society by enforcing the sanctity of contracts. Indian Banks have suffered immensely from the slow moving legal machinery for contract enforcement and strong lenders. However, it is too presumptuous to treat the enforcement of security and recovery of NPAs as a synonymous. Banks might find that the minefield of complex Indian procedures may create unforeseen stumbling blocks in putting theory into practice. In the ultimate analysis; the recovery process will need to be based on business analysis and restructuring rather than on the

---

legalistic approach of asset attachment. A legal system can help in setting the condition for discussion but cannot ensure asset utilisation. A new breed of restructuring experts will have to emerge to taken this process forward. It is knowledge more than law and capital that will help the process of change.

2.10 B. N. Rao

In the article titled “Basel II Compliance and Beyond” business and technological strategies should now be aligned to Basel II, which can no longer be viewed in isolation. Value creation for long term shareholders and stakeholders should receive primordial focus and an approach that could be benchmarked against International practices should be adopted.

There can no magic wand that can ensure compliance with Basel II and only a blend of regulatory and industry focused implementation exercise can pave the way for the creation of a roadmap. A diagnostic approach that could fathom the positioning of a Bank in terms of resources, data and risk practices which could in turn lead to the building up of a "risk architecture" that could satiate the risk appetite of the Bank is called for. Banks need to be aware that they have been vested with the freedom to have a flexibility to adopt various approaches vis-à-vis Basel II implementation. It is incumbent on the part of the top management to invest in commitment, involvement and understanding which will continue to be critical for implementation of the risk management.

While protecting the interests of the shareholders, it is a time for the Banks to broaden their vision and look beyond compliance in the global or Indian context and utilize the opportunity accorded by the New Accord to enhance and refine Risk Management practices further.

(II) Focal Issues concerning NPA management and capital adequacy.

2.11 Bank of India Hand Book

Pursuant to acceptance of M. Narasimham Committee reports the Banks were under obligation to implement all those recommendations which were presented to them under

---


directing guideline from the Central Bank of the country namely RBI. As is known to everybody today the Narasimham Committee report largely focused on income recognition, assets classification, provisioning and capital adequacy. Post economic reform, the PSB's in India were exposed all bookings on a realistic income beside hopelessly poor assets management and capital structure which was for being transparent. The Banks had accumulated on their back very huge NPA's without any clarity on direction to manage them. In such a backdrop, the above referred implementation of Narasimham Committee report was a challenging task for the management of PSB's in India. More or less all PSB's had presented hand book type of literature to their branches, inter alia conveying the core recommendation together with procedural guideline and explanation with examples, in line with actual bookkeeping practices of respective Banks. Bank of India also presented a similar handbook containing seven chapters and three appendixes. In the first opening chapter the management has highlighted the concept / management of NPA's which is descriptively covered in six pages containing definitions, the crux of the NPA's concept, RBI directives, treatment to consortium finance and project financing with illustrative examples and methodology of interest and installment recovery. The whole chapter has very nicely dealing with the first hand preparation to address NPA management. Similarly remaining chapter deals with accounting and income recognition with assets classification, provisioning and capital adequacy measure. The last chapter deals with the assets liability management and profitability with concluding guideline on preparation of annual returns.

2.12 Dr. Thakorsinh Parmar

In his article titled "Reducing NPA's " the author himself being actual official in Public Sector Banks and since to be handling credit portfolio which has enabled him to effectively highlight observation on the causes of NPA, makes suggestions for this chronic issues and draw meaningful conclusions. The author has clutched the very root of problem by projecting the disproportionately high credit growth up to 1980 in pursuit of Nationalisation objectives which coupled with hopelessly poor debt recovery. The author is thus critically observing huge blockade of the funds in NPA's which on analysis revealed the looseness in the credit practices and management of the Banks. The author

has also placed in records the lack sincerity of the staff beside emphases shortage of trained staff as also highlighted need for exclusively dedicated field staff. The author has also exposed the weak credit design and credit delivery system over and above gross ignorance to end used of funds. The author has also aggressively expressed need to evolve system of filing criminal FIR against such beneficiary borrower of Government sponsored scheme like Integrated Rural Development Programme (IRDP), in which the beneficiary sales assets financed by the Banks without permission. The author in his concluding remarks states the need for deployment of field staff, besides periodical review of credit risk and regular monitoring on actual credit system by upper class of the management and making leaders accountable. The author has lastly incorporated World Bank comments in respect of efficient collection and recovery in NPA's to improve Banks liquidity, profitability and quality of assets.

