



## **PROBLEM OF NPA IN INDIAN BANKING: AN ANALYSIS OF POST REFORM PERIOD**

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*Reform in the financial sector play an important role in the process of overall economic development of the country. Liberalization of this sector is one of the significant strategies of structural adjustment programmes. Major stability in monetary and fiscal mechanism is supposed to be the chief prerequisite for financial sector reform. As stabilization process is a long-term assessment, financial sector reforms have to be developed in the midst of macro-economic instability. The magnitude of instability has coined the problems of this sector so seriously that the policy-makers have no option except to attach them to the process of adjustment. Before opening the door of our economy to global competition, it is indispensable to have our domestic economy restructured and the financial sector reform is a forward step in this direction. The objective of present paper is to analyse the NPA of Indian Banking System, after banking reform.*

### **BANKING SECTOR REFORMS AND NON-PERFORMING ASSETS (NPAs)**

The problem of non-performing assets (NPAs) has shaken the entire Indian Banking Sector. The main reason of high percentage of NPAs is the target-oriented approach, which deteriorates the qualitative aspect of lending. NPAs put detrimental impact on the profitability, capital adequacy ratio and credibility of banks. This chapter highlights the most significant factors contributing towards the problem of non-performing assets from the point of view of top public sector banks in India, some foreign banks and the measures required for management of NPAs like reformulation of banks' credit appraisal techniques, establishment of monitoring department, etc.

As the build-up of NPAs has been a major factor in the erosion of profitability of public sector banks in India. The Narasimham Committee (II) underscored the need to reduce the average level of NPAs of all banks from 15 percent to 3 percent by 2002. The definition of weak banks given by this committee has internalized the concept of NPAs. The Working Group on Restructuring Weak Public Sector Banks supplemented the above definition by a combination of seven parameters covering solvency, earning capacity and profitability. The NPA's level in India is not so high as compared to China and other countries. This problem is seriously discussed in the context of public sector banks, but it is now evident, that even private banks are not in a better position either to avoid or curtail NPA's growth. Recovery performance is better with respect to individual small borrowers but it is slow in case of corporations and institutional borrowers. In present scenario NPAs are at the core of financial problem of the banks. Concrete efforts have to be made to improve recovery performance. Measures required to be undertaken are mainly two fold. Banks should make efforts first to avoid fresh addition on NPAs by their effective presentation appraisal and secondly to recover the amount from accounts which have already turned bad.

### **REVIEW**

The non-performing assets (NPAs) engrossed the attention of researchers in the late 1980's when the necessity to transform the banking sector was felt in Indian economy. The studies in this period highlighted the shortcomings in the functioning of the banking sector and stressed the need to incorporate prudential norms for income recognition, asset classification and provisioning. Such analysis and inferences to a great extent helped the researcher in identifying the stages of development in NPA management.

In an attempt to examine the presence of high average NPA shares in total bank advances and the higher level of dispersion among banks, Rajaraman, et al (1999) undertook specification tests for the

impact of region of operation on domestically-owned banks during 1996-97. The authors based on analysis confirmed that operational environment is an important determinant of bank efficiency. The authors further commented that no sustainable improvement in the performing efficiency of domestic banks is possible without prior improvement in the enforcement environment in difficult regions of the country.

In a descriptive and comparative study Reddy P. K. (2002) assessed NPA management measures in selected Asian countries. The study identified legal impediments, postponement of the problem by the banks to show higher returns and manipulation by the debtors using political influence as major reasons for the high NPA level in Indian banks.

In another major research article focused on comparing NPA in Asian markets, Batra S. (2003) made a significant observation on higher levels of the NPA in Indian banking. The author expressed the view that the most important business implication of the NPAs is that it leads to the credit risk management assuming priority over other aspects of bank's functioning.

Khasnobis S. (2005) in the research article "NPA- An emerging challenge in India" explained that the distribution of the NPA in the Indian banking system followed a 80-20 rule, wherein 20% of borrowers are responsible for 80% of value of impaired assets and vice versa. The study found that the large impaired assets which comprise industrial assets possess good restructuring potential. The small assets, however, have to be put through a recovery process, where the collateral- based financing practice followed by the banking system offers a fair recovery potential. The author recommended speeding up of the recovery process for successful NPA management.

In a study of the determinants of the NPA in Indian PSBs, Biswas and Deb (2005) examined the random and non-random reasons for NPA in PSBs during 1995-2004. The authors underlined the shortfalls of existing system and the existence of a high degree of arbitrariness in defining NPA. A notable contribution of this research study is its conceptualization of random reasons for default in a simplified framework of a Poisson process. The study pointed out that while one set of policies granting greater autonomy to the PSB are proved quite effective in restricting formation fresh NPA, the other set of policies designed to recover loans, after default, has failed to deliver the goods.

Various studies were conducted in the international context on NPA and its trends. These studies explained various facts of NPA that includes the various reasons behind the accumulation of NPA, the effectiveness of measures taken by the government to reduce NPA, to name a few. Some of the studies focused on specific factors and its impact on increasing or decreasing the level of the NPA in the banking sector.

Deogharia, P.C. (2006) in his article observed that the performance of public sector banks has been better than private sector banks both old and new - in terms of net NPAs. Foreign Banks, however, exhibited the best recovery performance and lowest NPL levels among the all bank groups. This raises a question mark on the applicability of the argument that links the performance of banks with ownership pattern in the context of Indian banking.

Herr and Miyazaki (1999) in their research article about the NPA problem in the Japanese banking industry briefed the various problems faced by the banking sector in managing their NPA accounts. Aggressive levels of NPA during 1990s, a tax system that doesn't provide tax reductions for write offs, increased number of bankruptcies etc., were evident in the Japanese banking sector since 1990. The authors based on literature review rated securitization as an effective way to handle NPAs in the banking industry.

Adhikari R. and Oh Soo Nam (1999) examined the banking sector reforms after the Asian financial crisis. The authors observed that in countries where not only the financial sector, but also the whole process of economic reform is not complete, the banking sector accumulated a huge financial burden.

