Chapter 1: Introduction

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INTRODUCTION

The banking sector plays an important role in an economy for the smooth as well as efficient functioning of the different activities of the society. Finance which acts as a catalytic agent, is a great necessity. Finance is like blood to every form of activities. Finance is at the core of socio-economic growth trajectory of a society. The principal objective of Indian planning had been the attainment of growth with social justice and equity. To meet this increasing need of finance, the demand for strengthening the banking system on sound footing gathered momentum during the early period of independence in India. Banking system occupies an important place in a nation’s economy and is indispensable in a modern society. The overwhelming role of finance in the economic development of a country is well recognized and hence forms the core of money market in economy.

Normally, banks collect money from those who have spare money or who are saving it out of their income and lend this money to those who need it. This mechanism of providing finance is highly valuable and necessary in any community. But the role of commercial banks is not only confined to savings and its transmission to those who are in a position to invest it in a profitable enterprise; but also an instrument of credit creation. The role of bank has been transformed as prime mover of economic change, particularly in developing countries. It is necessarily more complex in view of dynamic contribution expected from time to time in the challenging task of optimum economic growth.

Different opinions are there, with regard to the origin of the word ‘bank’ in the modern sense. According to some authors, the word ‘bank’ is derived from the French word ‘bancus’ or ‘banque’ which means a ‘bench’.
Initially, the bankers, the Jews in Italy, transacted their business on benches in the market place. If a banker failed, his ‘banque, (bench) was broken into pieces by the people, which indicated the bankruptcy of the individual banker. Some authors say that the word ‘bank’ is originally derived from the German word ‘Banck’ meaning a joint stock fund which was Italianised into ‘banco’ when the Germans were masters of a great part of Italy. ‘Banco’ means heap of money. The word ‘bank’ is used in modern times, means an institution accepting money as deposits which are used for lending.

In India, the Banking Regulation Act, 1949 defines bank as a banking company and a banking company is a company which transact the business of banking in India [Section 5(c)]. Section 5(b) defines banking as accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, and order or otherwise. The present day banker has three ancestors: goldsmiths, money lenders and merchants. The goldsmiths used to accept money and other important valuable items of their customers for safe custody and issued receipts of them. These receipts were used as medium of exchange. The money lenders lent their surplus funds to the needy and earned income by way of charging high interest. The merchants were primarily traders and they had to oblige their customers by accepting their money for safe custody. Banking business was their side occupation. Today, we can see all the characteristics of these three types of functions in modern banks.

During period of Queen Elizabeth, goldsmiths of England possessed a position for modern banking in England. They used to receive valuables and funds of their customers for safe custody and issued receipts acknowledging the same. But their business was affected by severe restrictions imposed on them by King Charles II and ruined. Ruin of goldsmiths marked a turning point in the history of English banking which led to the growth of private
banking and the establishment of the ‘Bank of England’ in 1694. This bank started its business with a view to finance the government’s war with France. The Bank received subscriptions from the people and it provided loans to the government.

The first joint stock bank was set up in 1770 at Calcutta under European management by the name of ‘Bank of Hindustan. Thereafter, East India Company established three ‘Presidency Bank’ in India – ‘Bank of Bengal’ (1806), ‘Bank of Bombay’ (1840) and ‘Bank of Madras’ (1843). After the enactment of Banking Act of 1833 the growth of joint-stock commercial banking was accelerated in England. During the 19th Century, the growth of modern commercial banking was found in England. The first purely Indian joint-stock bank was the ‘Oudh Commercial Bank’ which came into existence in 1889. These three Presidency Banks were merged in 1921 as per the ‘Imperial Bank of India Act’ 1920 and renamed as Imperial Bank of India.

On the recommendations of the Hilton Young Commission in 1926, Government passed the Reserve Bank of India Act, 1934 to establish a central bank in the country as a shareholder’s bank. Reserve Bank of India was established in 1935. In 1949 the Banking Regulation Act was passed and the Reserve Bank of India was nationalized on 1.1.1949. This Act gave extensive controlling powers to the Reserve Bank of India and the Government over the commercial banks. Enactment of the Banking Regulation act and nationalization of RBI were the precursor of the structural reforms in the Indian banking system during post-independence period. These two events proved to be the turning points in the development of India’s commercial banks.

On the recommendation of the Rural Credit Survey Committee, the Imperial Bank of India was renamed as the State Bank of India on July 1, 1955 as per SBI Act 1954 and the State Bank Group was established in 1960
as per State Bank of India (Associate Banks) Act 1959. SBI and its associate banks opened new offices especially in the rural and semi-urban areas. This attempt proved to be fruitful in increasing quantum of deposits of commercial banks.

A distinguishing feature of Indian banking industry comprises a wide range of functions. The financial sector plays a major role in mobilization and allocation of financial savings from the net savers to the borrowers. The banks are the most important segment of the financial sector. The structure of the banking industry affects its performance and efficiency which in turn affects the bank’s ability to collect savings and channelize them into productive investment. The effective role of intermediation performed by banks adds gain to the real sector of the economy.

