DEPARTMENT OF ECONOMICS
GOVERNMENT DEGREE COLLEGE
JAMMALAMADUGU-516434

2022-2023

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ISSN NO. 2394- 8965 GJMMS
Vol. – 8, Issue – 2, April-June-2022

A Study of Non-Performing Assets of Commercial Banks and its Recovery in India

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Abstract

The increasing number of non-performing assets (NPAs) has been a significant challenge for the Indian banking industry. The expansion of NPAs directly affects the profitability of banks. One of the main issues facing India's scheduled commercial banks is non-performing assets. Following the Narasimham and Verma committees' recommendations, various actions have been taken to address the issue of historical NPAs on bank balance sheets. The lack of a comprehensive evaluation of the most effective approach to solving the issue is still being echoed everywhere. It appears that differing opinions exist regarding the best course of action to take in order to solve this issue. NPAs show how well banks are doing. A high percentage of non-performing assets (NPAs) indicates a significant likelihood of many loan defaults, which can have an impact on a bank's profitability and net worth as well as the asset's value. In addition to endangering the quality of assets and the viability of banks, NPAs have an impact on liquidity and profitability. NPAs are a problem that affects not only banks but the entire economy. In truth, the high level of NPAs in Indian banks is nothing more than an indicator of how well the market and business are doing. To improve the financial stability of the banking sector, NPAs must be reduced. In this essay, an effort is made to comprehend NPA, the state and trend of NPAs in Indian Scheduled Commercial Banks, the causes of NPAs, the reasons for the significant impact of NPAs on Indian Scheduled Commercial Banks, and the many methods of NPAS

recovery.

Keywords: *Scheduled Commercial Banks, Narasimham Committee, Non-Performing Assets (NPA),*

INTRODUCTION

Commercial and cooperative banks make up the banking system in India, with the former accounting for more than 90% of the sector's assets. The State Bank of India (SBI), which has the majority equity holding with the Reserve Bank of India, and the associate banks of SBI, which have the majority equity holding with the State Bank of India, make up the commercial banks, along with a few foreign and Indian private banks. These institutions make up India's public sector (state-owned) banking system, along with regional rural banks. After the first phase of economic liberalization in 1991, the banking industry underwent a radical transformation, which also affected credit management.

Up until 1991, the Indian banking industry was more concerned with performance goals, including expanding their networks and branches, developing rural areas, prioritizing lending to certain industries, creating more jobs, etc., than it was with asset quality. Although offering loans to different industries and sectors, such as agriculture, industry, personal loans, home loans, etc., is the core job of banks, these institutions have recently become much more cautious. Growing nonperforming assets (NPAs), which are currently one of the main worries for Indian banks, are the cause. Bankers are responsible for maintaining and distributing the nation's liquid capital. The banking system's primary duty is to enable consumers to use their savings by taking deposits from the general public. The banker takes on the role of trustee for the public's surplus funds.

By regulating the flow of money and allocating it for investment and productive uses, deposit mobilization aids in the advancement of economic growth. The commercial banks engage in deposit mobilization using a variety of deposit programmes tailored to the various societal segments in order to raise deposits. The deposits, in addition to capital, reserves, and borrowings, serve as the banks' primary sources of funding. The bank bases its lending and investing activities on its funding sources.

The banks record a variety of assets in their books, including cash on hand, balances with other financial institutions, investments, loans and advances, fixed assets, and other assets. Loans, advances, and investments are the only things that fall under the definition of a non-performing asset (NPA). An asset is regarded as performing as long as it produces the revenue expected from it and does not reveal any unique risk aside from typical commercial risk, and it is referred to as a "Non-Performing Asset" when it does not.

To put it another way, a loan asset turns into a non-performing asset (NPA) when it stops producing income for the bank, such as interest, fees, commissions, or any other dues, for a period of time longer than 90 days. A NPA is an advance when either the interest payment or the principal repayment installment, or both, have been "past due" for two quarters or more. When a debt is unpaid for 30 days after its due date under any of the credit facilities, it is considered past due.

