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Banking Sector Reforms and NPA: A study of Indian Commercial Banks

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BANKING SECTOR REFORMS AND NPA:
A STUDY OF INDIAN COMMERCIAL BANKS

Meenakshi Rajeev and H P Mahesh[1]

Abstract

The issue of non-performing assets (NPA), the root cause of the recent global financial crisis, has been drawing the attention of the policy makers and academicians alike. The problem of NPAs, which was ignored till recently,has been given considerable attention after liberalisation of the financial sector in India. This exploratory paper examines the trends of NPAs in India from various dimensions and explains how mere recognition of the problem and self-monitoring has been able to reduce it to a great extent. It also shows that public sector banks in India, which function to some extent with welfare motives, have as good a record in reducing NPAs as their counterparts in the private sector. The paper also discusses the role of joint liability groups (JLGs) or self help groups (SHGs) in enhancing the loan recovery rate.

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 achieve 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.

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Broadly speaking, NPA is defined as an advance where payment of interest or repayment of installment of principal (in case of term loans) or both remains unpaid for a certain period[2]. 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 in 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. Against this backdrop, the paper is arranged as follows. The next section compares India with few other countries across the globe. Reform measures and the consequent changes in NPA norms are discussed in Section 3. The next two sections look at the loan recovery mechanisms that are in place, including the legal reforms and the recovery trends. Trends in NPAs both at the bank level and at the sector level are analysed in the penultimate section. The paper ends with a concluding section.

NPAs at the Global Level

In order to get a global picture[3] it is essential to look at the NPAs in the different countries of the world. Since the concept of NPA developed in India only in the post-reform era, it would be useful to look at recent figures rather than adhere to a historical account. A closer look at the Non-performing Loans (NPL), as they are called in many nations, reveals that in 2003 the NPL at the global level was US$ 1,300 billion. India ranks fourth with NPL of around US$ 30 billion (2.3 per cent of the global NPL), while Japan has the highest NPL of US$ 330 billion (25.4 per cent of the global NPL) and Turkey has the lowest NPL of US$ 8 billion (0.6 percent of global NPL, Table 1).

Table 1: Global Non-performing Loans: 2003

Countries	NPLs (US$ billion)	Share in Global (per cent)
Japan	330	25.4
China	307	23.6
Taiwan	19.1	1.5
Thailand	18.8	1.5
Philippines	9	0.7
Indonesia	16.9	1.3
India	30	2.3
Korea	15	1.2
Germany	283	21.8
Turkey	8	0.6
Global	**1300**	**100**

Source: Global NPL Report 2004, Ernst and Young.

[2] This time duration given for an asset to consider it as a NPA varies from country to country and can change over time within a particular country.

[3] See Munchisa, Kasuya (1998), Bonin *et al* (2001), Krueger *et al* (1999), Kunt *et al* (1997).

Though a clear picture of the magnitude of NPA emerges from the absolute values, it does not reveal the complete picture mainly because the absolute level of NPA depends on total advances. A country with a large population or GDP may have large advances and, in turn, larger NPA as well. Thus, apart from the absolute value, it is also important to look at what proportion of the total loan has become non-performing. The NPL levels of various countries as a percentage of their total loans are presented in Table 2. One interesting feature revealed by Table2 is that the NPA/NPL as a percentage of the total loans has been declining for almost all countries over the years. The average NPA as a percentage of total loans across the countries was around 11.89 per cent in 2001, which declined to around 6.44 per cent in 2005. This shows that the quality of bank assets has been improving across countries over the years. This could be the result of the stringent regulations prescribed by the BASEL norms (Sen and Ghosh, 2005). Examining the countries in terms of NPA as a percentage of total loans, we observed that for 16 countries NPA percentage was below 10 per cent and for around 5 countries it was between 10-20 per cent; for another 5 countries the NPA percentage was rather high at more than 20 per cent. Australia has the lowest NPA to total loan ratio, which is just 0.34 per cent whereas the Philippines tops the list with 25 per cent. India is in the 11th highest position with around 8.6 per cent. *One interesting observation is that most of the countries that fall under the higher 'NPL/Total Loan' ratio category are in the Asian region.* Out of 10 countries that have a ratio above 10 per cent, eight are Asian. The improvement in the quality of the assets across countries is also shown by the fact that in 2001, the NPA/Total Loan ratio of 11 countries was above 10 per cent and by 2005 this number reduced to 7.