Concentration of wealth and economic power was in the hands of a few industrialists and monopolistic business in banking system was created. The lending policy of the commercial banks was highly discriminatory. They did not grant credit to priority sectors like agriculture, small-scale industries and big and established business firms. Even, they were not interested in opening offices in semi-urban and rural areas due to lack of profitability. Credit policy of banks also encouraged some antisocial and illegal activities such as hoarding, black marketing etc. against the general public interest. To overcome these unfair affairs of the banks the Government nationalized 14 commercial banks with deposits of ₹ 50 crore or more on 19th July, 1969. On 15th April, 1980, the Government again nationalized another 6 commercial banks.

After nationalization, there had been a rapid progress in branch expansion of public sector banks. New branches were opened in the rural and semi-urban areas without any banking facilities. There had been massive rise in the deposits of the commercial banks. On the one hand, massive deposit
mobilization and on the other hand rapid expansion of money supply caused phenomenal growth in credit supply. Also, there was a remarkable change in the credit policy of the banks. Credit to the priority sectors especially agriculture, small scale industry and business and small transport operators were given more importance by the policy makers. In addition to these, other priority sectors, like retail trade, professional and self-employed persons, education, housing loans for weaker sections and consumption loans were also included. Many innovative schemes such as village adoption, agricultural development branches and equity funds for small units etc. were introduced for the potential disbursement of bank credit. For making the banking sector an integral part of the planning process in the country, credit planning was introduced. Banks has started preparing quarterly credit budgets to bring about more correlation between the demand for and supply of credit.

Despite a massive rise in deposit mobilization and in credit granting, public sector banks suffered from low profitability over the years. Several public sector banks and financial institutions became weak financially and some public sector banks incurred losses year after year. The reason of low profitability of public sector banks in India was - (i) declining interest income and (ii) increasing cost of operation for banks. Public sector banks had to keep major proportion of their deposits with RBI in CRR (Cash Reserve Ratio) and SLR (Statutory Liquidity Requirements) and earned relatively low rate of interest. Further, they had to allocate a high portion of their deposits to priority sectors under social banking at low rate of interest. Even, at least 1% of the total deposits had to be lent to the weaker sections of the community at a low concessional rate of interest of 4% only. As a result, quantum of income earned by them was lower. Above all, the public sector banks were bounded by the government to lend in agriculture and other priority sectors to insolvent parties who were not in a position to pay back their dues. Consequently, their
loans became bad and doubtful debts, commonly known as non-performing assets.

Many things like uneconomic branch expansion, heavy recruitment of employees, growing indiscipline and inefficiency of the staff due to trade union activity, low productivity, heavy salary bill etc. caused increase in cost of production of public sector banks. For these reasons, on one side these banks had lower their interest income and on another side, their mounting expenditures reduced their profitability. Hence, they were not in a position to face challenges in a competitive environment. So, there is an urgent need of certain reforms so that PSBs can get rid of their weaknesses.

In modern era, the process of globalization has imparted its huge influence on the Indian banking industry. In the post liberalization period, there was an ardent need to bring about structural changes in the Indian banking system in order make it economically viable and competitively strong.

Therefore, the Government of India set up a High Level Committee with Mr. M. Narasimham, a former Governor of RBI, as chairman to examine all respects relating to the structure, organization, functions and procedures of the financial system. Based on the recommendations of the Narasimham Committee, the first phase of Financial Sector Reforms was initiated in 1991. The second phase of Banking Sector Reforms was initiated in 1998.

1.1 Significance of the Study

In most of the countries, government regulation shielded the banks from the forces of competition. India is no exception for this. With the nationalization of the most of the major commercial banks in 1969, restrictions on entry and expansion of private and foreign banks were gradually increased. The Reserve Bank of India also started enforcing uniform interest rates, spreads and service changes among nationalized banks. This cause of lack competition
either among public banks or between the public and private banks is gradually eroded the spirit of competition from the banking sector. In addition, the labour policies of the public sector where employees salaries and promotions are not linked to their job performance has also led to a steady decline in the efficiency, quality of customer services and work culture in the banks.

In added some areas of concern in the form of increasing non-performing assets, declining profitability and efficiency, which were threatening the viability of commercial banks. In the light of this facets of banking, various committees were appointed to improve the productivity, profitability and efficiency of the financial sector in general and banking sector in particular.

Banks also exercise influence on the level of economic activities through the creation of manufacturing of money. Through their lending policies, they divert the economic activity to the needs of the country. In view of this, the role of commercial banks in underdeveloped countries and planned economies like India becomes particularly important. As admitted by the lending bankers, ‘banking is the kingpin of the chariot of economic process. As such its role in expending economy of a country like ours can neither be under estimated nor overlooked. The success of our giant five year plan is dependent, among other things on the smooth and satisfactory performance of the role by banking industry of our country.

Commercial banks have played an important role in giving direction to economic development by catering the financial requirement of trade and industry in the country. By encouraging thrift among the people, commercial banks have fastened the process of capital formation. Banks draw the community savings into the organized sector which can then be allotted among the different economic activities according to the priorities laid down by planning authorities in the country. ‘The banks are not only the safe deposit vaults for these savings, but taking the banking system as a whole,
they also create deposits in the process of their lending operations. However, the important function of a banker is the provision of convenient machinery by which people can make payments to each other without having to walk round each other’s house with bags of coins.

