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A Comparative Study of Priority Sector NPAs of Public and Private Sector Banks in India

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Abstract

India is a mixed economy focusing on priority sector to boost the economic and social status of the poor people in the country. Priority Sector refers to those sectors of the economy which may not get timely and adequate credit in the absence of special dispensation. Small loans are distributed for farming and allied activities, for study, for micro and small enterprises and for housing to weaker section of the society who have low income. Indian Domestic Commercial Banks / Foreign banks with 20 and above branches are required to achieve a target of lending 40% of Adjusted Net Bank Credit (ANBC) or Credit Equivalent of Off Balance Sheet Exposure (CEOBE) to Priority Sector. Agriculture is mainly dependent on weather conditions and small enterprises are more prone to different type of risks because they have low capital. All these circumstance increases risk of bank advances becoming NPAs. This study compared Priority Sector NPAs of Public and Private Sector Banks with the help of different variables such as Real GDP, Bank Credit Growth, Total NPAs and Total Advances of banks. Total NPA of Private Sector Banks had more growth rate as compare to their counterparts whereas increase in Total Advances is nearby. The paper lay bare that Public Sector Banks are controlling their NPAs in a superior way.

Keywords: NPA, public and private sector banks, priority sector

Introduction

Financial Sector plays a very important role in economy of any country by fulfilling the financial needs of the society such as mobilization of deposits from depositor to industry and other needy sectors. During the recent financial crisis including European Sovereign Debt Crisis, Indian Banking System remains stable. A long history, strong foundation, amalgamation, nationalization, regulatory mechanism and social objectives are the characteristics of Banks in India. The General Bank of India was the first Bank to be established in the year 1786.The Bank of Bengal /Calcutta (1809), Bank of Bombay (1840) & Bank of Madras established by the East India Company in 1870. These three individuals units were called Presidency Banks. Allahabad Bank was the first Bank that was completely run by Indians. In 1894, Punjab National Banks was set up with headquarters at Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank and Bank of Mysore were set up. Empirical Bank of India was formed by amalgamating all Presidency Banks. Reserve Bank of India was established in April, 1935. There were approximately 1100 small Banks in India during 1913 to 1948. To regulate the Commercial Banks, the Government of India introduced Banking Companies Act, 1949 & later it was changed to Banking Regulation Act, 1949. The Empirical Bank of India was nationalized in 1955 and was given the name,' State Bank of India' which acts as principai agent of RBI. To further safeguard the investor's interest, Indian government nationalized seven banks (all subsidiaries of SBI) in 1960, fourteen largest commercial banks in 1969 and another six banks in 1980. Government of India controlled around 91% of the Banking business with the 2nd phase of Nationalization. Financial Markets in India have witnessed a fundamental revolution in the years since liberalization along with the rest of the economy. This process has not been smooth all along but the overall effects have been largely positive.

Structure of Indian Banking Industry

RBI control banks and financial institutions in India. Scheduled Banks includes Scheduled Commercial Banks and Scheduled Cooperative Banks. Scheduled Commercial Banks includes Public Sector Banks, Private Sector Banks, Foreign Banks operating in India and Regional Rural Banks. Scheduled Cooperative Banks includes Scheduled Urban Cooperative Banks and Scheduled state Cooperative Banks. The country has 87 Scheduled Commercial Banks with deposits of Rs.71.6 trillion on 31 May, 2013. Of this, 26 are Public Sector Banks, which control over 70% of India's banking sector, 20 are Private Banks and 41 are Foreign Banks. Of the total, 41 banks are listed with a total market capitalization of Rs.9.35 trillion.

