CHAPTER – 7

CONCLUSIONS

The present study has focused on significant aspects of portfolio behavior of commercial banks in India. There can be no doubt that portfolio of commercial banks from point of view of both assets side and liability side plays a key role to determine the directions and dimension of their progress in the economy. Commercial banks are not only formidable intermediaries; they are the basis on which the government, the people and other competent authorities look forward as catalyst for the purpose of economic development. For the banks, therefore, designing and management of portfolio becomes an integral part of banking business. Over the period the theories of financial intermediation such as prior saving theory, theory of financial repression and theory of financial liberalization have facilitated financial intermediation, risk transformation and asset transformation so that the productive resources of the economy get channelized in the desirable directions in the most efficient manner. This calls for an optimal mix of components in both assets and liabilities portfolio so as to make the banking business truly a commercial proposition.

The present study has introduced portfolio of commercial banks in the forms of schedules as given by the Reserve Bank of India. On the liability side there are five schedules related to capital, reserve and surplus, deposits, borrowings and other liabilities. On the asset side there are seven schedules related to cash at bank, balances with RBI, balances with banks including call money, investments, advance, fixed assets and other assets. On the basis of the share of various components of assets and liabilities we have identified three items on liability side; capital, deposits and borrowings as the most significant items for analysis. On the asset sides we have identified two very important items for detail studies. They are investment and advances. In order to enhance the qualitative discussions on the items of assets and liabilities we have also taken non-performing assets and capital adequacy as important aspect of the study.

A comprehensive review of literature undertaken in the present study suggests the need to study the crucial aspects of portfolio behavior of commercial banks as highlighted above.
Although there are enormous studies on banks, in case of Indian banks most of the studies are found focusing on individual banks and/or few components of assets and liabilities. Some of the studies have concentrated on popular topics of discussion such as on deposits and advances, relationship with GDP growth, capital adequacy norms and non-performing assets separately. These studies also point out the growing importance of some of the portfolio items particularly capital and its quality and non-performing assets. Technical studies mainly focused on risk aspects of advances and investments. However, there are very limited studies to comprise these aspects for the bank group or banking system as a whole.

The present study has made a modest attempt to fill the existing gap in literature by undertaking a detailed study on some selected aspects of assets and liability portfolio of commercial banks. The detailed study undertaken by us on various aspects of portfolio behaviour brings forth the following points.

7.1 STUDY OF DEPOSIT BEHAVIOUR

I. Bank deposits constitute a major portion of bank liabilities. They constitute nearly 70 to 85 percent of the total liabilities of commercial banks. This means that the other liabilities range from 15 to 30 percent only. A detailed study of the share of total deposits of various bank groups in their respective total liabilities suggests that the share of deposit of SBI bank group has increased whereas that of private banks group and the group of foreign banks has fallen. In fact the foreign banks as a group show a continuous decline in their share of deposits to total liabilities from 74 percent in 1995 to 47 percent in 2012.

II. The deposits of all bank groups have increased with a great pace indicating a transformation in the saving habits of the Indian household sector. There are various reasons for the growth of bank deposits in absolute terms. This includes increase in the level of economic development and consequent rise in national income, deregulation of rate of interest, massive branch expansion by the banks and
limitation of available choice of investments in financial assets by the individuals. It is also clear from the available data that the growth of bank deposits in case of foreign banks has been comparatively slower than other bank groups. It is important to note here that foreign banks and to some extent private banks have limited number of branches mostly located in the urban areas only. It is also a fact that banking business in India depends much upon direct relationship with customers. Therefore, even if the private banks and foreign banks have attractive deposits schemes, they should not expect an immediate increase in deposit mobilization from the savers.

III. The study of deposit structure of various bank groups suggests that banks have the option to focus on mobilization of demand deposits or time deposits. The CASA (Current Account and Saving Account) deposit ratio defined as the ratio of deposit in current and saving accounts of a bank to total deposits help us to explain the strategy of the banks related to deposit mobilization. A high proportion of CASA deposit indicates the bank’s strategies to mobilize short term low cost funds. On the other hand a low CASA deposit ratio indicates the banks strategies to mobilize long term funds which may be at a higher cost. Although, there is no ideal CASA ratio the banks need to keep healthy relationship between time and demand deposits. It is interesting to note here that the CASA deposit ratio of foreign banks have increased over the period whereas those of nationalized banks reflect a decline indicating the differences in banks strategies in deposit mobilization. To put it differently we can say that nationalized banks of late have relied more on high cost term deposits, whereas private sector and foreign banks have reduced their dependence on term deposits. The rise and fall of CASA deposit ratio have important implications on both costs and profits of commercial banks.

