Chapter II

CHAPTER II

REVIEW OF LITERATURE

2.1 Introduction

"Literature" means "sources of information" or "research". A literature review is a critical analysis of a part of a distributed body of knowledge through summary, classification and comparison of prior research studies and theoretical articles. The review of literature guides the researcher for getting better understanding of the methodology, limitations of various accessible estimation procedures, database, lucid interpretation and reconciliation of the incompatible results. The reviews of earlier studies explore the avenues for present and future research related to the subject matter. This chapter summary reviews related to the performances of scheduled commercial banks in India and its NPAs management practices.

2.2 Performances of Scheduled Commercial Banks

The banking industry in India has endured a vast change in the first stage of economic liberalisation in 1991; As a result various norms have been set from time to time by various committees. The reviews related to the performances of Scheduled Commercial Banks have been discussed in this section of the study.

Robert (1991) study attempted to analyse the trends in profitability, and to evaluate the efficiency of operation in public sector banks and for the banking industry as a whole. The study covered 14 nationalised banks in 1969. The banks were classified as large-scale, medium scale and small-scale banks to make inter-bank comparisons. The study covers a period of 15 years from 1973 to 1987. Herfindhal's index of concentration was applied to study the performance of each unit of the system with reference to the system as a whole. The study found that out 14 banks considered for analysis 12 banks showed the decline in profitability and only two earned profit during the study period.

Jagwant (1993) book titled 'Trends and Changes in Productivity' with particular importance on employee and productivity of branch in the Indian banking industry. The study determines the level of productivity and its growth during the period 1969-85. The 22 public sector banks i.e. banks of the SBI group and 14 nationalised established in

1969 have been taken as a sample for the study. The study attempts to make the cross-sectional and inter-temporal analysis on the base of 17 indicators. The indicators have been divided into three categories which measure labour efficacy, branch productivity and financial output. t-scores have been used for giving ranking to the banks. The ranking analysis of the banks reveals that most significant improvement was achieved by Indian Bank and Indian Overseas Bank. United Commercial Bank recorded maximum decline in terms of its productivity. The performance of State Bank of India was better.

Chidambram and Alamelu's (1994) study analysed the Profitability Position of Public Sector and Private Sector Banks. The study findings pointed that Indian Public Sector Banks profits have registered a declining phase in comparison to their counterparts Private Sector Banks. The study also observed that in spite of similar social obligations; almost all the private sector banks have been registering both – high profits and high growth rate with respect to deposits, advances and reserves as compared to the public sector banks. Regional orientation, better customer services, right monitoring of advances and suitable marketing strategies were the secrets behind the success of private sector banks in India.

Subramanian and Swami's (1994) research paper had analysed and compared the efficiency of six public sector banks, four private sectors and three foreign banks between the years 1996-97. Operational efficiency was calculated in terms of total business and salary expenditure per employee. The study finding revealed that among the PSBs, Bank of Baroda registered high efficiency and operating profit per employee. The study also found that among the private sector banks Indus Bank followed by Citibank registered highest and second highest operating profit per employee respectively. The performance of the nationalized banks revealed wide variations in their operational efficiency.

Jadhav and Ajit (1996) study examined the role of banks in the economic development of India during the last five decades. The study observed that in spite of overall progress made by banking systems in terms of functional and it has experienced low geographical coverage and high NPAs (Non-Performing Assets). The study also commented that though financial division transformations have been made clear to the

balance sheets and improves the functionality systems, yet there are some challenges facing with concern to financial services i.e., merchant banking, mutual funds, leasing, money market and government securities.

Bhattacharyya et al., (1997) study aimed to analyse the performance of banks before liberalisation of economic reform in 1990.The study covered 70 banks during the period from 1986 to 1991. The findings of the study revealed a high level of efficiency of the banks under study. It has also found that the foreign and private banks have much lower efficiencies. The study results also confirmed that PSBs (Public Sector Banks) have started showing a decline in efficiency after 1987 and the private banks showed a sharp rise in efficiency. The result of the study has revealed that in the era of nationalised public sector banks have been successful in achieving their principle objective of deposit and loan expansion.

The Financial Express (1998) published its report on the performance of the commercial banks for the period 1997-1998. The performances of banks have been categorised on the basis of financial, operational, profitability and productivity. A total of 98 banks were considered for the study out of which, 27 were public sector banks, 33 banks were private sector banks and 38 banks were foreign banks. The results of the study revealed that the ANZ Grind lays Bank stood first in overall ranking, followed by the State Bank of Mauritius (Second place) and the Bank of America (Third position). The study also found that the public sector banks dominated the top 15 with the State Bank of India stood at the leading position. In terms of productivity, the Bank of America stood at the top position and followed by the Bank of Nova Scotia.

Sarkar et al., (1998) study aimed to analyse the impact of ownership pattern on the performances of scheduled commercial banks in India. The study has found that the foreign banks have been more profitable and efficient than Indian banks and amongst the Indian banks, private banks have been superior to the public sector banks. The study had concluded by stating that the non-traded private sector banks (unlisted in stock exchanges) had not differed significantly from that of public sector banks with respect to profitability and efficiency.

Bhatia and Verma (1999) research work aimed to determine empirically the factors that influenced the profitability of PSBs (Public Sector Banks) in India. Net Profit as a percentage of working funds has been used to measure the bank profitability during 1971 to 1995. The study found that priority sector advances; fixed/current deposit and establishment expenses affected the profitability of PSBs negatively. Net spread, which to a great extent depends on the management efficiency of the banks positively and significantly influenced its profitability. The high credit-deposit ratio has also been observed to be influenced profitability positively. However, its impact has been found to be statistically insignificant.

