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An Empirical Estimation of Loan Recovery and Asset Quality of Commercial Banks

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Introduction

The recovery performance of commercial banks is the *sin qua non* for their liquidity of funds. Loan recovery is the main factor that determines the quality of loan assets of banks. Lower recovery indicates erosion of banks' profitability and blocking of bank credit to developmental projects of the area. The mounting overdues lead to high level of non-performing assets (NPA) and thereby deteriorate the asset quality. Thus, improving the quality of loan assets is the true test of improved efficiency of banking system. The importance of efficiency has assumed a critical significance for the viability of commercial banks in the liberalized era particularly in the backward regions of the country. The success of the commercial banks to maintain a healthy profit growth not only depends on the hardening of interest rate, which owes its origin to reduction in operational expenses, but also rests on improvement in their assets quality.

The NPA of banks is an important criterion to assess the financial health of banking sector. It reflects the asset quality, credit risk and efficiency in the allocation of resources to productive sectors. Since the reform regime there have been various initiatives to contain growth of NPA to improve the asset quality of banking sector. Commercial banks have envisaged the greatest renovation in their operation with the introduction of new concepts like income recognition, prudential accounting norms and capital adequacy ratio etc which have placed them in a new platform. The growing competition from internal and external constituents and sluggish growth in economy coupled with poor credit-deposit ratio, the large volume of NPAs in the balance sheet and lack of automation and professionalization in operation have been affecting the banking situation in the country.

The NPA has emerged since over a decade as an alarming threat to

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the banking industry in our country sending distressing signals on the sustainability and endurability of the affected banks.[1] In the present scenario, NPAs have been the most vexing problem faced by public sector commercial banks.[2] The positive results of banking sector reforms by the Government of India (GoI) and Reserve Bank of India (RBI) in terms of Narasimham Committee Report in this contemporary period have been neutralized by the ill-effects of this surging threat. The GoI and RBI have initiated various measures to control NPAs in the post-reform years, but the commercial banks are still unable to solve the dilemma. Despite various correctional steps administered to solve this problem, concrete results have not taken place. It is a sweeping and all-pervasive virus confronted universally by banking and financial institutions. The severity of the problem is however suffered by nationalized banks, followed by the State Bank of India (SBI) group, and all India financial institutions. The asset quality of banks, however, has improved in recent years and is reflected in the decline in their gross and net NPA ratios. A survey of 77 commercial banks finds that their aggregate gross NPA has declined by 1.2 per cent in 2006-07 over 2005-06. The gross NPA as percentage of loans and advances has declined from 3.35 per cent in 2005-06 to 2.25 per cent in 2007-08. Incidentally, in absolute terms, the net NPA of Scheduled Commercial Banks (SCBs) increased to Rs. 24,733 crores in 2007-08 from Rs. 20,207 crores in 2006-07. The gravity of the situation will be clear from the total amount recovered (Rs. 28,283 crores) from gross NPA account, which was lower than the fresh accretion of Rs. 34,420 crores during 2007-08. This scenario underlines the following questions: Why is the loan recovery not up to the mark? How are the banks managing the NPAs?

These issues need to be addressed. With this backdrop, an attempt has been made in this paper to study the loan recovery and asset quality of commercial banks in the Barak Valley of Assam.

Studies on Asset Quality of Banks

There exist cross country studies on financial health and asset quality of banks. The recessions-caused banking crisis is studied by Hardy and Pazarbasioglu[3], and Kaminsky and Reinhart.[4] Salas and Saurina[5] establish the significant role of economic slump in increasing loan problem in Spanish banks. Meyer and Yeager[6] find that the loan quality of local banks in the US is affected by local economic slowdowns. Shu[7] observes that bad loans as a proportion to total loans of banks has decreased with high economic growth in Hong Kong. Gambera[8] has used a bivariate Vector Auto-Regression (VAR) technique and found that firm income and state annual product have significant influence on bank loan quality in the US. Recently some studies showed feedback effect from the banks to the real economy. Marcucci and Quagliariello[9] validate the cyclicality of write-offs to total loans for Italian banks. Hoggarth, Sorensen and Zicchino[10] observe cyclicality of aggregate write-offs in UK banks. Baboucek and Jancar[11] find no corroboration of the cyclicality of NPAs but conform pro-cyclicality for banks in Czech economy. Chaudhuri[12] has analysed the methods adopted by China to clear out the backlog of NPAs. The study observes that recapitalization, sale of NPAs to Asset Management Companies (AMCs), merger, corporatization, adoption of risk management techniques etc are followed by the banking system of China to contain the NPAs.

There are a large number of studies on the causes of NPAs in Indian banking sector. However, some of the studies relating to NPAs are mentioned to pinpoint the importance of the subject. Rangarajan[13] has pointed out that improving the quality of loan assets is the true test of improved efficiency of banking system. Ramala and Nagi[14] suggest proper end-use of loans to the entrepreneurs, which could only ensure economic development of the area and the country as a whole. Taori[15] has dealt with NPA management of banks and stated that the surest way of containing NPAs is to prevent their occurrences. He suggests proper risk management, strong and effective credit monitoring, co-operative working relationship between banks and borrowers etc as tenets of NPA management policy. Similar opinion has been echoed in a recent work by Bhattacharya.[16] In order to root out the NPA problem, Banmali[17] has suggested a multi-frontal attack involving all concerned staff members in the field up to the grass root level as well as in the controlling points. A number of studies viz., Ranjan and Dhal[18], Harpreet and Parricha[19], Ramkrishna and Bhargavi[20], Singh[21] etc agree that the asset quality of commercial banks has improved considerably due to reform package. Raul[22] suggests that an appropriate set of substantial financial sector regulation clarity, including changes in tax laws, is imperative for the banking system to get rid off NPAs as well as for the Qualified Institutional Buyers (QIBs) to look forward to the investment opportunity. Ghosh[23] has studied the management of NPAs with reference to Mugberia Central Co-operative Banks and Tamluk Ghatal Central Co-operative Bank Ltd. He has found that these banks are not successful in restricting the level of NPAs and suggested a change from NPAs to performing assets. In order to survive and compete with private and foreign banks, it is crucial for the Public Sector Banks (PSBs) to clean up their balance sheets by increasing the equity capital. Rajender and Suresh,[24] in a case study, examine the quality of loan assets of Indian banking and suggest some practical strategies to make Indian banks more viable by managing the level of NPAs. An assessment on the causes and consequences of NPAs of commercial banks by Rajesham and Rajender[25] has concluded that a strong political will is necessary for satisfactory solution to the problem of mounting NPAs.