2.13 K. Shankar

In his article deals with "Non Performing Assets Anomalies and Inconsistencies" written by a Bank faculty in mid 90's, it has very truly and comprehensively highlighted the core issues of anomalies and inconsistencies which are pregnant in the obtaining procedural guideline for management of NPA's. Indeed the author has not only studied the methods and formula for determining provision amount, but also well pondered on anomalies that exist either in overlaps or interpretational differences between judicial intellectual and commercial interest of the Banks. The author has also very intelligently uncovered prospects of overlap in respect of Government guarantees account where procedural requirements to file claims with Government and subsequent recovery of bad debts through legal machinery depicts the methodology for reasonable and judicious provisioning amount. As per prudential norms, banks are expected to make provision for 100% of unsecured portion and additional provision on secured portion depending on age of NPA's. However Government guarantees account does not require any provision for such amount which is guaranteed by the Government in case of default and hence at the time of making provision, the quantum of Government guarantee is meted out and only remaining balance is considered for provision. However the same account, when it is liquidated through execution of the court decree or any other means of recovery, then

Banks are under obligation to refund back to Government on prorate basis in the same proportion as claim may have been settled by Government under Government guarantee. This remained a big anomalies in the implementation of prudential norms in Public Sector Banks.

The author has further considered the discreet procedural implication of mortgages and its liquidation legal procedure which often play out as disconnect between account transaction appearing in the Bank statement and actual recovery that Bank is entitled to receive. Here the author has projected the lacuna of the system under which the bank is unable to incorporate interest amount in the plaint, which has ceased to apply in the books when account was classify as NPA. Also the author has indirectly addressed the issue of Banks inability to liquidate mortgaged assets by (Equitable mortgaged) without intervention of the court and court order. Similarly the author has nicely analysed the similar situation in respect of liquidation of assets under hypothecation charge and its relevance with variation in provision amount either due to physical custody of the hypothecated assets or a situation in which hypothecated assets are not in the physical custody of the Banks. The author's approach is so pragmatic in arriving at fair, reasonable and judicious provisioning liabilities of the Banks that the author has walked an extra mile by suggesting treatment of gold loan account at par with KVP, NSC, F.D etc. However it do not agree with such preposition as the 40% to 50% margin on gold loan account may be offset either due to cumulative interest chargeable in case of 4 to 5 years of NPA account, beside gold being a commodity subject to its cyclical trends as is seen in current commodity scenario during economic turmoil in the last lag of 2008.

2.14 N. P. Kurup\textsuperscript{13}

In his article titled "Banking Sector Reforms and Transparency" the author has closely observed practices of the Bank, to pursue the achievement of reduction in NPA with specific hidden intention. Substantial reduction in NPA by increasing substantial provision amount (and not by actual recovery) during a year when treasury operation, other fee based income and even higher interest income due to high credit growth in the high interest rate sector, is the most convenient way as multipronged strategy. Obviously

\textsuperscript{13} Economic and Political Weekly, Vol. XXXII, March, 1996.
substantial higher profit due to increased income as stated above would attract higher tax payment and Therefore strategic increased in provision amount to over bad NPA's will help Bank achieved two goals-

(1) would be reduction in taxable income due to higher provision and Therefore Bank will required to pay less tax on one hand and

(2) Higher provision will help Bank post substantial reduction in net NPA's without any actual recovery on other hand. This intelligent author has therefore suggested tax friendly reforms for Banks so that Banks need not show reduced income by higher provision, to save on tax and thus retain so saved profits for enhancing shareholder value and continued its focused efforts to reduce NPA not by increasing provision but by increase actual recovery.

