



# A Literature Review on Study of Non Performing Assets of Public and Private Sector Banks

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## **Abstract**

*Indian banking industry plays a vital role in the socio economic development of the country. This role is played by banks by extending credit to various deficit sectors for their growth and development. This credit creation process leads to credit risk which will lead to non performing asset. While the primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal loans, housing loans etc., in recent times the banks have become very cautious in extending loans. Non-performing Asset is an important parameter in the analysis of financial performance of a bank as it results in decreasing margin and higher provisioning requirements for doubtful debts. NPA is a virus affecting banking sector. It affects liquidity and profitability, in addition posing threat on quality of asset and survival of banks. The motive of present study is to study the researches related with NPA. It is scrutinized to see the context in which areas studies had been done and what are their observations and findings for understanding the various aspects of NPA.*

*Keywords : NPA, Macro Economic factor, Liquidity, Banking Sector.*

The review of literature is utmost important in any research as it offers an explanation for the necessity of the current research initiatives. NPA is a burning concern for the banking sector. The present study is the accumulated review of the literature in respect of understanding the reasons of NPA, the problems created by NPA and the impact of NPA on the banking sector, their performance of banking sector regarding NPA , and moreover came to a solution or remedies of the growing problem of NPA which is made by many authors. The review of the literature is used to formulate the theoretical analysis of Non-performing loans undertaken in the present study.

The various studies of npa is divided into the following two Contexts:

- A) Study of NPA in Indian Context
- B) Study of NPA in International Context

## A) Study of NPA in Indian Context

### Research Papers and theses

**Ranjan and Dhal (2003)** explored an empirical approach to the analysis of commercial banks' on performing loans (NPLs) in the Indian context. They evaluated as to how banks' non-performing loans are influenced by three major sets of economic and financial factors, i.e., terms of credit, bank size induced risk preferences and macroeconomic shocks. The empirical results from panel regression models suggest that terms of credit variables have significant effect on the banks' non-performing loans in the presence of bank size induced risk preferences and macroeconomic shocks. On the other hand, factors like horizon of maturity of credit, better credit culture, favorable macroeconomic and business conditions lead to lowering of NPAs.

**Ved Pal and Malik (2007)** in their empirical paper examined the difference in financial characteristics of public, private and foreign sector banks based on factors such as profitability, liquidity, risk and efficiency. Multinomial regression analysis was used and results revealed that foreign banks proved to be high performer in generating business with a given level of resources and they are better equipped with managerial practices and in terms of skills and technology. Foreign banks were more consistent with market system as reflected in terms of net interest margin. The public banks emerged as the next best performer after foreign banks. It was high performer in economizing their expenses which was reflected from expense rate and efficiency ratio. The private sector banks emerged with a better utilizer of resources as compared to PSB's.

**Bhatia (2007)** in his research paper entitled, "Non-Performing Assets of Indian Public, Private and Foreign Sector Banks: An Empirical Assessment", explores an empirical approach to the analysis of Non-Performing Assets (NPAs) of public, private, and foreign sector banks in India. This paper aims to find the fundamental factors which impact NPAs of banks. A model consisting of two types of factors, viz., macroeconomic factors and bank-specific parameters, is developed and the behaviour of NPAs of the three categories of banks is observed.

**Ashok Khurana and Mandeep Singh (2010)** stated that issue of mounting NPAs is a challenging to public sector banks. The study found that the asset wise classification of PSBs is in right direction and there is significant variation in the recovery of NPAs in the different sector. The research observed that PSBs should not be loaded with the twin object of profitability and social welfare.

**Malyadri and Sirisha (2011)** this study examine the NPA of Public Sector banks and Private sector banks of weaker sections for the period seven years in India. The secondary data compiled from Report on Trends and Progress of Banking in India, 2004-10 which has been analyzed by statistical tool such as percentages and compound Annual Growth rate. This study reveals that the public sector banks have achieved a greater penetration compared to the private sector banks.