Since 1992-93, the structure of the Indian banking system has undergone several changes in terms of scope, opportunities and operational buoyancy etc. The commercial banks have been facing much competition in the intermediation process from term lending institutions, non-banking intermediaries, chit funds and the capital market. To compete with them efficiently, the commercial banks have been permitted to undertake new activities like investment banking, securities trading, insurance business etc, on a selective basis at par with the competitors. Besides, various new banking services like ATM and internet banking have been emerged due to the advancement of computers and information technology.

The success of economic growth of a country mainly depends on the effective performance of banks. Indian capital market is highly dependent on the growth and prosperity of banking sectors. Therefore, it is high time to evaluate the financial performance of Indian banking companies. In view of this, the subject of management of assets has attained more importance. A better management of NPA will help to achieve the following objectives:

- To improve the quality of non-performing status so that income on such assets is recognized.
- To upgrade the status of different categories of assets in NPA (doubtful to sub-standard and sub-standard to standard) so as to reduce the provisioning requirement.
- To cleanse the balance sheet of loss assets and also unsecured position of doubtful assets, ultimately leading to increase the capital adequacy ratio.
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- To check the slippage from performing assets status so as to maintain overall quality of credit portfolio.

In this backdrop, the present study seeks to compare the non-performing assets of 4 banking companies, major players in the Indian money market, during the period 2005-06 to 2014-15. All the banking companies have been selected on the basis of their total income and balance sheet size.

The selected banking companies are:

**A. Public Sector Banks**
- State Bank of India (SBI)
- Punjab National Bank (PNB)

**B. Private Sector Banks**
- ICICI Bank Ltd. (ICICI)
- HDFC Bank (HDFC)

1.2 Review of Literature

In the banking literature, the problem of NPAs has been revisited in several theoretical and empirical studies. A synoptic review of the literature brings to the fore insights into the determinants of NPA across countries.

1.2.1 Foreign Studies

The issue of efficiency in financial institutions has been the subject of considerable examination. Berger and others provide a survey of the research on scale and scope economies, X-inefficiency in banking (which describes all allocative and technical efficiencies) and the impact on efficiency of bank mergers. (Berger, Hunter and Timme, 1993).

The authors note the research finding that X-inefficiencies account for around 20 percent or more of costs in banking, while scale and product-mix
inefficiencies are found to account for less than 5 percent of costs. They also observe that the measured inefficiency varies considerably depending on the choice of measurement method. One interesting finding they highlight is that output inefficiencies are on average larger than input inefficiencies, which suggests that most of the inefficiencies are in the form of deficient revenues rather than excessive costs. This suggests that focusing on the cost function could understate bank inefficiency.

As regards the sources of X-inefficiency, the authors highlight research findings that suggest this could be the result of agency problems between owners and managers, regulations and organizational and legal structures and scale and scope of operations.

The literature on bank privatization itself is rather scanty. In one of the few studies of its kind, Verbrugge, Owens and Megginson (1999) investigated bank privatization that used public security offerings as the divestment mechanism. Their study covered 65 banks from 12 high information and 13 emerging economies, although pre- and post privatization data was available for only 36 banks, of which 31 were located in high-information economies and five in emerging economies.

The authors found ‘limited improvement’ in bank profitability, operating efficiency, leverage, and non-interest revenue after privatization. There were significant returns to IPOs (although there was no information to compare these with market returns), which were consistent with those found in other non-financial privatization studies and in the IPO literature in general. This conclusion was limited to high-information economies, as pricing data for emerging economies was very limited. Seasonal issues were not significantly under priced. The authors found that the government retained substantial ownership even after the IPO; only in seven cases was government ownership totally eliminated at the IPO stage and there were eight cases where such
ownership was eliminated with a secondary offering. The authors are inclined to ascribe the limited improvement in performance post-privatization to the fact of continued government control over bank decision.

Another study involves a comprehensive survey of government ownership of banks and an examination of its implications for financial development and economic growth (La Porta, Lopez de-Silanes and Shleifer(2000). Surveying 92 countries around the world, the authors find that government ownership of banks is still common. In 1995, 42 percent of the equity of the top ten banks was owned by government in an average country. The authors also found that higher government ownership is associated with slower subsequent development of the financial system, lower efficiency in the financial sector and lower economic growth. Further, they find that government ownership of banks tends to be more prevalent in less-developed countries.

Whatever the author’s results for developing countries in general, it would be hard to argue that government ownership of banks has not contributed to financial development in India. Indeed, as highlighted earlier, the fact of financial deepening is, perhaps, among the least-contested propositions about government ownership of banks in India. This would hold even if we went by some of the measures that the authors employ: growth of private credit/GDP, growth of liquid liabilities/GDP, growth of commercial bank assets/total bank assets, and growth of stock market capitalization/GDP.

Moreover, this study also finds that state ownership need not always be bad for growth. The World Bank (2001) notes that the above study does show that ‘at higher per capita income levels, the negative effect diminishes to become insignificant’. Barth, Caprio and Levine (2001) showed that greater state ownership is associated with higher interest rate spreads, lower levels of private credit, lower stock market activity and less non bank credit. They also
find that state ownership tends to heighten the probability of crises, although this finding was not statistically significant. Reviewing further evidence on the subject of government ownership, the World Bank concludes there is a strong case for moving to sell government banks, but, for reasons that are clear, it qualifies its recommendation with the comment that ‘the findings do not demand elimination of all state ownership’.