Table 2: Bank Non-performing Loans to Total Loans

Countries	2001	2002	2003	2004	2005
Australia	0.6	0.4	0.3	0.2	0.2
Bangladesh	31.5	28	22.1	17.6	15.3
Brazil	5.6	4.8	4.8	3.8	4.4
Canada	1.5	1.6	1.2	0.7	0.5
Chile	1.6	1.8	1.6	1.2	0.9
China	29.8	25.6	20.1	15.6	10.5
Egypt	16.9	20.2	24.2	16.3	25
France	5	5	4.8	4.2	3.5
Germany	4.6	5	5.3	5.1	4.8
Hong Kong	6.5	5	3.9	2.3	1.5
India	11.4	10.4	8.8	7.2	5.2
Indonesia	31.9	24	19.4	14.2	15.6
Japan	8.4	7.2	5.2	2.9	1.8
Korea	3.4	2.4	2.6	1.9	1.2
Malaysia	17.8	15.8	13.9	11.8	9.9
Mexico	5.1	4.6	3.2	2.5	1.8
Pakistan	23.4	21.8	17	11.6	10.6
Philippines	27.7	26.5	26.1	24.7	20
Russia	6.2	5.6	5	3.8	3.2
Singapore	8	7.7	6.7	5	3.8
Sri Lanka	15.3	15.3	13.7	9.1	9.6
Switzerland	2.3	1.9	1.4	0.9	0.5
Thailand	11.5	16.5	13.5	11.8	11.1
Turkey	29.3	17.6	11.5	6	4.8
United Kingdom	2.6	2.6	2.5	1.9	1
United States	1.3	1.4	1.1	0.8	0.7

Source: Global Financial Stability Report, May 2006, IMF

While comparing the NPA levels of different countries, it should be remembered that the features relating to NPA reporting/evaluation practices are not uniform across the globe. In some countries, the NPA level may be low because losses are written off at an early stage. In some of the developing countries belonging to the Asia-Pacific Economic Co-operation (APEC), a loan is classified as non-performing only after it has been in arrears for at least six months. In India, currently, an asset is considered NPA if it is due for 90 days. Besides, in India due to the lengthy legal process, a considerably longer time is taken to recover the loan and due to many safeguards/procedures even after a NPA is written off, banks continue to hold them in their books often with the provisions made for those loans. Even the classification of NPA into Gross NPA and Net NPA is not uniform because in some countries general provisions are made, whereas in India, NPAs are considered GNPA for some time even after making provisions. Thus, while comparing the NPA of India with other countries one should keep in mind that in many respects asset classification norms in India are considerably more stringent than the best of international practices.

In addition, countries also do differ in various other respects, so a strict comparison across countries cannot be made. Nonetheless, the global picture reflects a comprehensive view of NPAs across the world.

NPA Norms

Though the issue of NPA was given more importance after the Narasimham Committee Report (1991) 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 overdue[4] 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.

[4] An amount is considered overdue when it remains outstanding 30 days beyond the due date.

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.

Recovery Mechanism of NPA

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.

