



ISSN: 0976-3031

Available Online at <http://www.recentscientific.com>

CODEN: IJRSFP (USA)

International Journal of Recent Scientific Research
Vol. 8, Issue, 3, pp. 16200-16205, March, 2017

**International Journal of
Recent Scientific
Research**

DOI: 10.24327/IJRSR

Case Study

A STUDY ON EFFECTIVENESS OF RECOVERY CHANNELS FOR THE RECOVERY OF NPAS: A CASE STUDY ON SCHEDULED COMMERCIAL BANKS IN INDIA

Ajit Kumar

Department of Applied Economics & Commerce Patna University, Patna, Bihar

DOI: <http://dx.doi.org/10.24327/ijrsr.2017.0803.0097>

ARTICLE INFO

Article History:

Received 18th December, 2016
Received in revised form 10th
January, 2017
Accepted 06th February, 2017
Published online 28th March, 2017

Key Words:

Nonperforming assets, credit appraisal,
DRTs, Lok Adalat, SARFAESI Act

ABSTRACT

Non-performing assets are those which are not generating income for the banks. It affects the profitability, liquidity and competitiveness of the banks. The impact is not only on the bank, it affects the whole economy as well. The banks should stop it at the time of credit appraisal rather than try to recover it after it becomes NPAs. There are many recovery channels through which the banks recover NPAs, such as DRTs, Lok Adalats SARFAESI Act. In this paper the effectiveness of DRTs, Lok Adalats SARFAESI Act in the recovery of NPAs during the year 2006 to 2015 has been evaluated. For the research financial statistical tool, correlation, regression has been used to explain the relationship between amount of NPA and its recovery.

Copyright © Ajit Kumar, 2017, this is an open-access article distributed under the terms of the Creative Commons Attribution License, which permits unrestricted use, distribution and reproduction in any medium, provided the original work is properly cited.

INTRODUCTION

A well developed and organized financial system beholds the key to the development of an economy. Banks are the one of the important segment of the financial system. The basic function of a bank is accepting deposits and providing loans and advances. It's not possible for a bank to accept deposit and sit quite. To manage their interest on deposits and other operating expense, banks lend money. The difference between interest on lending and deposits is known as spread. So, borrowers should repay the loan amount (Principal) along with interest on agreed contract. This is necessary for the banks to get some profit after the deduction of above said expenses. If the loan amount is recovered on time, everything is fine, if it is not, the problems arise for banks. The concept of NPAs comes to existence when the loan amount is not recovered according to contract. The NPAs is an asset which ceases to generate income for the banks. NPAs not only affect the profitability of a bank but the liquidity as well. The problem arises day by day due to increasing amount of NPA. It becomes a crisis, when to recover the NPAs. For the recovery of NPAs banks have to engage their employee that affect their efficiency and also increase the cost for the banks.

To reduce the cost on NPAs, banks should improve their credit appraisal system rather than to recover it after it becomes NPAs. Timely payment of interest and principal is necessary

for the health of the banking business. Default in payment of interest and principal will create a serious problem for the bank. It affects the profitability, liquidity and the credit cycle for the banks. All the banks are facing the problem of NPAs but for the public sectors banks this is too big.

Banks have the right to recover loans, but only through legal means," the Bench comprising Justices A R Lakshmanan and Altamas Kabir made it clear, as it asked for the guidelines issued by Reserve Bank of India and Indian Bank Association on the issue of recovery of loans by defaulters.¹ Judicial reforms are required to ensure that the rights of the Banks and Financial Institutions (FIs), popularly referred to as "lenders", lending money to the corporate and individuals, are adequately protected.

Currently, SARFAESI Act, Debt Recovery Tribunals and Lok Adalats are the three legal options available to banks for the recovery of NPAs. Among which, SARFAESI Act has been the most important means for recovery of NPAs. These recovery channels provide new options to banks to struggle against NPAs along with various rights to recovery it without the intervention of the court. To provide more power to creditors and ensure their rights various measures have been taken by the

¹Extracted From- <http://archive.indianexpress.com/news/no-force-recovery-of-bank-loans-only-through-legal-means-says-sc/22687/>

*Corresponding author: **Ajit Kumar**

Department of Applied Economics & Commerce Patna University, Patna, Bihar

regulatory bodies in India. There exist defined mechanisms to deal with NPAs of banks and financial institutions today. However, before 1993, banks have to file claims against the defaulters in the court which is a long and lengthy route to fight against NPAs. In this judicial process banks have to spend a lot of time to recover their loan.