Bhaumik and Piesse,[26] in their study, indicate that allocation of assets between risk-free government securities and risky credit is affected by past allocation patterns, risk averseness of banks, regulations regarding treatment of NPAs, and ability of banks to recover doubtful credit. Ahmed[27] has examined NPAs of PSBs in Indian milieu. He observes that PSBs have been committed towards the reduction and management of NPAs. The quality of asset portfolio has improved quite impressively over the period. In order to survive and compete with private and foreign banks, it is crucial for PSBs to clean up their balance sheets by increasing the equity capital. In the wake of deterioration in the overall economic climate, Lele[28] observes, on the basis of data available with the finance ministry, that out of 27 PSBs, 16, including SBI, reported higher level of gross NPAs than the target set for the year-ended March 2009. Singh and Singh,[29] in their paper, examine the recovery performance of Manipur Rural Bank. The study observes that repayment of loans mainly depends on proper utilization of the loan amount, supply of quality assets, generation of sufficient income from schemes, availability of infrastructure and marketing facilities, willingness to repay, continuous supervision and follow-up visits etc. Akhan[30] has attempted to study the NPA management of Non-Banking Financial Companies (NBFCs) in India during 2002-2007 and suggested that pre-sanctioned scrutiny and post-sanctioned supervision, effective recovery steps and full compliance with the prudential norms of RBI help to control NPA.

From this review it is clear that there are not many studies based exclusively on the management of NPAs of banks. Most of the studies relate to the quality of bank assets and loan portfolio. However, studies relating to loan recovery and asset quality of banks remain un-researched area.

Problem Identification

The NPAs of commercial banks is a legacy of the past when prudent norms of banking were ignored. Despite this the malaise remained invisible to the public eyes due to the practice of not following transparent accounting standards. In the wake of complex changes taking place during 1992-93, there was resultant chaos and confusion. As the problem exploded unexpectedly commercial banks were unable to analyze and make a realistic assessment of the prevailing situation. It was not realised that the root of the problem of NPA was the economy of the country. The un-preparedness and structural weakness of our banking system to act in the emerging scenario and face the challenges thrown by the new order further aggravated the crisis. The partial perceptions and hasty judgments led to a policy of ad-hocism, which characterised the approach of the authorities during the last two decades towards finding solutions to banking ailments and dismantling recovery impediments. Repeated correctional efforts were executed, but positive results evaded.

Although the level of NPA of the Indian banking system is now comparable to several advanced economies due to RBI rates reduction, still commercial banks have attributed to a huge quantum of NPAs. The gross NPA of the banking system amounts to Rs. 60,841 crores for 2000-01, which is a little over 16 per cent of the total assets of nationalized banks. During 2001-02, nationalized banks have recorded a collective growth of 130 per cent in net profits but more than double NPAs were also added during the year compared to the previous fiscal year. The gross NPAs of Scheduled Commercial Banks (SCBs) in absolute term increased to Rs. 56, 435 crores in March 2008 from Rs. 50,519 crores in March 2006. The net NPAs of banks in 2007-08 stood at Rs. 24,733 crores compared to Rs. 18,265 crores in 2005-06 and Rs. 17,435 crores in 1999-00. This has been largely possible because of the huge provisioning that most of these banks could make as a result of growth in treasury income and therefore profits. The priority sector added up a large proportion – about 46.4 per cent (Rs.21,184 crores) – of total NPAs in March 1998 and swelled to 54.4 per cent (Rs.28,705 crores) in March 2008. The priority sector NPAs increased by 11.1 per cent during 2007-08 (4.8 per cent in the previous year) mainly due to increase in NPAs in the agriculture sector (32.1 per cent). In the non-priority sector, the same has been reduced to 44.9 per cent (Rs.23,721 crores) in March 2008 from 50.6 per cent (Rs.23,107 crores) in March 1998. The higher NPAs in priority sector advances have pushed up the overall proportion of NPAs by three to four percent. Although the commercial banks in general have succeeded in reducing NPAs, or loans defaulted by borrowers, the new generation private sector banks have witnessed an increase over the years. The gross NPAs of

26 private sector banks have increased from Rs 7,791 crores in 2005-06 to Rs 9,255 crores in 2006-07.

