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CONTENTS

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AN ANALYSIS OF NON PERFORMING ASSETS OF INDIAN BANKS

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ABSTRACT
The paper analyses the recent trends in non-performing assets (NPAs) of different categories of Indian banks viz., public sector banks, private sector banks and foreign banks. It is found that NPAs of Indian banking industry as a whole are continuously increasing during the period 2008-09 to 2013-14 followed by the global financial crisis. Further, the impact of ownership pattern in deciding the level of NPAs is also investigated against the perception that public sector banks have relatively larger level of NPAs. However, no strong empirical evidence is found in support of this perception. The relationship between profitability, ownership pattern and level of NPAs is also examined. The empirical findings suggest that public sector banks are as good or as bad as their private counterparts, however, foreign banks have relatively higher profitability then domestic public and private banks. It is also found that the higher level of NPAs negatively affect the profitability of a bank.

KEYWORDS
NPAs, banks.

JEL CODES
G21, G28

1. INTRODUCTION
It has been argued by a number of economists that a well-developed financial system enables smooth flow of savings and investments and hence, supports economic growth (see King and Levine, 1993, Goldsmith, 1969). A healthy financial system can help in achieving efficient allocation of resources across time and space by reducing inefficiencies arising out of market frictions and other socio-economic factors. Amongst the various desirable characteristics of a well-functioning financial system, the maintenance of a few non-performing assets (NPA) is an important one. NPAs beyond a certain level are indeed cause for concern for everyone involved because credit is essential for economic growth and NPAs affect the smooth flow of credit. Banks raise resources not just on fresh deposits, but also by recycling the funds received from the borrowers. Thus, when a loan becomes non-performing, it affects recycling of credit and credit creation. Apart from this, NPAs affect profitability as well, since higher NPAs require higher provisioning, which means a large part of the profits needs to be kept aside as provision against bad loans. Therefore, the problem of NPAs is not the concern of the lenders alone but is, indeed, a concern for policy makers as well who are involved in putting economic growth on the fast track. In India due to the social banking motto, the problem of bad loans did not receive priority from policy makers initially. However, with the reform of the financial sector and the adoption of international banking practices the issue of NPAs received due focus. Thus, in India, the concept of NPA came into the reckoning after reforms in the financial sector were introduced on the recommendations of the Report of the Committee on the Financial System (Narasimham, 1991) and an appropriate accounting system was put in place.

Broadly speaking, NPA is defined as an advance where payment of interest or repayment of instalment of principal (in case of term loans) or both remains unpaid for a certain period2. In India, the definition of NPAs has changed over time. According to the Narasimham Committee Report (1991), those assets (advances, bills discounted, overdrafts, cash credit etc.) for which the interest remains due for a period of four quarters (180 days) should be considered as NPAs. Subsequently, this period was reduced, and from March 1995 onwards the assets for which the interest has remained unpaid for 90 days were considered as NPAs. Though the NPA issue has received considerable attention in the post reform period, academic work on the subject is not adequate (Ghosh, 2005, Mor and Sharma, 2003, Rajaraman et al, 1999). This paper attempts to provide an overview of the NPA problem in India concentrating on the various dimensions involved.

2. NPA NORMS
Though the issue of NPA was given more importance after the Narasimham Committee Report (1991) and highlighted its impact on the financial health of the commercial banks and, subsequently, various asset classification norms were introduced, the concept of classifying bank assets based on its quality began during 1985-86. A critical analysis to monitor credit comprehensively and uniformly was introduced in 1985-86 by the RBI by way of the Health Code System in banks. This system, inter alia, provided information regarding the health of individual advances, the quality of the credit portfolio and the extent of advances causing concern in relation to total advances. It was considered that such information would be of immense use to banks for control purposes. The RBI advised all commercial banks (excluding foreign banks, most of which had similar coding system) on November 7, 1985, to introduce the Health Code System indicating the quality (or health) of individual advances under the following eight categories, with a health code assigned to each borrowal account (source: RBI):