**Kaur and Saddy (2011)** in the research paper entitled “A Comparative Study of Non-Performing Assets of Public and Private Sector Banks” an attempt is made to clarify the concept of NPA, the factors contributing to NPAs, the magnitude of NPAs, reasons for high NPAs and their impact on Indian banking operations. Besides, management of credit risk and measures to control the threat of NPAs are also discussed.

**Jha and Sarangi (2011)** analyzed the performance of seven public sector and private sector banks for the year 2009-10. They used three sets of ratios, operating performance ratios, financial ratios, and efficiency ratios. In all eleven ratios were used. They found that Axis Bank took the first position, followed ICICI Bank,BOI, PNB, SBI, IDBI, and HDFC, in that order.

**Nikhil Prasad (2011)** submitted a project report on , “ Comparative Analysis of NPA of Public Sector Banks, Private Sector Banks and Foreign Banks” . Under this project , researcher studied concept of NPAs, NPA standard of RBI, reasons for and impact of NPAs, Evaluated the efficiency in management NPAs of different types of banks using NPA ratios and comparing NPA with profits.

**Kamalpreet Kaur and Balraj Singh (2011)** consider that the Non-performing assets are one of the major concerns for banks in India. The NPAs growth involves the necessity of provisions, which reduces the overall profits and shareholders' value. The extent of NPAs is comparatively higher in public sectors banks. To improve the efficiency and profitability the NPAs have to be scheduled. Various steps have been taken by government to reduce the NPAs. An attempt is made in the paper that what is NPAs? The factors contributing to NPAs, the magnitude of NPAs, reasons for high NPAs and their impact on Indian banking operations. Besides capital to risk weight age assets ratio of Public and Private sector banks, management of credit risk and measures to control the menace of NPAs are also discussed.

**Sandeep and Parul Mital (2012)** analysed the comparative position of nonperforming assets of selected public and private sector banks in India to find their efficiency through comparative study. Data has been collected from various secondary sources for period of 10 years and analysed with descriptive statistics and ANOVA. All the banks are making polices trying for the containment of NPA“S for improving their asset quality and profitability. PNB and HDFC banks are found superior in management of NPA“S comparative to SBI and ICICI and private sector banks are much comfortable and efficient comparative to public sector banks.

**Samir and Deepa Kamra (2013)** in their paper analyses the position of NPAs in selected banks namely State Bank of India (SBI), Punjab National Bank (PNB) and Central Bank of India (CBI). It also highlights the policies pursued by the banks to tackle the NPAs and suggests a multi-pronged strategy for speedy recovery of NPAs in banking sector. The study spans the period starting from 1996-1997 to 2009-2010. The authors analyze the trends in NPAs in terms of values, gross and net NPAs as a percentage of gross advances and net advances, gross and net NPAs as a percentage of Total Assets respectively. The paper details about the sector-wise classification of NPAs, reasons for their occurrence, the effects of NPAs on 13 banks, and frequency distribution of public sector banks by ratio of net NPAs to net advances

**Garg Sambhav (2013)** an attempts has been made to compare different bank groups as well as bank- wise data relating to Gross NPAs to Gross Advances. The paper also shows Priority and Non- Priority Sector Advances of Scheduled Commercial Banks. The present study highlighted that all the Indian banks are facing the challenge of NPAs and intensity of NPAs is much higher in Public Sector Banks. It shows that earlier Public Sector's NPAs was more as compared to Public Sector Banks. However, now it has been managed at lower end.

### Books

The study made by **Prof. E. Gordon and Dr. K. Natarajan** who published a book on, "Banking Theory , Law and Practice" in Himalaya Publishing House . In this book they studied Magnitude of NPA, factors contributing to NPAs like internal factors , external factors and other factors. Early Warning Signals like financial, operational , banking, managerial and External signals were discussed . Management of NPAs by adopting some techniques are discussed in this book.

