

# THE RECOVERY MANAGEMENT SYSTEM OF NPA'S- A CASE STUDY OF COMMERCIAL BANKS IN INDIA

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## ABSTRACT

The best indicator for the health of the banking industry in a country is its level of Non- performing assets (NPAs). The problem of non-performing assets has shaken the entire Indian banking sector. High NPAs are one of the major concerns for banks in India. The solution of NPAs and its recovery lies only with proper credit assessment and recovery management mechanism. When an asset becomes NPAs the recovery wings states its operations. There are many recovery channels through which the banks recover NPAs. Performance of various recovery channels of NPAs in Indian banking system is not found to be satisfactory. The Paper analyse the recovery mechanism of NPAs with its three important wings i.e. recovery through Lok Adalat, Debt Recovery Tribunals (DRTs) and Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act (SARFASEI Act) and its impact on NPA. The study is purely based on Secondary data collected from RBI Report on Trend and Progress of Banking in India, various research articles and journals. SPSS 10 is used to analyse the data. Further the study finds that there is significant difference among the number of cases referred to the three recovery mechanisms and significant difference in respect of percentage of amount recovered through various recovery channels. The study further finds that overall recovery mechanism in banking industry is very poor.

**Key words:** Recovery, NPAs, Lok Adalat, DRT, SARFASEI

## INTRODUCTION:

The banking industry plays an important landmark for the growth of Indian economy. The financial performance of banking industry is measured through the quantum of non-performing assets (NPAs) as it indicates the profitability and income growth of the banks. The high percentage of NPAs are due to the target oriented approach by banks, wilful defaulters, ineffective supervision, improper management of loan accounts, unwanted disbursement of loans and finally the improper recovery mechanism. According to RBI, terms loans on which interest or instalment of principal remain overdue for a period of more than 90 days from the end of a particular quarter is called a Non-performing Asset. NPAs create unfavourable impact on liquidity, profitability and solvency of banks. But the recovery of bad debts from borrowers and the management of NPAs to a considerable level is a challenge for the banks. So it has an appalling impact not only on banks but also on the economy as well.

The time asset ceases to generate income for the banks it is called NPAs. With the increasing amount of NPAs, gradually problem arises. The banks should develop their credit appraisal system rather than to recover it after it becomes NPAs. On time payment of interest and principal is necessary for sound health of the banking business. The public sector banks are facing more problems of NPAs than private sector banks. Presently, Lok Adalats, Debt Recovery Tribunals (DRTs) and Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act (SARFAESI Act) are the three legal methods available to banks for the recovery of NPAs. The NPAs play vital roles in sustainability of the banking industry. Hence, to reduce the NPA level, the assets to be recovered on time and managed properly. Mainly recovery is done through three major tools as are discussed below:

### **1. Lok Adalats**

The Lok Adalats have 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 amount Rs10 lakhs and more. The system seems to be more effective for recovery of loans by instant judgement on the cases referred. Lok Adalats have been helpful for mostly recovery on smaller loans.

### **2. Debt Recovery Tribunals (DRTs)**

The Debt Recovery Tribunals (DRTs) and Debt Recovery Appellate Tribunals (DRAT) were constituted under the provisions of the DRT Act for establishment of Tribunals for speedy settlement and recovery of debts due to Banks and Financial Institutions and for matters connected with these legal organs. The 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 and hassle free recovery of debts for banks and financial institution's by Government of India. The debt recovery tribunal is also the appellate authority for appeals filed against the proceedings initiated by secured creditors under SARFAESI Act 2002.

### **3. SARFAESI Act:**

The law did little until it discovered the volume of NPA's impact on the profitability, liquidity and income of the bank. The SARFAESI Act was formed on 17<sup>th</sup> December 2002 based on recommendations of a) Committee on Banking Sector reforms (Narasimham Committee Report II) and b) Restructuring of Weak Public sector Banks (Verma Committee). This Act aims at speedy recovery of defaulting loans and to reduce the increasing quantum of Non-performing Assets of financial institutions and banks. The provisions of the Act enable the banks and financial institutions to realize long-term assets, manage problems of liquidity and asset liability disparities and to improve recovery by exercising powers to take custody of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction.

## **Review of Literature:**

**Banana and Chepuri (2009)** find that performance of SARFAESI Act is more superior to the other recovery channels throughout the study.

**Bose (2005)** mentioned that, while there have been several schemes in the past to facilitate the recovery from NPAs, but they are not satisfactory in terms of NPAs reduction. It was hoped that establishment of SARFAESI Act will help banks in their efforts to reduce and recover money from NPAs. But due to certain limitation it is creating apprehensions amongst banks and financial institutions. For getting the full advantage of this Act, the root causes of NPAs, which were evident in the system, may have to be addressed first.

**Patel Urjit (2000)** highlighted the problem of bad loans and growing level of Non- performing assets in commercial banks in the post-reform period. It was observed that effective lending practices should be adopted by banks and supervisory authorities. Along with this corporate entity should be made more accountable through following more stringent disclosure, transparency practices, guidelines and principles. Efficient legal machinery, the larger number of Debt Recovery Tribunals and Credit Information Bureau in banks can prove effective and quick recoveries of dues.