To maintain the international practices and to recover the bad debts quickly and efficiently thirty three Debts Recovery Tribunals and five Debts Recovery Appellate Tribunals and five Debts Recovery Appellate Tribunals were constituted by Government of India across the country in the year 1993 under the Debts Recovery Tribunal (DRT) enforces provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, popularly known as the RDDBFI Act.

The main reasons for the formation of the Tribunal is to facilitate speedy recovery of assets and avoid delay in the adjudication proceeding and expedite adjudication proceedings. It helps to reduce the legal proceeding to 1 year time. Initially the DRTs performed well, but due to overburden with the huge volume of cases referred to them their progress suffered.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) was enacted in 2002 for regulation of securitization and reconstruction of financial assets and enforcement of security interest by secured creditors to maintain the process of recovery from NPAs. It 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: -

- Securitisation
- Asset Reconstruction
- Enforcement of Security without intervention of the court

Lok Adalats act provide a means by which banks can be assured of asset-recovery either through Tribunals or out-of court settlements. It was formed under Legal Service Authority Act, 1987. State Legal Service Authorities conduct Lok Adalats for ensuring speedy settlement. A former Chief Justice of India, Justice P.N. Bhagwati had advocated the idea of Lok Adalat. It 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.

Current scenario

Nonperforming assets are the one of the main reason of the global financial crisis. India is not apart from it; especially the public sector banks are facing more crisis than the other banks. The problem of NPA has received considerable attention after the liberalisation of the financial sector in India. So many changes have been made to reduce the impact of NPAs. 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.

To tackle sickness among financial institutions the Government along with the regulating authorities has adopted several ad-hoc measures to improve the performance of financial institution. Various mechanisms was put in place for cleaning the banking system from the threat of NPAs and revival of a healthy financial and banking sector by the Government. The Reserve Bank of India has also issued guidelines and directions relating to NPAs to make the banking system more efficient and effective. Prior to 1991, the legal process to recover the bad loans was tiresome, since it takes several years' legal civil proceedings for getting decree. Performance of various recovery channels of NPAs in Indian banking system is not found satisfactory. So that, there is requirement of improved the recovery of the NPAs and try to reduce the NPAs for the good health & future of Indian banks. The government is also very much keen to recover the NPAs by utilizing the available recovery channels like Lok Adalats, DRT and SARFAESI Act 2002. It shows that recoveries in NPAs are made easier by the amendments of SARFAESI Act 2002 and open the door for the bankers to recover their overdue amounts which is been identified as non performing assets in their books of accounts.

LITERATURE REVIEW

Due to absence of an adequate legal framework the banking system in India remains handicapped and able to ensure expeditious recovery of loans and also enforcement of security. To reduce the quantum of NPAs and prevention of future defaulters a comprehensive banking legislation and enforcement machinery be put in place. This is the right time to take strict action to convert "Non-Performing Assets" Into "Now-Performing Assets".

Khan (2000)² pointed that banks and financial institutions could convert part of the NPA debt into equity of the defaulting company as a recovery strategy. Researcher advocated usage of credit derivatives and credit default protection contracts as a part of credit risk management and observed that risks associated with economic environment, unforeseen events specific to corporate borrowers are not covered under the present credit risk models.

Patel Urjit (2000)³ 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.

Muniyappan G.P. (2002)⁴ updated the readers by providing a very comprehensive picture of NPA management. While NPAs are decreasing in percentage terms, the absolute figure is still going up. RBI has introduced various measures like credit risk management model, compromise settlement methods, effective

²Khan M.Y., *NPAs Recovery Blues' Business Line*. Feb 2nd, 2000.

³Patel and Urjit R., *Outlook of the Indian Financial Sector*. Economic and Political Weekly, Vol.XXXV, No.45, Nov 4, 2000, pp.29-38.