2.15 Brinda Jagir

In her article titled "Assets Reconstruction Fund" addressed amongst other thing at least two issues of this thesis viz. NPA's and capital adequacy. In favor of ARF apprehending the heritage of low level work culture in PSB's. The author suspects that Banks would indulge into concealing desired particulars on borrowers standing due to accountability fears. The author is also critical of that school of thoughts which believes that transforming of bad debt and refrain for being responsible to effect recovery of bad debt. On the other hand the author had considered ARF as a more needy option to save the Government from infusing capital again and again to service mounting losses due to bad debts.

As regards NPA's, the author has brushed upon general observation of many other authors like huge credit growth politically targeted for achieving socioeconomic goals by the Government, coupled with, very lose credit appraisal by the Banks, in the delayed delivery of credit, complete lack of supervision to verify the end use of funds, acute shortage of field staff for inspection of assets, very fragile system of review and monitoring, incomplete details on the particulars of assets and belonging to guarantors and borrowers, highly inefficient legal procedure and overburden judiciously etc. Illustratively the author has compelled the time taken by the normal judicial system in the suit filed accounts of PSB's which runs for several years in district civil and high court where as the

---

Narasimham Committee recommended setting up of DRT exclusively deals into cases of over RS. 10 lakhs with the obligation to ensure disposal within six months as against several years that may be taken in civil court or high court. Even decreed accounts from civil high court end up in a meaningless recovery prospects due to lack of minimum distinguishing particular of the assets attached of borrowers guarantors in the decree judgment. Thus the author has highlighted need for improved working and disposal through Debt Recovery Tribunal.

2.16 K.M. Shajahan

The author in his article titled "Non-Performing Assets of Banks Have They Really Declined? And on Whose Account?" has very intelligently considered critical scrutiny of both system procedure and figures. As a matter of fact RBI, when it came up with its report card showing a drastic reduction in an NPA figure about 50%, it was obvious that a person author's intelligence would comprehensively analysed the number crunching to determine as to how as large as 50% reduction is achieved in a single year. The author's exercise revealed that RBI had considered shift in its policy guideline concerning definition of NPA so as to give new nomenclature in terms of gross NPA's and net NPA's. The drastic reduction of above 50% in single year attributed to netting an NPA's from gross NPA's. The author has found out that RBI adopted a system of arriving at the net NPA figure redacting few sources of recovery such as Government guarantee DICGC/ ECGC claim and thereafter making a provision of the unsecured portion of the outstanding balance. Obviously netting like this a reduces quantum balance of NPA's without any "IN EFFECT" recovery from borrower. Thus, the reduction achieved represented very low portion of actual recovery from borrower but major portion was corresponding to liquidation of Government guarantee like DICGC/ ECGC, over and above increase provision available from Banks profit and loss account.

Such observation of this and many other authors may have provoked. RBI to examine more transparent means of presenting NPA's figures and therefore only perhaps notes on the account now show movement of gross NPA's during the year by tabling it as opening balance- increased during year to be added- actual recovery during the year to be deducted and then arrive at closing balance and similar tabulation status for provisioning amount make entire exercise very transparent to judge as to whether reduction in NPA is achieved only by

---

increasing provision amount or whether Bank has in actuality recovered any amount from NPA borrower.

2.17 V.K. Sudhakar\textsuperscript{16}

In his article titled "Managing NPA Menace in Banks: Using Computers And Critical Factors" addressing NPA management issues in the Banks where the Banks management may have remained careless in close credit monitoring and the Banks were NPA's slippage would have assumed a regular accumulation on quarter to quarter, half year to half year and year on year position. It is true that loses in credit monitoring system and weak fragile risk management system very quickly intense process of slippages from standard assets to NPA's and then it takes latter time to reach loss assets status when a credit portfolio is not monitor periodically on a regular basis. In such a case, the author recommended system of identifying potential NPA's in standard assets and considering up front action to recover the critical amount due, would precisely help bank arrest slippages to NPA's from standard assets and such account can continued remain classify as standard assets till next assets classification. Similarly midterm review of recently slipped standard assets into NPA's can help in identify critical amount in default and continued interaction and pursuance with borrowers can help Bank in recovery such critical amount in defaulting. So that freshly created NPA's can be upgraded to performing assets (standard assets) whenever next assets classification is due. The author has also raised assets cycle chart for credit monitoring purpose which help Bank judge as to where the NPA's status has reached and depending on actual findings Banks can take remedial measures including bifurcation of age old NPA's into hard core NPA's and non hard core NPA. Needless to mentioned that remaining action have to be triggered in respect of non hard core NPA's are considered for immediate write off through 100% provisioning and then such accounts are left for being dealt with by specialised field staff to explore to the remotest possibilities of recovery if any or knock down from the books of the Bank.

