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# A Study on Impactof Recovery Mechanisms in Managing NPAs in Indian Banks

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***Abstract***
*A healthy banking sector is important for a country's economy in order to achieve growth and remain competitive in global business environment. But Indian banking sector is adversely affected due to non-performing assets.This paper analyse the impact ofLokAdalats, Debt Recovery Tribunals and SARFAESI Act, 2002 in curtailing the issue of NPAs in Banks. This study is based on secondary data of ten years taken from RBI publications,newspaper articles, journals etc.After doing the analysis the results found that SARFAESI Act is the most effective recovery methods followed by debt recovery tribunals in solving the issue of stressed assets. The impact of LokAdalats in handling NPAs is least due to its low recovery rate. This study concludes thatfor curbing the problem of stressed assets, the government, banks' regulatory authorities should take various strong measures which increase the recovery rate of NPAs in order to maintain the financial stability of Indian banking sector.*

***Keywords:****NPAs, Debt Recovery Tribunal, LokAdalats, SARFAESI Act, Banks.*

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## I. Introduction

Non-performing assets (NPAs) reflect the overall efficiency of banks in conducting their business operations of mobilizing savings and lending funds to needy sectors. Therefore, lower efficiency leads to non-performing assets and it has a bad impact on of banks. In India, the major source of financing for firms is bank credit which further emphasizes the need to study the problem of non-performing assets which adversely affect the industrial growth.The main reasons for the incidence of loan default is due to ineffective monitoring, supervision on the part of banks, weak legal framework and lack of strong debt recovery measures (Bardhan et al., 2019). So an effort need to be made to strengthen these laws for timely detection and action.DRTs, LokAdalats, SARFAESI Act and IBC, 2016 are some measures enacted for solving the problem of these bad loans ( Agarwala and Agarwala, 2019).

***Meaning:*** According to RBI (Master Circular DBOD No. BP.BC/20/21.04.048/2001-2002), An asset becomes non-performing when it ceases to generate income for banks". In other words, an asset should be treated as non-performing, if interest or principal remains overdue and unpaid for a period of more than 90 days.

***Types of NPA:***Non-performing assets can be classified as Gross NPA and Net NPA

Gross NPA: Gross NPA is the sum total of all loan assets that are classified as NPA as per RBI guidelines as on balance sheet date. It reflects the quality of loans made by banks..

Net NPA: Net NPA are those in which the bank has deducted the provision regarding NPA. It shows the actual burden of banks.

***Classification of loan assets into four categories in order to arrive at an amount of provision:***

1) Standard Assets: Standard assets are one which is not an NPA.
2) Sub-standard Assets: It is classified as NPA not exceeding 12 months.
3) Doubtful Assets: It is classified as NPA for a period exceeding 12 months.
4) Loss Assets: Loss assets are those where loss has been identified by the banks or auditors but the amount has not been return of and are never considered to never recoverable.

***Some Loan loss recovery methods:***

1) LokAdalats
2) One Time settlement Schemes
3) SARFAESI Act
4) Debt Recovery Tribunals

5) Insolvency and Bankruptcy code, 2016
6) Corporate Debt Restructuring Scheme
7) Credit Information Bureau
8) Assets Reconstruction Companies (ARCs)
9) Recovery through Private Agencies

From the above mentioned recovery methods the most commonly used mechanisms are LokAdalats, Debt Recovery Tribunals, SARFAESI Act in recovering the amount of NPAs in Indian Banks.

## II. Literature Review

Many studies have been conducted by researchers on NPAs in banking sector.A review of literature on these studies is shown below.

Rajaraman et al., 1999 attempted to comprehend difference in interbanks in terms of non-performing assets through specification which comprises of intercept dummies. The sample comprised of 100 banks and the data is taken from RBI publication and sources for a period of 1996-1997. Region of operation and public sector banks had a positive and significant coefficient whereas capital adequacy had a negative and significant coefficient. The study suggested that enforcement environment should be improved for a better performance of domestic bank in order to curb the problem .Banking efficiency and technology consistency of the country of origin of foreign bank are the important factors of non-performing assets performance in Indian scenario rather than foreign ownership itself.

Mukherjee, 2003 said that asset management companies and decentralized restructuring are some good policies which are adopted everywhere to deal with non-performing assets' problem. From the world-view analysis the authors concluded that asset management companies were found to be a successful strategy for developed nations but not in developing countries while it is possible to create a healthy environment for a bank-based decentralized bad debt workout. It is suggested that developing countries should make efforts to create a good and compatible environment for the proper implementation of this strategy.