Woo D. (2000) examined two approaches to resolving NPAs during financial crisis with special focus on the Asian financial crisis that erupted in 1997. The study examined the creation of AMC and the development of out of-court centralized corporate debt workout framework to manage NPA accounts.

Ralph K. (2003) in a research study on "selected issues in the treatment of NPAs in macro economic statistics" explained that due to the linkages between loan recognition and interest accrual, and between loan write-offs and operating surplus, the treatment of NPAs significantly impacted the calculation of major aggregates in the national and international economic accounts. Based on statistical analysis, the authors recommended the treatment of loan principal and its valuation, loan interest and the operating surplus. The study is significant as it contributes to the literature on the statistical treatment of NPA in national and international accounts.

Shih, V. (2004) examined the political constraints and financial policies in China dealing with NPAs. The study is conducted in the wake of political distress on account of the stagnation of economic reforms and higher levels of NPAs in the banking sector.

In order to study the significance of the NPA in Bangladesh banking sector, Adhikary, B.K. (2007) examined the behavior of NPA statistics during the period 2000-2005. The results of the study highlighted the presence of the alarming level of NPA in both Nationalized Commercial Banks and in the Development Financial Institutions.

Chaffai, M.E., et al (2007) conducted a study on the price of bad loans, using a database of 2154 banks located in 29 emerging countries during 1996-2000. These banks were selected from Eastern Europe, Asia and Latin-America.

Siraj, K.K. (2010) undertook a study on banking sector in the Sultanate of Oman, with special focus on the effect of global financial crisis on the Oman banking sector.

Abel, E.E. (2011) examined the asset quality and identified the major determinants of bank asset quality in an era of regulation-induced industry consolidation, in a case study on Nigerian banking sector.

Nkusu, M. (2011) examined the link between NPA and macroeconomic performance using a sample of 26 advanced countries that spans the period from 1998 to 2009. The study addressed two empirical questions on the NPA and macro financial vulnerabilities: the question of the determinants of the NPA and that of the interactions between the NPA and economic performance.

Zeng, S. (2012) applied a dynamic model to study the NPA of banks in China. The author attempted to find: 1) the Hamiltonian multiplier of the bank NPA growth rate in the model which expresses the rate of change in NPA over time with respect to the NPAs, 2) a model that demonstrates the equilibrium value of the saddle point of the bank NPA; 3) a model explaining the NPA phenomenon in the Chinese banking system-mainly the state owned banks. 4) A test of hypothesis: the equilibrium value of the bank NPLs is dependent on micro-economic factors under the circumstances of macro-economic factors. The results of the study identified a significant decline in NPA of state owned banks, mainly due to the setting up of AMCs, implementation of new policies, etc. The results of the study also stressed the need to strengthen banks' internal management effort must be enhanced.

In an analytical study, Klein, N (2013) investigated the significant linkages between macroeconomic conditions, bank specific factors on incidence of NPA, with special focus on Central, Eastern and

South-Eastern Europe in the period of 1998-2011. The panel VAR analysis broadly confirms the existence of strong macro-financial linkages. In particular, the impulse response functions revealed that a positive shock to GDP growth and credit (as a ratio of GDP) contributes to the reduction of NPA while a higher inflation leads to higher NPAs.

In the international context, studies on NPA mainly focused on identifying the trend and the reasons for the incidence of NPA and its interaction with various performance indicators. The studies also contributed significantly towards implementing new measures to manage NPA in post-crisis (Asian financial crisis) period.

Review of literature on NPA in Indian and international context revealed the complexity of the NPA to the development and growth of banking across the world. The studies in general compared NPA and its incidence and suggested various measures to mitigate the risk of NPA and reduce to the minimum possible level. Many of the suggestions put forward in the literature are common and may be classified into two (1) strengthening the credit risk management system, and (2) changes in regulatory measures. These measures are significant and help banks to improve the quality of asset portfolio and recover NPA accounts at the earliest.

Many of the measures stated in the literature were implemented in the Indian banking sector. Still the level of NPA is alarming and its fluctuations during financial crisis are really a reason to worry about. Hence a further research on NPA in banking is required.

#### **PROBLEMS OF NPAs IN INDIAN BANKING SINCE 1991**

One of the major segments of the economy that has received renewed focus in recent time has been the financial sector, within the broad ambit of the financial sector; the banking sector has been the cynosure of academic and policy makers alike. Among the various reason attributable to the resurgence of interest in banking the world wide trend towards deregulation of financial sector, ascendancy of free market philosophy and the growing number, breadth and severity of bouts of financial distress that have plagued several economics since the eighties have been a dominant one. Such liberalization has raised gamut of questions relating to the linkage between deregulation and the various categories of risks confronting the banking sector. With concerns about financial stability emerging to the forefront of policy challenges facing central banks worldwide, it is being increasingly realized that promoting healthy financial institutions, especially banks, is a crucial prerequisite towards this end. In consonance of this trend, the traditional face of banking has also been undergoing a change from one of mere intermediate to one of provider of quick, cost effective, efficient and consumer-centric services.

A process of liberalization of the banking sector was initiated in India since 1991-92 which means (i) Softening of allocative regulations and hardening of the prudential regulations, (ii) Moving away from the regime of administered rates towards market determined rates, (iii) Providing better access to money and capital markets to higher credit rated industrial clients with an aim of promoting efficiency, and (iv) providing a chance to the Indian financial system to restructure itself.

Liberalization aimed at raising the allocative efficiency of efficiency of available saving, increasing the returns on investments and promoting accelerated growth and development of the real sector. Towards this end, wide ranging reforms were under taken across the entire gamut of the financial system in order to promote a diversified, efficient and competitive financial system.

Non-Performing Assets (NPAs) of the Indian Banking System are higher than Western standards. Slow pace of banking reforms is likely to raise the ultimate cost of bank restructuring both fiscally and in terms

of foregone economic growth. The most critical area in the improvement or profitability of banks is to bring down the NPAs level.

NPAs are those loans given by a bank or financial institution where the borrower defaults or delays interest or principal payments. Banks are not allowed to book any income from NPAs. They have to make provision for the NPAs or keep money aside in case they cannot collect from the borrower, which affects profitability adversely.