⁴Muniyappan G.P., *The NPA Overhang Magnitude, Solutions, Legal reforms*, speech at Cii Banking Summit, published in RBI Website, April 11, 2002.

use of debt recovery tribunals, and Lok Adalats. It also circulates real time information on defaulter against whom suits have been filed for recovery. However, strict legal reforms and good corporate governance is vital for the success in NPA management.

Kumar (2003)⁵ talked about the need, process, summary and pros and cons of the SARFAESI Act. Researcher analyzed that this Act empowered banks and financial institutions to directly enforce the security interest which was pledged to them at the time of sanctioning the loan without going through the judicial process of DRT or Civil Courts.

Bose (2005)⁶ 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.

Ahmed, J.U (2008)⁷ studied the NPA recovery management and explained that the debt recovery tribunals and SARFAESI Act has been the most effective available recovery channels in terms of the amount recovered among the various channels of recovery.

Sharma, M (2005)⁸ 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. It provided three different methods for recovery of non-performing assets, namely: -

- Securitization,
- Asset Reconstruction,
- Enforcement of Security without the intervention of the Court

Thus it may be observed that SARFAESI helped to toughen the banking sector and allows them to securitize recovery of NPAs.

⁵Kumar, *The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002*. 2003.

⁶Bose, "SARFAESI Act : An Effective Recovery Tool", 2005

⁷ Ahmed, J.U. (2008). *Asset Quality and Non Performing Assets of Commercial Banks*, 1st Edition, MD Publications Private Ltd, p. 156.

⁸Sharma, K.C., Josh, P., Mishra, J.C., Kumar, S., Amalorpavanathan, R. & Bhaskaran, R. (2001). *Recovery Management in Rural Credit*, Department of Economic Analysis and Research Wing, NABARD.

Lakshmana Swamy Amara (2006)⁹ has stated that credit risk is an important factor impairing on financial entities. In order to contain the growth in non-performing assets (NPAs), recovery management has become a keyword for the banking industry in recent years. In the Indian context, several initiatives have been taken by the Reserve Bank in conjunction with the Government to contain the NPAs of banks. As a consequence, NPAs of SCBs have witnessed a secular decline since the initiation of income recognition and asset classification (IRAC) norms.

Rational of the Study

Increasing amount of NPA is alarming for the banking sector that affects the growth and profitability. It also affects the stability and reduces the competitiveness of the banks. Government along with the RBI has taken many measures to reduce the level of NPAs in banking sector and provides direction for this. Banks are not the only effected sector due to NPAs, in fact the whole economy is system will be affected. Due to NPAs the credit cycle will be affected and bankers will be de-motivated for further lending. A proper recovery channel will not only boost the bankers for lending but also increase the profitability of the banks. These recovery channels help the banker to manage their NPA levels. The study would try to identify the impact of implementation of these channels and measure the importance in terms of recovery.

Objectives

- 1 To know about recovery channels for NPAs
- 2 To identify the impact of implementation of these recovery channels
- 3 To measure the importance of recovery channels in terms of recovery

Limitation

The present study has been conducted to identify and confirm the recovery aspects in scheduled commercial banks in India. The data used in the present analysis is confined to the period between 2005- 06 to 2014-15 only.

RESEARCH METHODOLOGY

Efficiency of various recovery channels available for the recovery of NPAs are measured and relatively compared with the amount of NPAs to know the effectiveness of theses recovery channel. General rule accepted worldwide is that a recovery measure is efficient if it enable recovery of more NPA in comparison to other measures. Also, a higher recovery as a percentage to Gross NPA, Net NPA is considered as indication of efficiency of recovery management.

This research investigates the trend in management of NPA with specific focus on three measures, i.e., SARFAESI Act, Debt Recovery Tribunals and Lok Adalats. The study infers based on statistical information on recovery of NPA accounts using the above three measures during the period 2005-06 to 2014-15. The data has been collected from secondary sources. ANOVA (one way) analysis is used for the purpose of accessing the date and checking the validity of the hypotheses.

⁹Lakshmi Swamy Amara, *An Evaluation of the Policy and Performance of Commercial Banks in India in the Post-Financial Sector Reforms Period- Strategies and Solutions for a Strong Banking*. Ph.D., thesis submitted to Andhra University, May, 2006, p.130.