Das (2000) empirical study estimated and compared the various efficiency measures of 27 public sector banks in India for the year ending 31st March 1998 under the framework of Data Envelopment Analysis (DEA) model. The study also examined the issue of how far a bank can increase its outputs by augmenting its efficiency was through the optimal deployment of resources. The components of the efficiency were considered in the study to measure the overall efficiency, technical efficiency, allocate efficiency and scale efficiency. The results of the study revealed that during the year 1998, the public sector banks had the scope of producing 1.23 times of the present amount of outputs from the same inputs. The technical efficiency of the State Bank Group stood at 96.5 per cent which was significantly higher than that of the nationalized banks which stood at 75.1 per cent. There was very little variation in the allocative efficiency of all banks. The results of the study have also conveyed that there has been a negative relationship between the efficiency scores and the bank size. The study has suggested that with the existing level of non-performing assets the banks need to concentrate on the business of its existing branches.

The empirical study of **Ganeshan (2001)** aimed to identify the determinant of profitability of public sector banks in India. The study finding revealed the fact that establishment of profit function that is interest cost, interest income, deposits per branch, credit to total assets, a proportion of priority sector advances and interest income loss are the significant determinants of the profits and profitability of Indian public sector banks.

Bisht and Mishra (2002) study focused its analysis on measuring the effect of liberalisation on Indian banking. The study findings highlighted that the banking structure from 2001 is experiencing a process of expansion, reorganisation, and consolidation

which have been going on for many years and can be perceived in their important phases such as pre-nationalization phase, post-nationalization phase and post-liberalization phase. The study also highlights by stating that with the advent of the internet, one can distinctly perceive the arrival of the fourth phase, which is expected lead to a mass structural change in banking by replacing brick and mortar branches with the electronic delivery channels to provide more options to customers.

Bikrram De (2003) aimed to analyse the effects of ownership on bank performance in the context of an emerging Indian economy. The study found that with the entire sample of public sector banks, old private sector banks and new private sector banks ownership will not have any effect on the Return on Assets, but, public sector banks have higher Net Interest Margin and Operating Cost Ratio in comparison to their counterparts.

Gupta and Jain (2004) conducted a comparative study among various bank groups to assess the liability management in commercial banks in India in the era of liberalisation. The study examined the liability structure of 68 commercial banks operating in India for eight consecutive years i.e., from 1992 to 2000. The study paid special emphasis to assess the influence of ownership structure and size on the performance of the banks. The study finding revealed that debt for each unit of owned funds, which was consistent with limitation set by regulation. The study findings also revealed that after recapitalisation, nationalized banks have appeared closer to foreign banks in terms of leverage and the leverage of private banks were closer to the State Bank Group and although net worth to total assets ratio was the highest for small banks. The study also commented that with the notable exception of the foreign banks, the share of deposits had increased for all bank groups in the process of the study. The relative importance of various types of deposits seems to depend on the nature and scale of operations of the sample banks. Borrowings have constituted a minuscule part of total sources of funds for the sample banks.

Arrora et al., (2005) aimed to analyse the performance of PSB's (Public Sector Banks) in the post-reform period on the basis of four parameters. The study found that the performance of corporation bank in case of financial and operational parameters was higher in comparison to other PSB's under study. The study findings also revealed that the Indian Bank has recorded a low score in some parameters of operational performance.

On the other side, Vijaya bank had scored well in profitability parameters, but United Commercial (UCO) bank had scored negative growth in case of all parameters of profitability except operating profits as the percentage of working funds. In case of productivity, the Union Bank of India ranked well, but UCO bank is ranked lower. Overall, it has been concluded that Indian banking system is becoming increasingly mature in terms of revolution of business process and the desire for risk management.

Punita Rao (2006) aimed to investigate the impact of monetary policy on the profitability of banks in the context of financial sector reforms in India. The study discussed on the financial sector reforms and the implication of the banks, the various instruments of monetary policy in India, and its effect on monetary policy in the profitability of banks. The study found that the profitability and efficiency of banks were volatile. The study drew the reference for this volatility based on the economic condition and experts opinion on economic policy reforms. The inter-bank's preferences were also considered for assessing the bank's operational efficiency.

Sathishkumar and Balasubramanian (2007) aimed to assess the financial performance of private sector banks in India. The study commended that private sector banks play an important role in the development of Indian economy. After liberalization, the banking industry underwent major changes. The economic reforms completely changed the banking sector. RBI permitted new banks to be started in the private sector as per the recommendation of Narashiman committee. The Indian banking industry has been dominated by public sector banks. But now the situations have replaced the new generation banks with the use of technology and professional management has gained a reasonable position in the banking industry.

Kumar and Gulati's (2008) aimed to analyse the effect of size and group affiliation on the Technical Efficiency (TE) of Indian Public Sector Banks (PSBs) from a cross-sectional perspective. The empirical results of the study found that the extent of TE in the Indian public sector banking industry has been to the tune of 88.5 per cent. Further, the study observed that the level of technical inefficiency primarily influences the managerial performance and in organising inputs (i.e., pure technical inefficiency) rather than divergence of the actual scale of operations from the most productive scale size

(i.e., scale inefficiency). Regarding group affiliation, the results have revealed that the banks affiliated to State Bank of India group are more efficient than the nationalized banks. The relationship between size and technical efficiency had indicated that the small banks are more efficient than their large counterparts. In addition, the study found that the larger the bank in terms of total assets, higher in the level of its efficiency does not hold a good position in Indian public sector banking industry.

Ramachandran and Kavitha (2009) viewed the importance of improving the profitability performance of the banking sector in recent years. A census study was adopted by covering all the Indian scheduled commercial banks, which have been divided into three groups i.e., the SBI group, the Nationalized Banks group and the Private Banks group with two sessions, i.e., Period I and Period II by dividing the 10 year-study period into the first five years and the last five years. The step-wise multiple regression analysis was applied. The study found that SBI group have revealed efficiency in managing provision and contingencies to total expenses. The nationalized banks group is revealed efficiency in managing provisions and possibilities to total expenses in the first half of the study period and Capital Adequacy Ratio (CAR) during the second half of the study period. Whereas, the study observed that the private sector banks exhibited efficiency in the effective management of other interest expenses ratio to capital adequacy ratio.