Emergence of Private Banks and Banking Reforms

Narsimham Rao government started policy of liberalization, licensing a small number of Private Banks. New generation Banks included Global Trust Bank (which was later amalgamated with Oriental Bank of Commerce), Axis Bank (earlier as UTI Bank), ICICI Bank and HDFC Bank. Ten licenses were issued to Private Sector Banks in 1993-94. The last time licenses were issued to Kotak Mahindra Bank Ltd and Yes Bank Ltd in 2003-04 by RBI. After the recommendations of Narasimham Committee under the chairmanship of Sh. M. Narasimham, the then Deputy Governor of Reserve Bank of India, the first phase of Banking reforms was introduced in the year 1992-93. These reforms provide functional autonomy and operational flexibility to Banking Sector and thereby enhancing Bank's efficiency, productivity and profitability. The Narasimham Committee has recommended Asset

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classification and provisioning (also called IRAC norms) at par with international standards prescribed by Bank for International Settlements (BIS) and introduction of Prudential Norms for income recognisition. In 1992, Narasimham Committee II was setup to review the financial Sector reforms.

Non Performing Assets

Second generations Banking reforms were introduced in 1998 on the basis of second Narasimham Committee and major recommendation was to adopt international practice of treating an asset as non-performing when the interest was overdue for at least two quarters. The interest was not considered on accrual basis but on actual receipt basis with few exceptions. RBI accepted many recommendations and advised Banks to classify their advances in two categories-standard Assets and Non-performing Assets and further classification of Non-Performing Assets into three categories, namely Sub Standard Assets, Doubtful Assets and loss Assets. RBI advised that certain specified percentage of the same should be held as provision against Non-Performing Assets. Standard Asset is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Sub Standard Asset is one which has been classified as NPA for a period not exceeding 12 months. A Doubtful asset is one which has remained NPA for a period exceeding 12 month and a loss of Assets is one where loss has been identified by the Bank or Internal or External auditor or Reserve Bank of India. Due to improvement in technology, settlement system and availability of more legal support, NPA norms have been changed from 31 March, 2004. Accordingly, as from the date, a Non-Performing Asset (NPA) is an advance where:

- Interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of tern loans.
- The account remains out of order for a period or more than 90 days, in respect of an overdraft/ cash credit (OD/ CC).
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
- Interest and /or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose and
- Any amount to be received remains overdue for a period of more than 90 days.

Public Sector Banks have been established to fulfill social objectives. This has led to increased risk of NPA'S as decisions of lending are not purely based on commercial basis. Competition and profitability concerns are driving Public Sector Banks towards greater profit orientation. Professionalism has been increased due to emergence of Private Sector Banks and greater participation by Foreign Banks. Private Banks operates on pure commercial basis and though aggressive business model help Private Banks to grow rapidly but increased NPA are one of the side effects of growth in lending. The issue of Non-Performing Assets (NPAs) came into existence in 1992 and its current status indicates poor quality in recovery management and high degree of riskiness in the credit-portfolio of the Public Banks, resulted adverse impact on profitability of Banks. Gross non-performing assets (NPAs) have increased sharply in public sector banks (PSBs) in the first quarter of the current financial year as a rapidly slowing economy is resulting in a quantum leap in bad loans. Gross NPAs as a percentage of advances stood at a two-and-half year high in several leading PSBs in the April-June quarter of 2013. State Bank of India (SBI), the country's largest lender, topped the list of banks with the highest gross NPAs (in percentage terms) during the quarter among BSE-Bankex constituents. Centre for Monitoring Indian Economy(CMIE) showed that the gross NPA to advances for SBI, which has seen a steady increase in bad loans, surged to 5.56% in April-June(2013), the highest since the quarter ending March 2011. Gross NPAs have increased 81 basis points (0.81%) for SBI during the quarter. The rise of bad loans is across the board. The growth has lowered,manufacturing sector is not doing that well and interest rates are going up instead of moving down. In such an environment, NPAs is likely to only move up. Gross NPA to advances surged to the highest in 10 quarters for Bank of Baroda, Canara Bankand Punjab National Bank. Incidentally, global ratings agency Moody's downgraded the bankfinance strength ratings of Bank of Baroda, Canara Bank and Union Bank of India on August 16. Moody's says PSBs would find it difficult to respond to slower economic growth, deteriorating asset quality and declining profit margins. According GoI Finance Ministry communique, the Gross Non-Performing Assets (NPAs) of Public Sector Banks (PSBs) as on 30th June 2013 was Rs. 1,76,009 crore. The Gross NPAs of PSBs were Rs. 1, 12,489 crore in March 2012 and Rs. 1,55,890 crore in March, 2013.