Research Questions

The study addresses the following research questions.

1. Will these recovery channels significantly improve the recovery management during the study period?
2. Do these recovery measures enabled recovery of total NPA in significant terms?
3. Which recovery channel generates more benefit for banks?
4. Descriptive statistics, correlation and regression analysis is used for the purpose of data analysis which is helpful for getting the answer of the above research questions.

Research Hypothesis

H₀₁: There is no significant difference between cases referred to Lok Adalats, DRTs and SARFAESI Act.

H₀₂: There is no significant difference between amount recovered through Lok Adalats, DRTs and SARFAESI Act.

Data Analysis

H₀₁: There is no significant difference between cases referred to Lok Adalats, DRTs and SARFAESI Act.

Table 1 Number of cases of NPAs referred

Year	Lok adalats	Drts	Sarfaesi act
2014-15	9131199	171113	1241086
2013-14	1636957	28258	194707
2012-13	840691	13408	190537
2011-12	476073	13365	140990
2010-11	616018	12872	118642
2009-10	778833	6019	78366
2008-09	548308	2004	61760
2007-08	186535	3728	83942
2006-07	160368	4028	60178
2005-06	268090	3534	41180

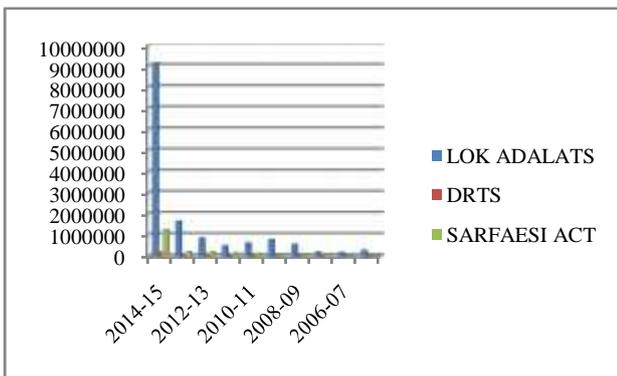


Figure 1 Number of cases of NPAs referred

Table 2 ANOVA

recovery channel	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	1.22E+13	2	6.09E+12	2.411	0.109
Within Groups	6.82E+13	27	2.53E+12		
Total	8.04E+13	29			

As the p value of the ANOVA table is 0.109 which is greater than .05, so the null hypothesis is accepted which means that there is no significant difference between these recovery channels in terms of number of cases referred.

Table 3 Multiple Comparisons

recovery channel		TukeyHSD			95% Confidence Interval	
(I) recover channel	(J) recover channel	Mean Difference (I-J)	Std. Error	Sig.	Lower Bound	Upper Bound
Lok Adalat	DRT	1.44E+06	7.11E+05	0.126	-3.23E+05	3.20E+06
	SARFAESI Act	1.24E+06	7.11E+05	0.206	-5.19E+05	3.01E+06
DRT	Lok Adalat	-1.44E+06	7.11E+05	0.126	-3.20E+06	323479.55
	SARFAESI Act	-1.95E+05	7.11E+05	0.959	-1.96E+06	1.57E+06
SARFAESI Act	Lok Adalat	-1.24E+06	7.11E+05	0.206	-3.01E+06	518785.45
	DRT	1.95E+05	7.11E+05	0.959	-1.57E+06	1.96E+06

H₀₂: There is no significant difference between amount recovered through Lok Adalats, DRTs and SARFAESI Act.

Table 4 Amount involved and recovered through these three channels

	Rs. Crore		
	Lok Adalats	DRTs	SARFAESI Act
2014-15			
Amount involved	88700	378900	470500
Amount recovered	4300	53100	115200
Percentage	4.84	14.01	24.48
2013-14			
Amount involved	23200	55300	95300
Amount recovered	1400	5300	25300
Percentage	6.03	9.58	26.55
2012-13			
Amount involved	6600	31000	68100
Amount recovered	400	4400	18500
Percentage	6.06	14.19	27.17
2011-12			
Amount involved	1700	24100	35300
Amount recovered	200	4100	10100
Percentage	11.76	17.01	28.61
2010-11			
Amount involved	5254	14092	30604
Amount recovered	151	3930	11561
Percentage	2.87	27.89	37.78
2009-10			
Amount involved	7235	9797	14249
Amount recovered	112	3133	4269
Percentage	1.55	31.98	29.96
2008-09			
Amount involved	4023	4130	12067
Amount recovered	96	3348	3982
Percentage	2.39	81.07	33.00
2007-08			
Amount involved	2142	5819	7263
Amount recovered	176	3020	4429
Percentage	8.22	51.90	60.98
2006-07			
Amount involved	758	9156	9058
Amount recovered	106	3463	3749
Percentage	13.98	37.82	41.39
2005-06			
Amount involved	2144	6273	8517
Amount recovered	265	4735	3363
Percentage	12.36	75.48	39.49