Das (2010) aimed to analyse the performance of the Indian banking sector in the beginning of financial liberalisation and also has aimed to measure the cost efficiency in the post-reform period of Indian banking sector. The study found that, after deregulation, the banks concentration on social welfare concentration had declined which resulted in increasing competition among bank groups. The share of private and foreign banks in banking asset, deposit and credit had risen. The profitability of all bank groups had raised, but the foreign banks have been more profitable. The study concluded by stating that after financial liberalisation there has been no substantial change in the cost efficiency of the public sector banks. The finding also revealed a marginal decline in public sector banks for a cost in the post-reform period. A comparison among various bank groups in the post reform period revealed that the domestic private banks are becoming more efficient in comparison to the public sector and the foreign banks. The study has also found that the public sector banks are functioning additional cost efficient than the private and the foreign bank's counterparts.

Siva and Natarajan (2011) analysed the CAMEL Rating Scanning (CRS) of SBI Groups. In order to measure the financial performance of SBI group through CAMEL (Capital Adequacy, Asset Quality, Managerial Efficiency, Earning and Liquidity) rating, eight constituents of SBI group have been selected using evaluator type of research methodology. The study found that there exists a significant difference in ratios in CAMEL among the SBI group in India.

Prasad and Ravinder (2012) study analysed the efficiency of nationalised banks in India by applying CAMEL MODEL. The performances of twenty nationalized banks in India have been analysed through CAMEL model for the period from 2005 to 2010. The study findings revealed that one or the other aspects of ratios of some banks are in the top position. It has been concluded that the following banks have been holding top five positions namely, Andhra Bank, Bank of Baroda, Punjab and Sindh Bank, Indian bank and Corporation Bank. The study found that Central Bank of India, Bank of Maharashtra, UCO Bank, United Bank of India, and Vijaya Bank have been the least five position in terms of their poor performance.

Uppal and Amit (2013) attempted to analyse the competitive status of banks based on their profitability in pre and post e-banking period. The study period was distributed as 1996-2001 (Pre e-banking period) and 2001-2012 as post e-banking period. Five bank groups namely nationalized banks, SBI and its Associates, old private sector banks, new private sector banks and foreign banks were selected and their profitability trends had evaluated in pre and post e-banking period. The study found that among the five selected bank groups, foreign bank group was the most profitable bank group as it exhibited a decline in its burden and an increase its spread and also registered the significant increase in its net profit/working funds, net profit /total income and net profit/total deposits. The study also found that bank groups are successful in utilising the benefits of e-banking channels for its profitability.

Devanadhen (2013) studied the performance of fourteen public sectors and three private sector banks under CAMELS model for the period of 2000 to 2011. The study found that the liberalised environment, the private sector banks gave very tough competition to the public sector banks in terms of earning capacity, management efficiency, and asset quality.

It has also been found that in the Public Sector Banks (PSBs) category Andhra Bank secured the first place followed by Corporation Bank and HDFC (Housing Development Finance Corporation) Bank in terms of their performance. Axis Bank and ICICI bank had been ranked in the sixth and fourteenth place respectively. Central Bank of India stood the last place in terms of its overall performance and SBI (largest public sector bank) exhibited better performance than ICICI Bank.

Makkar and Singh (2013) conducted a study to assess the comparative status of the financial performance of Indian commercial Banks. The study considered a sample of 37 banks (22 public and 15 Private Bank) for the period from 2006-07 to 2010-11. CAMELS rating methodology had been applied to measure the performance of the sample banks. The study found that the IDBI registered best performing bank, followed by Kotak Mahindra Bank and ICICI Bank. It was found that Dhanalakshmi Bank had exhibited the worst performance followed by Jammu and Kashmir Bank and Karnataka Bank. The results of t-test disclosed that there exists a significant difference in the capital adequacy, asset quality and earning capacity of public and private banks in India, while there exists no significant difference in the management, liquidity position and sensitivity to market risk of the two different bank group. The study concluded by stating that on an average, there exists no significant difference in the financial position of the public and private sector banks in India, it is essential for overall improvement in the public sector banks to make their position strong in the competitive market.

Sinha and Sharma (2014) aimed to analyse the impact of bank specific, industry- specific, and macroeconomic factors affects the profitability of Indian Banks in a dynamic model framework. They commented that the Indian banking sector is not far away from becoming a perfectly competitive industry. Bank specific variables namely; capital to assets ratio, operating efficiency and diversification has been found to be significantly and positively affecting the bank’s profit. Credit risk, measured by provisions for bad debts, negatively impacted the bank profitability. The findings stated that the crisis period did not make any significant effect on profitability of banks. The study concluded that there exists a moderate degree of persistence of bank profits and most of

the elements of profits have a positive and a significant impact on the profitability of banks which implies that Indian Banks those were functioning in the last decade are moving towards efficiency and dynamism.

Mamanshetty (2015) aimed to examine the difference in various aspects of the working results of the public sector banks and private banks in comparison with foreign banks. The study found that with the increasing levels of globalisation in the Indian banking industry and evolution of universal banking concept, bundling of financial services and competition among the bankers will intensify further. The banking industry has the positional and ability to rise to the occasion as proven in the quick pace of automation which has already had an insightful impact on increasing the standard of banking services.