According to RBI guidelines, any loan repayment, which is delayed beyond 180 days, has to be identified as an NPA. NPAs are further classified into sub-standard, doubtful and loss assets. Sub-standard assets are those, which are non-performing for a period not exceeding two years. Doubtful assets are those, which have remained non-performing for a period exceeding two years but are still not considered as loss assets. A loss asset is one where loss has been identified but the amount has not been written off wholly or partly. In other words, such asset is called uncollectible.

In terms of the prudential norms, NPA was defined as a credit facility in respect of which interest remained 'past due' for a period of four quarters in the year ended March 31, 1993, three quarters during the year ending March 31, 1994 and two quarters during the years ending March, 1995 and onwards.

#### **FACTORS RESPONSIBLE FOR NPAs**

According to the Reserve Bank of India (RBI, 1999) non-performing assets in the Indian banking sector is a historic legacy due to lacunae in credit recovery, largely arising from inadequate legal provisions on foreclosure and bankruptcy, long drawn legal procedures and difficulties in execution of the decrees awarded by the court. It calls for a reduction in NPAs to be treated as a 'national priority'. "The Indian legal system is sympathetic towards the borrowers and works against the banks interest. Despite most of the loans being backed by security, banks are unable to enforce their claims on the collateral, loan-recoveries have been insignificant" (Fitch IBCA - An International Agency).

In addition to internal factors such as weak credit appraisal, non-compliance and willful default, there are several external factors such as preponderance of certain banks, majority of which are suffering from serious inherent operational problems, natural calamities, policy and technological changes which increase the incidence of sickness, labour problems and non-availability of raw materials and other factors which are not within the control of the banks.

Diversion of funds has been identified as the No.1 factor leading to increased defaults by the industrial sector. "Diversification of funds, mostly for expansion/diversification/modernization, taking up new projects and for helping/promoting associate concerns, is the single most prominent such as inefficient management, strained labour relations, inappropriate technology/technical problems and product obsolescence. External factors comprise of recession, inputs/power shortage, price escalation and accidents. Time/cost overruns during the projects implementation stage leading to liquidity strain and turning into NPAs is another factor. Some other reasons are changes in excise/import duties, pollution control orders, willful default, siphoning-off of funds, fraud/misappropriation, promoters' directors' disputes, etc. Internal factors refer to those within the banks, such as weak appraisal or follow-up of loans. Banks have lax both in granting loans and in ensuring that the funds are not frittered to make real promoters' ambitions though the incidence of NPAs are increasingly occurring on borrowal accounts of industrial sector during the recent years. Because of the tradition of consortium lending, banks and financial institutions are exposed to the same companies. As such, if the diversion of funds contributed to the NPA menace in banks, it holds good for financial institutions too. Banks have no hold over the borrower, as the security is usually hypothecated current assets. In

contrast, land buildings, plants and so on are mortgaged to the financial institutions for long-term loans. Besides, in most cases, the financial institutions are also shareholders, giving them a reasonable hold over the borrower. Diversion of funds was an important factor behind the cost overruns in many of the projects. The banks and the financial institutions seem to have done precious little to ensure that funds, which were diverted, were brought back by the promoters. Even in the other cases there appears to be considerable laxity in protecting their origin investments. An entry into BIFR net is a recipe for extracting concessions from the banks and the financial institutions and also effectively, a moratorium on repayment. However, had the apex bank formally identified the malaise a year or two earlier, the impact of NPAs on the system could have been minimized.

The RBI study says that diversion of funds by promoters and time/cost overruns are among the main reasons of non-performing assets in the Indian banking system. The diversion of funds, mostly for expansion, diversification, modernization, taking up new projects and for helping/promoting associated concerns, is the single most prominent reason.

Internal factors like business failure, inefficient management, strained labour relations, inappropriate technology and product obsolescence have also contributed to the rise in NPAs. External factors like raw material shortage, price escalation, excess capacities and the natural calamities like floods and accidents have also contributed to the rise in NPAs on the books of banks.

The RBI study of about 800 top NPA accounts in 17 banks reveals that the single-most important reason for units becoming sick and rising NPAs is the diversion of funds by promoters. The RBI inferred that the internal factors far outweighed the external factors contributing to the NPAs, as on March 31, 1997. The study covered a cross-section of industries such as iron and steel, textiles, real estate, pharmaceuticals, leather exports, garment exports, fertilizers and chemicals among others.

Table-1: Estimated Gross NPA Level of Banks

Sl. No.	Country	Range
1.	Indonesia	50-70
2.	China	25-40
3.	Thailand	35
4.	Korea	25-30
5.	Malaysia	20-25
6.	Phillipine	15-20
7.	India	17
8.	Japan	15
9.	Taiwan	10
10.	Singapore	5-10
11.	Hong Kong	6

Source: *The Economic Times, Mumbai.*



### NPA DURING 1ST PHASE OF BANKING SECTOR REFORM

The report of the RBI on NPAs says that reducing NPAs should be treated as a 'national priority'. The average gross NPA level in the banking sector remains above 15 percent. This is high when compared to the Narasimham Committee's recommendation of 5 per cent by 2001. Out of 27 public sector banks, 10 continued to have non-performing assets above 10 per cent in their net advances in 1998. However, one bank's NPA level exceeded 20 per cent.

Against this, none of the 9 new private sector banks had NPAs exceeding 10 per cent, while only 4 out of 25 old private banks had an NPA above 10 per cent. These figures are published by the RBI for the Indian banking sector through a status paper on NPAs. The banks have been divided into three categories according to their NPA levels. These are up to 10 per cent, above 10 per cent and up to 20 per cent and above 20 per cent. The foreign banks in India showed great extremes. In 1998, out of 42 per cent, while there were only two banks with NPAs exceeding 20 per cent. In 1997, there were 36 banks in the below 10 per cent category, 16 banks had no NPAs, only one bank had NPAs in the 10-20 per cent category.

The RBI report quotes a paper brought out by Fitch IBCA (an International Agency), which blames the legal system for the high NPA level. According to the paper, "The Indian legal system is sympathetic towards the borrowers and works against the banks' interest".