Non-Performing Loans are another name for Non-Performing Assets. It is issued by a bank or financial firm to whom late interest or repayment installments apply. A loan is an asset for a bank since it generates cash flows through interest and principal repayment. A bank's profits are derived from interest payments. Assets that have not been maintained for a while are typically considered non-performing by banks. A loan is categorized as past due if payments are only slightly overdue, and as soon as payments are seriously overdue (often 90 days), the loan is categorized as non-performing. A high percentage of nonperforming assets in comparison to other lenders could be a red flag.

The Narasimham Committee ordered that the discovery and elimination of NPAs be given national priority because they directly affect the credit risk that banks face and the effectiveness of their resource allocation. NPA statistics have an impact on banks' profitability and earnings. If we take a quick look at the numbers for non-performing assets, we can see that in public sector banks, NPAs were Rs. 38385 crore in 1995 and reached Rs. 71047 crore in 2011, while in private sector banks, NPAs were Rs. 6410 crore and reached Rs. 17972 crore in 2011.

Examining the Literature Non-performing assets have a huge number of published publications, and many academics have looked into the problem of NPAs in the banking sector. The relevant literature has been reviewed and described.

Non-performing Assets (NPAs), according to Kumar (2013) in his paper on A Comparative Paper of NPA of Old Private Sector Banks and Foreign Banks, have become a hassle and a burden for the Indian banking industry over the past few years.

In A Study on Management of Non-Performing Assets in Priority Sectors with Reference to Indian Banks and Public Sector Banks (PSBs), Selvarajan & Vadivalagan (2013) find that the growth of Indian Banks lending to the priority sector is greater than that of the Public Sector Banks as a whole. The accumulation of enormous non-performing assets (NPAs) was one of the major issues challenging the performance of commercial banks in the late 1990s and negatively affecting it. Early in the decade, Indian Bank made mistakes in its management of NPAs.

In his article Recovery of NPAs in Indian Commercial Banks, Singh (2013) claims that the banks' system of credit risk management is where the issue of exploding NPAs originated. Banks must establish a pre-sanctioning appraisal responsibility and a strong post-disbursement supervisory system with sufficient preventive measures. Loans should be regularly monitored by banks in order to spot accounts that could go bad.

In her study, A Comparative Study of Non-Performing Assets of SBI & Associates and Other Public Sector Banks, Gupta (2012) came to the conclusion that each bank should have its own independent credit rating agency that would assess the borrower's financial capacity prior to extending credit and that credit rating agencies should routinely assess the clients' financial situations.

In her study on the performance of NPAs at Indian commercial banks, Rai (2012) discovered that even after repeatedly defaulting, corporate borrowers never felt threatened by the bank initiating legal action to recoup their debts. This is due to the lack of a legal framework to protect the true interests of banks.

In their study on the management of non-performing assets in a current scenario, Chatterjee C., Mukherjee J., and Das (2012) came to the conclusion that banks should ascertain the borrower's original needs for the loan as well as the guarantor's proper identification and wealth.

In their study on the non-performing assets of public and private sector banks (a comparative study), Kaur K. and Singh B. (2011) found that NPAs are regarded as a crucial criterion to assess the efficiency and financial stability of banks. One of the factors influencing the financial stability and expansion of the banking industry is the number of NPAs.

In their study on NPA Reduction Strategies for Commercial Banks in India, Prasad and Veena (2011) noted that while NPAs do not produce interest income for banks, they are still required to make provisions for them out of their current profits. As a result, NPAs negatively affect the return on assets in the following ways:

In their study, Chaudhary K. and Sharma M. (2011) recommended the creation of an effective management information system. The bank employees who are involved in authorizing the advances should receive training on correct documentation and charge of securities as well as motivation to take action to prevent advances from becoming NPAs.

In his study, Are Non-Performing Assets Gloomy or Greedy from an Indian Perspective? Karunakar (2008) brought attention to the issue of losses and lower profitability of Non-Performing Assets (NPA) and liability mismatch in banks and the financial sector, which depend on how various risks are managed in their industry. Only with an accurate credit evaluation and risk management strategy can the problem of NPAs be permanently solved.

The number of NPAs is one of the drivers of financial stability and growth in the banking industry, according to Bhatia's (2007) research study, which investigates how essential a criterion NPAs are to measure the performance and financial health of banks.