As p value of the ANOVA table is .001 which is less than .05, which means that there is a significant difference between these recovery channels in term of recovery(in percentage term). So, Null hypothesis is rejected.

Table 5 ANOVA

recovery channel	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	5425.436	2	2712.718	10.202	0.001
Within Groups	7179.132	27	265.894		
Total	12604.568	29			

Table 6 Multiple Comparisons

recovery channel		Mean Difference (I-J)	Std. Error	Sig.	95% Confidence Interval	
(I) recover channel	(J) recover channel				Lower Bound	Upper Bound
Lok Adalat	DRT	-29.08600*	7.29238	0.001	-47.1668	-11.0052
	SARFAESI Act	-27.93400*	7.29238	0.002	-46.0148	-9.8532
DRT	Lok Adalat	29.08600*	7.29238	0.001	11.0052	47.1668
	SARFAESI Act	1.152	7.29238	0.986	-16.9288	19.2328
SARFAESI Act	Lok Adalat	27.93400*	7.29238	0.002	9.8532	46.0148
	DRT	-1.152	7.29238	0.986	-19.2328	16.9288

*. The mean difference is significant at the 0.05 level.

Through the multiple comparisons table it can be easily defined that DRTs and SARFAESI Act is better than Lok Adalats in term of recovery of NPAs, but there is no significant difference between DRTs and SARFAESI ACT.

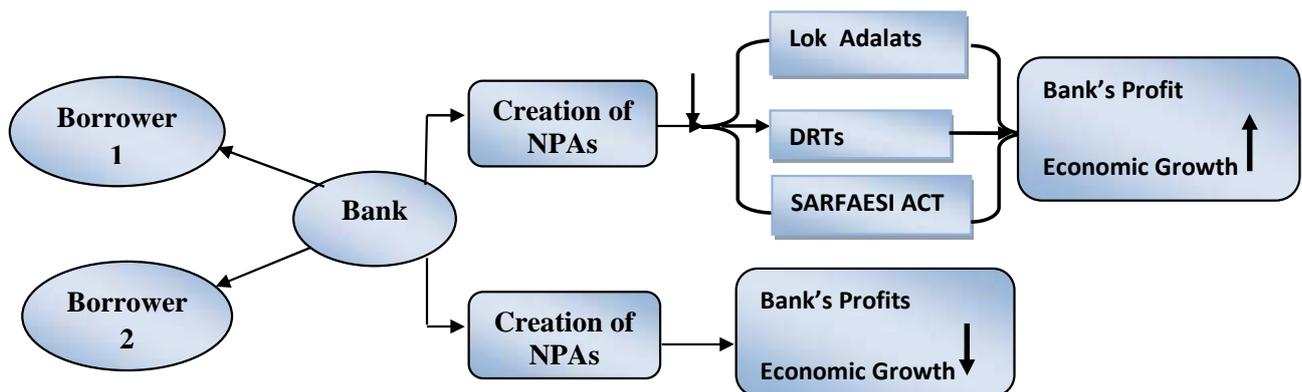


Figure 2 Importance of recovery channels

CONCLUSION

The purpose of this study was to analyse the various available recovery channel for the recovery of NPAs and measure the efficiency in terms of amount recovered and number of cases referred. This study shows that the percentage of recovery in terms of amount involved and number of cases referred to these channels, clearly denotes that SARFAESI Act 2002 and DRT does not have larger variations. Lok Adalats function by amicably settling disputes that are pending in a court of law or at a pre-litigation stage. This defines that DRTs and SARFAESI Act is much more efficient to recover the NPAs. While comparing the number of cases referred to Lok Adalats cover almost 80 percent on an average per year. Besides this in terms of amount recovered their performance is not so good. The reason may be that these court deals with a large number of cases involving smaller amounts having an individual ceiling. These recovery channels have great importance in increasing the profitability of the banks. The importance of the recovery channel can be understood with the help of the

following diagram that define how recovery channel is helpful in improving the profit of the bank as well as in economic growth.