Sodhi and Waraich (2016) provide insights on the financial performance of the selected banking companies. The study found that SBI scores the highest average in terms of Earnings Per Share and registered negative performance in all the parameters except for Net Profit Margin. Bank of Baroda registered positive CAGR (Capital Adequacy Gearing Ratio) in P/E Ratio and D/P Ratio. PNB (Punjab National Bank) has performed the best in terms of Operating Profit Margin and D/P Ratio. HDFC bank scores a higher average than other banks in Net Profit Margin, Return on Equity and P/E Ratio and the highest CAGR in terms of Net Profit Margin. ICICI Bank had the highest CAGR in Operating Profit Margin and Return on Equity stood high terms of in D/P Ratio. The study observed that the selected public sector banks' Net Profit Margins (NPMs) dropped after 2013, which has impacted their core profitability significantly. Given the improvement in assets, the public sector banks are likely to improve their NPMs. Return on Equity of public sector banks dropped significantly after 2013. However, it is expected to improve in future. The study also suggested that public sector bank's credit provisioning could decline if they were able to control the NPA generation rate. Also, continuous decline in G-sec yields and surge in equity markets could offer a marginally higher treasury income to banks in the coming years. The study concluded by stating that for the past few years banks have seen a slowdown in their operation and business performance because of high inflation, depreciation of the rupee and economic slowdown. However, private sector banks have still performed better than PSBs in terms of growth and profitability.

From the above stated literature of past studies, it has been clearly inferred that the Indian banking system is in the transition period, as the nation is experiencing the pros and cons of economic liberalization. The performance of the private sector banks depicted positive growth after the linearization of the economy, whereas the public sector banks are facing certain difficulties in passing positive growth since its primary object is social welfare. However, it is an undeniable fact that the competitive strength of this sector banks has increased over the years.

2.3 Growth of Retail Loan Market in India

In India, until the initiation of financial sector reforms in the 1990s, there were too many restrictions in retail credit and limits on the total amount of housing loan, loans distributed to individuals, interest rate, security margin requirement, and prescription of maximum repayment period etc. However, banks were granted the independence in the early 1990s to decide the quantum, rate of interest, margin requirement, repayment period and other associated conditions of retail loans. It has a positive impact on the growth of personal loans in the second half of the 1990s. This section of the study has summarised reviews on a growth of retail loan market in India.

According to **RBI report (2004)**, there are various types of retail loan products offered in Indian market by retail banks for consumers like housing loan, education loan, auto loan, credit cards, personal loans, car loans, mortgage loans, insurances capital loans etc. These retail loans are offered at a much cheaper rate with personal attention and care. Different banks have given the unique attractive brand names to these loans to differentiate their products from the products of other competitors' bank.

Gopinath (2005) claims that the growth of retail lending, especially, in emerging economies is attributable to the rapid advances in information technology, the evolving macroeconomic environment, financial market reform and various micro-level demand and supply side factors. India too experienced a surge in retail banking. The retail loan is estimated to have accounted for nearly one-fifth of overall bank credit. The housing sector is experiencing an increase in its credit. The retail loan market has decisively got transformed from a sellers' market to a buyers' market. The popular saying most related

to the growth of retail loan market in India is that "Gone are the days where getting a retail loan was somewhat cumbersome". All these statements emphasise fact that the retail banking has gained a momentum in the Indian economy in recent years.

According to **Paul and Mukherjee (2006)**, the sharp rise in retail bank credit was facilitated by the changing consumer demographics and socio-economic changes, has gained due to changing occupation status of both men and women and increase their income level. Moreover, India is endowed with the highest proportion of the young population with higher borrowing capacity. Convenient in terms of retail loan borrowing practices has motivated many of the youth working in Information Technology (IT) sectors to avail retail loans from banks.

According to **RBI's Report on Credit Market (2007)** the credit market in India has traditionally played a major role in meeting the financial needs of various segments of the economy. Credit institutions range from well- advanced and large sized commercial banks to Development Finance Institutions (DFIs) to localised tiny co-operatives. These financial institutions provide a variety of credit facilities like short-term working loans to corporates, medium and long-term loans for financing large infrastructure projects and retail loans for several purposes. Unlike other segments of the financial market, the credit market in India is well spread throughout the country and it touches the lives of all segments of the population.

According to **Misra (2009)**, retail lending by banks in India gathered drive following financial sector reforms in the 1990s. Till then, most of the banking credits were focused on agriculture, industry and commerce. The major role of bank lending till then was to support supply i.e., government agencies. To ensure that bank lending is provided to other than non-priority sector borrower the banking regulation were enhanced with various restrictions on retail credit such as limits on the total amount of housing loan and loan amount distributed to individual borrowers. Banks could lend only a quantified small percentage of their total lending to individuals for non-productive purposes. The regulator also enforced strict norms for the rate of interest, margin specification and maximum repayment period. These restrictions were gradually relaxed during the 1990s which paved the way for increased retail lending by Indian banks. During the period from

1992-93 to 2005-06, retail loans grew at an average annual growth rate of 28.40 per cent. The annual growth rate of retail loans immersed below the overall credit growth in the last two financial years, viz 2006-07 and 2007-08. Even in the financial year 2008-09, the retail loans growth rate was predicted to lag behind the overall credit growth rate.

Srinivasan (2011) stated that as per CRISIL (Credit Rating Information Services of India Limited) report 2011, five retail loans products: housing loans, Loan Against Property (LAP), car loans, two-wheeler loans and gold loans are highly demanded in the top fifteen tier II cities across India, the tier II markets are: Bhopal, Coimbatore, Indore, Jaipur, Kanpur, Kozhikode, Lucknow, Ludhiana, Madurai, Mysore, Nagpur, Nashik, Rajkot, Thiruvananthapuram and Vishakhapatnam. These markets are significant in terms of size and together account for about 15 per cent of the demand for retail loans in India.