In her thesis, Kaur (2006), titled Credit Management and the Problem of NPAs in Public Sector Banks, she made the argument that proper awareness-raising among bank employees, especially field functionaries, about the negative effects of NPAs on profitability is urgently required for effective handling of NPAs. For the purpose of fostering greater mutual understanding and trust, bankers and borrowers should frequently communicate and meet.

According to Balasubramanian C.S. (2001), all banks today have significant levels of non-performing assets, and banks are expected to lower these levels. This can be accomplished by employing sound internal control systems, efficient credit appraisal processes, and initiatives to raise the asset quality on their balance sheets.

THE TIME GAP IN LITERATURE AND RESEARCH

The many features of non-performing asset literature from various academics over the years have been gathered and used in this study, although there is a significant vacuum in the literature about the quality characteristics of non-performing assets. The majority of studies and research are focused on NPAs' causes, effects, and management.

• To investigate the situation with non-performing assets held by Indian Scheduled Commercial Banks in India.

• To research how NPAs affect banks.

• To learn about NPAS recovery via various channels.

• To offer relevant advice on how to manage and prevent current NPAs in Banks.

Limitations of the study

Constraints of the Study The following are some significant restrictions:

• The research on SCB non-performing assets is restricted to Indian banks and is conducted through the end of 2014. The Reserve Bank of India Publications serve as the foundation for recognizing non-performing assets, and NPAs are always evolving. Without considering potential developments in the future, the study is conducted in the present. The Study's Purpose The study's potential recommendations include ways for banks to prevent new non-performing loans and to cut back on current NPAs.

• The study might assist the government in developing and putting into practice new NPA control methods.

• The study will assist in choosing the best management strategies for NPAs and in creating a time-bound action plan to slow their expansion.

Sources of Data

The information gathered is primarily of a secondary nature. The literature produced by the Indian Bank and the Reserve Bank of India, as well as several periodicals, journals, and books dealing with the current state of banking, served as sources of information for this thesis.

RESEARCH METHODOLOGY

Non-Performing Assets in Scheduled Commercial Banks, which comprise public sector banks, private sector banks, and foreign banks listed in the Second Schedule of the Reserve Bank of India Act, 1934, were taken into consideration for our analysis. The research is supported by secondary data. The conceptual framework of NPA is discussed in the article, which also highlights the patterns, status, and effects of NPA on scheduled commercial banks during a 14-year period, from 2000 to 2014. The researchers have used articles and research papers from numerous reputable research journals. Additionally, websites, a book, and the RBI Report on Trend and Progress of Banking in India for various years have all been cited throughout the study.

For the study, the population-based banking sector is chosen, and aggregate NPA data for public sector banks, private sector banks, and foreign banks is used.

Time:

The Paper's Time Period The study uses aggregated data for 14 years, from 2000 to 2014. Assets with Negative Equity in Indian Scheduled Commercial Banks

Table 1 – Gross Advances and Gross NPAS of SCBs (Amount in Rupees Billion)

Year	Gross Advances	Gross NPA's (Amount)	Gross NPA's (Percentage)
2001-02	6809.58	708.61	10.4
2002-03	7780.43	687.17	8.8
2003-04	9020.26	648.12	7.2
2004-05	11526.82	593.73	5.2
2005-06	15513.78	510.97	3.3
2006-07	20125.10	504.86	2.5
2007-08	25078.85	563.09	2.3
2008-09	30382.54	683.28	2.3
2009-10	35449.65	846.98	2.4
2010-11	40120.79	979.00	2.5
2011-12	46655.44	1370.96	2.9
2012-13	59882.79	1931.94	3.2
2013-14	68757.48	2641.95	3.8

Source: dbie.rbi.org.in

The above table depicts the amount of Gross Advances, Gross NPA and the percentage of Gross NPA during the period of 2001-02 to 2013-14. The amount of advances of has increased from Rs. 6810 Billion in 2001-02 to Rs. 68757 Billion in 2013-14. The amount of gross NPA has increased from Rs. 708.61 billion in 2001-02 to Rs. 2642 billion in 2013-14. Similarly, NPA percentage is also showing the rising trend from 2.3 in 2007 to 3.8 in 2013.