The World Bank study also examines the experience of bank privatization in several countries and documents the gains from ownership, it underlines, are for ‘other things equal’, such as the ‘quality of financial infrastructure and the regulatory environment’. It cites the examples of Chile and Mexico, where there were major banking crises (including costs of 42 percent and 20 percent of GDP respectively) following privatization. This happened because of an underdeveloped supervisory and regulatory framework. The bank concludes that there must be a ‘deliberate and credible’ phasing out of state ownership, going hand-in-hand with a strengthening of the environment.

1.2.2 Indian Studies

Meeker Larry G. and Gray Laura (1987) in 1983, the public was given its first opportunity to review bank asset quality in the form of non-performing asset information. The purpose of this study is to evaluate that information. A regression analysis comparing the non-performing asset statistics with examiner classifications of assets suggests that the non-performing asset information can be a useful aid in analyzing the asset quality of banks, particularly when the information is timely.

Shawn Thomas (1999) in their study titled ‘Bank loan loss provisions’ describes that the 1990 change in capital adequacy regulations to construct more powerful tests of capital and earnings management effects on bank loan loss provisions. We find strong support for the hypothesis that loan loss
provisions are used for capital management. We also document the reasons for the conflicting results on these effects observed in prior studies.

**Vincent Bouvatier (2000)** in their study titled ‘Provisioning Rules and Bank Lending: A Theoretical Model’ describes that this paper develops a partial equilibrium model of a banking firm to analyze how provisioning rules influence loan market fluctuations. We show that a backward-looking provisioning system amplifies the pro-cyclicality of loan market fluctuations. We demonstrate that, in a forward-looking provisioning system where statistical provisions are used to smooth the evolution of total loan loss provisions, the issue of pro-cyclicality of loan market fluctuations does not exist.

**Balasubramaniam (2001)** in Non-performing assets and profitability of commercial banks in India: assessment and emerging issues said that the level of NPAs is high with all banks currently and the banks would be expected to bring down their NPA. This can be achieved by good credit appraisal procedures, effective internal control systems along with their efforts to improve asset quality in their balance sheets. However, maintaining profitability is a challenge to commercial banks especially in a highly competitive era and opening up of banking business to NBFC and foreign banks in general.

**S. N. Bidani (2002)** in his book “Managing Non-Performing Assets in Banks” states that Non-performing Assets (NPAs) are the smoking gun threatening the very stability of Indian banks. NPAs wreck a bank’s profitability both through a loss of interest income and write off of the principal loan amount itself. In his book, the author highlighted various aspects related to non-performing assets, Asset classification and assessment of provisions, Pre-sanction appraisal and post sanction supervision and followup, Monitoring system for existing and potential NPAs, Rehabilitation
of sick non-performing units, way to reduce risk weighted assets, NPA recovery through compromise and negotiated settlement, Strategies and actionable operational guidelines for reducing NPAs, and Suggestions for improving bank profitability.

**Larry G. Meeker and Laura Gray (2002)** in their study titled ‘A note on non-performing loans as an indicator of asset quality’ used the tool of regression analysis and described that, the public was given its first opportunity to review bank asset quality in the form of non-performing asset information. The purpose of this study is to evaluate that information. A regression analysis comparing the non-performing asset statistics with examiner classifications of assets suggests that the non-performing asset information can be useful aid in analyzing the asset quality of banks, particularly when the information is timely.

**Prashanth K. Reddy (2002)** in their study titled ‘A comparative study of Non Performing Assets in India in the Global context - similarities and dissimilarities, remedial measures’ analyzed that Financial sector reform in India has progressed rapidly on aspects like interest rate deregulation, reduction in reserve requirements, barriers to entry, prudential norms and risk-based supervision. But progress on the structural-institutional aspects has been much slower and is a cause for concern. The sheltering of weak institutions while liberalizing operational rules of the game is making implementation of operational changes difficult and ineffective. Changes required to tackle the NPA problem would have to span the entire gamut of judiciary, polity and the bureaucracy to be truly effective.

**Darell Duffie and Kenneth J. Singleton (2003)** in this book “Credit Risk: Pricing, Measurement, and Management (Princeton Series in Finance)” offer critical assessments of alternative approaches to credit-risk modeling, while highlighting the strengths and weaknesses of current practice. Their
approach blends in-depth discussions of the conceptual foundations of modeling with extensive analyses of the empirical properties of such credit-related time series as default probabilities, recoveries, ratings transitions, and yield spreads. Both the “structure” and “reduced-form” approaches to pricing defaultable securities are presented, and their Comparative fits to historical data are assessed. The authors also provides a comprehensive treatment of the pricing of credit derivatives, including credit swaps, collateralized debt obligations, credit guarantees, lines of credit and spread options.

Harpreet Kaur and J. S. Pasricha, (2004) concluded a research on management of NPAs in Public sector banks over a 8 years period ending 2002 and show that gross NPA has registered a constant increase from 1995-2002. This study point out the sector wise and bank wise position of NPA in PSBs. It was suggested that follow proper policy of appraisal, supervision and follow up of advances be taken up to controlling the NPAs.