Further, commercial banks in India in general suffer from a tendency to minimize their NPA figures. They practise what is called ‘ever-greening’ of advances through understated techniques. It has been reported that banking industry has under-estimated its NPAs by a whopping Rs. 3,862.1 crores in March 1997. The nationalized banks including the SBI and its associate banks have under-estimated their NPAs by Rs 3,029.29 crores. Such deception of NPA statistics is executed through various ways. Among these, non-identification of NPAs as per stipulated guidelines such as ‘sub-standard’ assets classified as ‘standard’, wrong classification of NPAs by classifying a ‘loss’ asset as ‘doubtful’ or a ‘doubtful’ asset as ‘sub-standard’ asset, avoiding prudential norms (RBI 2006).[31]

The NPAs of commercial banks have direct impact on the profitability, productivity, liquidity and equity of banks and finally influence the outlook of the banks towards credit delivery and credit expansion. The gravity of the situation may be revealed by the facts that return on assets (ROA) – the most telling measure of banks’ performance – was 0.83 for PSBs as against 1.65 for foreign banks in March 2007 (RBI 2008).[32] Further, net profit or spread ratio (the difference between interest earned and interest paid) usually considered as true measure of core operation of banking sector turned up trumps. The spread as percent of volume of business was 1.5 per cent for PSBs while the same for foreign banks was 4.0 per cent. The SCBs experienced a declining ratio of operating profits to total assets which has been declined to 1.9 per cent in March 2008 from 2.04 per cent in March 2005. The same for foreign banks has increased from 3.16 per cent to 3.75 per cent (RBI 2007-08).[33]

The RBI has proposed prompt corrective action (PCA) for arresting the menace of NPAs and has introduced various measures like Credit Risk Management models, Compromise Settlement methods, effective use of Debt Recovery Tribunals (DRTs), Asset Reconstruction Companies (ARC) and Recovery of Debts,[34] Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act 2002,[35] Circulation of information on defaulters, Corporate Debt Restructuring (CDR), *lokadalat*s etc to arrest unbridled virus of non-performing assets of commercial banks. With a view to providing additional option and developing a healthy secondary market for NPAs, the guidelines relating to sale/purchase of NPAs were issued in July 2005 covering the procedure for purchase/sale of NPAs by banks. The guidelines were partly modified in May 2007 whereby it was stipulated that atleast 10 per cent of the estimated cash flows should be realised in the first year and atleast 5 per cent in each half year thereafter subject to full recovery within three years.

The effectiveness of various measures initiated by GoI and RBI is limited and banks are still not able to tame the problem of NPAs. According to the latter authority, improved profitability and health of banks, underpinned by robust macroeconomic environment and upturn in interest rate cycle, has enabled banks to reduce the backlog of NPAs. Although asset quality of banks has improved in percentage terms over the years, commercial banks need to guard against any deterioration of credit quality, particularly in the wake of significant expansion of credit. As the economy is poised to grow at a stupendous pace the banks have to play a much larger role in the coming years. This requires a robust framework to deal with NPAs. Hence, in the present cut-throat competition, it is a permanent task for the banks to manage their NPAs more efficiently so that they can change their character from NPAs to performing assets. It is in this context that an in-depth study is warranted to detect this emerging problem of the economy.

Background of Commercial Banks in the Study Area

The Barak Valley comprises three districts of Assam viz., Cachar, Karimganj and Hailakandi. The valley has 12.5 per cent of the total bank offices of Assam. At present, 12 public sector banks (PSBs), 1 regional rural bank (RRBs) and 3 private banks are operating with a network of 147 branches. Cachar is bestowed with 72 branches (51 PSBs, 19 RRBs and 2 private banks) while Karimganj has 52 branches (32 PSBs, 17 RRBs and 3 private banks) and 23 branches (13 PSBs, 8 RRBs and 2 private banks) in Hailakandi are taking the care of banking activities (GoA 2008).[36] The growth performance of banks in the area has been summarized on the basis of parameters as presented in Table 1. It is observed that during 1991 population served per branch at all India average was 15,000, which went up to 16,000 in March 2007. The same has increased to 40,000 in December 2007 from 29,100 in 1991 in the study area. The deposits per branch are, however, far behind the national level. The absolute figures are Rs. 2.72 crores in 1991, Rs. 8.95 crores in 1999 and Rs.15.3 crores in 2007. During 1991-2007 deposits per office in the districts increased by 7 times in contrast to 11 times increase in the country as a whole. On the other hand, the advances per branch in the

districts remained lower than that of the national level. The net result of discrepancies is reflected in the credit deposit (C/D) ratio. It slipped to 19.3 per cent in 2007, from 38.6 per cent in 1991 compared to increase in national average from 54.2 per cent in 1991 to 55.8 per cent in 1999 and further a noteworthy increase to 73.5 per cent in 2007.

Table 1
Performance of Banks in Barak Valley vis-à-vis India

	Performance Indicators	Barak Valley			All India Average		
		1991	1999	2007	1991	1999	2007
1	Number of Commercial Banks	13	15	15	272	298	183
2	Branch expansion of banks (number)	140	140	149	60646	67868	73836
3	Population served per office ('000)	29100	37800	40000	14000	15000	16000
4	Total deposits (Rs. in crores)	233.94	457.72	1391.91	201199	607268	2608309
5	Deposit per branch (Rs. in crores)	2.72	8.95	15.3	3.34	14.50	36.75
6	Total advances (Rs. in crores)	91.25	125.12	313.72	105524	261279	1928913
7	Advances per branch (Rs in crores)	1.06	1.69	2.8	2.02	6.53	27.57
8	Credit-Deposit (C/D) ratio	38.6	20.8	19.3	54.2	55.8	73.5

Source: Figures for March compiled and computed from:
(i) Basic statistical Returns, Reserve Bank of India, Mumbai, and
(ii) Lead Bank offices of the region, United Bank of India.

Apart from the above, the process of computerization, which is vital for technological initiatives, is taking place very slowly in the branches of banks. Only 10 per cent of the total bank branches are fully computerized and a very negligible fraction of bank branches under core banking solution (UBI 2008).[1] As on today, only SBI has ATM facilities in the area. The RBI has been encouraging banks to use technology-based solutions for increased financial inclusion. Credit delivery in rural areas is expensive for banks, what with large number of small accounts. Thus information technology enabled method can reduce the cost of delivery.

Objectives of the Study

The key objective of the paper is to analyse the loan recovery and asset quality of commercial banks. The specific objectives of the study are

1. To study the recovery performance of commercial banks in the study area.

2. To study the nature and growth of NPAs of banks in the area under study.
3. To identify the reasons for assets becoming NPAs of SCBs in the area under study.
4. To study whether branch expansion has led to accretion in the volume of NPAs.