Table 2 – Net Advances and Net NPAS of SCBs (Amount in Rupees Billion)

Year	Net Advances	Net NPA's (Amount)	Net NPA's (Percentage)
2001-02	6458.59	355.54	5.5
2002-03	7404.73	296.92	4.0
2003-04	8626.43	243.96	2.8
2004-05	11156.63	217.54	2.0
2005-06	15168.11	185.43	1.2
2006-07	19812.37	201.01	1.0
2007-08	24769.36	247.30	1.0
2008-09	29999.24	315.64	1.1
2009-10	34970.92	387.23	1.1
2010-11	42987.04	417.00	1.1
2011-12	50735.59	652.00	1.3
2012-13	58797.03	986.00	1.7
2013-14	67352.32	1426.57	2.1

Source: dbie.rbi.org.in

The above table shows the amount of Net Advances, Net NPA and the percentage of Net NPA during the period of 2001-02 to 2013-14. The amount of advances has increased from Rs. 6458.59 billion in 2001-02 to 67352.32 billion in 2013-14. Further, the amount of NPA has also increased from Rs. 355.54 billion to Rs1426.57 billion during the period (2001-02 to 2013-14).

The percentage of Net NPA has first declined from 5.5 in 2001-02 to 1.0 in 2007-08. Then it has increased to 2.10% in 2013-14.

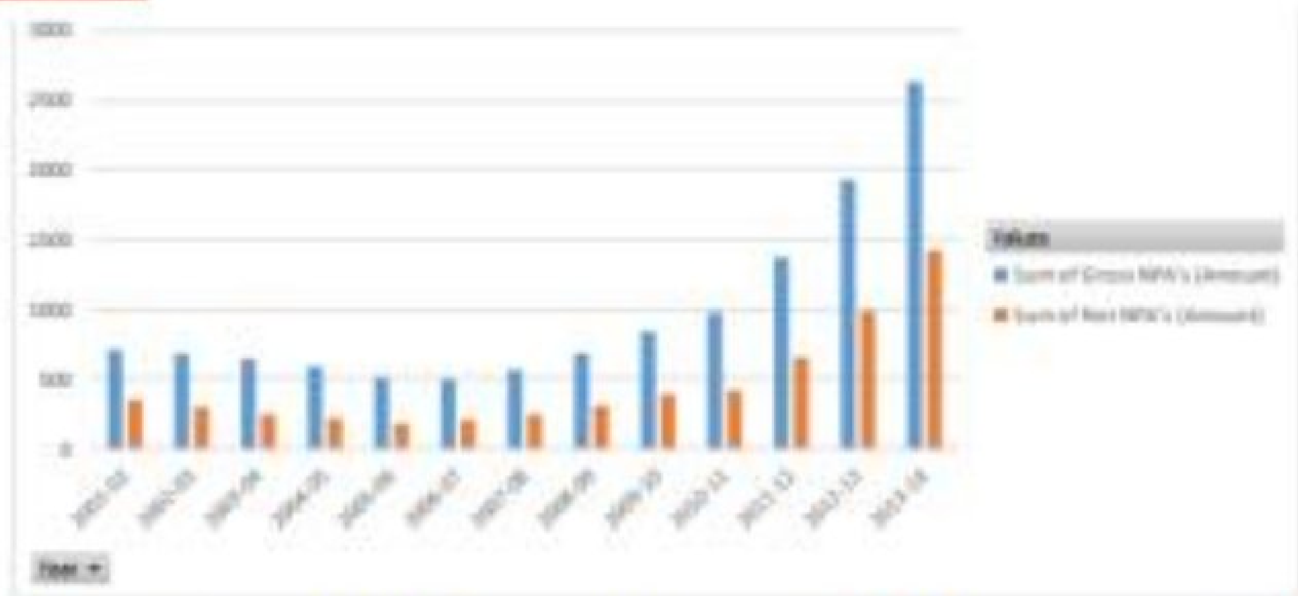


Figure 1 – Scheduled Commercial Banks (Gross and Net NPAs)