**Salunkhe et al. (2009)** argued that for banks it is necessary to keep the level of NPAs low as it impacts upon the profitability of the banks and hence it is necessary to have strong recovery system that should be operated effectively with control and supervision of higher authorities.

**Shaardha and Jain (2009)** studied the process and effect of SARFAESI act 2002 and its impact in recovering the Non-Performing Assets in public Sector Banks in India, found that recoveries in NPAs are made easier by the amendment of SARFAESI act 2002.

**Sharma, M (2005)** observed that more essential step to resolve NPA problem is timeliness of measures as it would save the system from a greater damage, obviating serious macroeconomic costs. In post - liberalization period various measures and recovery mechanisms were initiated in Indian banking system. Problems of NPA cannot be totally eliminated in banking; through proactive and reactive measures it can be controlled. Effective risk assessment, credit evaluation and monitoring techniques are proactive measures while various recovery measures that include Asset Reconstruction Companies (ARCs), Debt Recovery Tribunals (DRTs), Lok Adalats, SARFAESI Act etc. are reactive measures. The SARFAESI Act 2002 allows banks and other financial institutions to recover NPA accounts without the intervention of the Court.

**Singh (2009)** argued Indian banking sector is facing a serious problem of NPAs. To improve the efficiency and profitability of banks, NPAs should be reduced and controlled.

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

**Swain et al (2009)** study it is inferred that among different mechanisms made by the government, SARFAESI Act-2002 is the most effective reform measure in the Indian banking industry for NPA recovery.

**Tracey, M. (2009)** examined the impact of NPA on Loan Growth using an econometric case study of Jamaica and Trinidad and Tobago. To undertake 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 behaviour of banks. An implication of the study is the inferences drawn which highlight that banklending behaviour could restrain economic activity, especially in periods of stress when NPA is high.

#### **OBJECTIVE OF THE STUDY:**

- To know about recovery channels for NPAs.
- To compare and analyze the effectiveness of recovery channels viz, LokAdalats, DRT and SARFAESI Act.

#### **HYPOTHESIS OF THE STUDY:**

H<sub>0</sub>1: There is no significant difference in the cases referred to various recovery channels.

H<sub>0</sub>2: There is no significant difference in respect of percentage of amount recovered through various recovery channels.

#### **PROBLEM OF THE STUDY:**

The NPAs are reducing profit percentage and growth of income of the banks. This process leads to question of sustainability of the banking industry. Hence, bad loans should be recovered to solve the problem of NPAs.

#### **RATIONALE OF THE STUDY:**

The mounting amount of NPAs is ringing the alarm bell of banking industry of India. It is affecting the growth and profit position of banks. It also affects the financial stability and global competitiveness of the banks. The government of India and RBI has taken many initiatives to reduce the level of NPAs in the banking sector and whole economy as well. The bankers will be discouraged for fresh lending. Hence, a proper recovery channel is required to recover the amount of NPAs and will help to manage the level of NPAs. The study tries to find out the importance of recovery channels and analyze the effectiveness of recovery channels.

**LIMITATION OF THE STUDY:**

The study has included only three recovery channels whereas other recovery channels are not taken into consideration.

**RESEARCH METHODOLOGY:**

The above ANOVA table no 02, shows that the p value is 0.000 which is less than 0.05 at 5% level of significance, so the null hypothesis is rejected. Hence, the null hypothesis is rejected and the alternative hypothesis is accepted. So, it is proved that there is a statistical significance difference among the recovery channels in terms of cases referred. So, RBI should take corrective measures to address the more number of cases referred by the banks. This action should be taken on top most bases to safeguard the credibility of banks.

The above table shows that the mean difference is significant at 5% level of significance. There is a statistically significant difference between groups by one way ANOVA. The analysis further shows that the p-value is less than 0.05 ( $p < 0.05$ ) in case of Lokadalat, DRT and SARFAESI act. It implies there is a statistical significance difference in the number of cases referred to Lokadalat, DRT and SARFAESI act.

The above table no 05, shows the result output of one way ANOVA where the p value is 0.00 that is less than 0.05 at 5% level of significance, so the null hypothesis is rejected. Hence, the null hypothesis is rejected and the alternative hypothesis is accepted. So, it is proved that there is a statistical significance difference in respect of percentage of amount recovered through various recovery channels.

**Conclusion:**

The analysis shows that there is statistical significant difference among the mean score of number of cases and amount recovered through various channels. This implies that the present recovery channels are not sufficient to deal with the problem. The analysis shows that number of cases referred to Lok Adalat is highest in comparison to other two recovery channels. In other words, lok adalat cannot be challenged in upper courts. Further, more than 10 lakh amount of NPAs cannot be recovered through lok adalats. DRTs are taking more time and the decision in this tribunal is as lengthy as it can be challenged in higher courts. The amount involved in SARFAESI act recovery channel is below anticipation. Hence, the government has to apply combined recovery channels and also more effective measures to manage the mounting amount of NPAs. Further, effective bankers training, proper follow-up and asset classification, stringent recovery action, better credit appraisal system are highly imperative to recover the NPAs in a professional and systematic way in order to achieve financial sustainability of commercial banks in India.

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