1. Satisfactory - conduct is satisfactory; all terms and conditions are complied with; all accounts are in order and safety of the advance is not in doubt.
2. Irregular- the safety of the advance is not suspected, though there may be occasional irregularities, which may be considered as a short term phenomenon.
3. Sick, viable - advances to units that are sick but viable - under nursing and units for which nursing/revival programmes are taken up.
4. Sick: nonviable/sticky - the irregularities continue to persist and there are no immediate prospects of regularisation and the accounts could throw up some of the usual signs of incipient sickness
5. Advances recalled - accounts where the repayment is highly doubtful and nursing is not considered worthwhile and where decision has been taken to recall the advance.
6. Suit filed accounts - accounts where legal action or recovery proceedings have been initiated.
7. Decreed debts - where decrees (verdict) have been obtained.
8. Bad and Doubtful debts - where the recoverability of the bank's dues has become doubtful on account of short-fall in value of security, difficulty in enforcing and realising the securities or inability/unwillingness of the borrowers to repay the bank's dues partly or wholly

Under the above Health Code System, the RBI classified problem loans of each bank into three categories: i) advances classified as bad and doubtful by the bank (Health Code No.8) (ii) advances where suits were filed/decrees obtained (Health Codes No.6 and 7) and (iii) those advances with major undesirable features (Health Codes No.4 and 5). The Narasimham Committee (1991) felt that the classification of assets according to the health codes was not in accordance with international standards. It believed that a policy of income recognition should be objective and based on the record of recovery rather than on subjective considerations. In addition, before the Indian banks complied with the capital adequacy norms, their assets had to be revalued on a more realistic basis of their realisable value. Thus, the Narasimham Committee (1991) believed a system of income recognition and provisioning is fundamental to preserve the strength and stability of the banking system. The international practice is that an asset is treated as non-performing when interest is due for at least two quarters. In respect of such non-performing assets, interest is not recognised on accrual basis but is booked as income only when it is actually received. The committee suggested that a similar practice be followed by banks in financial institutions in India and recommended that interest on NPAs be booked as income on accrual basis. The NPA would be defined as advance, as on the balance sheet date in the following circumstances:

1. In respect of overdraft and cash credits, accounts remain out of order for a period of more than 180 days,
2. In respect of bills purchased and discounted, the bill remains overdue4 and unpaid for a period of more than 180 days,
3. In respect of other accounts, any account to be received remains past due for a period of more than 180 days.

As mentioned earlier, the grace period was reduced and from March 1995 onwards assets for which interest has unpaid for 90 days were considered as NPAs. Provisions need to be made for the NPAs and total NPA (gross) minus the provisions is defined as net NPA.

Besides providing a detailed definition of NPA, the Narasimham Committee (1991) also suggested that for the purpose of provisioning, banks and financial institutions should classify their assets by compressing the health codes into four broad groups; (i) Standard (ii) Sub-standard, (iii) Doubtful and (iv) Loss. Broadly, sub-standard assets would exhibit problems and include assets classified as non-performing for a period not exceeding two years. Doubtful assets are those that remain as such for more than two years and include loans that are overdue for more than two years. Loss assets are accounts where loss has been identified but amounts have not been written off. According to international norms, commercial banks need to keep aside a portion of their income as a provision against bad loans. The amount of the provision depends on the type of NPAs and the time duration. Now Indian banks need to make provisions for all bad loans.

3. NPA RECOVERY MECHANISM

The Government of India felt that the usual recovery measures like issue of notices for enforcement of securities and recovery of dues was a time consuming process. Thus, in order to speed up the recovery of NPAs, the government constituted a committee under the chairmanship of late Shri Tiwari in 1981. The committee examined the ways and means of recovering NPAs and recommended, inter alia, the setting up of 'Special Tribunals' to expedite the recovery process. Later the Narasimham Committee (1991) endorsed this recommendation, and, suggested setting up of the Asset Reconstruction Fund (ARF). It was suggested that the Government of India, if necessary, should establish this fund by special legislation to take over the NPAs from banks and financial institutions at a discount and recover the dues owed by the primary borrowers. Based on the recommendations of the Tiwari and the Narasimham Committees, Debt Recovery Tribunals were established in various parts of the country. An Asset Reconstruction Company was also established. The various measures taken to reduce NPAs include rescheduling and restructuring of banks, corporate debt restructuring and recovery through Lok Adalats, Civil Courts, Debt Recovery Tribunals and compromise settlement. In addition, some legal reforms were introduced to speed up recovery.