Gopalakrishnan, TV (2005) classified the causes for NPA into political, economic, social and technological. The author opined that neglect of proper credit appraisal, lack of follow-up and supervision, recessional pressures in economy, change in government policies, infrastructural bottlenecks, and diversion of funds etc as the major cause for NPA.

Murali and Krishna (2006) in their paper, Ensuring Qualitative Credit Growth through Effective Monitoring of Advances, observed that there has been a spirit in the lending activity of banks, in the recent past. This is due to two factors, viz. availability of huge surplus funds with the banks and the losses suffered by the banks in investment and treasury activities. The authors concluded that negligence in monitoring a loan was less excusable than an error at the appraisal stage.

Bhatia (2007) in his research paper entitled, Non-Performing Assets of Indian Public, Private and Foreign Sector Banks: An Empirical Assessment,
explores an empirical approach to the analysis of Non-Performing Assets (NPAs) of public, private, and foreign sector banks in India. This paper aims to find the fundamental factors which impact NPAs of banks. A model consisting of two types of factors, viz., macroeconomic factors and bank-specific parameters, is developed and the behaviour of NPAs of the three categories of banks is observed.

Karunakar (2008), in his study Are non-Performing Assets Gloomy or Greedy from Indian Perspective, has studied the important aspect of norms and guidelines for making the whole sector vibrant and competitive. The problem of losses and lower profitability of Non-Performing Assets (NPA) and liability mis-match in Banks and financial sector depend on how various risks are managed in their business. The lasting solution to the problem of NPAs can be achieved only with proper credit assessment and risk management mechanism. It is better to avoid NPAs at the market stage of credit consolidation by putting in place of rigorous and appropriate credit appraisal mechanisms.

Ambuj Gupta (2010) in his book “Non-Performing Assets (NPAs) in Indian Banks” deliberates on the various issues, perspectives and future directions of non-performing assets (NPAs) in Indian Banks. The approach to NPA management has to be multipronged, calling for different strategies at different stages a credit facility passes through. The book also discussed the global scenario of NPAs along with specific country analysis, the regulatory framework adopted in India along with a strategic course of action to stop conversion of loans and advances into NPAs, recovery NPAs and converting NPAs into performing advances.

Meenakshi Rajeev, H P Mahesh (2010) studied banking sector reforms and NPAs in Indian commercial banks to examine the trends of NPAs in India from various dimensions and to explain how immediate recognition
and self-monitoring has been able to reduce it to a great extent. The study analysed the different aspects of NPAs like NPA in India comparative to other countries, NPAs of Indian banks as per the different sectors and recovery of NPAs through various channels. It was found that NPAs in the contributory factor for crisis in the economy and root cause of the recent global financial crisis. It was observed that NPAs in priority sector is still higher than that of the non-priority sector due to socio-economic objectives of banks.

Rajput N., Arora A.P., Kaur B. (2011): The study was made to trace the movement of the NPAs present in Indian public sector banks by analyzing the financial performance of the banks with respect to key performance indicators and management of the non-performing assets under the purview of new policy actions and regulatory adherence of the Reserve Bank of India. It was examined that the banks take up different parameter to different borrowers, and agreed for a lesser amount as against claimed amount, regardless of availability of plentiful securities and thus ignoring RBI guidelines. It has been observed that the prudential and provisioning norms and other initiatives taken by the regulatory bodies has pressurized banks to improve their performance, and consequently resulted into trim down of NPA as well as improvement in the financial health of the Indian banking system.

G. V. Bhavani Prasad, D. Veena (2011) in their paper dealt with understanding the concept of NPAs, its magnitude and major causes for an account becoming non-performing and strategies for managing NPA in Indian banks. They suggested that the Indian banking sector is facing a serious problem of NPA. The magnitude of NPA is comparatively higher in public sectors banks. To improve the efficiency and profitability of banks the NPA need to be reduced and controlled. It is better to avoid NPAs at the nascent stage of credit consideration by putting in place of rigorous and appropriate credit appraisal mechanisms.
Kaur and Singh (2011) in their study on Non-performing assets of public and private sector banks (a comparative study) studied that NPAs are considered as an important parameter to judge the performance and financial health of banks. The level of NPAs is one of the drivers of financial stability and growth of the banking sector. The Financial companies and institutions are nowadays facing a major problem of managing the Non-Performing Assets (NPAs) as these assets are proving to become a major setback for the growth of the economy.

Chaudhary and Sharma (2011) in their research paper on Performance of Indian Public Sector Banks and Private Sector Banks: A Comparative Study stated that it is right time to take suitable and stringent measures to get rid of NPA problem. An efficient management information system should be developed. The bank staff involved in sanctioning the advances should be trained about the proper documentation and charge of securities and motivated to take measures in preventing advances turning into NPA. Banks should be well versed in proper selection of borrower/project and in analyzing the financial statement.

Sandeep and Parul Mital (2012) analysed the comparative position of non-performing assets of selected public and private sector banks in India to find their efficiency through comparative study. Data has been collected from various secondary sources for period of 10 years and analysed with descriptive statistics and ANOVA. All the banks are making polices trying for the containment of NPAs for improving their asset quality and profitability. PNB and HDFC banks are found superior in management of NPAs comparative to SBI and ICICI.