\textsuperscript{16} IBA Bulletin, Vol. XX, April 1998.
2.18 K.V Patel & V.S. Kaveri

In their article titled "Non-Performing Advances in Priority Sector - A Study" both the authors are trying to project the compulsion of Public Sector Banks where ownership domain is with the Government which has a definite politically ambitious policy framework. As is known to everybody all PSB’s of Government of India nominee directors on board who periodically monitor the actual flow of credit into targeted areas of policy makers. Such policy of the Government has targeted over 40% a credit flow into those segments of the economy which is named as a priority sector. Without mincing words, the authors have proved that such a targeted credit exposure of PSB’s are obvious potential NPA’s where the viability study, end use of funds critical scrutiny of loan proposals etc. are often compromise with in pursuit of achieving target given to each Bank by the Government policy maker. This apart, with priority sector advances have a spectrum length across the sector and thus it is assuming difficult status for close monitoring. The authors have also exposed Banks limitation in timely effective recovery procedure by clearly stating that by end large priority sector advances are capped below 10 lakhs rupees, the same falls out of the purview of expeditious disposal under DRT.

2.19 D.P. Sarda

In this article titled “Strategies for Reducing Non -performing Assets” mentioning various steps for reducing NPA. If one technique fails while dealing with a particular NPA, Banks may have to try with other techniques for that case. It is shown in the following chart.

---


In addition to solving the problem of existing NPA's, quality of appraisal, supervision and follow up should be improved for present advances to avoid further NPA's. Banks should examine the visibility of a project before providing financial assistance. It is necessary to ensure that project will generate sufficient return on the resources invested in it. The viability of a project depends upon technical feasibility, marketability of the product at a profitable price, availability of financial resources in time and proper management of the unit. Sanction of financial assistance after proper appraisal alone is not sufficient for recovery of advances. Disbursement of funds according to the requirements of the project and close supervision and follow up are also equally essential. If proper care is taken for appraisal close supervision and follow up of the advances, future NPA's can be avoided. Although risk is a part of lending, it can be minimised by taking necessary precautions,
which may help in avoiding NPA's. Special care should be taken for those advances which are showing irregularities and likely to become NPA's. It can be concluded that Banks should not only take steps to reducing present NPA's but also necessary precaution should also be taken to avoid future NPA's.

2.20 Shri Rashid Jilani

In his article titled "Key Note Address Non-Performing Assets: Issues and Prospects" concluded that by quoting the Narasimham Committee 1998 which succinctly captures the import of resolution of NPA's: "NPA's constitute a real economic cost to the nation in that they reflect the application of scarce capital and credit funds to unproductive uses. The money locked up in NPA's are not available for productive use and to extent that Banks seek, to make provision for NPA's or write them off, it is a charge on their profits. To be able to do so, Banks have to charge their productive and diligent customers a higher rate of interest. It thus becomes a tax on efficiency. It is the customers who use credit efficiently. It is the customers who uses credit efficiently that subsidises the inefficiency represented by NPA's. This also raise the transaction cost of the system thus denying the diligent credit customers the benefits of lower rates which would help them to more efficient and competitive. NPA's in short, are not just a problem for Banks. They are bad for the economy.