Review of the Literature

Dong (2002)[1] in his work, "Resolving Non Performing Assets of the Indian Banking System" point out the nature of NPA and key design features that would be important for Asset Management Companies (AMC) to plan an effective role in resolving NPAs. Credit Quality is low in Public Sector Banks and Development Finance Institutions, the dominant sub sectors of the Indian Banking system. The AMCs are used extensively to tackle the NPA problem. **Rajiv Ranjan & Sarat Chandra Dhal (2003)**[2] in their study, ' 'Non Performing Loans and Terms of Credit of Public Sector Banks in India" argue how Bank's non- performing loans are influenced by three major set of economic and financial factors i.e. terms of credit, Bank size induced risk preferences and macroeconomic shocks. The study finds out that terms of credit variables have significant effect on the Bank's non- performing loans in the presence if Bank size & macroeconomic shocks. Asset size has a negative impact and capital size has a positive & significant impact on gross NPAs but negligible effect on net NPAs. The level of NPAs decreases with horizon of maturity of credit, favorable macroeconomic & business conditions. **K. karthikeyan (2010)**[3] in his doctoral dissertation, "A Study on the Management of Non Performing Assets" examined the concept and prudential norms related to management of NPAs.

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The study finds that new Private Sector Banks show maximum compounded growth rate (CGR) in respect of gross NPAs. The study pointed out increase in Standard Assets indicating NPA recovery and reduction in asset slippage. There is a significant decrease in the share of Doubtful Assets, Sub-Standard Assets and Loss Assets. Punjab & Sind Bank has the highest gross NPA ratio among the Public Sector Banks and Development Credit Bank Limited has 15% gross NPA ratio among new Private Banks. The study suggested high powered committee, engagement of professional agencies and encouragement to securitization of stressed Assets of Banking Sector advances.

Jaya Agnani (2010)[4] in her paper, "NPAs in Banks: A Syndrome probing remedy" find out that only lower profitability or higher NPAs taken in isolation do not reflect the performance and future direction of success or failure of a Bank in real and absolute terms. Bank's rating does not depend on any single factor such as NPA or profitability or rating given by rating agencies. It is not always that increase in NPAs will reduce profits of Banks.

Dr. Harpreet Kaur & Dr. J. S. Pasricha (2010)[5] in their study, 'Management of Non-Performing Assets: A Study of Public and Private Sector Banks' highlights that Public Sector Banks have more NPAs as compared to Private Sector Banks. There are higher non priority sector NPAs as compare to priority sector. Most of the Banks decrease NPAs during 2003-2009. Even some Banks bring down the level of NPAs to zero level in 2003-04 but they are not able to maintain this trend. The Study suggested creation of awareness among Bank staff, frequent interactions with the borrowers for creating better understanding, sending reminders and set up of separate legal department for effective handling of NPAs. Credit audit, ABC technique and use of management information system can minimize NPAs. **Dr. M. Jayasree & R.Radha (2011)**[6] in their study, "Non Performing Assets: A Study of Scheduled Commercial Banks in India" examine sector wise NPAs. The study compares NPAs of Public Sector Banks, new Private Sector Banks and Foreign Sector Banks. It uses regression analysis to check the impact of NPAs on net profit & impact of total advances on NPAs. NPAs declined during the study period. NPA is lower in Public Sector Banks as compare to Private & Foreign Banks during the study period. **Jappanjyot Kaur Kalra and S. K. Singla (2011)[7] in their paper** "Comparison of Non Performing Assets of Selected Public Sector Banks" analyze the procedure and causes of NPAs. Doubtful assets of Punjab & Sind Bank and Central Bank of India decreases during study period (2005-2009). The study finds out that managers of both the Banks consider industry prospects and financial efficiency before giving loan. Lack of proper planning and wrong selection of customer are the main causes of NPAs. According to this study important reasons for nonpayment are business slow down, delay in disbursement of loan and political influence. NPAs can be cured with increase in the provisions of NPAs, effective inspection system and efficient reminder system.