Selvarajan and Vadivalagan, 2013 analysed the performance regarding the management of NPAs in priority sector advances and also provide remedial measures for solving the problem of NPAs.The results suggested that effective credit appraisal system, speedy recovery system is helpful in solving this issue.

Ojha and Jha, 2017 conducted a study of stressed assets on banking operations and financial performance of public sector banks. The study duration is from 2015 -16 to 2016- 2017 and the data is collected from websites of RBI and public sector banks, research articles and annual reports of banks etc. The results showed that non-performing loans adversely affect the profitability in terms of low rate of return on assets and operating expenses are increased by making provisions on these bad loans. Non-performing assets reduces the lending capacity of banks.Reddy and Naidu, 2017 conducted a study to find out the amount of non-performing loans on the basis of priority and non-priority sector lending and also tried to analyse financial performance of Indian banks. The study span is from 2005 to 2016 and the sample consists of Indian public sector banks. Regression, correlation and trend analysis are used and the secondary data is taken from RBI publications. The results suggest that there is a negative relationship between non-performing assets and banking profitability. Non-performing assets are increasing at high rate in Indian public sector banks and adversely affect their banking efficiency.

Banerjee et al., 2018 attempted to compare the stressed assets of some public and private sector commercial banks and also tried to analyse the trend of ROA, asset quality and nonperforming assets. The data is taken from annual reports, RBI publications, journals etc. for trend analysis. Average and standard deviation of all the factors related to asset quality of banks are examined. The results concluded that private sector banks have low GNPA and NNPA ratios as compare to public sector banks. Public sector banks' ROA have shown a declining trend .On the other hand, it is increasing in private sector banks. Both public and private banks show increasing trend of stressed assets. The major limitation of the study is that it has taken secondary data which is prone to biasness and also the sample size is very small.

Ghaloth, 2019 studied the impact of non-performing loans on banks' profitability and its recovery mechanisms.The study suggested that banks need to improve credit risk management practices to decrease this problem and SARFAESI act proved to be the most effective method.

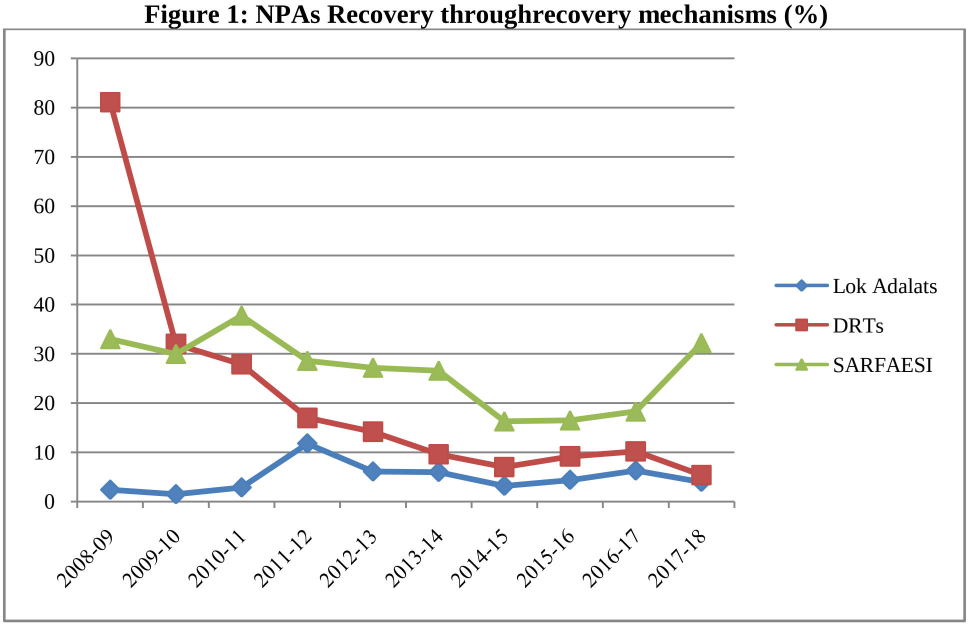
## III. Research Methodology

The data for the study is taken from secondary sources includes journals, books, magazine, newspapers, RBI's reports of Trend and Progress of banking in India and various other secondary sources.The study period is from 2008 to 2018 is taken into consideration for analysis purpose. Graphs andpercentages are the tools and techniques used for data analysis.

