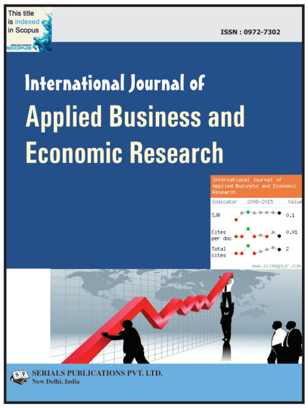


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# A Study on Role of Statutory Bodies in Handling NPAs

**K.S. Venkateswara Kumar[1], K. Sripathi[2] and S. Hanumantha Rao[3]**

*[1]Asst. Professor, K.L.U. Business School, K.L. University, Vaddeswaram, Guntur Dist., A.P. Email: venki@kluniversity.in, Research Scholar, Krishna University.*

*[2-3]Asst. Professor, Department of Management Studies, Vignan's FSTR University, Vadlamudi, Guntur Dist, A.P. Email: [2]sripathi.lead@gmail.com and [3]sama.hanumantharao@gmail.com*

**ABSTRACT**

The banking sector in India is in a crisis with the increase in burden of bad loans provisioning and the decline in profitability of commercial sector banks particularly Public sector banks. Bad loans are a drag on bank resources for two reasons – one, they don't earn any interest income and second, they lock up precious resources in the form of NPAs. Therefore, recovery of bad loans has assumed urgency. The value of loans in India increased 5.80 percent in December of 2016 over the same month in the previous year. Loan Growth in India averaged 12.79 percent from 2012 until 2016, reaching an all-time high of 18.70 percent in April of 2012 and a record low of 5.80 percent in December of 2016.This paper attempts to study the process and effect of SARFASEI Act with the other recovery methods adopted viz; Lok Adalats and DRT and its impact in recovering the non-performing assets in commercial banks in India. The study has been made to find out the percentage of recovery made in SARFAESI Act 2002 in compare with Lok Adalats and DRT and also to identify the number of cases referred to the Lok Adalats, DRT & SARFAESI Act.

***Keywords:*** SARFAESI Act 2002, DRT, Lok Adalats, NPA, Recovery.

## 1. INTRODUCTION

The problem of NPA is not limited to Indian banks but in fact, this is the problem of almost all countries of the world, no matter country is developing, developed or poor. It cannot be denied that mismanagement, wilful default, fund diversion and siphoning off of funds, delay in project completion, changes in industrial policy, and the dropping interest rate regime have contributed tremendously to rendering several assets sick. NPAs is an important benchmark to value the performance of a bank. The banking performance has been categorized by the percentage level Non-performance assets as it indicates the profit measurement for the banking industry. The Banking sector is facing difficulty to recover the bad debts from the borrowers, which is impacting not only the banks but also the economy. In order to reduce the NPA level, the assets need to be recovered timely and restructured properly.

The write off of bad loans to the tune of ₹725013 million for the year ended March 2016 by bankers shaken not only profitability's, also the economic and GDP growth of the country. Out of the total said amount public sector banks had written off to the tune of ₹594449 million, which is almost 82%, whereas, private and foreign banks had written off to the tune of ₹119275 million and ₹11289 million.

## Methods of Recovering NPAs

A. One Time Settlement Schemes

B. Lok Adalats.

C. Debt Recovery Tribunal (DRTs)

D. SARFAESI Act 2002

E. Assets Reconstruction Companies (ARC)

F. Corporate Debt Restructuring (CDR)

G. Information about the defaulters of loan by RBI

H. Credit Information Bureau

H. Recovery through Private Agencies

J. Recovery Camps

Among the above various ways to recover measures, the most effective ways practiced for recovering NPAs from defaulters are Lok Adalats, DRT, CDR and SARFAESI ACT 2002 which are discussed below:

## Lok Adalats

Lok Adalats has developed in India by Legal Services Authorities Act, 1987. Lok Adalats is a non-adversarial system, whereby mock courts (called Lok Adalats) are held by the State Authority, District Authority, Supreme Court Legal Services Committee, High Court Local Services Committee, or Taluk Legal Services Committee. Debt Recovery tribunals have been authorized to form the Lok Adalats to decide on cases of NPAs of ₹10 lakhs and more. The systems seemed to be more effective for recovery of loans by immediate judgement on the cases referred. Lok Adalats have been useful for mostly recovery on smaller loans.

## Debt Recovery Tribunals (DRTs)

Debts Recovery Tribunals (DRT) and Debts Recovery Appellate Tribunals (DRAT) were constituted under the provisions of the DRT Act for establishment of Tribunals for expeditious adjudication and recovery of debts due to Banks and Financial Institutions and for matters connected therewith. DRT has also been given the power to adjudicate the applications filed by the Borrower/Mortgagor against the action of the Secured Creditor initiated under the Securitization Act. The Debt Recovery Tribunals have been established in India under an Act of Parliament (act 51 of 1993) for speedy swift recovery of debts due to banks and financial institution's by GOI. The debt recovery tribunal is also the appellate authority for appeals filed against the proceedings initiated by secured creditors under SARFAESI Act 2002.