IV. Our study of cost of deposits indicate that for all banks there was a fall in cost of deposit mobilization during the period 1999 to 2006 and thereafter the cost of deposit have increased for all bank groups. However for foreign banks the fall in the cost of deposits has been sharper and their cost are still lower than those of the other bank groups.
V. The study has attempted to explain the maturity pattern of term deposits of scheduled commercial banks. It is clear that during the period 1993 to 2006 bank deposits up to 90 days period were dominating in terms of absolute amount. However since 2007 onwards the term deposits of 91 days to 6 months became important. If we compare the share of accounts we find that long term deposits account ranging from 1-5 years are more in number than the short term deposit accounts. We also find that the share of term deposits of 1 to 2 years in the total term deposits has always been on the higher side.

VI. The study of cash deposit ratio of various bank groups suggest a continuous decline in the cash deposit ratio for all bank groups during the period. The decline in case of SBI bank group and private sector banks have been sharper than other bank groups. However cash deposit ratios of Indian banks in comparison to those of other countries are still on a higher side. This is because unlike western countries there is still a greater demand for hard cash for financial transactions in India.

VII. The credit deposit ratio of commercial banks has been fluctuating over the years. The study of the ratio indicates that over the period there has been a rising tendency in relations to all bank groups. It is important to note here that healthy credit deposit ratio is desirable for all bank groups. If the ratio is too high the liquidity aspect of the bank is questioned. If the C-D ratio is too low it indicates that banks are not utilizing their ratio for lending as much as they should have.

VIII. In the case of investment deposit ratio the nationalized bank group and SBI group suggests a decline in the investment deposit ratio. In sharp contrast to this the private sector banks and the foreign banks suggest a remarkable rise in the investment deposit ratio.
7.2 STUDY OF CAPITAL ADEQUACY

I. Bank capital is divided into different tiers according to their characteristics. The Tier I capital also known as regulatory capital comprising of share capital, statutory reserves and other disclosed reserves. It is the highest quality of bank capital. Tier II capital also known as supplementary capital comprising undisclosed reserves, asset revaluation reserves, general provisions, hybrid debt capital instruments and subordinated debt is lower in quality with respect to its ability to mitigate losses in case of crisis. There is also Tier III capital issued to meet only the market risk capital charge in accordance with prescribed criteria of RBI.

II. The capital adequacy ratio, defined as a ratio of capital funds to the risk weighted assets, is a measure of soundness of a bank as well as its ability to protect the bank at the time of crisis.

III. The ratio of capital to total liabilities has declined for every bank group except in the case of foreign banks where it has increased. Although RBI does not suggest a particular ratio of capital to their liabilities, banks’ growing weakness may be perceived on account of serious deterioration in it over a period of time. It can be understood from the fact that the said ratio is lower than one percent for most of the bank groups as against 6 percent plus ratio for foreign banks.

IV. The ratio of net worth to total liabilities is an important measure to demonstrate immediate financial strength of banks. Here again the performance of private banks and the foreign banks are few notches ahead of Indian public sector banks.

V. It is important for the commercial banks to maintain adequate capital in the form of capital adequacy ratio. Simply, it means that banks should have sufficient amount of capital to make them able to absorb any losses arising from the risk in banking business. The crucial objective is to protect the interest of common depositors as well as the stakeholders. Quantitatively the bank capital is that amount against which immediate demand from the deposits holder cannot arise as they do not have
the claims. Therefore at the time of crisis banks can use the capital as safe cushion if the value of banks assets declines or the liabilities rise beyond redemption.

VI. Since capital is such a crucial issue, its regulation and monitoring by the central bank is completely justified. More so, because the depositors are unable to monitor the financial soundness of banks by themselves, the central bank has to closely monitor and regulate the financial health through the capital adequacy norms.

VII. All over the world, bank’s capital are monitored on the basis of recommendation of Basel committee on banking supervision. The first such committee was set up in 1988 for global uniform and consistent banking standards. Like other countries India also followed the Basel Accord since the very inception.

VIII. The Basel Accord I required the banks to maintain capital adequacy ratio of a minimum of 8 percent and incase of India most of the banks were keeping the minimum capital adequacy ratio as per Basel Accord I in 1998.