According to the RBI, in the second phase of reforms in the banking sector, the thrust is on improvement in the organizational efficiency of banks. This means that the most critical area in the improvement of profitability of banks is bringing down the NPAs level.

According to a detailed study of the Indian banking system by McKinsey and Co., Partner and Other which was published in a book entitled "Banking in Asia : The End of Entitlement", across all segments of financial services industry in India, a critical distinguished factor between winners and losers is their ability to improve efficiency. They say that in 1977, the cost to income ratio of Indian banks was as high as 64 per cent against only 50 per cent for the top players in South-East Asia.

Table-2: NPAs of Public Sector Banks During 1st Phase of Reform

Year Ending March	Gross NPAs	% to Gross Advances	% to Total Assets
1993	39253	23.20	11.80
1994	41041	24.80	10.80
1995	38385	19.50	8.70
1996	41661	18.00	8.20
1997	43577	17.80	7.80
1998	45653	16.00	7.00

Source: *The Economic Times, Mumbai.*

"The disclosed ratio of NPAs to total loans was 16 per cent in 1998, but market estimates based on the strictest international accounting norms place the ratio at 20-21 per cent. The crisis is likely to be overcome through a gradual process of tighter reforms, legal overhaul and industry restructuring and consolidation", they said.

### Mixed Performance of Indian and Foreign Banks

Foreign banks have shown a mixed performance in 1998-99 in their Indian operations. Banks of Tokyo has incurred a net loss of Rs.52.5 crore during 1998-99. The loss has been on account of a Rs.375.56 crore write-off of bad debt, which has been booked under operating expenses. ANZ Grindlays Bank has recorded at 23.54 per cent decline in profit compared to

1997-98. The bank has reported a net profit of Rs.175.9 crore in 1998-99. The bank's provisions toward doubtful assets have risen to Rs.52.16 crore in 1998-99 from Rs. 20.09 crore in 1997-98.

The Indian operations of the German Dresdner Bank have recorded a net loss of Rs.5.64 crore compared to a net profit of Rs.4.4 crore in 1997-98. The Bank's profit came under pressure following a Rs.10.96 crore provision towards non-performing assets to net advances rose to 16.16 per cent in 1998-99 from 12.33 per cent in 1997-98. The net NPA of ABN Amro Bank (Dutch Multinational) stood at Rs.0.45 crore in 1998-99 against 0.42 per cent in 1997-98.

Bank of Baroda has implemented the RBI's stringent provisioning norms ahead of the Central Bank's deadlines. The tighter provisions have come at a time when a slow-down in business and higher provisioning, largely on account of NPAs and wage costs, have pulled down the net profit of the bank to Rs.421 crore in 1998-99 which is 8.68 per cent lower than the net profit of Rs.461 crore in the previous year. Bank of Baroda has provided Rs.362 crore towards bad debts written-off and provisioning made towards non-performing assets. There has been a substantial increase in NPAs with net NPAs rising to 7.70 per cent in 1998-99 from 6.60 per cent in 1997-98. Net non-performing assets have increased to Rs.1623 crore from Rs.1238 crore in the previous year.

Bank of India had made a Rs.316 crore provisioning for NPA in 1997-98 compared to Rs. 4 crore in 1996-97. The General Manager says that the bank had made additional provisions following an economic slow-down, competition from imports and closure of industries on environmental grounds. The ratio of net NPAs to total advances increased from 6.5 per cent in 1996-97 to 7.34 per cent in 1997-98. The common concerns of the public sector banks are their relatively small size, higher cost of funds, slowing down of advances, rising operational costs, wage rise and tightening of prudential norms - all leading to more sparse spreads and more NPAs.

Table-3: Public Sector Banks: Health Watch (Ist Phase)

Sl. No.	Type of Assets	Amount (Rs. Crore)	Percentage
1.	Total Assets	284971	100.0
2.	Standard Assets	239318	84.0
3.	Sub-Standard Assets	14463	5.1
4.	Doubtful Assets	25819	9.1
5.	Loss Assets	5371	1.9
	Total NPAs	45653 (16%)	100.00

Source: The Economic Times, Mumbai.



## **NPA DURING IIND PHASE OF REFORM**

Present level of NPAs was considered as a very big problem for the banks and needs immediate steps to be taken to check it. As far as causes of NPAs are concerned, it may be different in case of priority sector and non-priority sector. The factors responsible for NPAs may be classified into two broad categories internal as well as external.

**Priority Sector Advances:** Willful default induced by officially announced loan waiver scheme vitiates the payment culture. People feel that loans given to them will be waived off with the passage of time by one political party or the other. Genuine viability problem of borrowing unit and willful default caused by other factors are graded as next in importance. Weak monitoring and absence of effective supervision of loan accounts on their part also leads to this problem. Lack of technical and managerial expertise on the part of borrowers is the next important factor. Moreover, wrong identification of beneficiary and weakness in credit appraisal systems are the other important reasons of this problem. Banks do not have much discretion in granting of loans to priority sector because targets are fixed under directed priority sector lending irrespective of recovery potential. Other factors like non-availability of reliable data related to market and industry and delay in disbursement of credit.

**Intravenous Causes in Non-priority Sector Advances:** Due to lack of networking banks do not have any information sharing system by which they can know the information regarding borrowers, his credit worthiness and past record. Credit appraisal system of the banks is also weak which leads to improper assessment of returns from the activities being financed, repaying capacities and risk bearing ability of the borrower and resultantly the NPAs. Slow disposal of recovery cases is major factor contributing towards accumulation of NPAs in non-priority sector advances. Once NPAs occurs, recovery through legal measures is a very lengthy and tedious process. There are some other external factor such as inadequate infrastructural facilities like supply of power and other essential inputs, and withdrawal of policies like product reservation and price preference etc., which make the units unviable in this competitive environment.

The Table - 4 depicts that total advances of commercial banks has increased from Rs. 558679 crore in 2001 to Rs.2507885 crore in 2008. It also depicts that percentage of NPA's of advances has declined from 11.44% to 2.3% in the same period. In case of doubtful assets these were maximum in year 2005 (63.80%). Loss assets were maximum in 2006 (13.50%). But later on it gain momentum and showed increase. Increasing of loss assets or NPA's is not good indicator for the development of a country or an economy.