The above figure shows the trend of Gross NPA and Net NPA in billion for the period of 13 years starting from 2001-02 till 2013-14. The x-axis represent the years i.e. as the period of (2001-02 – 2013-14) whereas y-axis represent the amount of NPA. We can observe here that the Gross and Net amount of NPA has been showing an upward trend beginning from 2006-07 to 2013-14

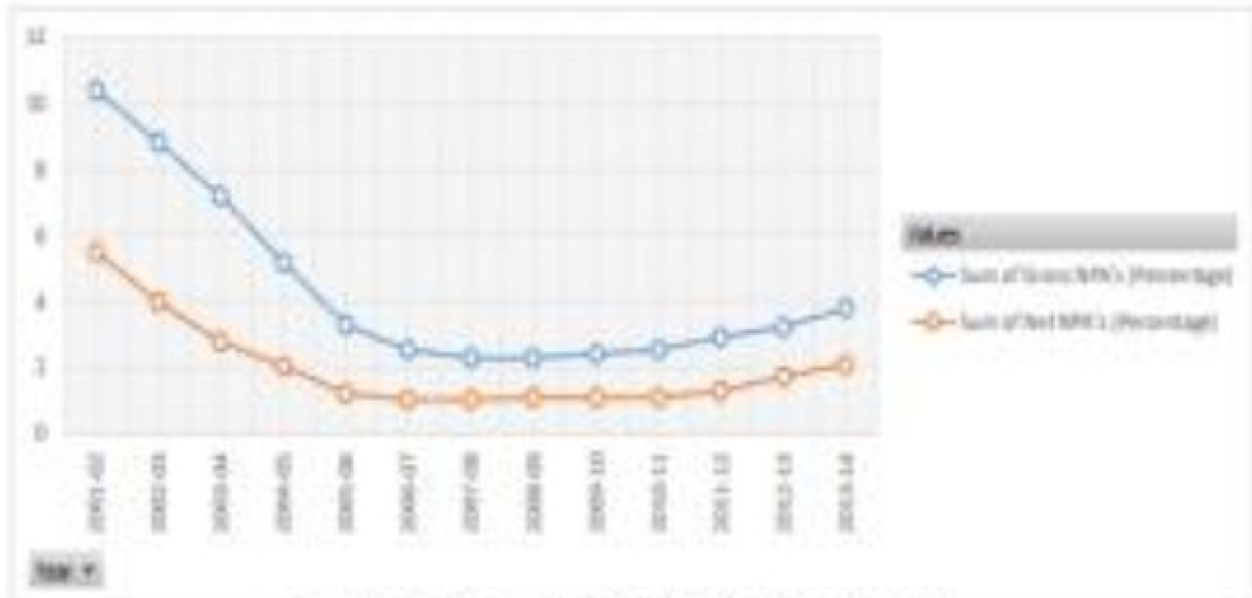
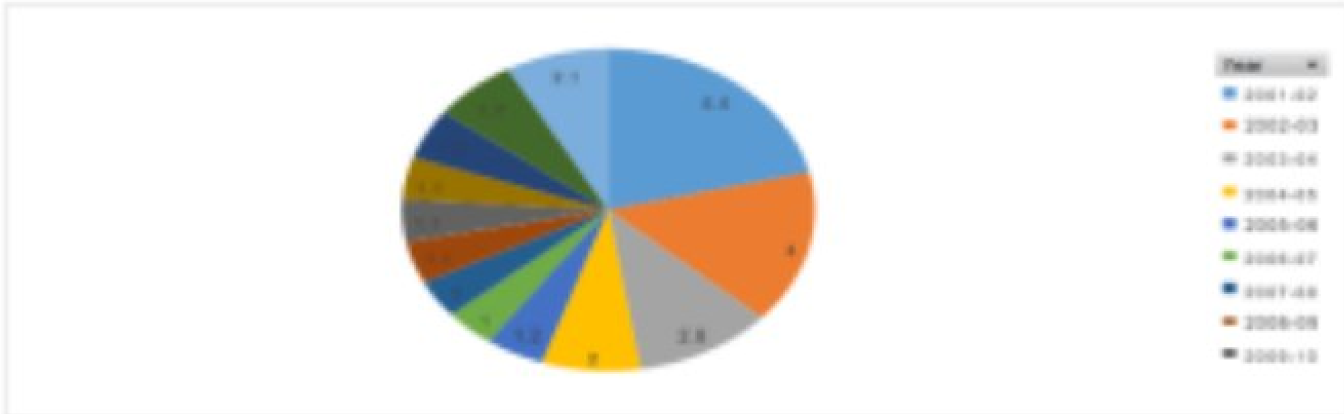