2.21 Banambar Sahoo

In his article titled "Rating of Banks on NPA Management" has considered all critical parameters and relevant ratios evaluate branch in respect of non-performing assets. Based on findings of the ratios as also its implications on health of the organisation, the author has come up with the suggestion to allocate number of marks variable from parameter to parameter and aggregate sum up of marks will place their organisation on scale of range between A+ (excellent) to F grade (Very poor). This is indeed a very nice and quality judgmental formula to place in focus all such organisation which forms in the rating range of average to very poor. In fact this is one of the most effective monitoring tools to create pressure for urgent corrective action on erring organisation and upgrade them on


consisting base, till it attains gradation of "good" level. Such an exercise would not only prove to be an effective tool for management of NPA but the same way improves liquidity, profitability, cleanliness in the balance sheet and ultimately placed the organisation in the pink of health. Unfortunately this proposition may have remained either unexpected or unimplemented has none of the literature review unfold NPA rated Banks or NPA rated branches. Needless to say that all the financial institutions have more or less similar kind of audit rating whose usefulness does not mean any mention.

2.22 O. P. Banmali
In this article titled "Life Line of Banking New RBI Formula for NPA Recovery" stated that it was in early 2000 the Banks had started accepting NPA management as a focused one point agenda, not only to pursue cleaning up of the balance sheet but also substantially improved liquidity on one hand and find higher credential as also higher ratings to improve stock prices and build brand value in place, it became imperative for the PSB's to recover huge NPA's either in time bound schedule or in the smallest time schedule. Country's Central Bank i.e. Reserve Bank of India provided guideline together with model scheme for effective recovery in NPA account with more than Rs. Five crore outstanding above or less than Rs. Five crore outstanding amounts. The author has very rightly expressed his concern over the fact that often important issues address by RBI are taken up in the spirit of the routine guideline by PSB's and thus the issues do not receive attention, it deserves as a result purposes defeated. In the opinion of the author, RBI provided with the scheme at very right time and it was up to the consent Banks to not only understand and propagated the scheme but also indulge from top senior brass management to middle management and down to grass route level workers so that specially created cells together with specialised team workers produced desired results, only to find the respective Banks at comparable levels with international peers.

2.23 Sardar N.S. Gujral
The author in his article titled "Assets Quality And Management of NPAs has begun by referring the implication of resultant NPA's occurred post implementation of prudential norms impacting country's economic growth and bottleneck in credit flow from Banks

---

and financial institutions. Obviously when funds deployed for credit gets blocked by way of non recoverable NPA's, then more credit flow would not be possible unless either NPA's are recover /return of or fresh liquidity / funds/ fresh capital is infused. Needless to mention that no organisation can afford infusing fresh capital gain and again leaving unrecovered NPA's as mounting debts. In such a situation, it is incumbent on part of Banks to liquidate NPA's through recovery which can be enforced through available means of legal option. Country's Central Bank had to intervene by way of proposition who set up "Lok Adalat" has also “Debt Recovery Tribunals" in line with recommendation of M. Narasimham Committee. This special set up has been meaningfully useful in speeding up recovery process which was otherwise never finding any momentum under normal conventional judicial system. In back drop of failing judicial system has also ARC's inability to provide one shot liquidity; the author has strongly propagated to creation of legal reforms by way of Securitisation Act. It was hoped that enacting such Act will help Bank attach assets and property of willfully defaulting borrowers and liquidate them even without seeking court order. Needless to mention that such an Act and its enforcement liquidate assets, will be considered only after failing to revive bad debt into performing assets has also if best efforts for corporate debt restructuring fails.

2.24 Jenifer Piesse, Sumon Kumar Bhaumik

In their article titled "The Risk Aversion of Banks in Emerging Credit markets: Evidence from India" This paper focuses on the behavior of Banks operating in emerging markets where they have the choice of disbursing resources collected through deposits either as credit to commercial borrowers or as an investment into sovereign securities. Commercial credit in these countries carries credit risk as well as liquidity risk, given the high cost of liquidating collateral for such credit, and the absence of markets for hedging these risks. Sovereign securities, on the other hand, carry near zero default risk, and a relatively low level of liquidity risk. The paper highlights three aspects of Bank behavior in the context of such emerging markets that are not captured by the literature that focuses on the relationship between ownership and performance of Banks. Our results indicate that the credit market behavior of Banks in emerging markets is influenced largely determined by past trends, presumably