Research Methodology

Variables Used in the Study

To make comparative study of Public Sector and Private Sector Banks, following variables are used-

- India's Real GDP Growth Rate (Factor cost)
- Bank Credit Growth
- Total NPAs of Public Sector Banks
- Total Advances of Public Sector Banks
- Total NPAs of Public Sector Banks
- Total Advances of Private Sector Banks
- Priority Sector of NPA of Public Sector Banks
- Priority Sector NPA of Private Sector Banks

Population of the Study

Public Sector and Private Sector Banks of equal numbers (5 each) are taken for the study.

Time Period

The study is conducted using information available- Priority Sector NPA from 2006 to 2011

Objectives of the study

- To analyze the trend and growth of priority sector NPAs of Public Sector Banks
- To analyze the trend and growth of priority sector NPAs of Private Sector Banks
- To compare the priority sector NPAs of in Public and

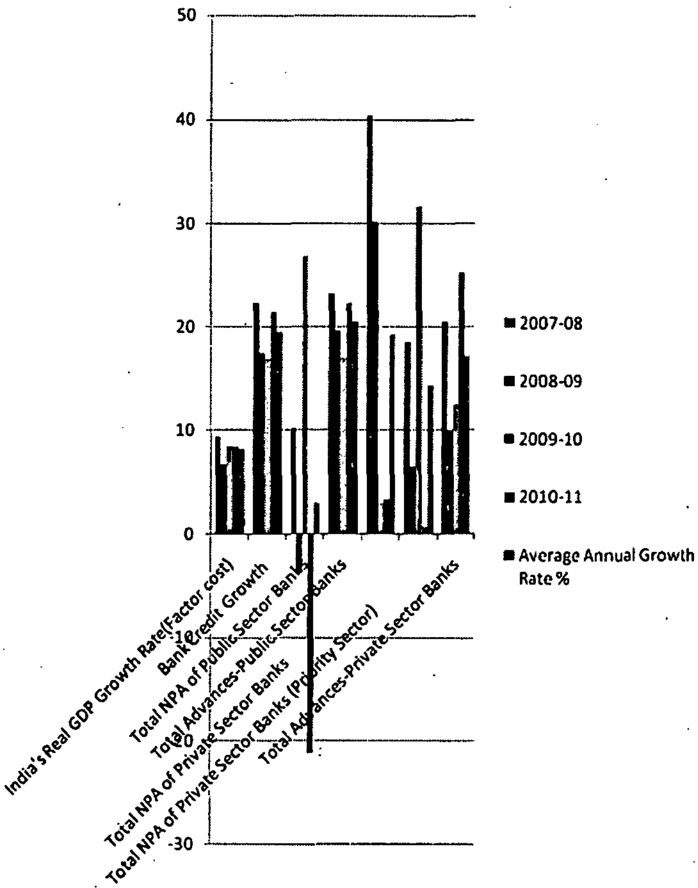
Private Sector Banks

Analysis and Interpretation of the data

Table No.-1: Annual Growth Rate of Real GDP, Bank Credit Growth, Total NPAs and Total Advances of Public Sector Banks and Priority Sector (in %)

Variables	Annual Growth %				Average Annual Growth Rate %
	2007-08	2008-09	2009-10	2010-11	
India's Real GDP Growth Rate(Factor cost)	9.3	6.7	8.4	8.37	8.19
Bank Credit Growth	22.3	17.5	16.9	21.5	19.55
Total NPA of Public Sector Banks	10.16	-3.83	26.85	-21.17	3
Total Advances-Public Sector Banks	23.14	19.63	17.03	22.27	20.52
Total NPA of Private Sector Banks	40.44	30.14	2.94	3.37	19.22
Total NPA of Private Sector Banks (Priority Sector)	18.53	6.48	31.65	0.65	14.33
Total Advances-Private Sector Banks	20.54	10.02	12.49	25.27	17.08

Figure No.-1: Annual Growth Rate of Real GDP, Bank Credit Growth, Total NPAs and Total Advances of Public Sector Banks and Priority Sector (in %)