1. SARFAESI ACT

The legal mechanism for recovery of default loans was so far cumbersome and time-consuming. Thus, it was felt that banks and financial institutions should be given the power to sell securities to recover dues. In this regard, the Government of India appointed a committee under the chairmanship of Shri T R Andhyarujina, senior Supreme Court advocate and former Solicitor General of India, in 1999 to look into these matters. The Committee submitted four reports. One of them is related to securitisation. Based on the recommendations of the Andhyarujina Committee, The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, was passed on December 17, 2002. The act provides enforcement of the security factor without recourse to civil suits. This act was passed with the aim of enabling banks and financial institutions to realise long- term assets, manage the problem of liquidity, reduce asset liability mismatches and improve recovery by taking possession of securities, selling them and reducing NPAs. The ordinance also allows banks and financial institutions to utilise the services of ARCs/SCs for speedy recovery of dues from defaulters and to reduce their NPAs. The ordinance contains provisions that would make it possible for ARCs/SCs to take possession directly of the secured assets and/or the management of the defaulting borrower companies without resorting to the time-consuming process of litigation and without allowing borrowers to take shelter under the provisions of SICA/BIFR. In addition to passing the SARFAESI Act, certain other legal reforms were also introduced to speed up the loan recovery process.

2. OTHER LEGAL REFORMS

One of the important factors responsible for the ever-increasing level of NPAs in the Indian banking industry is the weak legal system. According to an international rating agency called FITCHIBCA, "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." However, efforts have been made to rectify these problems through the judicial process as well as by enacting laws. In 1999, a standing committee under the aegis of Industrial Development Bank of India (IDBI) was constituted to initiate a co-ordinated approach to the recovery of large NPA accounts and for institutionalising an arrangement between banks and financial institutions for the systematic exchange of information in respect of large borrowers (including defaulters and NPAs). Moreover, as mentioned above, in 2002 the SARFAESI Act was passed and it empowered the creditors to foreclose non-performing loans and the underlying collateral without going through a lengthy judicial or tribunal process (Basu, 2005). All these efforts improved the recovery of NPAs by commercial banks, which in turn has helped in reducing the NPA level. The total worth of NPAs recovered through various channels was around Rs 4,039 crore during 2003-04, which increased many fold to Rs 20,578 crore during 2004- 05.

3. NPA TRENDS

Table 1 shows the trend and pattern of gross NPAs as the percentage of gross advances of four different categories of banks over the period 2002-03 to 2013-14. In 2002-03 all categories of Indian banks have highest gross NPAs as percentage gross advances after that year this ratio declines significantly, however, the pattern of decline is not same for the all categories of banks. For example, public sector banks have highest gross NPAs in 2002-03 and it declines consistently till 2008-09 which indicates the improved loan recovery system and increased management efficiency of public sector banks. But after 2008-09, the share of gross NPAs in gross advances starts to increase consistently. In 2008-09, it is only 2 percent which is lowest as compared to entire study period. In 2013–14, it increases to 4.4 percent which indicates relatively poor loan recovery mechanism and increased number of loan defaulters. As far as old private sector banks are concerned, the share of gross NPAs in their gross advances declines consistently over the entire period of the study which reflects relatively efficient loan recovery system of these banks as compared to the public sector banks. The share of gross NPAs in gross advances of new private sector banks declines consistently till 2005-06 and after that it starts to rise and in 2008-09 it reaches at level of 3.1 percent. But after 2008-09 it declines consistently. As far as foreign banks are concerned, we see a different picture. For these banks, the gross NPA ratio decline continuously during 2002-03 to 2008-09, but after 2008-09, it roughly it increases which reflects the effect of global financial crisis. For the entire banking industry, the share of gross NPA in total advances declines from 2002-03 to 2009-10 and after 2009-10 it starts to increase.