Figure 2 – Gross and Net NPA (in Percentage)

The above figure portrays the trend of Gross NPA and Net NPA in percentages for the period of 13 years i.e. from 2001-02 till 2012-14. The x-axis represents the years whereas y-axis represents the percentage of NPA. We can observe here that the Gross and Net percentage of NPA has been showing downward trend from 2001 to 2007-08 and an upward trend beginning from 2007-08 to 2013-14.

Figure 3 – Net NPAs as a Percentage of Net Advances (SCBs)



The above figure shows NPAs as a Percentage of Net Advances which was lowest 1.0 % in 2007-08 & 2008-09 and highest 5.5 % in 2001-02. It was 2.2 % in 2013-14.

Table 3 – Showing NPAs recovered by SCBs through Lok Adalats (Amount in Crore)

Item	2008	2009	2010	2011	2012	2013	2014
Number of Cases Referred	186535	548308	778833	616018	476073	840691	1636957
Amount Involved	2142	4023	7235	5254	1700	6600	23200
Amount Recovered	176	96	112	151	200	400	1400
% of Amount recovered	8.2	2.4	1.55	2.87	11.8	6.1	6.2

Sources: R.B.I

Table 3 is showing NPAs of commercial banks recovered through Lok Adalats during the study period of 2008 to 2014. From the analysis of the table, it is clear that the number of cases referred to Lok Adalats for the recovery of NPAs of commercial banks has increased largely in 2014 as compared to 2008. However, if we look at the amount recovered by Lok Adalats during the study period, it shows a continuous decline from 2008 to 2009 and then it shows improvement from 2010 to 2014, but it is much less than the other recovery channels. These Lok Adalats are only successful in recovering 1400 crore out of 23200 crore means only 6.2% of the total amount involved in NPAs of the commercial banks. Due to its inefficiency in recovering, the amount involved in NPAs, the commercial banks resorting to others means of recovery.

Table 4. Showing NPAs recovered by SCBs through DRTs (Amount in Crore)

Item	2008	2009	2010	2011	2012	2013	2014
Number of Cases Referred	3728	2004	6019	12872	13365	13408	28258
Amount Involved	5819	4130	9797	14092	24100	31000	55300
Amount Recovered	3020	3348	3133	3930	4100	4400	5300
% of Amount recovered	51.9	81.1	32.00	27.89	17.00	14.1	9.5

Sources: R.B.I.

Table 4 is showing NPAs of commercial banks recovered through DRTs during the study period of 2008 to 2014. From the analysis of the table, it is clear that the number of cases for the recovery of NPAs referred to DRTs is increasing through the study period and also the amount involved in these cases and the amount recovered through DRTs has increased. DRTs shows their efficiency in 2008-09 where it recovers 81.1pc of the total amount involved in NPAs and in later years also the amount recovered by DRTs is quite significant. This is the basic reason why the commercial banks are approaching DRTs for the recovery of their NPAs as compared to Lok Adalats in which the percentage of recovered amount of NPAs is very low. Though we can say that there is a slight decrease in the percentage of amount recovered by DRTs of the NPAs of commercial banks, though these are a significant recovery channel for the commercial banks.

Table 5. Showing NPAs recovered by SCBs through SARFAESI Act (Amount in Crore)

Item	2008	2009	2010	2011	2012	2013	2014
Number of Cases Referred	83942	61760	78366	118642	140991	190537	194707
Amount Involved	7263	12067	14249	30604	35300	68100	94600
Amount Recovered	4429	3982	4269	11561	10100	18500	24400
% of Amount recovered	61.0	33.0	30.0	37.78	28.6	27.1	25.8

Sources: R.B.I.