Gurumoorthy (2012) in their article Non-Performing Assets (A Study With Reference To Public Sector Banks) have analyzed that: In the liberalized economy, Banking and Financial sector get high priority. The banks in India
are facing the problem of Non-Performing Assets (NPAs). The earning capacity and profitability of the banks are highly affected because of the existence of NPAs. Moreover the non-performance or non-receipt of interest and principal blocked banks money in the form of funds and is not available for further use of banking business and thus the profit margin of the banks goes down. In this connection bank must aware of the problems and recovery legislations of NPAs.

Parul Khanna (2012) in her article “Managing Non Performing Assets in Commercial Bank” has opined that a strong banking sector is important for flourishing economy. The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management. While the primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., but in recent times the banks have become very cautious in extending loans. The reason being mounting nonperforming assets (NPAs) and nowadays these are one of the major concerns for banks in India.

Kavitha. N (2012), emphasized on the assessment of non-performing assets on profitability its magnitude and impact. Credit of total advances was in the form of doubtful assets in the past and has an adverse impact on profitability of all Public Sector Banks affected at very large extent when non-performing assets work with other banking and also affect productivity and efficiency of the banking groups. The study observed that there is increase in advances over the period of the study. However, the decline in ratio of Non-performing Assets indicates improvement in the assets quality of SBI groups, Nationalized Banks and Private Sector Banks.

Debarsh and Sukanya Goyal (2012) emphasized on management of non-performing assets in the perspective of the public sector banks in India under strict asset classification norms, use of latest technological platform
based on Core Banking Solution, recovery procedures and other bank specific indicators in the context of stringent regulatory framework of the RBI. Non-performing Asset is an important parameter in the analysis of financial performance of a bank as it results in decreasing margin and higher provisioning requirements for doubtful debts. The reduction of non-performing asset is necessary to improve profitability of banks and comply with the capital adequacy norms as per the Basel Accord 3.

Selvarajan B. and Vadivalagan, G. (2012) revealed that non-performing Assets is not a dilemma facing exclusively the bankers; it is in fact an all pervasive national scourge swaying the entire Indian economy. Non Performing Asset is a sore throat of the Indian economy as a whole. Non Performing Assets have affected the profitability, liquidity and competitive functioning of banks and developmental of financial institutions and finally the psychology of the bankers in respect of their disposition towards credit delivery and credit expansion. NPAs do not generate any income for the banks, but at the same time banks are required to make provisions for such NPAs from their current profits. Apart from internal and external complexities, increases in NPAs directly affects banks' profitability sometimes even their existence.

Chandan Chatterjee et al (2012) suggested that the NPAs have a negative influence on the achievement of capital adequacy level, funds mobilization and deployment policy, banking system credibility, productivity and overall economy. On one hand, the Public Sector Banks which are the said to be a focal point of the Indian Banking system are in trouble with excessive governmental equity, excessive NPAs and excessive manpower, while on the other hand the private sector banks are merging themselves through adoption of most up-to-date expertise and technological systems. This article was attempted to focus mainly on the causes and consequences of
NPAs, policy directives of RBI, initiatives of Indian Government, scenario of NPAs sector wise and bank group wise and finally the curative measures for NPAs in India.

Vandana Joshi (2012) in her book “Research on NPA Management: NPA and Recovery Management in Co-operative Banking Sector” reveals that Advance is heart and recovery is oxygen for the bank and for the bank to survive it is necessary to give advances and recover the amount at the appropriate time. After the global financial turmoil in 2008, Indian banks begin the new year with a lurking fear that their Non Performing Assets (NPA) would go up with their portfolios coming under severe stress. This book covers various aspects like credit policy, NPA management, recovery management, etc. It contains identification and concept of NPA, various stages of non-collectible financial Assets and suggestion for effective recovery management. This book helps in understanding the critical problem of NPA in banking sector.

Gupta (2012) in her study “A Comparative Study of Non-Performing Assets of SBI & Associates & Other Public Sector Banks” had concluded that each bank should have its own independence credit rating agency which should evaluate the financial capacity of the borrower before than credit facility. An effective committee can be formed for management of NPA comprising of financial experts who have wide knowledge in this field. Banks can appoint professionals to identify the genuine borrowers & can analyse their profile.

Rai (2012) in her study on Study on performance of NPAs of Indian commercial banks said that till recent past, corporate borrowers even after defaulting continuously never had the fear of bank taking action to recover their dues. This is because there was no legal framework to safeguard the real interest of banks. However with the introduction of SARFAESI ACT banks
can issue notices to defaulters to repay their loans. Also, the Supreme Court has recently given the banks the freedom to sell mortgage assets of the borrowers, if they do not respond to the legal proceedings initiated by lender.

Debas Rakshit and Sougata Chakrabarti (2012) dealt with understanding the magnitude of NPAs in cooperative bank and major causes for an account becoming non-performing in cooperative banks and concluding remarks.

Jyoti Gupta and Suman Jain (2012) suggested that the bank should adopt the latest. Technology of the banking like ATMs, internet / online banking, credit cards etc. so as to bring the bank at par with the private sector banks.