Bag's (2012) attempted to examine macro trends in personal finance in India and to understand their implications for the policy makers in emerging markets like India. The study found that increase in employment in the organised sector has certainly enhanced the demand for retail credit. The gap between the income and debt levels is increasing which confirms that the scheduled commercial banks operating in India have to assess their credit policy to fulfill the needs. The study concluded by stating that with or without financial inclusion, a large section of the population or households has remained unserved with retail credit products and the gap between incomes to debt at the retail level is increasing. A prevailing level of riskiness in few risk segments may deter the banks towards a policy of open credit culture. The study suggested that the banks need to have a lending mindset by having better credit management tools instead of signing away from new sanctions. This can actually improve the credit eligibility and also build a culture of credit taking among the bank customers. The study highlights the need for persistent emphasis on economic growth by the policy makers, will help the banks to sustain the credit quality in the economy and ensure the well-being of improving economy both customers and the banks.

As per **ICRA (Indian Credit Ratings Agency) report (2014)** retail loans market in India remains in focus with good asset quality, although lending yields are lower. The report highlights the fact that with asset quality in retail loans showing resilience to a

slowing economy and in the absence of adequate lending opportunities elsewhere, banks' retail loan portfolio grew by 15.5 per cent during the year 2013-14, which was 14.7 per cent during 2012-13. Within retail, housing loans which account over 50 per cent of banks' retail loan, gained the most reporting 18.4 per cent growth during 2013-14. Vehicles loans, on the other hand, grew 17.4 per cent during 2013-14. Further the report stated that banks' retail loan is expected to report faster growth than the overall credit growth, which considers the increasing focus of banks on housing and vehicle loans despite this segment being low interest yielding vis-à-vis corporate loan segment. The report also mentioned that the increase in the share of retails loans in total credit portfolio of banks could be lending yields dilutive however same is expected to offset by low credit provisioning in the segment vis-à-vis corporate loans.

Chadha (2015) stated in their study that the growth of retail lending, especially in emerging economies like India is due to the rapid up gradation in information and technology, financial market reforms and several demands and also due to influences of supply side factors. In India, a retail loan is estimated to have accounted for nearly one-fifth of all bank credit. Housing sector is experiencing a boom in its credit. The study stated that the future prospects for retail banking have emerged as the showcase of innovation and development, through various products like personal loan, home loans, educational loans, deposits, credit cards and depository services. The report commented that there is a need of constant innovation of retail banking services.

Nayak (2016) stated that as far as banks' loan risk matrix is concerned, with weak corporate demand and risks associated with infrastructure lending, retail lending is perceived to be safe as these loans are well collateralised. Private sector banks have avoided risky sectors and focused on SMEs (Small and Medium Enterprises) and retail insist on appropriate collaterals and mortgages.

Few kinds of literatures discussed in this sub-section throw light on the causes and reasons that influenced the growth of retail credit market in India.

2.4 Impact of NPAs on the Performances of Banks in India

Non-performing asset has become an important parameter in the analysing the financial performance of a bank, as the problem of raising Non-Performing Assets

(NPAs) is mounting day by day. Due to mounting NPA's the profits are declining and higher provisioning are created by for meeting out the doubtful debts. Few literature reviews on this issue are discussed in this section of the study.

Sergio (1996) aimed to assess the cyclical pattern and sectoral risk arisen for a bank due to its non-performing loan assets. The study comment that the banking business is exposed to various risks such as credit risk, liquidity risk, interest risk, market risk, operational risk and management risk. But, credit risk stands out as the most damaging of them all. The risk of erosion in asset value due to simple default or non-payment of dues by the borrowers is credit risk or default risk. This study disproved that business cycle could be a primary reason for banks' NPAs. The study emphasised that increase in bad debts is the consequence of the economic recession.

Fuentes and Maquieira's (1998) aimed to examine variables that may affect loan repayment: (a) limitations on the access to credit (b) macro-economic in stability (c) collection technology (d) bankruptcy code (e) information sharing (f) the judicial system (g) pre-screening techniques and (h) major changes in financial market regulation in the Chilean credit market. The study observed a satisfactory performance of the Chilean credit market. The study finding stated that the credit market function i.e., loan lending and loan repayments are based on a good information sharing system, an advanced collection technology, macroeconomic performance and major changes in the financial market regulation.

McGoven (1998) studied on the causes of bad banks occurrences from the bankers point of view. The study found that banks have suffered loan losses through relaxed lending standards, unguaranteed credits, the influence of the 1980s culture and the borrowers' perceptions. Thus, the author suggests that bankers should make a fairly accurate personality-morale profile for assessment of prospective and current borrowers and guarantors. Besides considering personal interaction, the banker should (i) try to draw some conclusions about staff morale and loyalty, (ii) study the person's personal credit report, (iii) do trade-credit reference checking, (iv) check references from present and former bankers and (v) determine how the borrower handles stress. In addition, banks can minimise risks by securing the borrower's guarantee, using Government guaranteed loan programs and by calculating conservative loan-to-value ratios.

Keeton (1999) study aimed to analyse the impact of credit growth and loan delinquencies in the US. The study used data from 1982 to 1996 and vector auto regression model for analysis. In this study loan delinquency was defined as loans which are overdue for more than 90 days or does not accrue interest. The study reports evidence of a strong relationship between credit growth and impaired assets. Specifically, the study revealed that rapid credit growth, which was associated with lower credit standards, contributed to higher loan losses in certain states in the US.