Table 5 is showing NPAs of commercial banks recovered through SARFAESI Act during the study period of 2008 to 2014. From the analysis of the table, it is clear that the number of cases referred to SARFAESI Act and the amount of NPAs involved is increased largely during the study period. This is done because of the efficiency of SARFAESI Act in recovering these NPAs of commercial banks. From the table it is clear that the SARFAESI Act is able to recover 25.8% of the amount of NPAs of the cases referred to it in the year 2014. In 2008 recovery percentage was quite higher 61.0% this act has emerged as a blessing in disguise for the commercial banks as now they are using this act largely in recovering their NPAs in order to increase their profitability.

Figure 4 – Recovery of NPAs of SCBs through various Channels (Amount in Rs. Crore)

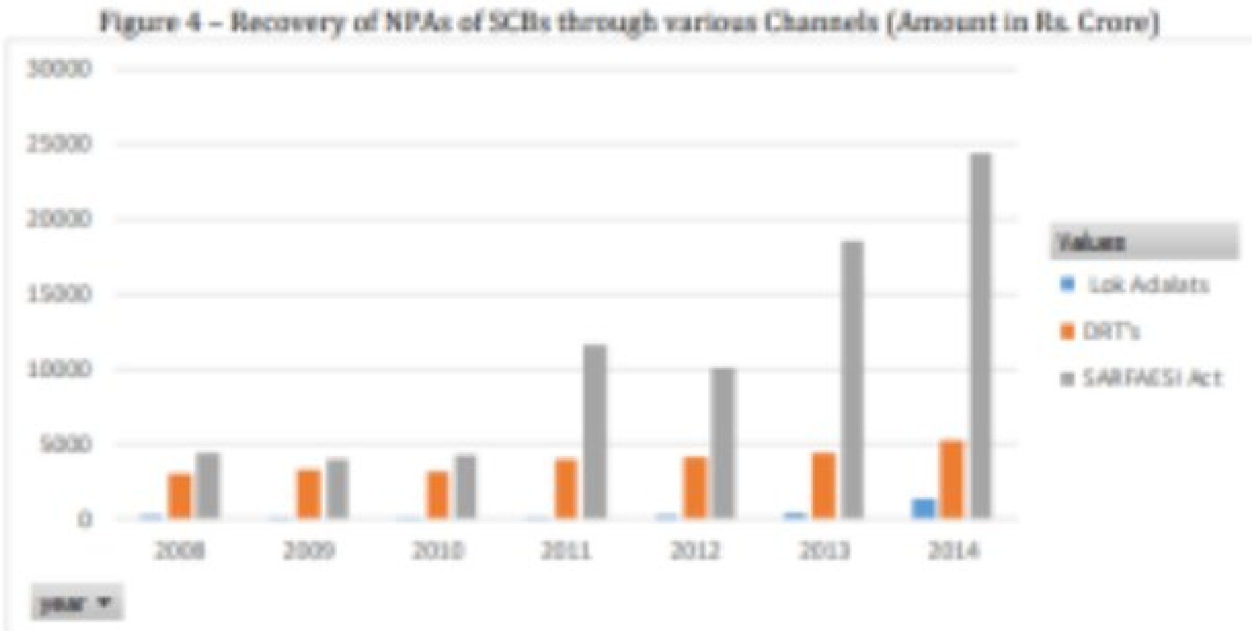


Figure 4 demonstrates the clear recovery of Scheduled Commercial Bank NPAs under various SARFAESI Act routes from 2008 to 2014. The SARFAESI Act is the most efficient method of recovering NPA. In 2014, this route helped recover Rs. 24,400 crore. Impact of NPA Bank performance and profitability are impacted by NPAs. The most prominent effect of NPA is a shift in bankers' attitudes, which may prevent credit from being expanded for useful purposes. To minimize and reduce risk, banks may lean more towards risk-free investments, which is not good for the economy's expansion. If NPA levels are not timely controlled, they will:

• The cost of capital will increase; • Assets' ability to earn income will be reduced, which will negatively impact ROI. The disparity between assets and liabilities will grow.

• Increased provisioning requirements due to rising NPAs have a negative impact on banks' profitability and capital adequacy ratios.