Table - 4: Classification Of Loan Assets Of All Commercial Banks  
As On 31st March

(Rs. In Crore)

Year	Total Advance	Total NPA	% of NPA to Advance	Standard Assets	Sub-standard Assets	Doubtful Assets	Loss Assets
2001	558679	63963 (100)	11.44	494716	18206 (28.50)	37756 (59.00)	8001 (12.50)
2002	680925	70953 (100)	10.42	609972	21382 (30.13)	41201 (58.06)	8370 (11.81)
2003	778040	68780 (100)	8.84	709260	20078 (29.20)	39731 (57.80)	8971 (13.00)
2004	902027	64898 (100)	0.72	837130	21026 (32.40)	36247 (55.90)	7625 (11.70)
2005	1124926	58023 (100)	5.16	1066903	14073 (23.70)	36955 (63.80)	6996 (12.50)
2006	1473527	51242 (100)	3.48	1422285	14737 (28.50)	29940 (58.00)	6565 (13.50)
2007	1893513	50296 (100)	2.66	1843220	19883 (39.55)	24505 (48.71)	5905 (11.74)
2008	2331678	55842 (100)	2.39	2275836	26113 (46.08)	24386 (43.03)	5343 (9.43)
2009	2793133	68220 (100)	2.44	2724912	35920 (52.67)	26736 (39.19)	5564 (8.14)
2010	3271361	81813 (100)	2.50	3189548	41294 (50.47)	32668 (39.93)	7850 (9.60)

Source: Economics Intelligence Service Center for monitoring Indian Economy Money and Banking, 2000-11

Note: Figures in bracket is representing in percentage to total NPA

Table - 5: Classification Of Loan Assets According To Bank Group-wise -  
Standard Assets

(Rs. In Crore)

Standard Assets								
Year	PSB's	%age	PVT SB's	%age	FORG SB's	%age	AL SCB'sL	%age
2001	387360 (78.29)	87.61	65071 (13.15)	91.46	42285 (8.54)	93.15	494716 (100)	88.55
2002	452862 (74.24)	88.91	109272 (17.91)	90.35	47838 (7.84)	94.51	609972 (100)	89.58
2003	523724 (73.84)	90.64	134248 (18.92)	91.92	51288 (7.23)	94.66	709260 (100)	91.16
2004	610435 (72.91)	92.21	167076 (19.95)	94.17	59619 (7.12)	95.19	837130 (100)	92.81
2005	830029 (75.90)	94.27	188789 (17.26)	1.35	74705 (6.83)	3.69	1093523 (100)	0.67
2006	1092607 (72.86)	96.14	309918 (20.66)	1.06	96907 (6.46)	2.32	1499431 (100)	0.48
2007	1335175 (72.44)	97.19	382628 (20.76)	1.03	125415 (6.80)	1.45	1843218 (100)	0.33
2008	1656585 (72.79)	97.66	459369 (20.18)	0.99	159882 (7.03)	1.13	2275836 (100)	0.22
2009	2059725 (75.59)	97.91	502768 (18.45)	0.93	162420 (5.96)	0.98	2724912 (100)	0.18
2010	2462030 (77.19)	97.73	567207 (17.78)	1.10	160311 (5.03)	0.98	3189548 (100)	0.20

Source: Economics Intelligence Service Center for monitoring Indian Economy- Money and Banking, 2000-11.

Note: Figures in bracket is representing in percentage to total NPA's.

Table - 6: Classification Of Loan Assets According To Bank Group-wise -  
Sub- Standard Assets

(Rs. In Crore)

Sub-Standard Assets								
Year	PSB's	%age	PVT SB's	%age	FORG SB's	%age	AL SCB'sL	%age
2001	14745 (80.99)	3.33	2585 (14.20)	3.63	876 (4.81)	1.93	18206 (28.50)	3.26
2002	15788 (73.84)	3.01	4738 (22.16)	3.92	856 (4.00)	1.69	21382 (30.13)	3.14
2003	14909 (74.25)	2.58	4174 (20.79)	2.86	995 (4.96)	1.84	20078 (29.20)	2.58
2004	16909 (80.42)	2.55	3127 (14.87)	1.76	990 (4.71)	1.58	21026 (32.40)	2.33
2005	11084 (78.97)	1.35	2270 (15.93)	0.98	718 (5.10)	0.93	14073 (23.70)	1.25
2006	11394 (77.25)	1.06	2396 (16.37)	0.79	946 (6.38)	0.96	14737 (28.50)	1.00
2007	14147 (71.12)	1.03	4368 (22.01)	1.11	1367 (6.87)	1.07	19883 (39.55)	1.05
2008	16870 (64.60)	0.99	7280 (27.88)	1.54	1963 (7.52)	1.20	26113 (46.08)	1.12
2009	19521	0.93	10526	2.03	5874	3.46	35920 (52.67)	1.29
2010	27688	1.10	8676	1.48	4930	2.94	41294 (50.47)	1.26

Source: Economics Intelligence Service Center for monitoring Indian Economy- Money and Banking, 2000-11.

Note: Figures in bracket is representing in percentage to total NPA's.

**Table - 7: Classification Of Loan Assets According To Bank  
Group-wise - Doubtful Assets**

(Rs. In Crore)

Doubtful Assets								
Year	PSB's	%age	PVT SB's	%age	FORG SB's	%age	AL SCB'sL	%age
2001	33485 (88.68)	7.57	3069 (8.12)	4.31	1202 (3.18)	2.65	37756 (59.00)	6.75
2002	33658 (81.69)	6.61	6539 (15.87)	5.41	1004 (2.43)	1.98	41201 (58.06)	6.05
2003	32340 (81.39)	5.60	6447 (16.22)	4.41	944 (2.37)	1.74	39731 (57.80)	5.11
2004	28756 (79.33)	4.34	6392 (17.63)	3.60	1099 (3.03)	1.75	36247 (55.90)	4.02
2005	30218 (81.50)	3.69	5671 (15.70)	2.49	1066 (2.74)	1.38	36955 (63.80)	3.29
2006	24804 (83.13)	2.32	4438 (14.60)	1.46	698 (2.22)	0.71	29940 (58.00)	2.03
2007	19945 (81.41)	1.45	3930 (16.01)	1.00	631 (2.58)	0.49	24505 (48.71)	1.29
2008	19167 (78.60)	1.13	4452 (18.26)	0.94	768 (3.14)	0.47	24387 (43.03)	1.05
2009	20715	0.98	5017	0.97	1004	0.59	26736 (39.19)	0.96
2010	24685	0.98	6542	1.12	1441	0.86	32668 (39.93)	1.00

Source: Economics Intelligence Service Center for monitoring Indian Economy- Money and Banking, 2000-11.