Table 2 shows trend and pattern of gross NPAs as the percentage of total assets of Indian scheduled commercial banks. A look at the table 2 indicates that as far as the share of gross NPA in total assets are concerned; the story is almost similar to that of table 1. For example, the share of NPAs in total assets roughly declines for the old and new private sector bank over the entire period of the study. On the other hand, as far as public sector banks and foreign banks are concerned, the share of gross NPA declines till 2008-09 and it dramatically starts to rise thereafter which shows the poor performance of these banks. It is interesting to note that before the global financial crisis public sector banks and foreign banks are successful in reducing the gross NPA in line with old and new private sector banks. But after the global financial crisis, the old and new private sector banks are still able to keep this momentum. However, this is not true for public sector and foreign banks. Other thing which is very important to note that in the post crisis period, rise in gross NPA of public and foreign banks is greater than the fall in gross NPA of private sector banks. As consequence, gross NPA of the entire banking industry shows rising trend in post crisis period.

Table 3 shows the trend in the share of net NPAs in net advances over the period under consideration. If we divide the entire period of the study into two sub periods viz, pre crises period or period prior to 2008-09 and the post crisis period or period after 2008-09, it can be clearly seen that in the pre-crisis period gross (net) NPAs of all categories of in Indian bank whether these are seen as the percentage of gross (net) advances or as the percentage of total assets, recorded with a continuous decline. But in the post crisis period, the gross (net) NPAs of public sector banks show a rising trend. A number of factors have lent to this increase in NPAs, including investment-related policy logjams in a low-growth, high-inflation (stagflation) environment and poor lending practices of several banks. A surge[1] in lending provided easy access to credit, which drove up prices. However, this was not followed by a concomitant rise in growth.[2]Despite this economic slowdown, the central bank resorted to hiking interest rates to combat inflation. This unusual stagflationary cycle compounded the cost of debt servicing for borrowers. The rising prices not only eroded the disposable income of borrowers, but the economic slump also reduced the market value of assets, impeding the repayment capacity of borrowers.

TABLE 1: GROSS NPA AS THE PERCENTAGE OF GROSS ADVANCES

YEARS	PUBLIC SECTOR BANKS	OLD PRIVATE SECTOR BANKS	NEW PRIVATE SECTOR BANKS	FOREIGN BAKS	ALL BANKS
2002-03	9.4	8.9	7.6	5.3	8.8
2003-04	7.8	7.6	5.0	4.6	7.2
2004-05	5.5	6.0	3.6	2.8	5.2
2005-06	3.6	4.4	1.7	1.9	3.3
2006-07	2.7	3.1	1.9	1.8	2.5
2007-08	2.2	2.3	2.5	1.8	2.3
2008-09	2.0	2.4	3.1	3.8	2.3
2009-10	2.2	2.3	2.9	4.3	2.4
2010-11	2.4	1.9	2.7	2.5	2.5
2011-12	3.3	1.8	2.2	2.7	3.1
2012-13	3.6	1.9	1.8	3.0	3.2
2013-14	4.4	NA	1.8	3.9	3.8
Mean	4.09	3.87	3.07	3.20	3.88
SD	2.36	2.53	1.71	1.17	2.12

Source: RBI

In particular, according to a recent study, conglomerates significantly increased their leverage ratios in 2012 and 2013. It is striking that the 10 corporate groups under examination were heavily involved in the infrastructure sector, the largest contributor of NPAs under industrial credit (Gynedi, 2014). Policy gridlock led to several stalled projects in this sector, which strained revenue generation for corporations. This further transmitted to banks exposed to these corporations and intensified the deterioration in bank asset quality.

The onus, however, does not lie with the government alone. The RBI drew attention to the inadequate credit appraisal processes of banks, where insufficient discipline and oversight was enforced over companies. In one instance, a bank lent several million dollars to a project years after its completion. Further, banks tended to favor certain applicants over others owing to political pressure, while also racking up vast exposures to government lending schemes (Sender, 2013).