Rajput N., Arora A.P., Kaur B. (2012): This study focuses on management of non-performing assets of the public sector banks under stringent asset classification norms. The study tried to trace the movement of the non-performing assets present in Indian public sector banks and also analysed the performance of the banks in managing the NPA.

Rajput, N., Gupta, M., Chauhan, A.K. (2012): This paper provides an empirical approach to the analysis of profitability indicators on NPA, it also discusses the factors which contribute towards NPA, and also analyses the solution for the same. All empirical findings were done by using statistical tools like correlation, regression and data representation techniques and DEA.

Asha Singh (2013) found that the non performing assets of the Public Sector Banks have been increasing regularly year by year. NPAs reflect the overall performance of the banks. The NPAs have always been a big worry for the banks in India. The Indian banking sector faced a serious problem of NPAs. A high level of NPAs suggests high probability of a large number of
credit defaults that affect the profitability and liquidity of banks. The extent of NPAs has comparatively higher in public sectors banks. To improve the efficiency and profitability, the NPAs have to be scheduled. It is highly impossible to have zero percentage NPAs. But at least Indian banks should take care to ensure that they give loans to creditworthy customers.

S. Poongavanam (2013) in his article highlighted the reasons for an assets becoming NPA and remedial measures to be taken. Due to various steps taken by the Government of India NPA levels were reduced to considerable level. So it is an indication for the bankers with bad loan in their portfolio to take appropriate actions immediately. It has been found that banking industry has undergone a major change after the first phase of economic liberalization; hence the importance of credit management has emerged. This article highlights the reasons for an assets becoming NPA and remedial measures to be taken. Due to various steps taken by the Government of India NPA levels were reduced to considerable level. (Nearly 2.7% of the loans on the balance sheet of bank, from 8.8%) So it is an indication for the bankers with bad loan in their portfolio to take appropriate actions immediately.

Prashanth K Reddy (2013) in his paper dealt with the experiences of other Asian countries in handling of NPAs. It further looked into the effect of the reforms on the level of NPAs and suggests mechanisms to handle the problem by drawing on experiences from other countries. The paper stressed the importance of a sound understanding of the macroeconomic variables and systemic issues pertaining to banks and the economy for solving the NPA problem along with the criticality of a strong legal framework and legislative framework.

Srinivas, K.T. (2013) presented a paper to study the reasons for loans and advances becoming NPA in the Indian Commercial banking Sector and give a suitable solution to overcome the mentioned problem. It has been
concluded that the banks can avoid sanctioning loans to the non creditworthy borrowers by adopting certain measures. By considering all the factors the banker can reduce the non-performing assets in a bank. The use of technology like Core Banking Solutions in Apex bank should make more reachable to all borrowers. At last the problem of NPAs has been a major issue for the banking industry. Reduction of NPAs in banking sector should be treated as national priority item to make the Indian Banking system more strong, vibrant and geared to meet the challenges of globalization.

**Shalini (2013)** in her article “A study on causes and remedies for non-performing assets in Indian public sector banks with special reference to agricultural development branch, state bank of Mysore” concluded that the bankers can avoid sanctioning loans to the non creditworthy borrowers by adopting certain measures. They are careful appraisal of the project which involves checking the economic viability of the project. A banker must consider the return on investment on a proposed project. If the calculated return is sufficiently higher than the credit amount he can sanction the loan. Secondly, he can constantly monitor the borrower in order to ensure that the amount sanctioned is utilized properly for the purpose to which it has been sanctioned. This involves the post sanction inspection by the banker.

**Kumar (2013)** in his study on “A Comparative study of NPA of Old Private Sector Banks and Foreign Banks” said that Non-performing Assets (NPAs) have become a nuisance and headache for the Indian banking sector for the past several years. One of the major issues challenging the performance of commercial banks in the late 90s adversely affecting was the accumulation of huge non-performing assets (NPAs). The quality of loan portfolio is very crucial for the health and existence of the banks. High level of (NPAs) has many implications on profitability, productivity, liquidity, solvency, capital adequacy and image of the bank.
Pradhan Tanmaya Kumar (2013) found that Gross NPA of both Old Private Sector Banks and Foreign Banks continue to rise except the year 2008 in Old Private Sector Banks and 2011 in Foreign Banks continue to fall.

Satpal (2014) in his paper concluded that NPAs have always created a big problem for the banks in India. It is just not only problem for the banks but for the economy too. The money locked up in NPAs has a direct impact on profitability of the bank as Indian banks are highly dependent on income from interest on funds lended. The study emphasized that the extent of NPA is comparatively very high in public sectors banks as compared to private bank. An attempt has been made in this paper to find out the actual definition of NPA and the factors contributing to the formation NPAs, reasons for high NPAs and their impact on Indian banking operations.

1.3 Objective of the Study

Unprecedented growth of non-performing assets has been a matter of great concern to the RBI, the government, the financial institutions and even the banks. There are several internal and external factors affecting NPA level. The purpose of this study is to analyse the present position of non-performing assets in selected public sector and private sector banks and to provide ways for the removal of this menacing problem of non-performing assets. Therefore, it is the objective of the present study to have an in-depth analysis of NPAs and suggest suitable measures to bring its level down especially in selected banks.