## Corporate Debt Recovery Cell/Restructuring

The Corporate Debt Restructuring System evolved and detailed guidelines issued by Reserve bank of India on August 23, 2001 for implementation by financial institutions and banks. The Corporate Debt Restructuring (CDR) Mechanism is a voluntary non-statutory system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). The CDR Mechanism covers only multiple banking accounts, syndication/consortium accounts, where all banks and institutions together have an outstanding aggregate exposure of ₹100 million/10 lakhs and above. It covers all categories of assets in the books of member-creditors classified in terms of RBI's prudential asset classification standards.

## The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

SARFAESI empowers Banks/Financial Institutions to recover their non-performing assets without the intervention of the Court.

The Act provides three alternative methods for recovery of non-performing assets, namely:

(i) Securitisation

(ii) Asset Reconstruction

(iii) Enforcement of Security without the intervention of the Court.

The provisions of this Act are applicable only for NPA loans with outstanding above ₹1.00 lac. NPA loan accounts where the amount is less than 20% of the principal and interest are not eligible to be dealt with under this Act.

Non-performing assets should be backed by securities charged to the Bank by way of hypothecation or mortgage or assignment. Security Interest by way of Lien, pledge, hire purchase and lease not liable for attachment under sec.60 of CPC, are not covered under this Act

## 2. REVIEW OF THE LITERATURE

Dash, M.K. and Kabra, G. (2010) examined the determinants of NPA in the Indian Commercial Banks with particular emphasis on the sensitivity of NPA to macroeconomic and bank specific factors in India. The study used regression analysis and a panel data set covering 10 years (1998-99 to 2008-09). The authors explained that both bank specific and macroeconomic factors has impacted the loan portfolio of commercial banks in India. Based on analysis, the study concluded that the commercial banks that are aggressive and charge relatively higher interest rates incurred greater NPAs.

Prasad and Veena, D. (2011) in their study examined the trends and issues relating to the NPA in Indian Banking Sector. Inference based on analysis indicated that the impact of increased recovery on NPA, decline in fresh slippage, sharp increase in gross loans, setting up of ARC, etc helped to present better NPA ratio's. The authors pointed out that PSBs problems are mainly due to excessive manpower, excessive NPA while private sector banks consolidated themselves through the adoption of latest technology and systems. The study recommended revitalizing the PSBs and incorporating the best practices in operations, technology and management to improve financial performance.

Poongavanam, S. (2011) examined various literatures on issues, causes and remedial solution to manage NPA in Indian banking sector. The article explained the significant changes in Indian banking during the liberalization period and indicated the need to further enhance measures to manage the NPA. The author concluded the study stating the need to provide more importance to NPA management and proper remedial solutions.

Patidar and Kataria (2012)criticized Priority sector lending as one of the major reasons for accumulation of non-performing assets during pre-reform period.

Pandey and Kaur(2012) observed that the willful default is non-payment of dues despite having adequate cash flow and net worth, Signs of siphoning of funds by the borrower, falsification of records, disposal of securities without bank's approval, fraudulent practices etc., point out a default situation.

Siraj and Pillai (2012) opined that the SARFAESI Act provided the much needed momentum for NPA management in banks.

Siraj, K.K. and Pillai, P.S. (2012) examined the performance of NPA in Indian banking during post-millennium period. To achieve its stated objectives, the authors utilized bank-group wise performance statistics during post-millennium period up to the period ended 31st December 2011. Using various statistical tools such as AAG rate, correlation and regression study, the study recognized that NPA remains a major threat and the incremental component explained through additions to NPA poses a great question mark on the efficiency of credit risk management practices of banks in India.

Tracey, M. (2011) examined the impact of NPA on Loan Growth using an econometric case study of Jamaica and Trinidad and Tobago. To under take the study, the author utilized banking statistics from Bank of Jamaica, the Central Bank of Trinidad and Tobago. The study estimated the threshold range for the Loan-NPL relationship using regression analysis for two Caribbean countries. The results of the study suggested a threshold range for NPA as determining differential loan behavior of banks. An implication of the study is the inference drawn which highlight that bank lending behavior could restrain economic activity, especially in periods of stress when NPA is high.