IX. The Basel Accord I also assigned weights to the assets according to the risk category of debtors. In other words the banks were required to maintain capital only against those assets which had some degree of risk. The assets which had zero risk weights such as government securities did not require banks to maintain capital against them. Basel Accord I was criticized because it could not recognize the changing nature of credit risk and its dynamic structure over different economic setups. Basel II requirements therefore strengthened capital adequacy norms further by adding other types of risks attached to the assets.

X. Our study of capital adequacy ratio under Basel Accord suggest that initially there were some commercial banks who had capital adequacy ratio less than 4 percent in the year 1995-96 but by the year 1998-99 almost all banks of SBI groups and about 75 percent banks of nationalized banks groups and private sector banks had capital adequacy ratio of more than 10 percent. Some of the foreign banks had capital adequacy ratio between 10 to 12 percent. By the year 2006-07 only about 6 percent of old private sector banks had capital adequacy ratio of less than 8 percent.
XI. Basel II Accord for capital adequacy did not proved sufficient protection as the capital adequacy ratio was not able to keep pace with the rapidly prevailing trade cycle of the economy. There was no provision in the norms by which the banks could require lower amount of capital against risks during boom period and higher amount of capital against risk against downturn of the economy. Although the commercial banks followed capital adequacy norms more rigorously than ever, and most of the banks had capital adequacy ratio above 13 percent during the year 2009-10, the nature of capital compliance has changed drastically over a period of time.

XII. The Basel III accord therefore has recommended a comprehensive restructuring of capital and enhancement of minimum capital requirement under the new norms. The latest accord considers safety as an important issue and focuses on banks strength to increase over a period of time. The direct implication of Basel III accord is enhanced requirement of various categories of capital particularly equity capital to safeguard individual banks. A huge amount of capital infusion is required into the Indian banking system to the tune of rupees 6 lakh crores by the year 2020. Such a massive jack-up of capital is not possible without comprehensive structuring of commercial banks.

XIII. In our study we have presented the transitional arrangement of scheduled commercial banks with respect to various components of capital adequacy now introduced by Basel Accord III. The most interesting aspect of new norms is that capital is partly adjustable to the changing risk dimensions for the banks. For example the capital buffer introduced by the new accord is a variable component to adjust bank’s lending operations in good and bad times.
7.3 STUDY OF LENDING AND INVESTMENT BEHAVIOUR

I. The bank advances for all bank groups has increased over a period of time particularly during the period 2004 to 12. In absolute terms the advances of nationalized banks stand at the highest level followed by the private sector banks and foreign banks. However, if we compare the growth rate of bank advances during the period 1992 to 2012, then we find that the CAGR was 16.54 percent for SBI group, 18.59 percent of nationalized bank group, 28.47 percent of private bank group and 17.37 percent of foreign bank groups. Thus, in terms of growth, private sector banks have performed better than rest of the groups.

II. The bank advances can be classified as type wise, security wise, and sector wise. Under the type wise classification loan can be studied in relation with types such as bills purchase and discounted, cash credit, overdraft, demand loans and term loans. The loans are classified as security wise to understand the difference between secured loans and unsecured loans. Finally loans are given to various sectors such as priority sector advances etc.

III. The behavior of bank advances during the study period is worth noting. In case of types of bank advances for SBI and Nationalized banks, the share of cash credit and overdraft has fallen and the share of term loans has increased particularly after 2004. In case of private sector banks the same change has occurred earlier in 2002 and for the foreign banks still much earlier in 1996. It is also interesting to note that the bill purchase and discounting of foreign banks have witnessed a declining share in total loans during the study period.

IV. Bank group wise share of advances secured by tangible assets reveal that the foreign banks have experienced a decline in share of secured advances (secured by tangible assets) during the period 1992 to 2012. The behavior of other bank groups are more or less stable. The advances secured by banks or government securities have also a declining tendency for all bank groups and therefore there is a consequent rise of unsecured advances for all bank groups and particularly the group of foreign banks.
V. Priority sector advances are basically targeted credit and depend upon government policy from time to time. While the public sector banks have maintained a steady flow of priority sector loans as desired by the government and the central bank. It is only of late that private banks and foreign banks are required to provide priority sector loans almost at par with the public sector banks.