TABLE 2: GROSS NPA AS THE PERCENTAGE OF TOTAL ASSETS

YEARS	PUBLIC SECTOR BANKS	OLD PRIVATE SECTOR BANKS	NEW PRIVATE SECTOR BANKS	FOREIGN BAKS	ALL BANKS
2002-03	4.2	4.3	3.8	2.4	4.1
2003-04	3.5	3.6	2.4	2.1	3.3
2004-05	2.7	3.1	1.6	1.4	2.5
2005-06	2.1	2.5	1.0	1.0	1.8
2006-07	1.6	1.8	1.1	0.8	1.5
2007-08	1.3	1.3	1.4	0.8	1.3
2008-09	1.2	1.3	1.7	1.5	1.3
2009-10	1.3	1.3	1.6	1.6	1.4
2010-11	1.4	1.2	1.3	1.0	1.4
2011-12	2.0	1.1	1.1	1.1	1.7
2012-13	2.4	1.2	1.0	1.3	2.0
2013-14	2.9	NA	1.1	1.6	2.4
Mean	2.22	2.06	1.59	1.38	2.06
SD	0.96	1.13	080	0.50	0.88

Source: RBI

TABLE 3: NET NPA AS THE PERCENTAGE OF NET ADVANCE

YEARS	PUBLIC SECTOR BANKS	OLD PRIVATE SECTOR BANKS	NEW PRIVATE SECTOR BANKS	FOREIGN BAKS	ALL BANKS
2002-03	4.5	5.2	1.5	1.7	4.0
2003-04	3.1	3.8	1.7	1.5	2.8
2004-05	2.1	2.7	1.9	0.8	2.0
2005-06	1.3	1.7	0.8	0.8	1.2
2006-07	1.1	1.0	1.0	0.7	1.0
2007-08	1.0	0.7	1.2	0.8	1.0
2008-09	0.9	0.9	1.4	1.8	1.1
2009-10	1.1	0.8	1.1	1.8	1.1
2010-11	1.2	0.5	0.6	0.6	1.1
2011-12	1.5	0.6	0.4	0.6	1.3
2012-13	2.0	0.7	0.4	1.0	1.7
2013-14	2.6	NA	0.7	1.1	2.1
Mean	1.87	1.69	1.06	1.10	1.70
SD	1.08	1.55	0.50	0.47	0.92

Source: RBI

TABLE 4: NET NPAs AS THE PERCENTAGE OF TOTAL ASSETS

YEARS	PUBLIC SECTOR BANKS	OLD PRIVATE SECTOR BANKS	NEW PRIVATE SECTOR BANKS	FOREIGN BAKS	ALL BANKS
2002-03	1.9	2.5	0.7	0.8	1.8
2003-04	1.3	1.8	0.8	0.7	1.2
2004-05	1.0	1.4	0.8	0.4	0.9
2005-06	0.7	0.9	0.4	0.4	0.7
2006-07	0.6	0.6	0.5	0.3	0.6
2007-08	0.6	0.4	0.7	0.3	0.6
2008-09	0.6	0.5	0.8	0.7	0.6
2009-10	0.7	0.5	0.6	0.7	0.6
2010-11	0.7	0.3	0.3	0.3	0.6
2011-12	1.0	0.4	0.2	0.2	0.8
2012-13	1.3	0.5	0.3	0.4	1.0
2013-14	1.6	NA	0.4	0.4	1.3
Mean	1.00	0.89	0.54	0.47	0.84
SD	0.44	0.71	0.22	0.20	0.38