Recovery of NPA

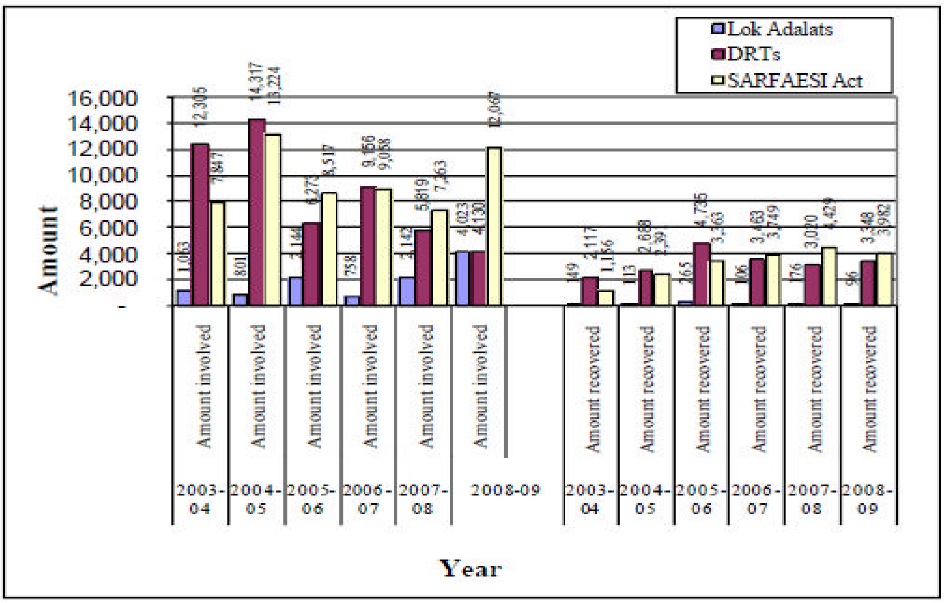
Using the new institutions and legal options, banks and financial institutions accelerated their recovery of NPAs. The NPAs recovered by scheduled commercial banks through various channels is presented in Table 3 and Fig1. Between 2003-04 and 2005-06, the total cases referred to various institutions was 93,2377 which was worth about Rs 70,226 crores. Out of this, around Rs 19,075 crore was recovered. In terms of cases, the highest number (5,53,042) was referred to the Lok Adalats and the lowest (15,812) to the DRTs. In terms of the amount involved, the DRTs recovered the highest amount of around Rs 32,745 crore and Lok Adalats the least, around Rs 2,965 crore. In terms of the recovery, 58 per cent of the amount involved was recovered through one-time settlement/compromise schemes. DRTs recovered around 29 per cent and Lok Adalats recovered around 16 per cent, while 22 per cent of the amount was recovered under the SARFAESI Act.

Table 3: NPAs Recovered by SCBs through Various Channels (Rs crores)

	One-time Settlement / compromise Scheme	Lok Adalats	DRTs	SARFAESI Act
2003-04				
No of cases referred	139,562	186,100	7,544	2,661
Amount involved	1,510	1,063	12,305	7,847
Amount recovered	617	149	2,117	1,156
2004-05				
No of cases referred	132,781	185,395	4,744	39,288
Amount involved	1,332	801	14,317	13,224
Amount recovered	880	113	2,688	2,391
2005-06				
No of cases referred	10,262	2,68,090	3,534	41,180
Amount involved	772	2,144	6,273	8,517
Amount recovered	608	265	4,735	3,363
2006-07				
No of cases referred	—	1,60,368	4,028	60,178
Amount involved	—	758	9,156	9,058
Amount recovered	—	106	3,463	3,749
2007-08				
No of cases referred	—	1,86,535	3,728	83,942
Amount involved	—	2,142	5,819	7,263
Amount recovered	—	176	3,020	4,429
2008-09				
No of cases referred	—	5,48,308	2,004	61,760
Amount involved	—	4,023	4,130	12,067
Amount recovered	—	96	3,348	3,982

Source: RBI

Figure 1: NPA Recovered through Various Channels



Source: Computed using RBI data

Thus, we observe that considerable attention has been paid to the NPA issue and various regulatory as well as institutional mechanisms are put in place. How effective are these changes? This calls for a closer look at the NPA trends in the recent past.

NPA Trends

While efforts are on for NPA classifications, refinement of the accounting system and measures to reduce NPA in the decade of 1990s, proper implementation of these norms took time. **Systematic data on NPAs started to become available in a usable form from 1998 only.** Though the total GNPA increased significantly between 1998 and 2002, it started to decline after that (Table 4). During 1998 the total Gross NPA and Net NPA of the total banking sector was Rs 34,428 crore (around 14.4 per cent of gross advance) and Rs 16,098 crore (around 7 per cent of net advance) respectively. During 2005, the GNPA increased even in real terms to Rs 38,558 crore (around 5.2 per cent of gross advance) whereas NNPA reduced to Rs 14,181 crore (around 2 per cent of net advance). The growth rate of GNPA was about 11 per cent in 1999, which started to fall drastically and became negative after 2002. The growth rate becoming negative implies that there is a substantial decline in the GNPA of commercial banks showing some impact of the sensitisation and regulatory changes. A similar trend is observed in the case of Net NPA (NNPA). The decline in the NNPA is sharper than GNPA, mainly because of the increasing level of provisions, as shown in the last three rows of Table 4. Thus it is clear that sensitisation to the problem has helped to tackle it.