VI. The study of distribution of priority sector loans highlights the fact that more than one third of the loans are given to agriculture and allied activities and another one third of loans go to manufacturing and service sectors. The share of housing loans under the priority sector reduced from 24.16 percent to 18.71 percent during the period 2008 to 2012.

VII. The share of investment to total assets increased during the period 1992 to 2004 and thereafter declined gradually for almost all bank groups except the foreign banks. For the foreign banks there has been a steady rise in the share of investment to total asset during the period 2009 to 2012.

VIII. The public sector banks in Indian have a very strong tendency to invest in government securities and other approved securities due to SLR requirements imposed on them. In fact the public sector bank were found to hold a higher proportion of government securities than were actually stipulated because adequate safety and stable returns from them. Their participation in investment of shares, debentures and bonds and other avenues are almost insignificant. The public sector banks had a share of more than 90 percent invested in government securities and other approved securities. If studied separately, the investment of public sector banks in other approved securities has seriously declined from more than 25 percent to a negligible proportion.

IX. The behavior of private sector banks regarding investment is slightly different in the sense their investment in government securities have been declining but their investment in debentures and bonds are now significant that is about 11 to 12 percent. Although the foreign banks also prefer to have substantial proportion of
their investment in government securities their investment in the categories of other investment has increased from 7 percent to almost 30 percent.

X. The group wise information of credit-GDP ratio and investment-GDP ratio is not available. However the available data suggest that the credit-GDP ratio of commercial banks in India have increased remarkably form 19 percent to 50 percent. This is also encouraging to note that the investment-GDP ratio has also improved from about 16 percent in 1992 to marginally less than 20 percent in 2012.

7.4 STUDY OF IMPLICATION OF NON-PERFORMING ASSETS

I. A non-performing asset is a loan or an advance in whose respect payment of interest and/or installments of principal amount remains due for a period of more than 90 days for term loan. The NPA in case of overdraft and cash credit represents a status where an account becomes out of order. Similarly non-performing assets may also be identified as per the prescribed rules of RBI in the context of other form of loans.

II. It is important to note that if any advance or lending by the bank to a borrower becomes non-performing, all advances and credit facilities granted to that borrower becomes non-performing irrespective of the fact that there may still be certain advances not having NPA status.

III. As per the RBI guidelines, all advances of commercial banks are classified as standard assets, sub-standard assets, doubtful assets and loss assets.

IV. The four important measures of non-performing assets, they are (a) Gross NPAs as percentage of Gross Advances, (b) Gross NPAs as percentage of Total Assets, (c) Net NPAs as percentage of Net Advances and (d) Net NPAs as percentage of Total Assets. It is desirable that all these ratios remain at the minimum.

V. It is encouraging to find that all the four ratios with the respect to all bank groups declined during the period 1996-97 to 2011-12. However the decline for public sector banks are relatively slower and at the end of the period all the four ratios
remain higher for them in comparison to other bank groups. One reason for this trend is faster rise of advances than the increase in non-performing assets. Therefore there is invariably a decline in the ratio of non-performing assets. For example for all the scheduled commercial banks in India during the period 1996 to 2012 the gross NPAs and net NPAs increased by about 3 times approximately, gross advances during the same period increased by 15 times and net advances by more than 18 times. Therefore, the declining ratio of NPAs is only a mathematical truism.

VI. The growth of NPAs in absolute terms is quite alarming. The volume of gross NPAs and net NPAs have significantly increased which reflects the fact that there is a serious deterioration in the quality of banks assets. This has important implications on the lending and profitability of commercial banks.

VII. It is interesting to note that share of public sector banks in total NPAs has declined from about 92 percent to 82 percent, whereas share of private sector banks has increased from 5 percent to 13 percent and foreign banks from 2.5 percent to 4 percent during the period 1996-2012. Thus, the public sector banks continued to hold a share of more than 80 percent of gross NPAs generated by the banking system. That is a matter of great concern.

VIII. The present study has also peeped into the changing structure of NPAs. The study suggests that for public sector banks the share of loss making assets has declined from 12.5 percent in 2000 to 6.98 percent in 2012 of total NPAs. However an increase in the share of sub-standard assets from 32 percent to 50 percent and a alarming level of doubtful assets of 44 percent are likely to put the public sector banks into dangerous situations in years to come. Similarly in case of private sector bank and foreign banks the loss assets are already on rise and other categories of non-performing assets are also substantial in proportion. Therefore these banks also are also likely to suffer due to rising non-performing assets. Particularly those assets converted into loss assets from other categories. The study suggest that the banking system is sitting on a chair about to explore due to the massive deterioration in the quality of the assets. Unfortunately there is no escape route and the country does
not have any specified bankruptcy laws to help the commercial banks exit the market.