• Banks are upset about their economic value adds (EVA), which are calculated as net operating profit minus capital expense.

• NPAs reduce the value of shares in the capital market, sometimes even below their book value.

• NPAs have an impact on banks' capacity to handle risk.

• Decrease the earning potential of assets, which negatively impacts ROI.

• The price of capital will increase. The disparity between assets and liabilities will grow.

• Increased provisioning requirements due to rising NPAs have a negative impact on banks' profitability and capital adequacy ratios.

• Banks are upset about their economic value adds (EVA), which are calculated as net operating profit minus capital expense.

• NPAs cause shares to lose value on the capital market, sometimes even to their book value.

• NPAs have an impact on banks' capacity to handle risk.

Findings:

• The gross non-performing assets (NPAs) of the scheduled commercial banks increased from Rs. 708 billion in 2000-01 to Rs. 2642 billion in 2012-13.

• According to NPAs as a Percentage of Net Advances, scheduled commercial banks' Net NPAs climbed from Rs. 355 billion in 2000–01 to Rs. 986 billion in 2012–13. The lowest percentages were 1.0% and 5.5% in 2001–02 and 2012–13, respectively. In 2013–2014, it was 2.2%.

• From 2001–02 to 2013–14, the average percentage of Net NPAs was roughly 2.0%.

• There were 1,86,535 cases referred to Lok Adalat in 2008, and there were 16,36,957 cases in 2014;

• There were Rs. 2535 crores of SCB NPAs recovered through Lok Adalat; Rs. 27231 crores of SCB NPAs recovered through DRTs; Rs. 77241 crores of SCB NPAs recovered through the SARFAESI Act;

• Ineffective recovery, willful defaults, and defective lending processes are the important factors Management suggestions for NPAs

• The RBI should update its current credit monitoring and evaluation systems.

• Banks should enhance and improve their loan recovery procedures.

• Credit evaluation and post-loan monitoring are essential steps on which all public sector banks should focus.

• Follow-up with consumers must be ongoing, and it is the responsibility of the banker to prevent money from being diverted. This procedure can be carried out on a regular basis.

• After credit has been approved and disbursed, personal visits should be conducted, and credit accounts should also be closely monitored on a regular basis.

• Managers in the department of credit monitoring and recovery ought to be dynamic in their jobs. Many managers assert that while they "do not fear to negotiate," they do not do so out of fear. Such anxiety causes arbitrary negotiation, which is unsuccessful.

• Regular interactions with branch personnel and consideration of their recommendations for debt recovery

• Helping the borrower develop his or her entrepreneurial skills would not only build positive relationships among the borrowers but also make it easier for the bankers to monitor their finances.

• The RBI has the authority to take enforcement measures against defaulters, such as publicizing defaulters' names in newspapers and broadcast media, which is beneficial to other banks and financial organizations.

• Bankers may use a compromise settlement or one-time settlement as part of preventative measures. Other options for recovering unpaid debts include Lok Adalat and Debt Recovery Tribunals. It has been noted that banks are heavily using the SARFAESI Act these days to manage NPAs.

• If the borrower is unable to repay the loan because of draughts, floods, or other natural disasters, the lender shall restructure the loan in a way that takes into account the borrower's actual hardship.

CONCLUSION

For Indian banks, non-performing assets have long been a major issue. It affects the economy as well as the banks, unfortunately. Since Indian banks rely heavily on interest income from loans, the money trapped in NPAs has a direct influence on the bank's profitability. This analysis demonstrates that the extent of NPAs in public sector banks is comparably high. Even though the government has taken a number of actions to lower NPAs, much more has to be done to address this issue. When compared to foreign banks, our banks' NPA level is still high. There is absolutely no way to have no NPAs. The recovery procedure needs to be expedited by the bank management. Large debtors are the problem when it comes to recovery; a tight policy should be implemented to address this issue. As this is the main area that causes problems, the government should also make more arrangements for the quicker resolution of outstanding cases and lower the amount of mandated loans to priority sectors. Therefore, addressing the NPA issue requires significant effort; otherwise, NPAs will continue to kill bank profitability, which is absolutely bad for the expanding Indian economy.

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