Note: Figures in bracket is representing in percentage to total NPA's.

Table - 8: Classification Of Loan Assets According To Bank Group-  
Wise - Loss Assets

(Rs. In Crore)

Loss Assets								
Year	PSB's	%age	PVT SB's	%age	FORG SB's	%age	AL SCB'sL	%age
2001	6544 (81.78)	1.48	424 (5.29)	0.60	1033 (12.9)	2.27	8001 (12.50)	1.43
2002	7061 (84.36)	1.39	389 (4.64)	0.32	920 (10.99)	1.82	8370 (11.81)	1.23
2003	6840 (76.24)	1.18	1177 (13.12)	0.81	954 (10.63)	1.76	8971 (13.00)	1.15
2004	5876 (77.06)	0.89	825 (10.81)	0.46	924 (12.11)	1.47	7625 (11.70)	0.85
2005	5514 (80.31)	0.67	910 (11.96)	0.39	572 (7.72)	0.74	6996 (12.50)	0.62
2006	5180 (80.33)	0.48	940 (13.38)	0.31	446 (6.28)	0.45	6565 (13.50)	0.45
2007	4510 (76.38)	0.33	941 (15.93)	0.24	454 (7.69)	0.36	5905 (11.74)	0.31
2008	3712 (69.47)	0.22	1244 (23.28)	0.26	387 (7.25)	0.24	5343 (9.43)	0.23
2009	3803	0.18	1345	0.26	416	0.25	5564 (8.14)	0.20
2010	4928	0.20	2166	0.37	757	0.45	7850 (9.60)	0.24

Source: Economics Intelligence Service Center for monitoring Indian Economy- Money and Banking, 2000-11

Note: Figures in bracket is representing in percentage to total NPA's.



Table - 9: Bank Group's Wise - NPA's

(Rs. in Crore)

Year	Total Advances	Total NPA of all CB's	Advances	NPA's	Advances	NPA's	Advances	NPA's
	All CB's	All CB's	PSB's	PSB's	Pvt. SB's	Pvt. SB's	Foreign	Foreign
2001	558679	63963	442134 (100)	54774 (12.38)	71149 (100)	6078 (8.54)	45396 (100)	3111 (6.85)
2002	680925	70953	509369 (100)	56507 (11.09)	120938 (100)	11666 (9.64)	50618 (100)	2780 (5.49)
2003	778040	68780	577813 (100)	54.89 (9.36)	146046 (100)	11798 (8.07)	54181 (100)	2893 (5.33)
2004	902027	64898	661975 (100)	51541 (7.78)	177420 (100)	10344 (5.83)	62632 (100)	3013 (4.81)
2005	1124926	58023	817248 (100)	46817 (5.44)	230632 (100)	8851 (4.57)	77046 (100)	2355 (4.81)
2006	1473527	51242	1070872 (100)	41378 (3.71)	303793 (100)	7774 (2.45)	98862 (100)	2090 (2.07)
2007	1893513	50293	1373777 (100)	38602 (2.81)	391870 (100)	9239 (2.36)	127867 (100)	2452 (1.92)
2008	2331678	55842	1696333 (100)	39749 (2.34)	472345 (100)	12976 (2.75)	163000 (100)	3118 (1.91)
2009	2793133	68220	2103763 (100)	44039 (2.09)	519655 (100)	16888 (3.25)	169714 (100)	7294 (4.30)
2010	3271361	81813	2519331 (100)	57301 (2.27)	584591 (100)	17384 (2.97)	167439 (100)	7128 (4.26)

Source: Economics Intelligence Service Center for monitoring Indian Economy- Money and Banking, 2000-11

**Note:** PSB's - Public Sector Banks, Pvt. - Private and Figure in bracket is percentage to advance

The Table - 9 reveals that NPA's of public sector banks shows declined trend since 2001 to 2008. It has declined from 12.38% in 2001 to 2.34% of public sector banks of total advances

in 2008. This shows public sector banks are taking corrective measure to improve their profitability.

In case of private sector banks, NPA's were maximum in the year 2002 (9.64%). Then it decline 2.75% in the year 2008. In case of foreign banks, NPA's were maximum in the year 2001 (6.85%). It decline 1.91% in 2008. The table also shows that NPA's are declining of all banks. If we compare among different bank, NPA's public sector bank have maximum in all period.

Table - 10: Gross And Net Npa's Of Scbs Bank Group-wise

(Rs. In Crore)

Item /⇒ Year ↓	Advance		Non-Performing Assets				
	Gross	Gross NPA's	As % of Gross Advance	As % of Total Assets	Net NPA's	As % of Gross Advance	As % of Total Assets
Scheduled Commercial Banks							
2001	558766	63741	11.4	4.9	32461	6.2	2.5
2002	680958	70861	10.4	4.6	32554	5.5	2.3
2003	778043	68717	8.8	4.1	29692	4.0	1.8
2004	902026	64785	7.2	3.3	24396	2.8	1.2
2005	1110986	58300	5.2	2.6	21441	2.0	0.9
2006	1551378	51816	3.3	1.9	18529	1.2	0.7
2007	1893514	50299	2.5	2.7	33959	1.0	1.5
2008	2507885	56668	2.3	2.4	24734	1.1	1.3
Public Sector Banks							
2001	442134	54672	12.4	5.3	27977	6.7	2.7
2002	509368	56473	11.1	4.9	27958	5.8	2.4
2003	577813	54090	9.4	4.2	24877	4.5	1.9
2004	661975	51538	7.8	3.5	19335	3.1	1.3
2005	836128	47325	5.7	2.8	16642	2.1	1.0
2006	1134725	42106	3.7	2.1	14561	1.3	0.7
2007	1373777	38968	2.7	2.3	29076	1.1	1.6
2008	1819074	40600	2.3	2.2	17837	1.0	1.3