Table 4: Non Performing Assets of Total Banking Sector (Rs Crore, Real Values)

	2002	2003	2004	2005	2006	2007	2008	2009
Gross NPA	**41430**	**39012**	**35007**	**38558**	**38817**	**36568**	**38117**	**46689**
Change	2602	-2418	-4006	3551	259	-2249	1549	8573
Percentage growth	6.7	-5.8	-10.3	10.1	0.7	-5.8	4.2	22.5
Percent to Gross Advance	10.4	8.9	7.2	5.3	3.3	2.5	2.3	2.3
Net NPA	**20787**	**18548**	**13302**	**14181**	**14087**	**14560**	**16740**	**21272**
Change	1013	-2240	-5246	879	-94	473	2181	4531
Percentage growth	5.1	-10.8	-28.3	6.6	-0.7	3.4	15.0	27.1
Percent to Net Advance	5.5	4.4	2.9	1.9	1.2	1.0	1.0	1.1

Source: Computed by authors using RBI data.

At the bank group level, when we compare the public sector banks with private banks in terms of NPA as a percentage of total lending (Table 5) we observe that the public sector banks are as good as or as bad as their counterparts in the private sector. Sometimes, public sector banks are indeed doing better that the old Indian private sector banks. However, when compared with the foreign banks they do not fare well. This may be partly because foreign banks are already accustomed to NPA norms in their parent country. Further, various credit related welfare programmes are carried out through public sector banks. They also have maximum reach in the rural areas. One feature, however, is worth taking note of – growth rate of gross NPAs of the old private sector banks are higher than the public sector banks while growth of advances of public sector banks are at par with the private banks. It, thus, appears that after reforms, the public sector banks were able to tackle the NPA problem more effectively than the Indian private banks (Table 5). However, one important observation from Table 5 is that GNPA as a percentage of gross advances has been declining over time across all bank groups.

Table 5: Gross and Net NPAs of Scheduled Commercial Banks (Nominal Values, Rs Crore)

	2002	2003	2004	2005	2006	2007	2008	2009
Public Sector Banks								
Gross NPAs	56473	54090	51538	47325	41358	38968	40452	45156
Percent to Gross Advance	11.1	9.4	7.8	5.7	3.6	2.7	2.2	2.0
Old Private Banks								
Gross NPAs	4851	4550	4392	4206	3759	2969	2557	3072
Percent to Gross Advance	11.0	8.9	7.6	6.0	4.4	3.1	2.3	2.4
New Private Banks								
Gross NPAs	6811	7232	5963	4576	4052	6287	10440	13911
Percent to Gross Advance	8.9	7.6	5.0	3.6	1.7	1.9	2.5	3.1
Foreign Banks								
Gross NPAs	2726	2845	2894	2192	1928	2263	2859	6833
Percent to Gross Advance	5.4	5.3	4.6	2.8	1.9	1.8	1.8	4.0

Source: Computed using RBI data

The above statistics shows the NPA problem at the aggregate level. In order to tackle the problem a disaggregated analysis is necessary to examine what type of loans lead to more NPAs. This necessitates an analysis of sector-wise NPAs.

1. Sector-wise NPAs

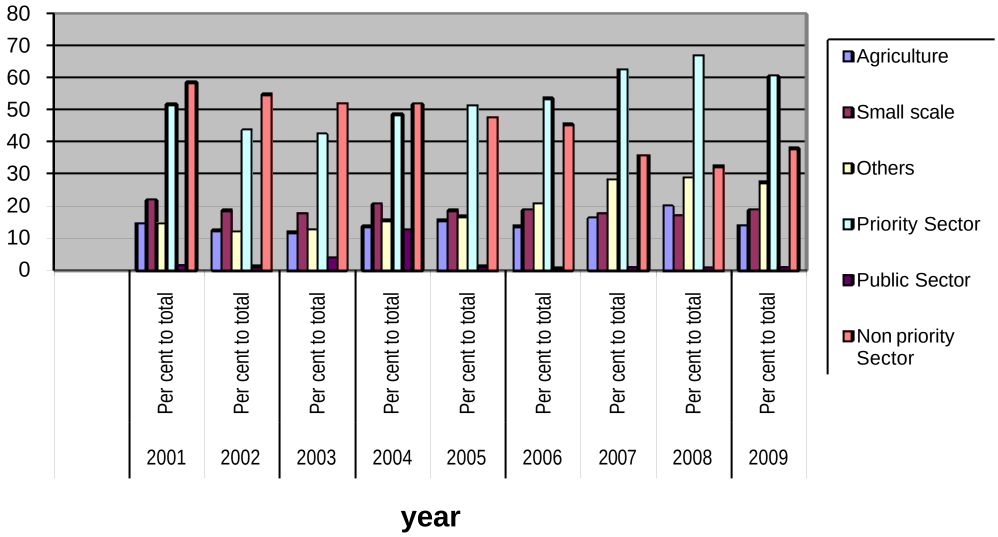
One of the important issues raised in the case of the NPAs of Indian commercial banks is that the credit policy followed by the RBI under the social banking motto of the government led to increase in NPAs. To examine this we first look at the NPAs of the priority sector vis-à-vis non-priority sector loans. Table 6 reveals that the NPA of the priority sector is indeed higher than the NPA of non-priority sector and this trend has been continuing over the years (see also Fig.2).