IX. Commercial banks in India are required to make provisions against their non-performing assets and as these assets are increasing in volume all groups of banks are required to make more and more provisioning against the non-performing assets. For example the public sector banks made provisioning for non-performing assets to the tune of 25876 crores in 2003 and increased this provisions to 55800 crore in 2012. Similarly, the private banks had to increase their provisioning for 4681 crore in 2003 to 13900 crore in 2012. Foreign banks have also increased their provisions over the years. Thus the total provisioning of scheduled commercial banks at the end of 2012 stood at a staggering figure of 74700 crores which pulls the alarm bell for the commercial banks in India.

X. During the period 1996 to 2008 for the public sector banks there was an increase in NPAs relating to priority sector advances from 48.8 percent to 63.9 percent of the total NPAs. During the same period the share on non-priority sector NPAs declined from 48.2 percent to 35.4 percent. After 2008 the share of NPAs in priority sector declined and stood at 50 percent in 2012. The share of non-priority sector NPAs were equal to the balance of total NPAs.

XI. The other bank groups also behave in the similar manner which indicates that the priority sector advances is not the only source of NPAs. The reckless commercial lending without proper monitoring has also resulted into substantial generation of non-performing assets over the years.

XII. Within the priority sector advances the NPAs arising due to agriculture loans has increased from 14.44 percent in 2004 to 20.10 percent in 2012, whereas, other sectors contribution to NPAs including those of small scale industries have reduced.

XIII. There have been serious attempts to reduce NPAs of scheduled commercial banks through Lok-Adalts, DRTs and SARFAESI Act. However the proportion of amount
recovered in relation to amount involved is very less and in some years it is even 20 percent of the total amount involved in these cases.

7.5 SUGGESTIONS AND POLICY RECOMMENDATION.

I. By the time the financial reforms in India started in 1992 the banking business was leisurely dominated by the public sector banks inclusive of the State bank of India and its Associates. In fact by March, 1992 the public sector banks had a share of more than 90 percent of total banking business spread over 60646 branches across the country. The public sector banks where handling deposits of more than 1.10 lakhs crores and advances of more than 60000 crore. Admittedly the government possessed enormous capacity to mobilize and allocate funds in the economy as per her own direction. At the same time, these positives not-withstanding, the monopolistic share of public sector banks might have created serious distortions in the financial system.

II. The advantage of the present work is that its period of study starts at a point where these distortions had already started their many manifestations and the immediate challenge of financial reforms carried out in subsequent years was to diagnose and rectify the ramification arising out of the monopolistic behavior of public sector banks.

III. The study of our deposit behavior suggests that the public sector banks had a massive share of deposit ranging from 70 to 80 percent on an average of their total liabilities. The private sector banks were able to reduce their deposit holdings from more than 85 percent in 1992 to almost 70 percent in 2012; but more strikingly the foreign banks reduced their share of deposits in total liabilities from about 70 percent in 1992 to less than 50 percent in 2012. This suggests that with respect to diversification of liability portfolio of commercial banks the performance of foreign banks and private sector banks are better than the public sector banks. This is important because diversification of portfolio into variety of items lowers the uncertainties and risk profile of the banks. Public sector banks taking deposits as
sine qua non will have to search for alternatives avenues for improving their credentials in highly competitive environment now emerging in the country. This means that they would be required to increase their capital, reserves and surpluses even at the cost of jeopardizing their temptation to attract more deposits. This ultimately requires substantial government intervention to restructure the capital reserve of public sector banks as she is the major stake holder for them.

IV. The financial control and repression of commercial banks prevailed for more than two decades since nationalization up to 1992. This did not give freedom to commercial banks to mobilize their deposits in line with their lending behavior. The financial reforms freed the banks to certain extent to change composition of their deposits consistent with their strategies to go for short term deposit mobilization or depend on long term deposit mobilization. It is for this reason the components of deposits have fluctuated severally in terms of their shares and volume during the period under study. Here again there is a dramatic fall of share of term deposits to total deposits for foreign banks in India from about 78 percent in 1992 to close to 56 percent in 2012. As the financial reforms are likely to step up further, commercial banks will have much more freedom regarding deposit composition and branch expansion so as to improve the nature and strength of their deposit portfolio.