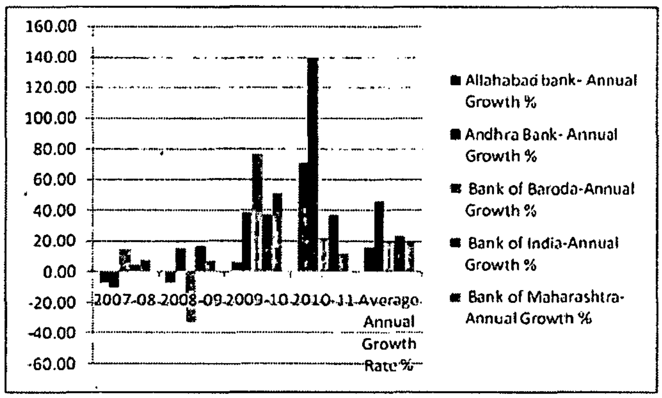


India registered a good Average Annual Growth Rate in Real GDP during 2006-2011. Bank credit growth is more impressive as government stress on financial inclusion and banks generously provide credit to customer whose income increased with the rise in the economy. Government implemented its agenda of focusing on priority Sector; the Sector is one of the main sources of employment for rural people generating demand for industrial goods and services. Agriculture which is included in priority Sector provides food security to the nation. With the robust credit growth in the Bank Credit, Total NPAs of Public Sector Banks registered Average Annual Growth Rate of 16.96%. There was economic crisis during the 2008-2011 which may be one of the reasons of increased NPAs. Allahabad Bank's NPA's Average Annual Growth Rate is less than growth rate of Bank Credit Growth and Total NPAs of Public Sector Banks and its NPA's Average Annual Growth Rate (15.63) is much more than Total NPA of Public Sector Banks-Priority Sector (3%). Total NPA of Private Sector Banks (Priority Sector) increased more than increase in total advances in whereas performance in priority sector is not so good.

Table No-2: Annual Growth Rate of Priority Sector NPAs of Public Sector Banks (in %)

Name of the Bank	% Annual Growth in NPAs				Average Annual Growth Rate %
	2007-08	2008-09	2009-10	2010-11	
Allahabad bank-Annual Growth %	-7.08	-7.37	6.26	70.75	15.64
Andhra Bank-Annual Growth %	-9.99	14.96	38.85	139.67	45.88
Bank of Baroda-Annual Growth %	14.61	-33.01	76.10	22.01	19.93
Bank of India-Annual Growth %	4.62	16.77	37.28	36.89	23.89
Bank of Maharashtra-Annual Growth %	7.86	7.59	50.85	11.72	19.51

Figure No-2: Annual Growth Rate of Priority Sector NPAs of Public Sector Banks (in %)



Andhra Bank registered a maximum Average Annual Growth Rate of 45.88% among all the Public Sector Banks under study. It is a worried situation for management of Andhra Bank as they are accountable to, first and foremost depositors, then other stakeholders i.e. government and society. Allahabad Bank registered minimum growth in Total NPAs reflecting better results of Assets management which is supported by good loan recovery mechanism. Bank of Baroda, Bank of Maharashtra and Bank of India also recorded increase in Priority Sector NPAs in the range of 19% to 24% which is more than Bank Credit Growth and Total NPAs of Public Sector Banks Growth. All of the Public Sector Banks under study could not control Priority Sector NPAs growth rate below the bank credit growth rate. The first hypothesis that

Table No-3: Priority Sector NPAs of Private Sector Banks

Name of the Bank	% Annual Growth in NPAs				Average Annual Growth Rate %
	2007-08	2008-09	2009-10	2010-11	
Total NPA of Private Sector Banks	40.44	30.14	2.94	3.37	19.22
Total NPA of Private Sector Banks (Priority Sector)	18.53	6.48	31.65	0.65	14.33
Total Advances-Private Sector Banks- Annual Growth %	20.54	10.02	12.49	25.27	17.08
Axis Bank Ltd.	91.27	41.03	77.78	27.48	59.39
Development Credit Bank Ltd.	-82.66	257.14	70.00	-17.68	56.70
HDFC Bank Ltd.	16.73	95.46	5.26	20.93	34.60
ICICI Bank Ltd.	38.17	6.60	34.30	-7.11	17.99
IndusInd Bank	-23.70	55.56	-15.15	27.07	10.95