limiting significantly the ability of new and dynamic firms and sectors to grow rapidly. There is also evidence to support the hypothesis that prudential regulations have a significant impact on Bank behavior with respect to credit disbursal, by making these decisions sensitive to the prevailing stock of NPAs. The regulations also have an impact on Bank-lending in India by way of the priority sector norms of the RBI; these norms make Banks less willing to disburse credit. Finally, we find evidence that the second generation of reforms in India, the thrust of which was then the element of Banks to clear NPA off their balance sheets, had a positive impact on the credit disbursal of the Banks. The results are instructive, and consistent with our priors about Bank-behavior in the context of lending in an emerging market. They also raise some policy issues like, e.g., the effectiveness of the priority sector norms. But while decisions on issues like priority sector lending are likely to be made in the political arena, and while consolidation of incumbent Private Banks by way of M&A can hardly be a policy objective, the results indicate that, given that the Indian Banks are demonstratively risk averse, there is a politically neutral policy issue that can and should be addressed with immediate effect.

2.25 Price Waterhouse Coopers

The article titled "Management of NPA's By Indian Banks" under reference neither from a working Bank official nor from any other financial institution but the same has come up from a word class multinational management consultancy firm. It was in 2002 at Central Bank RBI, in pursuit of addressing core NPA issue in Indian PSB's, staged a conference at Bangalore in which the world class organisation name PRICE WATERHOUSE COOPERS initiated and considered comprehensive study of the subject. Needless to mention that PWC has reputation of a firm headed by professionals of international repute with rich experience gathered from spectrum of financial organisation operating across the globe. PWC as a body, has excellent talent at their disposal, to look into the obtaining historical status of accumulated NPA's in PSB's in India together with classic sectorial analysis and study of different causes and condition relevant to emergence of NPA's and its life cycle till liquidation. The whole exercise involved thread bar analysis of economic condition, management machinery and system for handling credit profile and risk

assessment techniques and quality of appraisals, time flow chart and signal, internal and external control system, a legal framework and judicial set up which all together make a comprehensive report to deal with the issue's of NPA's in Indian PSB's. Obviously such reputed organisation detailing on above referred comprehensive study, translated into a recommendation and suggestion which are recorded in this article and the same has been more or less played out themes in the Indian Banking system during last four years. This perhaps one of the best articles under signed has come across.

2.26 A. S. Rajeev

In his article titled “Basel II - Issues And Constraints" the author by virtue of being an operating Banking official an opportunity to closely assess situational impact on credit, market and operational risk integrated in the Banking business. In all three parameters the author has analysed factual conditions based on historical data, current scenario, the business model of the Bank, the socio economic obligation of the Bank and modern technical tool as also role of credit rating agencies. The net findings have been considered as issues and constraints together with his own suggestion in each parameter. The author has made a very sincere effort in addressing issues concerning the probabilities vis. a vis. actual experience. The volume of business and numbers of Banks in a very highly diverse economy of our nature as a model policy to be raised on a uniform basis in respect of operational risk and market risk is indeed a very complex and difficult. Even the author has gone to the extent of excluding entire retail finance portfolio from risk weight age consideration as the same is in many numbers beside individual variance being a difficult to judge by Banks. Thus, it appears that the author has well brought out issues and constraints. However, all the suggestions together fall short of justification to assessment of judicious capital assessment.

2.27 S. K. Bagchi

In this article titled " Basel II: Operational Risk Management- Need for a Structured Operational Risk Policy in Banks" author clearly stated the likely impact on Indian Banking industry. The requirement of the specific regulatory capital requirement under the

---


Basel II Accord will have a limited impact as far as Banks Capital level maintenance is concerned owing to following reasons.

* Most of the Commercial banks in India maintain a minimum capital adequacy ratio above Basel Committee requirement of 8%
* As for the time being adopted Basic Indicator Approach (BIS) is to be apportioned 15% gross income may not pose serious constraints to meet regulatory capital requirement.
* Public Sector Insurance Companies/ Approved Private Sector Insurance Companies provide operational risk mitigated by way of Fidelity Insurance Policy for staff and Insurance Policy against business assets, against external events which will reduce overall quantum of operational risk amount and regulatory capital Basel II Accord on operational risk management is a welcome move. This will surely strengthen the business orientation and focus of Indian Banking. Furthermore since each Bank is likely to have a specific operational risk policy, it will provide a clear direction to operating staff and simultaneously enable top management to monitor and control the risk on an ongoing basis. Basic Indicator Approach is a simple and viable method of capital computation it would set apart necessary amount to take care of operational risk in tune with integral best practices.