Table 6: Sector Wise Non Performing Assets of Indian Scheduled Commercial Banks (Rs Crore, Real Values)

Year	Item	Agriculture	Small Scale	Others	Priority Sector	Public Sector	Non Priority Sector
Bank Group: State Bank and Associates							
2004	Amount	1351	1232	1272	3856	119	4216
	Per cent to total	16.5	15.0	15.5	47.1	1.5	51.5
2005	Amount	1504	1175	1926	4641	111	5042
	Per cent to total	15.4	12.0	19.7	47.4	1.1	51.5
2006	Amount	1750	1210	2547	5508	95	4420
	Per cent to total	17.5	12.1	25.4	55.0	1.0	44.1
2007	Amount	1721	982	2494	5197	136	3761
	Per cent to total	18.9	10.8	27.4	57.2	1.5	41.4
2008	Amount	2248	1039	2739	6026	65	4212
	Per cent to total	21.8	10.1	26.6	58.5	0.6	40.9
2009	Amount	1355	1371	2992	5718	120	6262
	Per cent to total	11.2	11.3	24.7	47.3	1.0	51.8
Nationalised Banks							
2004	Amount	2561	3871	2922	9026	2379	9669
	Per cent to total	13.8	20.8	15.7	48.6	12.8	52.0
2005	Amount	3294	3972	3569	10834	274	10120
	Per cent to total	15.6	18.8	16.9	51.3	1.3	47.9
2006	Amount	2962	4045	4482	11489	164	9758
	Per cent to total	13.8	18.9	20.9	53.7	0.8	45.6
2007	Amount	2938	3202	5095	11235	212	6418
	Per cent to total	16.5	17.9	28.5	62.9	1.2	35.9
2008	Amount	3349	2890	4852	11091	137	5376
	Per cent to total	20.2	17.4	29.2	66.8	0.8	32.4
2009	Amount	2509	3356	4878	10743	201	6770
	Per cent to total	14.2	18.9	27.5	60.6	1.1	38.2
Private Banks							
2004	Amount	248	681	408	1338	40	4204
	Per cent to total	4.4	12.2	7.3	24.0	0.7	75.3
2005	Amount	307	638	497	1442	28	4331
	Per cent to total	5.3	11.0	8.6	24.9	0.5	74.7
2006	Amount	391	613	731	1735	3	4210
	Per cent to total	6.6	10.3	12.3	29.2	0.1	70.8
2007	Amount	623	467	999	2089	2	4601
	Per cent to total	9.3	7.0	14.9	31.2	0.0	68.8
2008	Amount	993	441	880	2314	0	6470
	Per cent to total	11.3	5.0	10.0	26.3	-	73.7
2009	Amount	975	454	1035	2464	51	8916
	Per cent to total	8.5	4.0	9.1	21.6	0.4	78.0

Source: Computed by author using RBI data

Figure 2: NPAs from Different Sectors in Nationalised Banks: Percentage to Total



Source: Computed using RBI data

As can be seen from the table, the average share the NPA of non-priority sector in the total NPA is around 50.5 per cent, 53.4 per cent and 74.7 per cent for SB&A, NP and PB respectively in 2005, whereas, the average share of NPA of the priority sector in the total NPA is around 46.2 per cent, 47.9 per cent and 23.9 per cent for SB&A, NB and PB respectively (in 2005). We also observe that NPA share of the non-priority sector increased, especially for the public sector banks in recent years vis-à-vis their NPAs from the priority sector (see figure for 2009 in Table 6). This may partly be due to the loan waiver policy adopted by the government for the priority sector. One can indeed see that NPAs in the agricultural sector show a sharp decline. Another important observation is that the NPA of the priority sector is less in private banks compared to other bank groups. In the case of the sub-category of priority sector, the share of agriculture sector NPA in the total NPA is only around 4.61 per cent for private banks whereas it is around 16 per cent for SB&A and 13 per cent for NB.