**Dr. P.K. Srivastava** had written a book on "Basics of Banking & Finance" which is published in Himalaya Publishing House. In this book author had discussed Norms for treating different advances as non-performing, Impact of NPAs , Assets classification , Some important aspect on provisioning of NPAs , Guidelines for classification of Assets , NPA- recovery measures , Sector –wise NPAs of public sector banks , Reasons for NPAs , RBI tightens norms for Bank's Non- performing lease assets etc.

### Study of NPA in International Context

**Prashanth K. Reddy (2002)** in his research paper on the topic, "A comparative study of Non Performing Assets in India in the Global context" examined the similarities and dissimilarities, remedial measures. Financial sector reform in India has progressed rapidly on aspects like interest rate deregulation, reduction in reserve requirements, barriers to entry, prudential norms and risk-based supervision. The study reveals that the sheltering of weak institutions while liberalizing operational rules of the game is making implementation of operational changes difficult and ineffective. This paper deals with the experiences of other Asian countries in



handling of NPAs. It further looks into the effect of the reforms on the level of NPAs and suggests mechanisms to handle the problem by drawing on experiences from other countries.

**Isaac k. Otchere (2005)** conducted a study on the performance of privatized banks in middle and low income countries shows mixed results by “ Competitive and value effects of bank privatization in Developed countries .” The paper observed that private banks in developed countries have experienced significant improvements in operating performance. A comparison of the performance of privatized banks in developed and developing countries suggests that privatization has encouraged excessive risk taking among privatized banks in developing countries with the consequence that those banks carry large NPAs than their counterparts in the developed countries . They also observed that consistent with the competitive effect hypothesis, investors view privatization announcements as foreshadowing bad news for rival banks.

**Thomas P. Ferguson (2007)** conducted a research on “Observations on the Securitization of Non-Performing Loans in Russia”. Asset securitization is a 15 burgeoning trend in Russia as companies burdened by poor credit ratings seek access to capital at lower costs than they would be allowed in traditional equity or debt markets. Study indicates that securitization of these bad loans has not occurred in Russia at the levels one might expect. This has been due to both a relatively small amount of loans that under-perform as well as legal and regulatory impediments that have discouraged investors and lenders alike. The study has been conducted to examine the expansion of consumer credit in Russia and the circumstances under which it is occurring indicate that the level of non-performing loans is due to rapidly increase and as the rationale for maintaining the impediments that stand in the way of securitizing these loans is being re-examined, those impediments are being scaled back to make way for market participants to engage in such securitizations. Thus, this article anticipates a significant rise in the level of non-performing loans, which will be logically paired with an increased interest of Russian lenders in securitizing these assets.

**Nelson M. Waweru et.al (2009)** study that many financial institutions that collapsed in Kenya since 1986 failed due to non performing loans, this study investigated the causes of nonperforming loans, the actions that bank managers have taken to mitigate that problem and the level of success of such actions. Using a sample of 30 managers selected from the ten largest banks the study found that national economic downturn was perceived as the most important external factor. Customer failure to disclose vital information during the loan application process was considered to be the main customer specific factor. The study further found that Lack of an aggressive debt collection policy was perceived as the main bank specific factor, contributing to the non performing debt problem in Kenya.

## Conclusion of the Literature Review

After studying all these research papers, some major points can be concluded, like NPA are becoming a major threat to the profitability of both Public as well as Private sector banks. The level of NPA is more in Public

sector banks than private banks and the most important reason of high level of NPA in public sector banks is priority sector lending or directed loan system. Besides this, various studies show that the other important reason for rising NPA level are poor credit appraisal system and poor follow up of the borrower. And credit rating information about the borrower is also not available. Among the important ways of curbing rising NPA level is that banks should have their own independent credit agency and a proper credit appraisal of the projects should be done before granting loan to anyone. And effective follow up should be done once the loan is granted. Changes in legal framework as well as government policies regarding priority sector lending needs to be changed.

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