V. We found that the correlation coefficient between Deposits and GDP of various bank groups and commercial banks as a whole was quite strong during the period of study. However, the correlation between deposits rate of various banks groups and their deposits mobilization for various maturity period were not quite strong. Moreover we found that advances and investments were negatively related as expected. However, the relationship was not quite strong for the group of foreign banks which suggests that they are more likely to be diversified for their allocation of funds.

VI. The credit deposit ratio (C-D Ratio) is an important tool to understand the capability of the banks to create loans out of the deposits received by them. Although there is
no specified ideal credit deposit ratio stipulated by the RBI or the government. Too high or too low a ratio is taken as indicators of a snag in lending behavior. If the C-D ratio is too low, banks may not be using their deposits resourcefully and adequately and therefore the health of the bank will suffer. If the ratio is too high, the bank might not have enough liquidity to cover the unforeseen requirements of funds. At the extreme the banks may be required to deplete their capital resources which is not a healthy sign for business of a bank. The credit deposit ratios of all groups of commercial banks have increased, particularly for nationalized banks and private sector bank groups. The improvement in the ratio is over 20 basis point during the period under study. By the end of 2012 the SBI group, private sector banks and foreign banks had a credit deposit ratio of more than 80 percent. Only the nationalized banks group had a C-D ratio of about 75 percent. Considering statutory ratio (CRR and SLR) an average of more than 80 percent of C-D ratio is a whistle-blower level for the commercial banks. However, the behaviour of C-D ratio of bank groups must be decomposed at bank and branch level and also at various regional levels so as to extol or deplore any further.

VII. The investment deposit ratio (I-D Ratio) in Indian context indicates the extent to which the commercial banks invest their deposits in fixed income yielding securities. This is important because of all the investment opportunities for banks, the reliance on government securities and other approved securities has been found very strong. For the group of SBI banks and nationalized banks the investment deposit ratio went on increasing during the period 1992 to 2006 and thereafter declined subsequently so as to remain at about 30 percent in 2012. The private sector banks had an investment deposit ratio of 33 percent in 1992 which increased to about 45 percent in 2012. The foreign banks that have an I-D ratio of more than 47 percent increased their share to about 72 percent in 2012.

VIII. Two things are important in relation to I-D ratio. First, the performance of public sector banks is in sharp contrast to the private sector banks and group of foreign banks. Second, the composition of investment is such there is a strong dominance of government securities in the investment portfolio of public sector banks. The
The advances of public sector banks grew at the rate of about 17 percent during the period under the study which was lower than that of private banks (28.47 percent). The period 2002-06 was the golden period of deposit mobilization as an average growth of deposit was more than 20 percent for almost all bank groups. An important aspect of bank advances is that over the period the demand loan (cash credit and overdraft) has declined in proportion and term loans has increased in share. The point of inflexion came to appear in 2004 for public sector banks and 2001 for private sector banks. The allocation of advances by various banks group seems to be influenced by changing interest rates and also government policies from time to time. Over the years the public sector banks have insisted for secured advances i.e., secured by tangible assets whereas proportion of such advances have declined significantly for the foreign banks. In other words the foreign banks have witnessed significant rise in unsecured advances. This is an important conclusion.
because even after the high proportion of secured advances public sector banks in particular are unable to recover the principal and interest component and there is a significant rise in various categories of non-performing assets.

X. In the component of total liabilities, the proportion of capital has important connotations. However, the group of State Bank of India had a share of capital to total liabilities of less than 1 percent throughout the period. The capital of public sector banks also declined in proportion from 5 percent in 1994 to less than 1 percent in 2012. The private sector banks share of capital in total liabilities declined from about 3 percent in 1995 to less than 1 percent in 2012. In contrast to this the foreign banks witnessed a sustained increase in the ratio from 0.29 percent in 1993 to almost 7 percent in 2012. A poor proportion of capital in total liabilities is the first indication of deteriorating financial health of commercial banks, particularly the public sector banks. The groups of foreign banks are able to increase their proportion of capital but at the same time their deposits as a proportion of total liabilities have fallen.

XI. Going a step further the study has also found that the foreign banks and the private sector banks as a group have been able to improve their net worth as a proportion to total liabilities which is a healthy sign. In contrast to these the public sector banks at best could witness a discrete trend of net worth ratio indicating a flat uncomfortable position for the public sector banks. The poor ratio of capital and reserves to liabilities and net worth to liabilities is a definite sign of increased weakness of financial strength of public sector banks. As such banks are facing a tough challenge to keep pace with ever rising capital requirements due to growth of deposits.