While it has been often highlighted in the literature whenever NPA in the priority sector is less than that of the non-priority sector, a point often missed is that the priority sector constitutes about 40 per cent of total lending. Therefore, it is important to examine NPA figures in proportion to the advances made in that particular sector. Computation of sector-wise NPAs indeed reveals that NPA from the SSI sector is much higher that the other sectors. While NPAs from the agricultural sector was about 12.7 per cent in 2002 for the nationalised banks, it was as high as 18.8 per cent for the SSI sector in the same year. For the non-priority sectors together, the NPA as a percentage of total advances declined from about 8 per cent to 4 per cent from 2002 to 2005. This percentage however declined to 6 per cent for the agriculture sector and to 11 per cent for the SSI sector in 2005. Thus, the declining trend is prominently uniform across all sectors. While the problem of non-recovery of agricultural loans is a well-discussed issue (Bardhan, 1989, Bell and Srinivasan, 1989, Rajeev and Dev, 2007), not many studies in India have focused on the non-recovery of loans in the SSI sector (see Gang, 1995 and Rajeev, 2008).

The above figures reveal that even though the SSI sector currently has a higher NPA to total advance ratio there is an improvement in recovery rates and NPA from this sector shows a declining trend even in real terms.

An important question arises at this juncture. While it is essential to reduce NPA to sustain banks, will such an endeavour have an adverse effect on the poor, especially poor farmers and small entrepreneurs? The issue assumes importance as this group constitutes more than 60 per cent of the population of India.

Self Help Groups: An Institution that makes the Poor Bankable

Potential borrowers in the priority sector (both agriculture and SSI) are mostly poor. Banks, in an attempt to reduce their NPAs, often shun these borrowers. These borrowers then turn to the informal lenders with unfavourable terms such as high rates of interest. These lenders, however, do not face the risk of default from these poor borrowers. This shows that poor are somehow able to repay, which is an important message for the formal banking sector. The self-help group is an institution, which has, indeed proved to the banks that the poor are bankable.

A self-help group in India refers to a small group of 10 to 20 individuals who come together to carry out saving and lending activities amongst themselves. They are usually informal organisations and are not legally incorporated. According to the National Bank for Agriculture and Rural Development (NABARD), SHGs are, "small, economically homogenous affinity groups of usually rural poor, voluntarily formed to save and mutually contribute to a common fund to be lent to its members as per the group members' decision." Saving is collected in small amounts at frequent intervals usually once a week or a fortnight during group meetings. The group meeting is also the forum in which it is decided who gets credit and how much, usually in a collaborative process. The most important feature is that the group takes joint liability for recovery of the loan.

The provision of hassle-free access to the financial services and products through the formal sector at low rates of interest has a number of benefits for the poor. In addition, the programme fulfills several other objectives. First, it provides consumption as well as production loan without any collateral. Secondly, it enables SHG members to reap economic benefit out of mutual help, solidarity and joint responsibility. The programme also ensures long-term help for a number of activities, most notably income-generating activities. Constant dealing with the banking sector helps the members to be at ease with the formal lending institutions. It also helps the formal banking sector to identify rural needs and provide assistance accordingly. In other words, capacity-building takes place at both ends. Maintenance of accounts on a regular basis helps the group members to understand how to handle financial resources.

Currently, SHGs in India are formed mainly by women. NABARD is presently in the process of forming farmers groups on the same principle. If such endeavours become successful, it will not only solve the problem of non-repayment of loans but also the improve accessibility to credit for the poor.

Conclusion

The NPA is the root cause of the global financial crisis that we observed recently. The world is still trying to recover from the after-effects of the crisis. The problem of NPA has received considerable attention after the liberalisation of the financial sector in India. Accounting norms have been modified substantially and mechanisms are in place for reduction of bad loans. Our discussions with banks, however, show that such decline is mainly due to the awareness of the problem of bad loans at the bank level (see Rajeev and Mahesh, 2007). It remains true that NPA jn the priority sector is still higher than that of the non-priority sector. Within the priority sector, the SSI's performance is the worst. However, even this sector has shown reduction in bad loans over time. In the process of reducing NPAs, will banks shun the poor borrowers? In this context, the self-help group model can be applied to some of the sectors to help the poor access loans and ensure repayment for the banks.

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