2.28 Dr. K.C. Chakraborty

In his article titled "Management of NPA’s Trends and Challenges" the author had concluded that in the ultimate analysis, Banks have to face several challenges in managing NPAs. Besides ensuring better scrutiny of the credit proposals before sanction, Banks need to watch closely and monitor the assets from the beginning. In fact, NPA management begins right from the selection of borrowers. A continuous and consistent monitoring mechanism is a must for ensuring the best quality of the asset. Early warning signals or symptoms of any sickness should be addressed immediately and appropriate remedial action implemented.

Despite the availability of various avenues of recovery, in the ultimate analysis, it is the borrower's willingness to repay rather than his ability to repay. Hence, repayment ethics amongst the borrowers should be inculcated prior to any loan disbursement.

---

The mindset of the borrowers from the beginning should be turned in such a way that he is willing to repay rather than turn into willful defaulter. Banks should come forward to nurture and promote the above cultural changes among the borrowing public in order to ensure an effective recycling of the precious lendable resources for an all-round improvement of the economy.

2.29 Ram Pratap Sinha

In his article titled "Capital Adequacy of Indian Commercial Banks: Some Empirical Results" concluded that the existing capital adequacy standard has many weaknesses. This makes assessment of capital adequacy of Indian Commercial Banks a difficult proposition. The capital adequacy standards are, however, expected to change radically once the new framework is accepted. The Banks adopting the new framework will experience a lowering of capital requirements as compared to the rest who are not adopting it. Thus sooner or later, all commercial Banks will be compelled to adopt Basel II. Given the emerging scenario, Indian Commercial Banks face two major challenges. In the first place, they need to adopt the RAROC (Return on Risk Adjusted Capital) framework so that capital requirements are directly linked with the business decisions. This not only facilitates prudent decision-making but also ensures necessary capital allocation. The second challenge relates to the Public Sector Banks and is the task of mobilizing resources for meeting their Tier I capital requirements. The current legal provisions do not allow them to mobilize resources (from the market) beyond 49% of total equity capital. Whether this restriction will be a bottleneck for them or not is yet to be seen.

2.30 B Krishna Reddy, P Premchanda Babu, V Mallikarjuna and P Viswanath

In their article titled "Non-Performing Assets in Public Sector Banks: An Investigation" had observed that the Non-Performing assets in Indian PSB's appears to have subsided as the gross and net NPA ratios are declining, but in quantity terms there is no significant progress made by the Banks. The quantum of NPAs has increased notwithstanding the efforts of the Banks to reduce or curtail them. The effectiveness of various measures initiated by the RBI and Government of India is limited and Banks are still not able to tame the problem of NPAs. The health of the Banks and their financial performance


improved significantly due to the buoyant economic growth witnessed in the past decade and the rise of financial intermediation in the country.

Banks have made a windfall gain from the Government bond market in the last three or four years to build reserves for writing off NPAs. With no long lasting antidote for the NPAs in sight, the Banks are looking forward for Assets Reconstruction Companies to sell their NPAs off at whatever price they can. This is a post hoc solution but the real problem at hand is arresting the creation of NPAs at the first place. As the economy is poised to grow at a stupendous pace, the Banks have to play a much larger role in the coming years, this requires a robust framework to deal with NPAs.

Moreover the Indian Banking sector will be open for foreign participation; fully owned subsidiaries of Foreign Banks will operate on a par with domestic Banks. This will intensify the competition and the weak PSBs may find it difficult to survive. Hence, cleaning - up of balance sheets and shoring -up of equity capital are essential in the coming days. There is another danger lurking in the dark, if the economy slows down and recession prevails, NPAs will zoom-up making the problem uncontrollable. The answer lies in changing the attitudes of Bankers and borrowers and not just the processes.