XII. The capital compliance of Indian commercial banks with respect to Basel I and II has been praise worthy. Most of the banks are found to maintain at present a capital adequacy ratio (CRAR) of more than stipulated 8 percent. In fact by the end of 2006-07 all public sector banks had a capital adequacy ratio of more than 10 percent. More than 80 percent of old private sector banks and most of the foreign
banks had also maintained capital adequacy ratio of about 10 percent. By the end of 2012 foreign banks and new private sector banks had an average CRAR of 16.7 percent, old private sector banks (14.1 percent), SBI group (13.7 percent) and nationalized banks (13 percent). As the Basel Accord I stipulated 8 percent CRAR and strengthened the quality of capital by incorporating various pillars of risk under Basel Accord II, the commercial banks in India geared up to improve their capital compliance. However, Basel III accord has implicated a sense of gauntness in the banking business by restructuring the quality of capital to be maintained over the years. Thus, even if the basic ratio of capital adequacy remains at 8 percent the new elements of capital structure requires the banks to add to their capital and improve the quality to face the highly dynamic and competitive changes in the banking system.

XIII. The banks are required to jack up their capital both in volume and quality to a very high level from the present level. This requires a massive capital infusion by the government. However, it is not known that such a huge capital infusion is possible for the banking industry in such a quick time. The banks also need to calibrate their capital and modify their data in such a manner that supervision and regulation of capital adequacy ratio is not only possible but effective for all practical purposes. For this the Reserve Bank of India is also required to improve its mechanism for quantitative as well as qualitative assessment. Several issues of liquidity, volatility and safety are hanging in balance and questions pertaining to these have remained unanswered.

XIV. The recommendations of Narasimham committee and the report of committee on banking sector reforms introduced prudential disclosure and classification of assets in the late 90’s. The immediate outcome of this was prevention of window dressing done by the banks. The banks were required to classify their non-performing assets into sub-standard assets, doubtful assets and loss assets. Initially they were little liberal but gradually the Reserve Bank of India tighten the noose around them so as to make the banks fully accountable for generating non-performing assets.
XV. From the study we gather that four important measures of NPAs – Gross NPAs to Gross Advances, Gross NPAs to Total Assets and Net NPAs to Net Advances and Net NPAs to Total Assets have steadily declined for all bank groups. However, this is only a mathematical truism as the decline is largely due to enormous growth of advances and assets over the period. However in terms of volume the gross NPAs of Public sector banks have increased from 435.77 billion in 1997 to 1124.89 billion in 2012. Similarly the net NPAs of public sector banks have grown from 202.85 billion in 1997 to 593 billion in 2012. The recent data suggest a massive jump of NPAs both in terms of gross and net in the last three years. It is also interesting to note that the public sector banks who had a share of about 75 percent of total banking NPAs in 2003 has increased to more than 84 percent in 2012, whereas the share of old private sector banks declined from 6.2 percent to 3.2 percent and the new private sector banks from 14.2 percent to 7 percent. Thus, the public sector banks are pushed to the point where NPA has already assumed alarming proportion. Even in terms of total bank credit the public sector banks at present has a share of more than 75 percent and the new private sector banks have a share of more than 15 percent. The old private sector banks and foreign banks share 5 percent each of total bank credit. It is a mute question therefore- what extent the government and Reserve Bank of India would go on to tolerate the NPAs of public sector banks.

XVI. Priority sector advances alone cannot be blamed for generating huge NPAs in the economic system. The non-priority sectors are equally responsible for generation of non-performing assets. According to one report the top 30 companies with respect to NPAs together account for Rs.16877 crores by September, 2013. Thus, it suggests that targeted credit and social banking are needlessly blamed for generation of NPAs in comparison to the non-priority sector advances given by the commercial banks. Immediate actions are required to curb the menace of growing NPAs in the banking system as there are long drawn implications of such growing NPAs on profitability, productivity and performance of commercial banks.