Kent and Arcy (2000) examined the relationship between the cyclical lending behaviour of banks' in Australia and influence of economic growth cycle on the lending practices of the banks. The authors argued that the potential for banks to experience huge losses on their loan portfolios increases towards the peak of the expansionary phase of the cycle. The study identified that towards the top of the cycle, banks appear to be relatively healthy that is, non-performing loans are less and profits are high, reflecting the fact that even the riskiest of borrowers tend to benefit from buoyant economic conditions. While the risk inherent in banks' lending portfolios peaks at the top of the cycle, this risk tends to be realised during the contractionary phase of the business cycle. At this time, banks' non-performing loans increase, profits decline and substantial losses to capital may become apparent. Eventually, the economy reaches a channel and turns towards a new expansionary phase, as a result the risk of future losses reaches a low point, even though banks may still appear unhealthy at this stage in the cycle.

Lis et al. (2000) aimed to assess credit growth, problem loans and credit risk provisioning in Spain. The study used simultaneous equation model in which the described bank loan losses in Spain using a host of indicators included Gross Domestic Product (GDP) growth rate, debt-equity ratios of firms, regulation regime, loan growth, bank branch growth rates, bank size (assets over total size), collateral loans, net interest margin, Capital Asset Ratio (CAR) and market power of default companies. The study found that GDP growth (contemporaneous, as well as one period, lag term), bank size, and CAR had the negative effect, while loan growth, collateral, net-interest margin, debt-equity, market power, the regulation regime and lagged dependent variable had the positive effect on loans. The effect of branch growth could vary with different lags.

Bloem and Gorter (2001) commented a more or less predictable level of non-performing loans, though may vary slightly from year to year, is caused by an inevitable number of wrong economic decisions by individuals and uncontrollable factors (extreme weather, unexpected price changes for certain products, etc.). Under such circumstances, the banker can make an allowance for a normal share of non-performance in the form of bad loan provisions or they may spread the risk by taking out insurance. The authors comment that due to an occurrence of default payment banks' non-performing loans increase, profits decline and substantial losses to capital may become apparent. The authors say that increasing non-performance assets of banking sectors effects the economic growth and leads to the risk of unhealthy financial cycles in the future.

Khan and Bishnoni (2001) mentioned that Narasimhan Committee have been proceeding the banking reforms in India and the committee highlights the high level of NPAs poses a serious hurdle for the growth of schedule commercial banks operating in India. The author concluded the study by stating that the loss of income from NPAs not only brings down the level of income of the banks but also hinders them from quoting finer Prime Lending Rates (PLR).

Bercoff et al. (2002) using Accelerated Failure Time (AFT) model in their study analysed the Argentina's banking sector's weakness. The bank's weakness are measured by the ratio of non-performing loans to total loans. The study found that specific indicators of the bank such as growth of asset, the ratio of net worth to net assets, the ratio of operating cost to assets, exposure to Peso loans and institutional characteristics relating to private bank and foreign bank and macro-economic variables including growth of credit, foreign interest rate, reserve adequacy (imports/reserves) and monetary expansion, besides the effect of tequila were reasons behind the fragility banking. The empirical results of the study suggested that bank size measured by the log of assets had a positive effect, but asset growth had a negative effect on NPLs (Non Performing Loans). The study also found the variables such as operating cost, exposure to peso loans, credit growth, and foreign interest rate had the negative effect on NPLs. The macro-economic variables such as money multiplier and reserve adequacy, institutional characteristics and tequila effect had a positive influence on NPLs.

Reddy's (2002) empirical study focused on analysing the comparative status of Non-Performing Assets in India in the global context and its similarities and dissimilarities and remedial measures to be prevented NPAs. The study emphasised the importance of a sound understanding of the macro-economic variables, systemic issues pertaining to banks and the economy for solving the NPAs problem along with the criticality of a strong legal framework and legislative framework. The study suggested that the foreign experiences must be utilized along with a clear understanding of the local conditions to create a tailor made solution, which is transparent and fair to all stakeholders.

Rajaraman and Vasishtha (2002) empirical study provided an evidence of the significant bivariate relationship between an operating inefficiency indicator and the problem loans of public sector banks in India. The study commented that the problem of NPAs was related to several internal and external factors confronting the borrowers. The internal factors were diversion of funds for expansion/diversification/modernisation, taking up new projects, helping/promoting associate concerns, time /cost over runs during the project implementation stage, business (product, marketing, etc.) failure, inefficient management, strained labour relations, inappropriate technology/technical problems, product obsolescence, etc. While external factors were a recession, like non-payment in other countries, inputs/power shortage, price escalation, accidents and natural calamities.

Jimenez and Saurina (2003) used logit model for analysing the determinants of the Probability of Default (PD) of bank loans in the terms of variables such as collateral, type of lender and bank-borrower relationship while controlling for the other explanatory variables such as size of loan, size of borrower, maturity structure of loans and currency composition of loans. Their empirical results of the study highlighted that collateralized loans had a higher PD, loans granted by savings banks were riskier and a close bank-borrower relationship had a positive effect on the willingness to hire more risk. Bank loan size had a negative effect on default while maturity term of loans, i.e., short-term loans of less than 1-year maturity had a significant positive effect on default.

In an another study, **Mohan Rakesh (2003)** observed that lending rates of banks have not come down as much as deposit rates and interest rates on Government bonds. While banks have reduced their Prime Lending Rates (PLRs) to some extent and are also

extending sub-PLR loans, effective lending rates continue to remain high. This development has adverse systemic implications, especially in a country like India where interest cost as a proportion of sales of corporate is much higher as compared to many emerging economies.

Ranjan and Dhal (2003) aimed to explore an empirical approach to the analysis of commercial banks' Non-Performing Loans (NPLs) in the Indian context. The empirical analysis evaluates as to how banks' non-performing loans are influenced by 3 major sets of economic and financial factors, i.e., terms of credit, bank size induced risk preferences and macro-economic shocks. The empirical results from panel regression models suggest that terms of credit variables have a significant effect on the banks' non-performing loans in the presence of bank size induced risk preferences and macroeconomic shocks.