Hypotheses

The following hypotheses are formulated to meet the objectives of the study:

1. There exists significant difference in sector-wise loan recovery over the years.
2. The priority sector lending over the years has led to insignificant increase in the volume of NPAs of banks.
3. The branch expansion of banks has led to fresh accretion in the volume of NPAs.

Methodology

Research population of the study comprises commercial banks operating in three districts of the study area. As in March 2008, there are 15 banks with a network of 149 branches catering to financial requirements of three districts in the valley. For the purpose of the present study we have considered all commercial banks for the analysis of finances of the banks. An attempt has also been made to do a cross-sectional analysis of NPAs of bank branches over the years. The data prior to the period has also been considered in some cases to comprehend the background of the banks in the study area. The relevant data have been collected from both primary and secondary sources. The sources of secondary data are RBI Annual Reports, RBI Trend and Progress of Banking in India, financial statements compiled by the regional offices of the banks operating in the study area, Lead Bank statements, Directorate of Economics and Statistics, various reports, etc. The survey cum interview method has been used for assessing the work system, recovery system, processing loan applications and other impeding factors associated with loan portfolio.

In order to assess the nature of NPAs in banks, the variables are net and gross NPAs, total standard, doubtful and loss assets, total write off amount

during the year, total unrealized interest and amount recovered from bad loans. The variables to analyse loan portfolio of banks include advances to agriculture, small industries, service sector etc. The statistical and financial techniques have been applied to test the hypotheses of the study. In order to assess the inter-relationship between the variables and their interdependency Pearson's correlation coefficient is used. The parametric test viz.,'t' test is also conducted in appropriate cases. The growth of NPAs along with its components has been tested with the help of linear growth rate (*b*) and compound growth rate (Cgr). The correlation matrix analysis is employed to assess the relationship between total advances and total NPAs along with its components.

In order to have an in-depth idea of the issue, a reasonably suited period of 10 years commencing from 1998-99 to 2007-2008 has been considered. The rationale for considering the aforesaid time period is that RBI announced a package of measures following the report of the Narasimham Committee (1998), which includes rising the minimum capital adequacy ratio and moving towards tighter asset classification, income recognition and provisioning norms. The different variables in respect of loan recovery and asset quality of banks in the area under consideration will be compared with national scenario during the aforesaid time period.

Recovery Position and Asset Quality of Banks

A. Recovery Performance of Commercial Banks

The recovery performance of commercial banks is the *sin qua non* for their liquidity of funds. It consequently restricts the banks' lending capacity and stands in the way of dilution of funds to developmental activities and hence the socio-economic development of the area. The recovery position of banks in the area under study is quite unsatisfactory, as shown in Table 2. It has been observed that the recovery position was very poor in almost all the sectors in the area under study. In December 1990, it was 14.9 per cent in agriculture and allied activities followed by 28.4 per cent in small sector and 19.9 per cent in trade and service sector for Karimganj while 16.3 per cent, 22.9 per cent and 46.9 per cent in the respective sectors for Cachar as in June 1989. The recovery position in agriculture and allied activities is relatively discouraging to other priority sectors in the three districts under consideration.

Table 2
Sector-wise Recovery Position of Banks in Barak Valley

(Amount Rs. in Lakhs)

Date	Agriculture & Allied			Small Sector & Rural Artisans			Trade & Service		
	Demand	Recovery	Overdues	Demand	Recovery	Overdues	Demand	Recovery	Overdues
Karimganj District									
31-12-90	292.3	43.8	248.5	92.3	26.3	66.0	1025.2	204.3	820.9
	(100)	(14.9)	(85.1)	(100)	(28.4)	(71.6)	(100)	(19.9)	(80.1)
30-09-96	363.2	98.2	265.0	143.0	45.2	97.8	1530.8	345.6	1185.2
	(100)	(27.0)	(73.0)	(100)	(31.6)	(69.4)	(100)	(22.5)	(77.5)
30-03-99	458.8	115.8	343.0	206.3	92.6	113.7	1960.3	558.2	1402.1
	(100)	(25.2)	(74.8)	(100)	(44.8)	(55.2)	(100)	(28.4)	(71.6)
30-03-05	543.2	231.1	320.9	245.7	110.8	134.2	2134.0	602.8	1432.0
	(100)	(27.9)	(72.1)	(100)	(43.6)	(56.4)	(100)	(27.6)	(72.4)
30-03-08	599.1	250.0	349.1	287.4	140.2	147.2	2359.0	879.0	1480.0
	(100)	(35.4)	(65.6)	(100)	(45.8)	(55.2)	(100)	(29.9)	(70.1)
Cachar District									
30-06-89	325.6	53.3	272.3	118.3	27.7	90.5	524.6	246.3	278.3
	(100)	(16.3)	(83.7)	(100)	(22.9)	(77.1)	(100)	(46.9)	(53.1)
31-12-94	638.3	113.0	525.3	299.2	45.8	253.4	853.2	424.6	428.6
	(100)	(17.7)	(82.3)	(100)	(15.8)	(84.7)	(100)	(49.7)	(50.3)
31-03-98	758.6	215.6	543.0	345.2	96.2	249.0	1022.8	511.2	511.6
	(100)	(28.4)	(71.6)	(100)	(27.8)	(72.2)	(100)	(49.9)	(50.1)
31-03-05	875.9	298.7	576.5	398.5	100.5	298.0	2563.9	1263.8	1300.1
	(100)	(27.9)	(72.1)	(100)	(32.1)	(67.9)	(100)	(48.1)	(51.9)
30-03-08	915.8	314.7	601.1	450.5	210.2	240.3	3290.3	1687.0	1603.3
	(100)	(32.7)	(67.3)	(100)	(35.1)	(64.9)	(100)	(50.9)	(49.1)
Hailakandi District									
31-12-91	192.0	20.2	171.8	62.8	19.2	43.6	302.7	145.6	157.1
	(100)	(10.5)	(89.5)	(100)	(30.5)	(69.5)	(100)	(48.1)	(55.9)
31-03-94	258.3	45.0	213.3	85.3	41.6	43.7	512.6	213.9	298.7
	(100)	(17.4)	(82.6)	(100)	(48.7)	(51.3)	(100)	(41.7)	(58.3)
31-12-99	482.9	102.9	380.0	90.6	45.2	45.4	418.2	219.0	199.2
	(100)	(21.3)	(78.7)	(100)	(49.8)	(50.2)	(100)	(52.3)	(47.7)
31-03-05	879.6	278.6	601.0	201.6	95.3	106.3	657.2	321.1	336.1
	(100)	(25.3)	(74.7)	(100)	(47.4)	(52.3)	(100)	(49.1)	(50.9)
30-06-08	970.8	290.1	680.7	234.8	103.5	131.3	879.4	432.1	445.3
	(100)	(26.5)	(73.5)	(100)	(46.0)	(54.0)	(100)	(49.8)	(50.2)