Source: RBI

4. NPA AND OWNERSHIP OF BANKS

A common perception is that public sector banks have higher level of NPAs as compared to the private sector banks. Therefore, ownership pattern of a bank plays of a significant role in deciding the level of NPAs. To verify this hypothesis, we perform independent sample t-test to compare the mean NPAs of the different categories of banks for the period under consideration. For this purpose, public sector banks have taken as a base or reference category. The results are shown in table 5 to table 8. Table 5 shows mean gross NPAs as percentage of gross advances of all categories of banks for the entire study period. The mean Gross NPAs of public sector banks are greater than the mean NPAs of other banks, but this difference is not significant as indicated by the p-values. Table 6 shows the mean gross NPAs as the percentage of total assets. The table shows that foreign banks have significantly lower level of NPAs as compared to public sector banks. However, no significant difference is found between mean NPAs of public sector banks and private sector (old as well as new) banks. Table 7 and table 8 show net NPAs of Indian banks as the percentage of net advances and total assets respectively. Both of the tables show that new private sector banks and foreign banks have significantly lower level of net NPAs whether these are considered as percentage of net advances or as the percentage of total assets. As far as old private sector banks are concerned, they have relatively lower level of Net NPA's as compared to the public sector banks; however, the difference is not significant.

TABLE 5: AVERAGE GROSS NPA AS THE PERCENTAGE OF GROSS ADVANCES; 2002-03 TO 2013-14

Banks	N	Mean	Std. Deviation	t-statistic
Public banks	12	4.0917	2.36353	0.215
Old private banks	11	3.8727	2.52511	(0.832)
Public banks	12	4.0917	2.36353	1.217
New private banks	12	3.0667	1.71217	(0.237)
Public banks	12	4.0917	2.36353	1.172
Foreign banks	12	3.2000	1.16697	(0.254)
Public banks	12	4.0917	2.36353	0.227
All banks	12	3.8833	2.11868	(0.822)

Note: the values in parenthesis indicate p-values

TABLE 6: AVERAGE GROSS NPA AS THE PERCENTAGE OF TOTAL ASSETS; 2002-03 TO 2013-14

Banks	N	Mean	Std. Deviation	t-statistic
Public banks	12	2.2167	0.95996	0.350
Old private banks	11	2.0636	1.13426	(0.730)
Public banks	12	2.2167	0.95996	1.730
New private banks	12	1.5917	0.80279	(0.098)
Public banks	12	2.2167	0.95996	2.671*
Foreign banks	12	1.3833	0.49696	(0.014)
Public banks	12	2.2167	0.95996	0.421
All banks	12	2.0583	0.88159	(0.678)

Note: the values in parenthesis indicate p-value.
**significant at 5 percent level*

TABLE 7: AVERAGE NET NPA AS THE PERCENTAGE OF NET ADVANCES; 2002-03 TO 2013-14

Banks	N	Mean	Std. Deviation	t-statistic
Public banks	12	1.8667	1.07984	0.317
Old private banks	11	1.6909	1.55721	(0.754)
Public banks	12	1.8667	1.07984	2.355*
New private banks	12	1.0583	.49810	(0.028)
Public banks	12	1.8667	1.07984	2.254*
Foreign banks	12	1.1000	.47098	(0.040)
Public banks	12	1.8667	1.07984	0.408
All banks	12	1.7000	.91552	(0.687)

Note: the values in parenthesis indicate p-value.
**significant at 5 percent level*

TABLE 8: AVERAGE NET NPA AS THE PERCENTAGE OF TOTAL ASSETS; 2002-03 TO 2013-14

Banks	N	Mean	Std. Deviation	t-statistic
Public banks	12	1.0000	0.43693	0.448
Old private banks	11	0.8909	0.71057	(0.659)
Public banks	12	1.0000	0.43693	3.248*
New private banks	12	0.5417	0.21933	(0.004)
Public banks	12	1.0000	0.43693	3.840*
Foreign banks	12	0.4667	0.20151	(0.001)
Public banks	12	1.0000	0.43693	0.650
All banks	12	0.8917	0.37769	(0.523)

Note: the values in parenthesis indicate p-value.
**significant at 5 percent level*

In order to cross verify the above hypothesis we run regression analysis using dummy variables and considering gross NPAs as the percentage gross advances and net NPAs as the percentage of net advances as the dependent variables separately and estimate following regression functions.