XVII. The earning and profitability of commercial banks are adversely affected because the banks have to make excess provisions against each category of non-performing
assets. The total provisions of all scheduled commercial banks were about Rs.32254 crores at the end of 2003 which increased to Rs.74700 crores by 2012. Major proportion of this provision was due to NPAs in public sector banks. The total provisions at the end of 2003 for public sector banks were Rs.25876 crores which increased to Rs.55800 crores by the end of 2012. Thus, 75 percent of total provisions where due to NPAs generated by public sector banks. In fact public sector banks had to make excess provisioning of Rs.19100 crores for the year 2012 which was very high in comparison to private sector banks (Rs.500 crores) and foreign banks (Rs.1100 crores). The composition of NPAs suggests that the substandard assets of public sector banks are rising. This is also a matter of great concern because sub-standard assets are likely to become doubtful and loss assets over a period of time. This gives no guarantee that the public sector banks will be able to reduce their provisions against non-performing assets over a period of time.

XVIII. It seems that the government is not ready to accept the fact that there are severe loopholes in the effective management of NPAs by the commercial banks particularly by the public sector banks. Our study does not suggest that non-performing assets is generated from a particular sector or a typical borrower. The contribution of various sources in generating NPA is almost wide spread. Instead of undertaking corrective policy measures the government becomes liberal to wave of the loans particularly in the agriculture sector. The government effort to recover the loans through Lok-Adalat’s, DRTs and SARFAESI Act has yielded very little result. The legal loopholes and the lengthy judicial process also do not encourage the Asset Reconstructing companies to purchase such non-performing assets in auctions. Thus, the banks are left high and dry to fight a losing battle against non-performing assets.

XIX. We have attempted some interesting econometric study related to total assets, advances, investment and non-performing assets. The first such study given in chapter 5 is related to impact of advances and investments on return on assets. The study suggest that investment to total assets and advances to total assets in case of SBI bank group and Nationalised banks group are positively related to ROA, i.e.
the increase in advances and investment lead to increase in return on assets. The $R^2$ was found to be high in both cases and t values and F ratios were found to be statistically significant. However, in case of private banks and foreign banks, the model was not found to be significant. This indicates that in case of private sector banks and foreign banks, there are other factors than the advances and investments to effect return on assets. This also indicates that in terms of dependence, foreign banks and private sector banks are more diversified to improve their return on assets.

XX. The second quantitative study relates to the impact of NPAs on return on assets (ROA). The model seems to be significant i.e., the ratio of net NPAs to net advances in all three cases affect the ROA. In all three cases a rise in the ratio of non-performing assets to the net advances is mostly likely to adversely affect or reduce the return on assets. In case of both public sector banks and private sector banks the t values are significant at 1 percent level and in case of foreign banks t value is significant at 5 percent. At comparative levels the value of $R^2$ for private sector banks is higher (0.584) than that of public sector banks (0.476) indicating a closer explainable relationship between the non-performing assets and return of assets. The $R^2$ for foreign banks are 0.444 stood to be lowest. The F ratio is found to be significant at 1 percent level for public and private sector banks and significant at 5 percent for foreign banks group which explains, among other things the reliability of the model.

XXI. We have also undertaken a quantitative study to find significant determinates of NPAs. We found that in case of private and foreign banks the explanatory variables term loan to total assets, priority sector loans to total assets and lending rate were quite significant. This helps us to conclude that a rise in the term loans and priority sector advances in case of public sector and foreign banks push the Net NPAs to Total Assets downwards. Similarly a rise in the lending rate will result into a rise in the Net NPAs ratio.
The model related to public sector banks is not very significant statistically and the behavior of coefficient is also contrary to other two models. It should be noted that the public sector banks are huge in size and are responsible for almost three quarter share of NPAs. It is possible that rise in term loans and priority sector financing may push the NPAs of public sector banks upward. It is also possible that with the fall in the lending rate the public sector banks tend to increase their lending without proper monitoring and follow up and end up with piling higher level of non-performing assets. The contrary behaviour of public sector banks and heterogeneity of their characteristics in the relation to private sector banks and foreign banks suggest us that we cannot rely with absolute surety on any of the variables to determine the financial strength of the banks and therefore an optimal mix of assets will always be less pronounced for the banking system.

7.6 SUM UP

The study has attempted to explore some selected issues of portfolio behaviour of various banks groups. Due to enormity of the theme, we had to undertake group wise study than an elaborated study of all individual banks. Admittedly, details of individual bank’s behaviour are not within the scope of our study. It is left to the intriguing researchers to further unfold the dimensions of asset quality and its impact on individual banks. Our study would remain prospective in nature and indicative in prescription.

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