(Figures in parentheses indicate percentage to total.)

Source: Lead Bank Statements (LBS), Lead Bank Office, Cachar, Karimganj and Hailakandi districts of Assam.

The gravity of the situation will be clear when we find that Rs. 250.0 lakhs (35.5 per cent) was realized against the total outstanding dues of Rs. 599.1 lakhs under agriculture sector in Karimganj as on 30-03-08. While in Cachar Rs. 314.7 lakhs (32.7 per cent) was realized against the total dues of Rs. 915.8 lakhs, as on 30-03-08, in Hailakandi Rs. 290.8 lakhs (26.5 per cent) was realized against total dues of Rs. 970.8 lakhs on 30.06.08. Similar trend was noticed in small sector and service sector in

the districts. However, the recovery position of small sector (46.0 per cent) is relatively better than that of agriculture (26.5 per cent) in 2008. The service sector has experienced a recovery of 49.8 per cent in June 2008.

A noteworthy feature of banks' lending is that despite mounting over dues in each year the agriculture and allied sectors enjoyed relatively major portion of bank credit but the recovery performance is extremely low. This indicates that the agriculturists and poor people of the area could not repay the loans. This may be because they spent their loan on consumption purposes rather than productive purposes. The reasons for poor recovery may also be attributed to various other factors such as lack of supervision of end use of fund owing to lack of vehicle and paucity of staff, defective processing of loan applications, political interferences, communication gap between banker and customer etc.

Furthermore, no effort is made by the banks for recovery of such loan. The local leaders do not encourage them to pay it back. They assure them that government will exempt the same later. Consequently the loan is often not recovered. As a result the mounting over-dues restrict the banks' lending capacity. Therefore, an immediate action from appropriate authority to accelerate the loan recovery in all sectors is necessary.

Asset Classification of Banks in the Study Area

As per present asset classification norms, assets of commercial banks are classified into four categories viz., standard assets, sub-standard assets, doubtful assets and loss assets. Table 3 presents the nature of assets available with the banks in the study area. The total NPAs of banks, in absolute term, increased to Rs. 5143.0 lakhs in March 2007 from Rs. 538.2 lakhs in March 1998 recording a 9.5 times increase, while the percentage of NPAs to total advance was hovering around 5.7 per cent. It was 4.3 per cent in March 1998, which increased to 7.3 per cent in March 2002 and thereafter gradually reduced to 4.2 per cent in March 2007. The all India average percentage of the same was 19.4 per cent in March 1995, which decreased to 7.8 per cent in March 2004 and further down to 2.7 per cent in March 2007 (RBI 2006-07).[38] The proportion of both doubtful assets and sub-standard assets has been around 2 per cent throughout the period whereas the loss assets constituted around 0.5 per cent of total advances.

Table 3

Classification of NPA of Banks in Barak Valley (1998-2007)

(Amount Rs. in lakhs)

Asset Classification	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
1. Advances	12380 (100)	12943 (100)	12918 (100)	15132 (100)	15779 (100)	18213 (100)	20967 (100)	23687 (100)	26786 (100)	34210 (100)
A. Standard Assets	11841.8 (95.7)	12243.2 (94.6)	12156.2 (94.1)	14302. 1 (94.5)	14624.1 (92.7)	17196.8 (94.4)	18970.0 (93.4)	20087.1 (94.0)	23809.8 (93.9))	29067.0 (95.8)
B. NPAs	538.2 (4.3)	699.8 (5.4)	761.8 (5.9)	829.9 (5.5)	1154.9 (7.3)	1016.2 (5.6)	1997.5 (6.6)	3686.9 (6.0)	2976.2 (6.1)	5143.0 (4.2)
i) Sub Standard assets	245.1 (1.9)	298.6 (2.3)	412.6 (3.2)	314.2 (2.1)	458.9 (2.9)	530.8 (2.9)	832.5 (2.6)	1786.4 (2.9)	1523.7 (3.0)	3051.5 (2.6)
ii) Doubtful Assets	219.6 (1.7)	305.4 (2.4)	299.1 (2.3)	425.0 (2.8)	411.0 (2.6)	398.2 (2.2)	613.1 (2.1)	1209.2 (2.0)	945.0 (1.5)	1397.5 (1.1)
iii) Loss assets	75.5 (0.5)	9.5.8 (0.7)	50.1 (0.3)	90.7 (0.5)	285.0 (1.8)	87.2 (0.4)	346.0 (0.8)	691.3 (0.7)	345.5 (0.7)	697.0 (0.8)

(Figures in parentheses indicate percentage to total advances.)