2.3.1 Ram Pratap Sinha\textsuperscript{30}

In his article titled "Capital Adequacy of Indian Commercial Banks: Some Empirical Results" concluded that the existing capital adequacy standard has many weaknesses. This makes assessment of capital adequacy of Indian Commercial Banks a difficult proposition. The capital adequacy standards are, however, expected to change radically once the new framework is accepted. The Banks adopting the new framework will experience a lowering of capital requirements as compared to the rest who are not adopting it. Thus sooner or later, all commercial Banks will be compelled to adopt Basel II.

Given the emerging scenario, Indian Commercial Banks face two major challenges. In the first place, they need to adopt the RAROC (Return on Risk Adjusted Capital) framework so that capital requirements are directly linked with the business decisions. This not only facilitates prudent decision-making but also ensures necessary capital allocation.

The second challenge relates to the Public Sector Banks and is the task of mobilizing resources for meeting their Tier I capital requirements. The current legal provisions do not

allow them to mobilize resources (from the market) beyond 49% of total equity capital. Whether this restriction will be a bottleneck for them or not is yet to be seen.

2.32 Gourav Vallabh, Anoop Bhatia and Saurabh Mishra 31
In their article titled "Non- Performing Assets of Indian Public, Private and Foreign Sector Banks: An Empirical Assessment " focus that Non -Performing Assets which are nothing but loan assets of a Bank that have non-functional as the respective borrowers have defaulted on their liabilities , of a Bank have become critical in defining the financial health of the Bank. Here, it is immaterial whether a borrower defaulted on his repayment obligation by virtue of his not being able to realize the anticipatory cash flows from the business either due to his managerial incompetence, financial inadequacy, product failure, market competition, technological obsolescence etc, or due to changes in Government policies, macro economical fundamentals, natural calamities, labor problems etc, or because of the fact that the lending Bank failed to respond to the borrower's capital needs emanating from the altered market reflections well in time. Thus, it has become a critical for a Bank to anticipate the possibilities of an account turning into NPA and initiate a suitable arresting mechanism at its very initial stages, for that is the only way for it to remain healthy.

The study throws open a new field of research for testing the impact of other important macroeconomic fundamentals, such as inflation rate, interest rate and exchange rate and their variation on the accretion or otherwise of NPA's. Similarly, Bank - specific parameters, such as Bank's sensitivity to time the debt restructuring rightly or providing adequate capital in time vis-à-vis the demand

2.33 Vasant Desai 32
In his book chapter "Non- Performing Assets" had concluded that the accumulation of huge Non- Performing Assets in Banks and financial institution has assumed great importance. The depth of the problem of bad debts was first realised only in early 1990s. The magnitude of NPAs in Banks and financial institution is over Rs. 150000 crores.

While the gross NPA reflects the quality of loans made by Banks, net NPA shows the


actual burden of Banks. Now it is increasingly evident that the major defaulters are big borrowers coming from non-priority sector. The Banks and financial institution have to take the initiative to reduce NPA in a time bound strategic approach. The Government has empowered the Banks to take over the management of business of a borrower merely by publishing a notice in a newspaper.

In India, it is observed that the probability of success of such a strategy in much higher compared with the policy of debt transfer to AMCs. So it is suggested that India should opt for the decentralised creditor-led strategy and adopt policies to create an amicably environment for the success of such a strategy. However, in some Bank - specific cases, a time bound AMC can be conceived after meeting all the pre- conditions of AMC - based restructuring, if need arises.

2.34 Jyoti Sharma
In her article titled "NPA Management A Major Challenge for Banks " conclude that a variety of avenues are available to Banks and financial institutions in India to recover funds blocked in NPA and to use them for productive purposes. However, practically it is observed that they face many hurdles in this task consequent to borrowers taking benefit of loopholes in the existing statutes. Therefore, there is a need to remove such hurdles faced by the Banks and financial institutions by bringing in appropriate changes in the existing legal framework.

2.35 Geetika Gupta
In her article titled "BASEL III Indian Banking Perspective" conclude that the new rules provide a clear timeline on when and how these changes should be implemented. The process will be quite gradual and not in full effect until 2019. But implementation will be undertaken in a very smart way, providing benchmarks within the process to ensure that

---

Banks are on their way to full compliance, with some preliminary standards needing to met starting 2013. It is likely that market will push Banks to implement new standards faster than as required under Basel III.