Thiagarajan, S. and Ramachandran, A. (2011) analyzed the credit risk component of the Indian Banking sector using financial data for the period 2001-2010. In specific terms, the authors examined the use of certain key credit risk ratios to measure the credit risk. Inference based on ratio analysis highlighted a gradual decrease in the ratio of NPA to total loans for both public and private sector banks from 2001 to 2008 and gradual increase from2009 to 2010. Their findings are consistent with the findings that although a similarity exists in movement of selected ratios, the sector wise comparison showed significant differences among different bank groups.

## Statement of the Problem

Bad loans are a drag on bank resources – on the one hand, they don't earn any interest, and on the other, precious resources are locked up. Therefore, recovery of bad loans has assumed urgency for the sector.

## Rationale of the Study

The increase in level of non-performing assets in public sector banks alarming the growth and profitability of banking sectors. Proper recovery of loans only will boost the lending and improve the profit growth of the banks. The study would analyze the impact of implementation of Lok Adalats, DRT and SARFAESI Act.

## Objective

1. To study the measures followed for recovery of NPAs by commercial banks.
2. To compare and analyze the effectiveness of recovery methods viz, Lok Adalats, DRT and SARFAESI Act.
3. To study the impact of non-performing assets on banks.

## Hypothesis

H0: There is no significant difference in the cases referred to recovery channels.

H1: There is significant difference in the cases referred to recovery channels.

H0: There is no significant difference in respect of average % of recovery.

H1: There is significant difference in respect of average % of recovery.

## 3. RESEARCH METHODOLOGY

The method of study adopted in this paper follows a mixed approach comprising the qualitative analysis as well as the quantitative analysis of the data collected from annual report of "Reserve Bank of India" publication including "Trend & Progress of banking in India", statistical tables related to banks in India. For qualitative analysis the guidelines issued by RBI effective to the period of study, journals, magazines, newspaper, were studied and data available through credible sources on NPAs recovery and causes have also been used for analysis.

The data used in the present analysis is confined to the period between the years 2008 to 2016.

The data obtained has been analyzed using appropriate descriptive and inferential measures specifically testing of hypothesis.

## Analysis and Interpretation

**Number of Cases of NPA's Referred**

| *Year* | *LOK ADALATS* | *DRTs* | *SARFAESI ACT-2002* |
|---|---|---|---|
| 2008-09 | 548308 | 2004 | 61760 |
| 2009-10 | 778833 | 6019 | 78366 |
| 2010-11 | 616018 | 12872 | 118642 |
| 2011-12 | 479073 | 13365 | 630429 |
| 2012-13 | 840691 | 13408 | 190537 |
| 2013-14 | 1636957 | 28258 | 194707 |
| 2014-15 | 2958313 | 22004 | 175355 |
| 2015-16 | 4456634 | 24537 | 173582 |

**ANOVA: Single Factor**
**SUMMARY**

| *Groups* | *Count* | *Sum* | *Average* | *Variance* |
|---|---|---|---|---|
| LOK ADALATS | 8 | 12314827 | 1539353.375 | 2.08E+12 |
| DRTs | 8 | 122467 | 15308.375 | 82044948 |
| SARFAESI ACT | 8 | 1623378 | 202922.25 | 3.24E+10 |

**ANOVA**

| *Source of Variation* | *SS* | *df* | *MS* | *F* | *P-value* | *F crit* |
|---|---|---|---|---|---|---|
| Between Groups | 11050560746630.10 | 2 | 5525280373315.04 | 7.847 | 0.002851 | 3.4668 |
| Within Groups | 14786655333675.20 | 21 | 704126444460.73 | | | |
| Total | 25837216080305.30 | 23 | | | | |

At 95% level of significance the value of P = 0.002851 less than 0.05 the null hypothesis is rejected and the alternative hypothesis is accepted. There is enough evidence to believe that there a significant difference between the cases referred to Lok Adalat, DRT and SARFAESI Act 2002. So, RBI must initiate the corrective steps to solve the more cases referred by the banks. This must be done urgently to protect the credibility of banks.

**Multiple Comparison**

| | *Mean Difference* | *Standard Error* | *t-value* | *P-value* | |
|---|---|---|---|---|---|
| DRT<br>LOK ADALAT | 1524045.00 | 509893.326 | 2.989 | 0.010 | Accept H1 |
| DRTs<br>SARFAESI ACT | 187613.88 | 63786.870 | 2.940 | 0.011 | Accept H1 |
| LOK ADALAT<br>SARFAESI ACT 2002 | 1336431.30 | 513845.464 | 2.600 | 0.020 | Accept H1 |

The mean difference is significant at the 0.05 level. There is a statistically significant difference between groups by one-way ANOVA. Here also we observe that regarding DRT, Lokadalat, and SARFAESI act 2002 P-value <0.05, it means there is a statistical significance difference in the average cases referred to DRT, Lokadalat, and SARFAESI act 2002.