Source: Compiled from the data collected from zonal offices of the study area.

Further, Table 3 demonstrates that NPAs in absolute figure recorded 9.5 times increase whereas it was 1.43 times increase at the national level during the same time span. This does not reflect NPAs' reduction tempo at the national level. This is partly because of complex regional economic settings, multi-faceted clientele and failure on the part of the bankers to design suitable mechanism/channel to recover from NPAs in the study area. However, the significant reduction of NPAs as percentage of advances may be due to the definitional changes introduced by the RBI in 1995-96 and shyness on the part of the banker while granting fresh loan. This, however, may also be owing to the fact that managerial strategy of the banks has undergone radical change over the years, moving from opacity towards transparency.

In order to study the growth of various components of NPAs and the relationship between the advances and NPA components of banks, we have employed correlation analysis. Table 4 below exhibits the matrix of co-relation co-efficient among the components of NPAs and advances.

Table 4

Matrix of Correlation Coefficient

	Advances	NPAs	Sub-standard Assets	Doubtful Assets	Loss Assets
Advances	1.00				
Non Performing Assets	0.82 (2.867)*	1.00			
Sub-Standard Assets	0.80 (2.667)	0.84 (3.099)*	1.00		
Doubtful Assets	0.86 (3.373)*	0.85 (3.231)*	0.89 (3.912)*	1.00	
Loss Assets	0.71 (2.017)	0.87 (3.529)*	0.74 (2.202)	0.85 (3.231)*	1.00

* Significant at 5 % level.

(Figures in parentheses indicate respective 't' values.)

The analysis shows that with the increase in the advances the total NPA has increased in the same proportion. The positive correlation between advances and NPAs (0.82) is statistically significant at 5 per cent level of significance. The 'r' value of advances with doubtful assets (0.86) is also significant while with sub-standard and loss assets are not statistically significant. This indicates that with the increase in advances doubtful assets also increase but the increasing rate for sub-standard assets and loss assets is not followed by the rate of increase in advances. The correlation coefficient between NPA components and their respective 't' values reveals that high positive correlation exists between NPA components except in the sub-standard and loss assets.

Non-Performing Assets: Bank-wise Analysis

The bank-wise analysis shows that in absolute terms NPAs of commercial banks have increased except Vijaya Bank (having only one branch) in the area under study. It is also clear that throughout the period the SBI holds maximum share of NPAs to total advances followed by the United Bank of India (UBI), Punjab National Bank (PNB), Allahabad Bank (AB), Vijaya Bank (VB), Punjab and Sind Bank (P & S) respectively where the Central Bank of India (CBI), United Commercial Bank (UCo), Indian Bank (IB) hold a very small percentage of NPA of total advances. The data have been summarized in Table 5.

Table 5
Bank Group-wise NPAs in Barak Valley

(Amount Rs. in lakhs)

Sl. No	Banks	1998	1999	2000	2001	2002	2003	2004	2005	2006	agr	cv
1	SBI	206.3 (12.6)	252.8 (11.1)	318 (12.2)	211.2 (9.8)	498.3 (10.6)	426.7 (9.1)	510.9 (9.8)	967.5 (9.7)	907.7 (8.7)	11.5	34.4
2	UBI	200.1 (9.1)	264.0 (8.6)	286.0 (10.6)	431.0 (9.5)	439.1 (9.6)	379.0 (8.2)	410.6 (8.9)	839.7 (9.0)	967.6 (9.7)	9.8	26.7
3	AB	21.6 (7.2)	18.2 (6.9)	24.8 (7.1)	21.2 (5.8)	19.6 (3.8)	24.6 (4.3)	27.5 (4.4)	75.0 (4.7)	110.6 (4.5)	2.3	11.1
4	PNB	10.8 (8.6)	8.9 (6.2)	15.6 (7.1)	12.3 (7.2)	27.2 (4.9)	28.6 (5.6)	31.1 (5.1)	35.6 (5.2)	76.4 (5.0)	17.2	45.3
5	CBI	17.2 (5.2)	19.0 (5.1)	22.3 (3.6)	28.6 (3.5)	35.2 (2.0)	26.9 (2.1)	27.6 (2.2)	76.4 (2.9)	101.6 (3.7)	6.5	24.6
6	IB	5.2 (2.6)	7.9 (5.5)	7.0 (4.8)	9.6 (4.2)	7.8 (2.8)	8.9 (3.8)	9.7 (3.2)	23.5 (3.4)	54.2 (2.9)	7.9	18.2
7	UB	23.2 (7.6)	37.8 (9.1)	24.1 (5.2)	27.9 (6.8)	33.2 (7.7)	30.8 (6.8)	28.6 (6.6)	56.7 (6.3)	97.5 (7.0)	4.3	17.3
8	PSB	NA	7.8 (8.9)	7.6 (7.2)	12.8 (7.1)	10.6 (6.2)	11.3 (5.2)	9.6 (5.7)	17.8 (5.9)	42.6 (6.0)	5.8	20.2
9	BB	21.6 (4.5)	36.7 (6.2)	19.0 (7.1)	25.6 (6.3)	30.0 (5.2)	31.6 (6.1)	37.4 (6.5)	56.7 (6.0)	98.7 (6.0)	6.1	22.0
10	Uco	NA	NA	8.1 (4.1)	7.2 (0.7)	7.6 (0.4)	5.6 (0.7)	7.9 (0.8)	23.9 (0.9)	75.9 (1.9)	– 8.7	13.1
11	CB	8.2 (4.0)	9.6 (3.9)	7.8 (3.6)	12.6 (5.1)	11.2 (6.7)	9.0 (4.9)	15.6 (5.4)	40.9 (5.7)	103.7 (4.9)	1.4	17.3
12	VB	24.0 (8.6)	37.1 (10.6)	20.9 (5.7)	29.9 (6.7)	35.1 (6.8)	33.2 (5.6)	38.7 (5.7)	97.2 (5.9)	167.3 (5.5)	5.1	19.5
All Commercial Banks		**538.2 (4.3)**	**699.8 (5.4)**	**761.8 (5.9)**	**829.9 (5.5)**	**1154.9 (7.3)**	**1016.2 (5.6)**	**1997.5 (6.6)**	**3686.9 (6.0)**	**2976.2 (6.1)**	**9.6**	**24.3**

(Figures in parentheses indicate percentage to total advances.)