Item /⇒ Year ↓	Advance		Non-Performing Assets				
	Gross	Gross NPA's	As % of Gross Advance	As % of Total Assets	Net NPA's	As % of Gross Advance	As % of Total Assets
Private Sector Banks							
2001	71237	5963	8.00	3.6	3700	5.2	2.3
2002	120958	11662	10.00	4.6	6676	6.0	2.7
2003	146047	11782	8.30	4.1	3963	3.4	1.6
2004	177419	10354	6.30	3.0	4128	2.8	1.3
2005	197832	8782	4.80	2.4	4212	2.3	1.1
2006	317690	7782	3.00	1.8	3161	1.2	0.7
2007	391870	50229	2.20	1.5	3969	1.0	1.2
2008	525845	12985	2.50	1.0	5647	1.1	1.4
Foreign Banks							
2001	45395	3106	6.8	3.0	785	1.8	0.8
2002	50631	2726	5.4	2.4	920	1.9	0.8
2003	54184	2845	5.3	2.4	903	1.7	0.8
2004	62632	2894	4.6	2.1	933	1.5	0.7
2005	77026	2192	2.8	1.4	639	0.8	0.4
2006	98965	1927	1.9	1.0	808	0.8	0.4
2007	127867	2234	1.8	1.0	914	1.0	0.8
2008	162965	3084	1.9	0.8	1250	1.2	0.8

Source: Report on Trend and Progress of Banking in India 2000 to 2011.

The Table - 10 depicts the Gross and Net NPA's of Scheduled Commercial Banks. There is a significant improvement in recovering the NPA's and there is a sharp decline in gross NPA's from 11.4% in 2001 to 2.3% in 2008 of gross advance ratio of all banks.

**Table - 11: Moment in NPA's and CRAR of  
all Scheduled Commercial Banks**

Year	Gross NPA Ratio to Gross Advance	Net NPA Ratio to Net Advance	Capital Adequacy Ratio
2001	11.44	6.2	11.40
2002	10.42	5.5	12.00
2003	8.84	4.0	12.70
2004	0.72	2.8	12.90
2005	5.16	2.0	12.80
2006	3.48	1.2	12.32
2007	2.66	1.0	12.28
2008	2.39	1.1	13.01
2009	2.44	--	--
2010	2.50	--	--

*Source: Center for Monitoring of Indian Economy 2000 to 2011.*

The Table - 11 shows that ratio of gross non-performing assets is continuously decreasing from 11.4% in 2001 to 2.16% in 2008. The table shows that ratio of net non-performing assets is continuously decreasing from 6.2% in 2001 to 1.1% in 2008. The table also shows that capital adequacy ratio is continuously increasing from 11.40% to 13.01% in above said period.

#### **IMPACT OF NON-PERFORMING ASSETS**

There are some indicators on which basis we can analyze the impact of NPAs on the performance of banks.

**Profitability:** NPAs put detrimental impact on the profitability, as interest on NPAs cannot be included in the income of banks. Moreover, it puts an end to recycling of funds mobilized with great difficulty, hence reduces the ability of banks for lending more and thus results in lesser interest income. The profitability of bank will increase if standard assets are increasing. These assets have increased from 88.55 percent to 90.74 percent during the study period. Moreover, total NPAs have declined from 11.44% in 2001 to 2.3% in 2008.

**Employment Generation:** Since NPA's are reducing than banks will able to provide more and more loan to borrowers for set up their business which will turn improves employment opportunities for unemployed.

**Living Standard of People:** When people are getting more and more employment their purchasing power will improve. Due to this their standard of living will improve. They will be able to meet their basic requirements on both ends. Population below poverty line came down from 49.5% in 1951 to 26% in 2008 which implies the growth of Indian economy.

**Income Level:** The productivity of individual funds and manpower will utilize. The advances given by bank to borrower will also utilize properly. Banks will get their advances back on time. Due to this banks will also be able to provide extra benefit and bonus to their employees, high dividend to their shareholders which will increase their income level.

**Capital Adequacy Level:** It may be pointed out with higher amount of NPAs in the total of risk weighted loan assets. The loss would continue to be a part of risk weighted assets where as these assets are not earning any income. As per Basel Committee norms, capital should be eight percent of risk-weighted assets. Thus distribution base is increasing where as profitability is falling due to higher level of NPAs. Credibility of banking system is also affected greatly due to higher level NPAs because it shakes the confidence of general public in the soundness of the banking system. NPAs not only affect the performance of the banks but also affect the economy as a whole. Some other impacts of NPA's are like as:

1. Owners do not receive a market return on their capital. In the worst case, if the bank fails, owners lose their assets. In modern times, this may affect a broad pool of shareholder.
  2. Depositors do not receive a market on savings in the worst case if the bank fails, depositors lose their assets or uninsured balance. Banks also redistribute losses to other borrowers by charging higher interest rates. Lower deposits rate and higher lending rate repress saving and repress saving and financial markets, which hampers economic growth.
  3. Non-performing loan epitomize bad investment. They misallocate credit from good projects. Which do not receive funding to failed projects? Bad-investment ends up in misallocation of capital and by extension, labour and natural resources. The economy performs below its production potential.
  4. Non-performing loans may spill over the banking system and contract the money stock, which may lead to economic contraction. These spills over effect can channels through illiquidity or bank insolvency.
- (A) When many borrowers fail to pay interest, banks may experience liquidity shortage. These shortages can jam payment across the country.
- (B) Illiquidity constraints bank in paying depositors e.g. cash their pay checks. Banking panic follows a run bank by depositors.