$$NPA_{it} = \alpha_1 + \alpha_2 D_{2it} + \alpha_3 D_{3it} + \alpha_4 D_{4it} + U_{it}$$

Where NPAit = gross (net) NPAs of ith bank category in year t as the percentage of its gross (net) advances. D2it = 1 if a particular observation belongs to old private sector banks and 0 otherwise. D3it = 1 if a particular observation belongs to new private sector banks and 0 otherwise. Similarly, D 4it = 1 if a particular observation belongs to foreign banks and 0 otherwise. α1 represents the mean level of NPAs of PSBs and α2 α3 and α4 are the deferential coefficients which show that by which extent the mean NPAs levels of other categories of banks differ from the mean NPAs of public sector banks. The results of the above regression analysis are given in table 9.

The results show that the intercept is statistically significant which refers the mean NPAs of the reference category which is public sector banks in our analysis. The coefficients α2, α3 and α4 refer the differential coefficients, that is, by which extent the mean NPAs of the other categories of banks differ from mean NPAs of the public sector banks. Though all the deferential coefficients are negative, but they are statistically insignificant. Therefore, the results of the regression analysis show that the pattern of ownership does not matter in deciding the level of NPAs.

TABLE 9: OWNERSHIP AND NPAs – REGRESSION ANALYSIS

Variables	Model 1	Model 2
Dependent variable	GNPA	NNPA
Constant	4.064*	1.80*
D_2	-.147	-.033
D_3	-.997	-.742
D_4	-.864	-.700
R^2	0.22	0.35

*significant at 5 percent level

5. PROFITABILITY, NPAs AND OWNERSHIP

To find out the magnitude of impact of the level of NPAs and bank ownership on its profitability we run another regression analysis in which ROA is taken as the dependent variable and percentage and net NPAs as the percentage of net advances and ownership as independent variable.

$$ROA_{it} = \alpha_1 + \alpha_2 \ D_{2it} + \alpha_3 \ D_{3it} \ + \beta \ NPA_{it} + U_{it}$$

Where ROAit = is returns on assets for the ith bank group in year t. ROA is taken as a measure of profitability. D 2it = 1 if a particular observation belongs to (old or new) sector private banks (Note: Due to the non-availability of data on ROA for Old and New private sector banks separately we consider them as a single category.) D3it = 1 if a particular observation belongs to foreign banks and 0 otherwise. α1 refers the magnitude of the impact of public sector banks on profitability whereas α2 and α3 are the differential coefficients and β refers the magnitude of the impact of NPAs on the profitability of a bank. The results of this regression analysis are shown in table 10. The effect of public and private sector banks on profitability does not differ significantly. However foreign banks have significantly higher profitability as compared to public and private sector banks. Further the level NPAs has negative impact on the profitability of a bank, since higher NPAs require higher provisioning, which means a large part of the profits needs to be kept aside as provision against bad loans.

TABLE 10: PROFITABILITY, OWNERSHIP AND NPAs – REGRESSION ANALYSIS

Variables	Model 3
Dependent variable	ROA
Constant	1.20*
D_2	0.08
D_3	0.68
NNA	-0.11*
R^2	0.73

*significant at 5 percent level

6. TACKLING RISING NPAs

In order to reduce the NPA ratio, assets are typically recovered or restructured. However, India's lack of a comprehensive bankruptcy law makes asset recovery extremely difficult. As such, borrowers usually resort to legal injunctions—relying on an over-burdened court system to delay the process (Bhoir, 2013). As per RBI report on trend and progress of banking in India 2012-13, only 22 percent of bad loans were retrieved in 2013 compared to 31 percent in 2011. Recognizing the problem, the government initiated an inquiry in to the top 30 NPA accounts of the public sector banks (PSBs), the single largest source of NPAs (public sector banks account for 84.8 percent of total NPAs of Indian banking industry). Additionally, the Finance Ministry dedicated approximately $2 billion to recapitalize these banks, while the RBI designed a new regulatory framework for the early detection and resolution of distressed assets, effective from April1 2014. Along with these steps, the timely implementation of the national company law tribunal aimed at rehabilitating sick companies could play an important role in fast-tracking asset recovery.