Source: 1. Statement of Recovery of NPA Accounts of the respective banks, and
2. Zonal office, file registers of respective banks.

The position and extent of growth are revealed by cv and average annual growth rate (agr) of NPAs of individual banks. During the period under consideration the UCo Bank has witnessed negative growth rate (agr= - 8.7). With regard to variation in the volume of NPAs, Allahabad Bank is well placed (cv=11.1), as others have attained higher volume of NPAs as fresh accretion over the years.

Growth of Advances and Non Performing Assets

A comparison of growth of standard assets, NPAs and advances per branch is presented in Table 6. For this purpose total advances, NPAs and standard assets per office and their growth rate has been analysed with compound growth rate (cgr). The analysis shows that volume of NPA registered a higher growth (cgr = 14.9) in contrast to the growth of advances (cgr = 10.9) and standard assets (cgr=12.1) during 1998-2007. Further, NPAs per office recorded a higher growth rate (cgr=14.6) than that of advances per office (cgr =7.9) and standard assets per office (cgr= 7.8). Thus, higher growth of

NPAs over the years reveals inefficient profile of the asset portfolio of banks. This may be due to the banker's inappropriate managerial strategy. An appropriate strategy for the purpose of containing the microbes of NPA of banks is warranted based on the situation.

Table 6
Position of Advances, Standard Assets, and Non-Performing Assets of Banks

(Amount Rs in lakhs)

Year	Advances (Rs)	Standard Assets (Rs)	NPAs (Rs.)	Advances per branch (Rs.)	Standard Asset per branch (Rs.)	NPA per branch (Rs.)
1998	12380	11841.8	538.2	136.0	130.1	5.9
1999	12943	12243.2	699.8	139.2	131.6	7.5
2000	12918	12156.2	761.8	138.9	130.7	5.8
2001	15132	14302.1	829.9	156.3	150.5	5.5
2002	15779	14624.1	1154.9	166.0	153.9	12.1
2003	18213	17196.8	1016.2	191.8	181.0	10.6
2004	20967	18970.0	1997.5	201.8	177.8	22.0
2005	23687	20087.1	3686.9	229.0	198.6	30.6
2006	26786	23809.8	2976.2	242.9	213.7	28.5
2007	34210	29067.0	5143.0	298.6	227.0	48.4
Cgr	**10.9**	**12.1**	**14.9**	**7.92**	**7.8**	**14.6**

Source: Adapted from the data collected from lead bank offices and zonal offices of the banks.

Interrelationship between Non-Performing Assets and Priority Sector Advances

Due to non-availability of information relating to priority sector NPAs in the area under study, an attempt has been made here to study the relationship between NPA and priority sector advances to identify the contribution of the same to total NPA. Table 7 presents the position of the variables relating to performing assets, priority and non-priority sector advances per bank branch.

Table 7
Position of Priority and Non-Priority Sector NPA of Commercial Banks

(Amount Rs in Lakhs)

Year	Non Performing Assets (Rs.)	Priority sector advances (Rs.)	Non-priority sector advances (Rs.)	NPA per branch (Rs.)	Priority sector advances per branch (Rs.)	Non-priority sector advances per branch (Rs.)
1998	538.2	7245	5135	5.9	79.6	56.4
1999	699.8	8185	4758	7.5	88.0	51.1
2000	761.8	8310	4608	5.8	89.3	49.5
2001	829.9	8720	6412	5.5	91.7	67.5
2002	1154.9	9135	6644	12.1	96.2	69.9
2003	1016.2	9753	8466	10.6	102.7	89.1
2004	1997.5	9980	9754	22.0	120.7	87.9
2005	3686.9	12780	9831	30.6	132.9	121.0
2006	2976.2	14328	10895	28.5	186.0	113.9
2007	5143.0	16453	11342	48.4	231.0	128.6

Source: Adapted from the data collected from lead bank offices and zonal offices of the banks.

For this purpose, we have calculated 'r' between NPAs per branch (a) and priority sector advances per branch (b) and non-priority sector advances per branch (c) during the period 1998-2007. The results are summarized hereunder

$r_{ac} = 0.65$	$r_{ab} = 0.742.$
't' value (cal) = 2.404	't' value (cal) = 3.123
't' value (tab) at 8 d.f.	't' value (tab) at 8 d.f.
1 pc = 2.896	1 pc = 2.896
5 pc = 1.860	5 pc = 1.860

The analysis reveals that the positive correlation 0.74 is statistically not significant at 1 per cent and 5 per cent levels of significance at their respective degree of freedom for priority sector advances. The 'r' value 0.65 for non-priority sector advances is significant at 5 per cent level but not at 1 per cent level of significance. This implies that with the increase in priority sector lending, there has been corresponding increase in the volume of NPAs. However, it cannot be argued that priority sector lending is the sole factor in enhancing the volume of NPAs in the area under study.

Interrelationship between NPAs and Branch Expansion

An attempt has been made here to determine whether growth of advances per branch is associated with growth of NPAs per branch. In this connection we have used co-efficient of correlation (r) between advances per branch and NPAs per branch. The 'r' value is found as under

r = 0.857
't' value (cal) = 3.729
't' value (tab) at 8 df,
1 *pc* = 2.896
5 *pc* = 1.860

The analysis manifests that the high positive correlation is significant at 5 percent and 1 percent levels at their 8 df. This implies that there exists a positive relationship between advances and NPAs per branch. In other words, it can be argued that high volume of advances lead to increase in the volume of NPAs. Thus, with the expansion of bank branches, banks have acquired high volume of deposit, and at the same time the volume of NPAs has grown considerably over the years.