## IV. Analysisand Interpretation

This section provides the detailed analysis and interpretation part of the study.
The figure 1 shows the amount of non-performing assets recovered through LokAdalats, DRTs and SARFAESI Act during this period from 2008 to 2018. It shows that SARFAESI Act is performing better than the other mechanisms like DRTs and LokAdalats. In terms of performance after SARFAESI mechanism DRTs come at the second position regarding recovery rate. Initially, DRTs are performing better during the year from 2008 to 2010. After this period performance of DRTs is decreasing till 2014 to 2015.In the next years its recovery rate is improving as compare to LokAdalats. LokAdalats are the least effective recovery channel of NPAs recovery because of its low and decreasing recovery rate as compare to other two mechanisms.

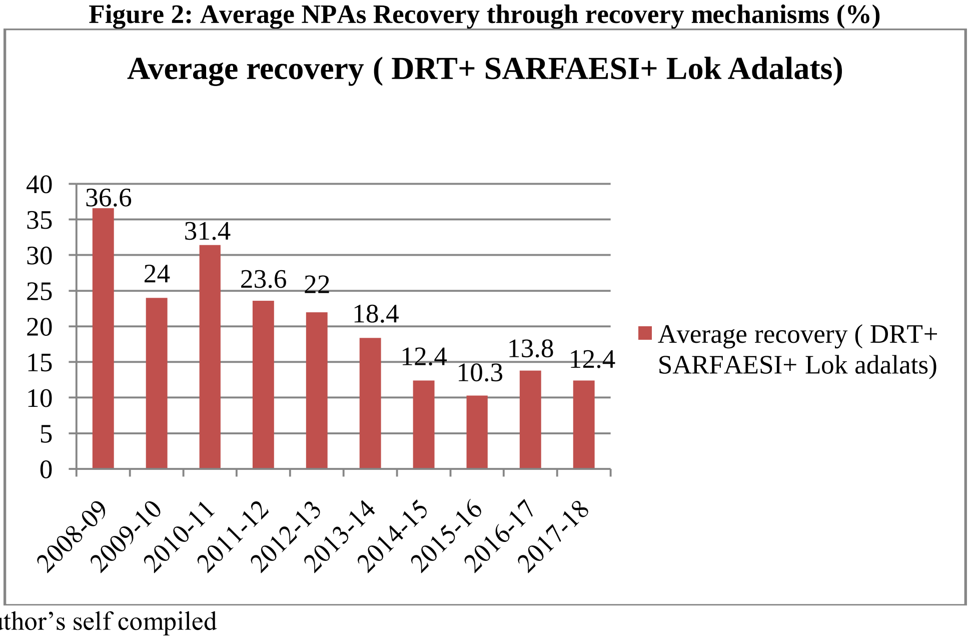
**Figure 1: NPAs Recovery throughrecovery mechanisms (%)**




Source: Author’s self compiled

The figure 2 shows the average recovery through these three measures (LokAdalats, DRTs, SARFAESI). It clearly shows that the average recovery significantly decreased from 36.6 % in 2008-2009 to 12.4% only in 2017-2018. This figure also indicates that government should take some strong steps for removing the weakness in these recovery mechanisms and come with robust recovery measures as the average recovery of NPAs through Lokadalats, DRTs and SARFAESI act showed a declining trend. Due to problem of non-performing assets and its low recovery rate the liquidity and financial position of banks is adversely affected.

**Figure 2: Average NPAs Recovery through recovery mechanisms (%)**




Source: Author’s self compiled

## V. Conclusion

For managing the issue of stressed assets , the government has taken various mechanisms include setting up ofLokAdalats, DRTs and enacting laws such as SARFAESI Act and IBC code, 2016. The study concludes that the proportion of amount recovered is greater in case of SARFAESI Act as compared to other mechanisms in solving the issue of stressed assets. The impact of LokAdalats in recovering the amount of NPAs is least due to its low recovery rate. From the above study we can conclude that there are various reasons behind the low recovery rate of NPAs such asrecovery mechanisms are not so effective, poor law enforcement, delay in court proceedings and many more. This studyhas some important implications for bank regulators for removing the weakness in these recovery mechanisms and for any future policy changes for resolving the issue of non-performing assets. These recovery mechanisms must be strengthened so that recovery rate is improved and financial stability of Indian banking sectors remains good and efficient in the long run.

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