In terms of restructuring, several banks attempted to window-dress their NPA accounts using restructured assets. The ratio of restructured assets to total advances in 2012 nearly doubled to 8 percent from 2009. Such heavy reliance on restructuring could have implications on asset quality if a large proportion of these assets turn into bad loans. In order to prevent such an outcome, the central bank tightened restructuring norms, which included raising capital requirements. Further, the comparative lack of asset reconstruction companies (ARCs) in India impedes the process of price discovery between banks and the ARCs. In order to deepen this market to adequately compensate banks, the sale of assets between ARCs must be permitted.

While the above measures are an important first step in addressing the problem of rising NPAs, additional steps must be taken in order to strengthen the institutional architecture behind the process of lending. Public sector banks typically mobilize resources from deposits, but lending to infrastructure projects involves long gestation periods. A deep bond market and financial institutions focused on infrastructure projects are better equipped to deal with this type of investment, and attention needs to be focused on improving them. Out of the nine development financial institutions (i.e. Power Finance Corporation, Indian Railway Finance Corporation, India Infrastructure Finance Company Ltd etc.) two have converted to banks and three others have applied for banking licenses. New institutions need to take their place in order to provide funds for long-term projects. Further, allowing insurance funds to invest in corporate debt, similar to pension fund provisioning, would also help in taking the pressure off of banks to fill this gap. The development of a liquid corporate debt market would facilitate the growth of potentially large investors such as mutual funds and financial institutions.

In terms of borrowers, if India is to stem the rise of NPAs, it is not sufficient simply to pursue recalcitrant borrowers. Officials also need to take punitive action against banks' lending under political pressure. To improve the due diligence process, the central bank is already taking steps toward devising a post-loan-sanction monitoring system that pools and scrutinizes common exposures across banks. This would enable banks to monitor shared borrowers with considerable leverage and keep track of debtors with a poor credit record. Finally, the Credit Information Bureau India Limited (CIBIL) and the three private credit information companies — which keep a credit record of banks' borrowers— need to grow their base of institutions to include non bank financial companies, micro finance institutions, and unregistered sources. This would assist banks in casting a wider net to monitor borrowers and streamline lending to dubious parties. An RBI committee tasked with expanding the use of credit information systems has recently come out with a set of draft recommendations.

4. CONCLUSION AND POLICY IMPLICATION

The present study tries to investigate the recent trends in NPAs of Indian banks from the different angles. It is found that NPAs of Indian banks show a rising trend in 2009 onwards. The reason may be assigned to mismanaged lending practices of banks, a surge in lending and investment-related policy inertia in a low-growth, high-inflation environment. Further, it is also investigated whether there is any impact of a bank ownership pattern on the level of NPAs. At the bank group level, when we compare the public sector banks with private banks in terms of NPAs as a percentage of gross (net) and total assets, we observe that the public sector banks are as good as or as bad as their counterparts in the private sector. However, when compared with the foreign banks they do not fare well. While the results of the regression analysis show that ownership pattern of a bank does not have a significant role in deciding the level of NPAs. Therefore, the study remains inconclusive as far as the relation between ownership pattern and level of NPAs is concerned. At the same time, the relationship between profitability, ownership pattern and NPAs level is also verified. It is found that public and private sector banks do not differ significantly as far as profitability is concerned; however, foreign banks have higher profitability as compared to domestic (public as well as private) banks. It is also found that higher level of NPAs severely affects the profitability of a bank. Further it is suggested that in order to avert the damaging effects of a banking crisis to the rest of the economy, as in the case of the United States, internal processes of banks in India need revision. Not only do poor lending practices need to be checked, the government needs to step up its game in implementing laws to speed up the process of NPA resolution. More importantly, for growth to return to 7–8 percent, it is imperative that the private sector begin investing again, which is unviable without support from healthy banks. A sound banking system is a necessary requirement for the desired growth trajectory. The Reserve Bank of India is actively working to avoid a wider crisis, and the next government must be prepared to put its energies into this effort.

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