Causes for Poor Recovery and Reasons for Asset becoming NPAs

There are a number of factors responsible for low recovery and increase in size of NPAs of commercial banks. A few prominent reasons for assets becoming NPAs in the study area are mentioned as under:

- Poor credit appraisal system
- Lack of vision/foresightedness while sanctioning/reviewing or enhancing credit limits
- Lack of proper monitoring
- Reckless advances to achieve the budgetary targets
- Lack of sincere corporate culture
- Inadequate legal provisions on foreclosure and bankruptcy
- Change in economic policies/environment at the macro level
- Non-transparent accounting policy and poor auditing practices
- Lack of coordination between banks and their customers
- Directed/schematic lending to certain sectors

Conclusion

The study concludes that a number of factors are responsible for poor recovery and increasing volume of NPAs of banks in the districts of Assam under study. These are poor credit appraisal system, lack of foresightedness while sanctioning credit limits, lack of proper monitoring, reckless advances to achieve the budgetary targets, lack of sincere corporate culture, inadequate legal provisions on foreclosure and bankruptcy, change in economic environment at the macro level, non-transparent accounting policy, poor auditing practices, and lack of coordination between banks and their customers. NPA being an important parameter for assessing financial performance of banks, reduction is necessary to improve the profitability of the banks and compliance with capital adequacy norms. The quality appraisal, supervision and proper follow up undoubtedly will help solve the problem. The judicial system needs to be restored to have a smooth recovery of dues from defaulters. The pre-credit and post-credit appraisals should be done objectively. The banking secrecy Act must be amended to enable the publication of defaulters' names and willful default has to be treated as criminal offence. The mounting NPAs of banks affect their financial health in terms of profitability, liquidity and economics of scale of operation. Banks have to take timely action against degradation of performing assets. The management of NPAs has been an immense task before the bankers because it challenges the banks' resistance capacity. The occurrences of NPAs may not be avoidable entirely but they can be managed effectively. The fresh incidence of NPAs should be avoided but not at the cost of fresh deployment of credit.

Implications of the Study

Having analyzed various lacunae of loan recovery and accumulation of NPAs in the loan portfolio of commercial banks, following suggestions are offered for improvement of loan recovery and effective management of NPAs.

(a) The timely edifice of loan portfolio is indispensable for effective management of NPAs. Keeping in view the present stipulation of sensitive sector where the instability is escalating gradually the bank should diversify its services into capital market, consultancy, credit card, housing finance and insurance sector etc.

(b) Although the asset quality of banking system has improved considerably banks need to safeguard against any deterioration of credit quality. Banks need to have a comprehensive system in which the process of risk monitoring is combined with proper risk assessment.

(c) Prevention is better than cure. It has been observed that there is unprecedented rise in fresh accretion of NPAs in some banks. Pre-arrangements must be made to contain this. The surest way for containing NPA is to prevent their occurrences. The doctrine of this prevention policy lies on
   - Proper risk management system in banks
   - Strong and effective credit monitoring
   - Open and co-operative working relation between banks and borrowers

(d) The judicial system needs to be revamped to facilitate quicker recovery of dues from defaulters. It is essential to enforce the securitization Act with more stringent provisions to realize the securities and personal assets of the defaulters.

(e) Internal governing factors of banks are, possibly, responsible for current level of NPAs. The onus, therefore, rests with the banks themselves. The organizational structuring, improvement in managerial efficiency, up-gradation of skills for proper assessment of credit worthiness and a change in the banks' attitude towards legal action are needed.

(f) The specific strategy of writing off loans may be adopted, particularly where the amounts of outstanding loans are small, the security available to the bankers is negligible and the expenses to be incurred might be more than the amount likely to be recovered. They may reduce the volume of NPAs to an appreciable level without much loss to the banks.

(g) Supervision and follow-up are two sides of the same coin. Regular monitoring makes the borrowers not to divest the funds for purposes other than the purpose for which the loan is sanctioned. Funds should not be sanctioned and released suddenly. A personal enquiry may be conducted about the borrowers whose accounts become NPA.

(h) Repayment ethics should be inculcated in the minds of the borrowers by optional utilization of various media, i.e., television, video films, All India Radio and press. The incentives could be offered to the regular payers by financing again or providing bonus and disincentives for the willful defaulters in the form of public crime action or adverse publicity in the newspapers.

(i) The mounting overdue thwarts the banks' lending in the area. No effort is made to improve the recovery performance. The local leaders do not encourage the loanee to pay it back. Consequently, loan is not recovered. Therefore, an immediate action plan in the line of provisions made in the securitization Act 2002 is necessary to expedite the recovery position.

Limitations of the Study

The financial data collected for the present study is mostly based on secondary sources. In order to maintain the year-wise uniformity of data, some adjustment has been made keeping in view the objective of the study. Apart from this, the analysis of the data for the purpose of the study is based on quantitative techniques. The qualitative aspects of banks, which have a bearing on the profitability and asset quality, have not been taken care of.

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[35] In order to solve the problem of NPAs, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 is an important landmark in Indian banking scenario. With the passage of the Act, banks and financial institutions (FIs) have been quick to initiate action against the defaulters on loans. About 9000 notices have been issued for the recovery of loan amounting to Rs. 70 billion as in March 2003. Furthermore, they are empowered to take over the assets of the defaulting borrowers. The SRFAESI Act 2002 has given the much needed weapon to the bankers to fight the menace of NPAs and redress a historic imbalance between lenders and borrowers.
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