Sathe (2003) while studying the performance of Indian commercial banking sector found that the public sector banks performed better than their private sector counterparts with regards to their overall efficiency. The author also raised concern over the higher level of non-performing assets in the banking system and suggested that policies be implemented to reduce the bad loans.

Kaur and Pasricha (2004) assessed the transition of NPAs management in public sector banks over a period of eight years period 1995-2002. The study found that gross NPA of Public Sector Banks (PSBs) registered a constant increase from 1995-2002. This study pointed out the sector wise and bank wise position of NPAs in PSBs. The study suggested following a proper policy of appraisal, supervision and following up of advances for controlling the rising NPAs.

Reddy (2004) focused in the terms of credit such as interest rate charged to various productive activities and borrowers, the approach to risk management, and portfolio management in general by the RBI (Reserve Bank of India). The author mentions that there are three pillars on which India's credit system was based in the past; fixing of prices of credit or interest rate and quantum of credit associated with purpose; insists on collateral, and prescribing the end-use of credit. The author commented that the interest rate prescription and fixing quantum has been significantly reduced in the recent period. The study also emphasized the problems in security-based or collateralised lending, which need careful examination in the context of growing services sector. Furthermore, in the

context of NPAs on account of priority sector lending, it was pointed out that the NPAs of banks' lending to priority sector has marginal differences than banks' lending to the private corporate sector.

Khasnobis (2005) explained that the distribution of the NPAs in the Indian banking system followed an 80-20 rule, wherein 20 per cent of borrowers were responsible for 80 per cent of the value of impaired assets and vice versa. The study found that the large impaired assets which comprised industrial assets possess good restructuring potential. The small assets, however, should be put through a recovery process, in which the collateral- based financing practice followed by the banking system offered a fair recovery potential. The study suggested speeding up of the recovery process for successful NPA management in India.

Naik (2006) focused on the NPAs management challenges faced by the banking sector in India. The study pointed out that the nature of problems faced by the banks in NPAs management and concluded that government of India had to set ARCs (Assets Reconstruction Companies) to manage NPAs effectively.

Vibha (2007) clarified that in the early stages, the NPAs was mainly contributed by directed lending and significant government intervention. The analytical part evaluated the trend in the measure of NPAs during 1997-2003 and concluded that the root cause of NPAs is the inadequate credit risk management system. The author reiterated that the profitability of banks is invariably related to its alertness, operational efficiency, customer orientation, a creation of large volumes of performing assets and attainment of an optimum level of productivity.

Dash and Kabra (2010) aimed to analyse the sensitivity of non-performing loans to macroeconomic and bank-specific factors in India. The study employed regression analysis and a panel dataset covering 10 years (1998-99 to 2008-09) to examine the relationship among non-performing loans several key macro-economic and bank-specific variables. The study found that the quantity or percentage of Non-Performing Loans (NPLs) is often associated with bank failures and financial crises in both developing and developed countries. In fact, there is ample evidence that the financial / banking crisis in

India is preceded by high non-performing loans. The study stated that the current global financial crisis, which originated in the US, was also attributed to the rapid default of sub-prime loans / mortgages.

Prasad and Veena (2011) studied on the NPAs status of banking Sector in India. The study was focused on public sector banks and it concluded that PSBs, which currently accounted for more than 78 percent of total banking industry assets were saddled with NPAs, by falling revenues from traditional sources, lack of modern technology and a substantial workforce. Whereas the innovative private sector banks were forging ahead and rewriting the traditional banking business model by the way of their more innovation in service and also by an adoption of modern technology.

Ghosh and Ghosh (2011) aimed to identify the movement of the non-performing assets in public sector banks of India. The study focused on analyzing the financial performance of the banks with respect to key performance indicators and also aspired to assess the management of the non-performing assets under the purview of new policy actions and regulatory compliance of the RBI. The study found that NPAs management is the major challenges faced by the public sector banks in India at present. Thus, the study emphasised the PSBs to adopt effective management of non-performing assets in the outlook of the public sector banks in India beneath strict asset classification norms, to use latest technological platform based on Core Banking Solution (CBS), to frame recovery procedures and other bank specific indicators in the context of strict regulatory framework of the RBI.

Rani (2011) examined the existing position of NPAs in the scheduled commercial banks in India. The study assessed causes and remedial measures for raising NPAs. The study found that increased in the recent past and it has eroded the profits margin of the bank. The study stated that RBI has taken remedial measures for controlling fresh NPAs rise from time to time. The author comment that the though total elimination of NPAs is not possible in the business of banking so it is wise to follow the proper policy for appraisal, supervision and follow- up of advances to avoid NPAs.

Viswanathan et al. (2011) focused on the Asset Liability Management (ALM) process is multidimensional in nature. The objective of the study was to estimate, the relative importance of advances, investments, deposits and other income in predicting profits.

The study suggests the best possible trade-off solution for profitability which strikes an appropriate balance among the key drivers viz., advances, investments, deposits and other income (non-interest income), while simultaneously taking care of the regulatory and other constraints.

Aggarwal and Mittal (2012) aimed to analyse how efficiently public and private sector banks have been managing NPA. The study found that all categories of banks in India were facing a hard time managing their NPA. Moreover, the findings of the study revealed that magnitude of NPA was comparatively higher in public sectors banks compared to private banks.

Pradhan (2012) aimed to analyse the trend in NPAs of public sector banks in India in the post-reform period. The study found that the rate of decline in Gross NPA of PSBs has been extremely low during the last decade. There has been a noticeable enhancement in the quality of the asset with the percentage of Gross NPA to Gross advances reduced in the post-reform period. The study also commented that the Non-Performing Assets have been substantially reduced since regulations were being tightened in 1993, but due to the recent economic slowed down, the levels of NPA remained high for Indian banks in comparison to international standards.