- To compare the quantitative degree of NPAs among Public Sector & Private Sector Banks.
- To find out the impact of NPA over Banking Industries.
- To find the preventive as well as curative measures to overcome the increasing problem of NPA.
• To evaluate an effective NPA management system for a sound banking system.
• To examine the existing structure of the financial system of banks and its various components and to improve the efficiency and effectiveness of the system with particularly reference to the economy of operations, accountability and profitability of the commercial banks and financial institutions.

1.4 Working Hypotheses
• \( H_{01} \): There is no significant difference in Gross NPAs to Gross Advances ratio of Public Sector & Private Sector Banks.
• \( H_{a1} \): There is significant difference in Gross NPAs to Gross Advances ratio of Public Sector & Private Sector Banks.
• \( H_{02} \): There is no significant difference in Net NPAs to Net Advances ratio of Public Sector & Private Sector Banks.
• \( H_{a2} \): There is significant difference in Net NPAs to Net Advances ratio of Public Sector & Private Sector Banks.
• \( H_{03} \): There is no significant difference in GNPA to Total Assets of Public Sector & Private Sector Banks.
• \( H_{a3} \): There is significant difference in GNPA to Total Assets of Public Sector & Private Sector Banks.
• \( H_{04} \): There is no significant difference in NNPA to Total Assets of Public Sector & Private Sector Banks.
• \( H_{a4} \): There is significant difference in NNPA to Total Assets of Public Sector & Private Sector Banks.

1.5 Research Methodology

Four leading Indian banks, two banks from public sector and two banks from the private sector have been selected for this study. All these banks have been selected on the basis of quantum of total income and balance
sheet size. In the present study, various statistical tools like Averages, percentages, ratio analysis, Measure of central tendency, Standard Deviations, coefficient of variation and ANOVA test are used to analyze and interpret the data. In the light of objective mentioned above, the present study is confirmed to examine the various aspects of NPAs in PSBs & Private banks of India (selected banks). The study covers the period from 2005-06 to 2014-2015. To study NPA ratio variation, data over the year 2014-2015 is analyzed. After analysis, Interpretation of data is done in order to drawn inferences from the collected facts. ANOVA test are conducted to test the various hypotheses so as to reach on conclusion whether the hypothesis should be accepted or rejected.

1.6 Limitations and Assumptions of the study

The study has the following limitations and is based on certain assumptions:

- The study is limited to only ten years period (i.e. 2005-06 to 2014-15).
- The study is limited to the published secondary data of annual reports of RBI, Reserve Bank of India Publications, various issues of Economic Review of RBI, Statistical Tables Relating to Banks in India and Indian Banker’s Association Bulletins, Reserve Bank of India’s Report on Trend and Progress in Banking.
- It is assumed that the selected banks under study have given much emphasis on creation of money and profits by lending loans and receiving deposits and by other activities keeping in mind their obligations to the society for using public money and for enjoying social and economic franchise for utilizing and holding of money resource.
- While selecting the public and private sector banks for research purposes, focus has been given on the basis of the availability of requisite information needed for conducting the research.
1.7 **Collection of Data**

The analysis is mainly based on secondary data. However, personal interviews and discussions were also held with the managing director of the banks, other bank officials, and experts in the field. The primary data was collected by observation and personal discussions.

The following sources have been used in the collection of secondary data.

- Report on trends and progress of banks in India.
- Report on currency and finance.
- Statistical tables related to banks in India.
- RBI Bulletins
- RBI Occasional Papers.
- Banking Statistics.
- Journals and other publications of the Indian Institute of bankers.
- Bulletins of Indian Bank Association.
- Annual Reports and Balance Sheets of Selected Banks (SBI, PNB, HDFC, ICICI).

For in-depth analysis of NPAs in Selected Banks, the relevant authorities were approached and the required disaggregated data was collected personally from the head office of the selected banks. On the basis of collected data, the information has been classified and grouped under suitable heads.
1.8 Chapter Scheme

The present study is divided into seven chapters.

The First Chapter introduces the topic, objective of study, various Hypotheses, review of literature, methodology, scope and coverage are dealt with.

The Second Chapter gives profile of banks, overview of the present status, growth and trends of selected public sector and private sector banks over the period of 10 years taken for the study. A comparative performance evaluation has also been made with the help of selected parameters.

The Third Chapter invades a conceptual framework of non-performing assets, various committees on Regulation of bank finance, conceptual framework of capital adequacy ratio.

The Fourth Chapter covers the analysis of various aspects of Non-performing Assets in selected public sector and private sector banks, such as Gross NPAs and Net NPAs, Gross NPA to Gross Advances ratio, Net NPA to Net Advances ratio, Gross NPA to total assets ratio, Net NPA to total assets ratio and Movements of NPA. Impact of NPAs on Bank’s Profitability, Net Interest Margin, and Capital Adequacy Ratio is also discussed.

The Fifth Chapter presents Data Analysis and Interpretation, testing of various Hypotheses with the help of ANOVA test.

The Sixth chapter discusses the available Remedial Measures for the problem of NPA management policy of selected banks is also being examined and suggestions for reducing NPAs are discussed.

Lastly, the Seventh Chapter is of conclusions and suggestions.