The above figure defines that the bank has provide loan to two borrowers. They have not paid their installment which creates NPAs. In case of borrower 1 the bank has recovered their loan which not only increases the profit of the bank but also help in economic growth. In case of borrower 2 non recovery of loan reduces the profit of the bank and economic growth.

Suggestions

A proverb is that the time will fill the gap, but in case of NPAs the time is the main enemy, as it increases the repair bill, rapidly. As the bank does not have the time and money to go for experiment, the problems of NPAs is increasing day by day and expected to increase in future unless proper actions are taken.

These recovery channels are established by RBI for the purpose of loan recovery are still not up to the mark. The amount recovered in the ratio of NPAs show that they are not helping too much to recover the NPAs. In fact this recovery system is very much time consuming as well. These systems should ensure sustainability and profitability with strict regulations cum refocused strategies. So, it is the need of the hour that the RBI should focus on establishing such a kind of recovery mechanism.

There are certain suggestions which help to reduce the NPAs as well as to recover more through these channels. They are-

1. Government has farmed numerous laws to recovery NPAs but is several decades old. Those are not suitable for present environment. These laws requires urgent amendment and some new law should be framed which would be able to fulfill the changed requirements.
2. Recovery process should be easy and completed with less complexities. This can accelerate the recovery process.
3. Proper circulation of information among defaulter by banks or banks group to improve the Settlement Advisory Committee (SACs) and utilizing the power given to the banks under the SARFAESI Act.
4. Strict legal action should be taken against willful defaulters.

5. The impact of NPAs on the economy should be clear to the general public. This will help the bank to collect the information about the borrowers.

References

1. Ahmed, J.U. (2008). Asset Quality and Non Performing Assets of Commercial Banks, 1st Edition, MD Publications Private Ltd, p. 156.
2. Bose, "SARFAESI Act: An Effective Recovery Tool", 2005
3. Khan M.Y., NPAs Recovery Blues' Business Line. Feb 2nd, 2000.
4. Kumar, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. 2003.
5. Lakshmi Swamy Amara, An Evaluation of the Policy and Performance of Commercial Banks in India in the Post-Financial Sector Reforms Period– Strategies and Solutions for a Strong Banking. Ph.D., thesis submitted to Andhra University, May, 2006, p.130.
6. Muniyappan G.P., The NPA Overhang Magnitude, Solutions, Legal reforms, speech at Cii Banking Summit, published in RBI Website, April 11, 2002.
7. Patel and Urjit R., Outlook of the Indian Financial Sector. Economic and Political Weekly, Vol. XXXV, No.45, Nov 4, 2000, pp.29-38.
8. Report on Trend and progress of banking in India 2000-01 to 2010-11. Reserve Bank of India.
9. Report on *Trend and Progress of banking in India, Various issues*. Bombay, India.
10. Sharma, K.C., Josh, P., Mishra, J.C., Kumar, S., Amalorpavanathan, R. & Bhaskaran, R. (2001). *Recovery Management in Rural Credit*, Department of Economic Analysis and Research Wing, NABARD.
11. Unny, M.P. (2010). A Study on the Effectiveness of Remedies Available For Banks in a Debt Recovery Tribunal - A Case Study on Ernakulam DRT. Working Paper Series, Centre for Public Policy Research. pp.1-35.

Web sites referred

1. www.iibf.org.in
2. www.rbi.org.in
3. www.indianexpress.com

How to cite this article:

Ajit Kumar.2017, A Study on Effectiveness of Recovery Channels For The Recovery of Npas: A case Study on Scheduled Commercial Banks in India. *Int J Recent Sci Res.* 8(3), pp. 16200-16205. DOI: <http://dx.doi.org/10.24327/ijrsr.2017.0803.0097>.