According to **Selvarajan and Vadivalagan (2013)** in India, the amount of the problem of bad debts was not taken seriously. Subsequently, the following recommendations and some steps of Narasimhan committee and Verma committee were taken to solve the problem of old NPAs in the balance sheets of the banks. The authors said that the problem of NPA is not limited to only Indian public sector banks, but it prevailed in the entire banking industry. A major portion of bad debts in Indian banks arose out of lending to the priority sector at the dictates of politicians and bureaucrats. The authors commented that if only banks regularly had monitored their loans effectively, the bad debt problem would have been contained else it would affect banks liquidity and profitability positions.

Siraj and Pillai (2013) aimed to investigate the growth of selected NPA variables and compares it with banking performance indicators. The findings of the study revealed the quality of asset and efficiency of the bank which were highly correlated with each other. Thus, the efficiency of banking in post-liberalization period could be judged not only based on the profitability but also on the quality of assets it holds.

Mohnani and Deshmukh's (2013) provided an empirical approach to the analysis of profitability indicators with a focal point on Non-Performing Assets (NPAs) of public and private sector banks. The study found that NPAs reflected on the performance of banks. The study commented that non-performing assets were one of the major concerns for banks in India. The earning capacity and profitability of the banks were highly affected because of the existence of NPAs. The study pointed out that a high level of NPAs was caused due to the credit defaults by the borrowers that in turn affect the profitability and net-worth of banks.

Narula and Singla (2014) empirical study aimed to analyse the non- performing assets of banks in India. The study used the annual reports of Punjab National Bank (PNB) for the period of six years from 2006-07 to 2011-12. The study found that there was mismanagement of NPAs by the PNB. The findings of the study also revealed that there exist a positive relation between Net Profits and NPAs of PNB. It resulted in an increase of NPAs along with the rise in profits of the bank, as the NPAs of the PNB are mismanaged. The study suggested that effective measures to be taken by the bank to reduce its NPAs, as it is essential to improve the profitability of banks. Furthermore, the study suggested that the advances provided by banks required pre-sanctioning evaluation and post-disbursement control to constrain the rising non-performing assets.

Satpal (2014) compared non-performing assets of public and private sector banks in the new age of technology. The finding of the study revealed that extent of NPAs is relatively very high in public sectors banks as compared to private banks. Although various steps have been taken by the government to reduce the NPAs, still a lot need to be done to curb this problem. The NPAs level of banks in India is still high as compared to the foreign banks. Indian banks were unable to maintain a zero NPAs. The study suggested that the bank management should speed up the loan recovery process. Since the loan recovery problem is not vested with the only small borrowers but with large borrowers and a strict policy should be followed for solving this problem. The government should also make more requirements for soon settlement of pending cases and also it should reduce the necessary lending to a significant sector as it is the major problem

creating an area. In short, the study commented that the problem of NPAs required lots of serious efforts otherwise NPAs would keep killing the profitability of banks which is not good for the growing Indian economy in general.

Grover (2015) aimed to identify the reasons for an increase in NPA and aimed to measures taken by banks to recover the NPA. The findings of the study revealed that as per RBI data, the level of Gross Non-Performing Advances (GNPAs) acted as the percentage of total gross advances for the entire banking system which declined to 4 per cent in March 2014 from 4.2 per cent in September 2013. The Net Non-Performing Advances (NNPAs), of total percentage net advances, also declined to 2.2 per cent in March 2014 from 2.3 per cent in September 2013. This improvement in asset quality was due to the lower slippage of standard advances to non-performing advances and a seasonal pattern of higher recovery and write-offs that generally took place during the last quarter of the financial year. Sale of NPAs to Asset Reconstruction Companies (ARCs) in the light of the Framework on Revitalizing Stressed Assets (FRSA) could be another reason for this improvement. The study also observed that scheduled commercial banks stressed advances also declined to 9.8 per cent of the total advances from 10.2 per cent between September 2013 and March 2014. The study highlighted that the public sector banks continued to register the highest stressed advances at 11.7 per cent of the total advances, followed by old private banks at 5.9 per cent.

Rana (2016) aimed to assess the non–performing assets of public banks in India. NPA’s are further categorised and studied with respect to loan advances to priority and non-priority sectors. The study used the published reports of Reserve Bank of India for the period of ten years from 2004 to 2014. The study found that NPAs are continuously raising in the public sector banks in India and the amount and percentage share of NPAs of both in priority as well as the non-priority sector are continuously increasing since 2006. The study findings also revealed that public sector share in NPAs is continuously decreasing from the year 2010. The loans given to the public sector resulted in lesser NPAs as compared to priority and non-priority sector lending made by private sector banks which is a good sign of effective performance of the public sector banks in India.

From the literature discussion made in this section of the study, it has been inferred that non-performing assets affect not only the performance of banks as an individual organisation it also affects the economy of a nation at the large. The reviews highlighted various causes for rising NPAs i.e., both external and internal factors. The reviews also contain few valuable suggestion that may be implemented for overcoming the issue of rising NPAs.

2.5 Conclusion

From the detailed literature reviews, the researcher has gained knowledge about the growth of banking business in India, retail lending practices and side by side the rise of the debt non-recovery trend. From the literature reviews, it has been inferred that NPA is not only limited to Indian public sector banks, but it prevails in the entire banking industry. The NPAs level of Indian scheduled commercial banks is still high as compared to the foreign banks. It is not at all possible to have zero NPAs. The bank management should speed up the recovery process. One of the studies revealed and concluded that PSBs, which currently account for more than 78 percent of total banking industry assets are loaded with NPAs. Though there are many studies that had discussed on NPAs, it is observed that not many studies have been conducted in the past either on the growth of retail credit or on its recovery mechanism. Thus, identified research gaps have offered required scope for the conduct of this study.