#### MEASURES TO CONTROL NPAs

In the present scenario, NPAs are at the core of financial problem of the banks. Concrete efforts have to be made to improve recovery performance. Measures required to be undertaken are mainly two fold. Banks should make efforts first to avoid fresh addition on NPAs by their effective presentation appraisal and secondly to recover the amount from accounts which have already turned bad.

#### Preventive Measures

Most of the bankers feel that genuine viability problem of the borrowing units, weakness in credit appraisal system, absence of effective monitoring and supervision of loan account, absence of credit information sharing among the banks etc. are some of the significant causative factors of high level of NPAs internal to the banks.

- \* So far preventive the fresh inflow of funds into the non-performing category, banks should

reformulate their credit appraisal techniques.

- \* Proper evaluation of the loan application may help in detecting the unviable projects at the first instance.
- \* Full information about unit, industry, its financial stake; management etc. should be collected.
- \* Industrial cell should be established at the bank level, which would have complete information about the industry and its prospects in future.
- \* Proper credit monitoring should be equally emphasized. There should be proper flow of information from the units regarding their financial area, annual accounts, stock reports etc., which would enable the banker to know the need based credit requirement of borrower and warning signals for taking quick remedial action.
- \* Banks should inspect the progress of the project or the business. Separate monitoring department should be established in large branches for periodical review of accounts, comparative risk analysis and compliance of terms and conditions of sanction. Equal emphasis should be given for monitoring of standard assets also.
- \* Banks should be equipped with latest credit risk management techniques to protect the bank funds and minimize insolvency risks. Banks should develop credit derivatives markets to avoid these risks. There should be regular outflow of senior bank officers from all public sector banks for specialized training in training institute to equip them with latest procedures and practices.

#### Curative Measures

Besides making efforts to stop the fresh additions of NPAs banks have to take steps to recover the amount from assets, which have already slipped into NPAs category. Significant causative factors highlighted were slow recovery of legal cases, willful default induced by officially announced loan waiver schemes etc., the Indian legal system is sympathetic towards the borrowers and works against the banks interest.

- \* Despite most of their loans being backed by security, banks are unable to enforce their claims on the collateral, when the loans turn non-performing and therefore loan recoveries have been insignificant.
- \* The Narshimham Committee on Financial System (1991) has recommended the establishment of Debt Recovery Tribunal (DRT) for the speedy recovery of the assets from NPAs category. On the basis of recommendations, 22 DRTs were established by passing the bill on Recovery of Debt due to Banks and Financial Institutions Act 1993. But the performance of DRTs for the past years has not been found satisfactory or up to the mark.
- \* The Act has some limitations, which must be removed to make its effective implementation.
- \* At present one Presiding Officer is handling at least 80-90 cases per day. It is suggested that DRT Act may be amended to enable the Central Government to appoint additional Presiding Officers for speedy disposal of recovery cases.
- \* One of the major factors accounting for delay in disposing of application by DRT is the delay caused due to refusal by defendants to accept the summons and at times due to change in



address too.

- \* DRT may be empowered to order service of summons by hand, registered post and by publications simultaneously. Attachment of immovable property of borrower is not admitted due to service of summons.
- \* Enforcement of security and obtaining court decree take unduly long time, it encourages willful default and ultimately the banks may be compelled to write off loans. Willful default should be declared a criminal offence.
- \* Government should not go for mass waiver of interest/installments as it sends unhealthy signals to the borrower. During 1990-91, there was a massive waiver of rural debt amounting to over Rs.15000 crore and Rs.65000 crore in 2008. These types of activities put a premium on willful default and dishonesty. It lowers the repayment ethics.
- \* In case of government sponsored schemes, Government should assist in recovery. It may be noted that suggestions enumerated will go a long way in reducing the NPAs. This will only considerably improve the profitability of the banks, improve the quality of assets, but also make the Indian Banking System stringent, resilient and geared to meet the challenges of globalization.

The NPA's level in India is not so high as compared to China and other countries. This problem is seriously discussed in the context of public sector banks, but it is now evident that even private banks are not in a better position either to avoid or curtail NPA's growth. Recovery performance is better with respect to individual small borrowers but it is slow in case of corporations and institutional borrowers. When over 5,000 units involving Rs.30,000 crores are pending in courts with respect to bad loans of Rs.1,00,000 crores and above, the ARC's may not be in a position to expedite recoveries. There are some suggestions for banks to make high beneficiary are like as:

- (a) **Other Income Sources:** The banks are now concentrating on increasing its share of high-margin based income by expanding third party product offerings and increase their fee-based services. Banks intends to grow its other income from fee-based services by offering new products and services by cross selling. The share of fee income in Non-interest income is rising continuously, as the bank ventures into wealth management, custody services, online broking and third party product distribution as alternative sources of income.
- (b) **General Ways of Dealing with NPA's:** There are three ways of dealing with NPA's. They are: (i) recapitalization of banks with Government aid, (ii) disposal and write off of NPA's; and (iii) increased regulation.
- (c) **Credit Management System:** The origin of the problem of burgeoning NPA's lies in the system of credit risk management by the banks. Banks are required to have adequate preventive measures in fixing pre-sanctioning appraisal responsibility and an effective post-disbursement supervision. Banks should continuously monitor loans to identify accounts that have potential to become non-performing.
- (d) **Proper Provisioning:** The Basel Committee on Banking Supervision (BCBS) has also provisioning laid down certain minimum risk based capital standards that apply to all internationally active commercial banks. That is, bank's capital should at least be 8% of their

risk-weighted assets. This helps bank to provide protection to the depositor's and the creditor's interest. The main objective of BCBS is to build a sort of support system to take care of unexpected financial losses due to market risks and operational risks thereby ensuring healthy financial markets and protecting depositors.

- (e) **Strictness in Rules:** The SRFESAI Act should be made stricter and the legal actions should be taken against the defaulters. The retail borrowers should also have unlimited liability towards their loan and mortgaged assets.
- (f) **Power to Banks:** Banks have to be given powers of inspection of the use of loans and the loan should be disbursed on the point of purchase by the borrowers to ensure proper utilization of deposits. Banks may also be given powers to recover loans from the guarantor of the borrower.

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