**Percentage of Amount Recovered through Various Channel**

| | *LOK ADALATS* | *DRTs* | *SARFAESI ACT-2002* |
|---|---|---|---|
| 2008-09 | 2.40 | 81.10 | 33.00 |
| 2009-10 | 1.50 | 32.00 | 30.00 |
| 2010-11 | 2.87 | 27.89 | 37.78 |
| 2011-12 | 11.80 | 17.00 | 23.60 |
| 2012-13 | 6.10 | 14.20 | 27.20 |
| 2013-14 | 6.00 | 9.60 | 26.60 |
| 2014-15 | 3.20 | 7.00 | 16.30 |
| 2015-16 | 4.40 | 9.20 | 16.50 |

**ANOVA: Single Factor**
**SUMMARY**

| *Groups* | *Count* | *Sum* | *Average* | *Variance* |
|---|---|---|---|---|
| LOK ADALATS | 8 | 38.27 | 4.78375 | 10.74611 |
| DRTs | 8 | 197.99 | 24.74875 | 599.3567 |
| SARFAESI ACT | 8 | 210.98 | 26.3725 | 56.36548 |

**ANOVA**

| *Source of Variation* | *SS* | *df* | *MS* | *F* | *P-value* | *F crit* |
|---|---|---|---|---|---|---|
| Between Groups | 2312.832 | 2 | 1156.416 | 5.20542 | 0.014587 | 3.4668 |
| Within Groups | 4665.278 | 21 | 222.1561 | | | |
| Total | 6978.11 | 23 | | | | |

From this table, we observe that the output of the ANOVA One way analysis shows that there isa statistically significant difference between the percentage of recovery through various channels, Lok Adalat, DRT and SARFAESI Act 2002.

**Multiple Comparison**

| | *Mean Difference* | *Standard Error* | *t-value* | *P-value* | |
|---|---|---|---|---|---|
| DRT<br>LOK ADALAT | 19.97 | 8.733 | 2.286 | 0.038 | Accept H1 |
| DRTs<br>SARFAESI ACT 2002 | 1.62 | 9.053 | 0.179 | 0.860 | Accept H0 |
| LOK ADALAT<br>SARFAESI ACT | 21.59 | 2.896 | 7.454 | 0.000 | Accept H1 |

There is enough evidence to believe that there are significant differences between the groups from the ANOVA table. The above table Multiple Comparisons shows which is differed from others. The *p* value is 0.860 both with DRT & SARFAESI Act 2002. Since, here $P > .05$, that means there is no statistical significant difference between DRT & SARFAESI Act in respect of average % of recovery. Hence H0 is accepted.

## 4. CONCLUSION

Radical changes have been made in the Indian Banking Sector after the liberalization and globalization emerged in the year 1991. The reforms were like interest rate regulation, reducing of reserve, prudential norms etc. Prior to 1991, the legal process to recover the bad loans was tiresome, since it takes several years' legal civil proceedings for getting decree.

Indian Banks improved their business and technology to meet the requirement of the customers at ease and made the banking systems as friendly user. Though, there is a progress, bankers are struggling (particularly Public Sector banks) to reduce their NPAs level to maintain the stability and profitability in the business.

The increase in the ratio of Non-Performance Assets (NPA) affects the profitability and of the banks, as they have to allocate provisions for the settlement of NPAs. Under the Recovery of Debts to Banks and Financial Institutions Act 1993, Debt Recovery Tribunals (DRTs) were set up for recovery of loans of banks and financial institutions. This led to speedy recovery of loans in about 1 years' time as against the average time of 5 to 7 years required in civil suits. While initially the DRTs performed well, their progress suffered as they got overburdened with the huge volume of cases referred to them.

The formation of the SARFAESI Act has been a benchmark reform in the Indian banking sector. The progress under this Act had been significant, as evidenced by the fact that during 2002-03 when the Act came into effect, there was an overall reduction of non-performing loans. When we see the recovery aspects of NPAs in public sector banks, inspite of having various recovery channels, like Lok Adalats, DRT, SARFAESI Act 2002, this study shows that the percentage of recovery of NPAs and number of cases referred to these channels, clearly denotes that SARFAESI Act 2002 and DRT does not have larger variations of recovering the amount in NPAs. Lok Adalats function by amicably settling disputes that are pending in a court of law or at a pre-litigation stage. Of these, while the SARFESI Act helped recover 80 per cent of the amount, the lion's share of number of cases were referred to the Lok Adalats.

The government has to take more effective measures to constraint the increasing level of NPAs in public sector by forming strict regulations in the systems. Bankers have to be trained to recover the loans in a systematic way before it turns to NPAs category. By proper follow-up, good rapport, having continuous watching on the movement of borrowers stocks and assets, proper identification and classification of assets etc.

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