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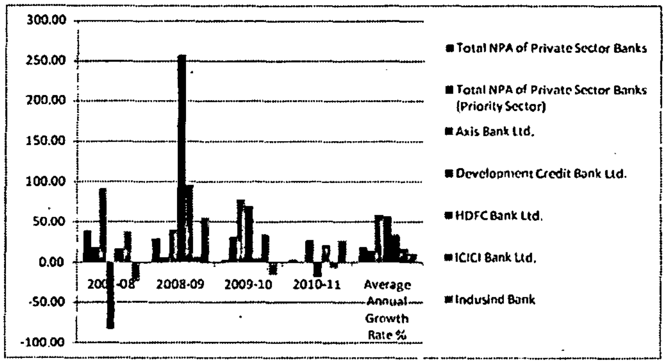
Figure No-3: Priority Sector NPAs of Private Sector Banks



Private Sector Banks are playing their role in fulfilling growing demand for Bank Credit from different sections of the society. Few of the leading Private Banks are competing with Public Sector Banks in deposits and loans. Total NPA of Private Sector Banks (Priority Sector) increased at lessor rate than Overall NPA of Private Sector Banks. Most of the Private Sector Banks registered more growth in NPAs than Bank Credit. Private Banks have to look after their Loan granting and recovery mechanism. IndusInd Bank's performance is better than other Private Banks and this kind of management can be helpful to bank in enhancing its customer base without substantial provisions for NPA.

Table No.-4: Comparison of Public Sector and Private Sector Banks

Particulars	Annual Growth %				Average Annual Growth Rate %
	2007-08	2008-09	2009-10	2010-11	
India's Real GDP Growth Rate(Factor cost)%	9.30	6.70	8.40	8.37	8.19
Bank Credit Growth %	22.30	17.50	16.90	21.50	19.55
Total NPA of Public Sector Banks-Annual Growth %	10.16	-3.83	26.85	-21.17	3.00
Total Advances-Public Sector Banks- Annual Growth %	23.14	19.63	17.03	22.27	20.52
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ICICI Bank Ltd.	38.17	6.60	34.30	-7.11	17.99
Indusind Bank	-23.70	55.56	-15.15	27.07	10.95

Liberalization, privatization and globalization was started in 1991 to promote Private Sector to boost economy, increase export and earn foreign exchange to support import, mainly of oil; Private Sector displayed efficiency in many areas specially IT, Telecom and other services. In Banking Sector also Private Sector Banks increased their foothold many folds till 2013. Above mentioned comparison of NPAs of Public Sector and Private Sector Banks portray a different scenario that four out of five Public Sector Banks have less than 25% AAG (Average Annual Growth Rate) in priority Sector NPA whereas only two Private Sector Banks under study have less than 25% AAG. This study illustrate that Public Sector Banks are better managing their Assets though there is difference at individual level.

Conclusion

The government will reconsider a clause that requires all state-run banks to treat a borrower's account as non-performing if a loan to the company by any bank has become a bad asset in the books of that bank. According to a report by BofA-ML, loan growth of Indian banks will fall to a 15-year low of less than 13% in the current fiscal. The latest data from RBI shows that in the last two weeks to June 14,2013 credit growth has slipped by 0.39%. Bankers have argued that adhering to a common NPA norm will further weaken the banks given that RBI has already come up with stringent guidelines in June 2013, increasing the provisioning on the newly restructured account by 300 bps to 5% from June. India is important contributor in growth of world economy along with other BRIC (Brazil, Russia, India & China) who collectively challenging the dominance of western countries in agriculture, manufacturing and service. In this turbulent times Indian financial sector; especially banks have to be more careful in disbursing loans to achieve the targets set either by government or management of banks.

Asset and Liability portfolio are two main thrust areas of banks in India. Most of the people deposit their money in banks thus making Liability targets somehow easy as compare to targets of distributing good loans. Public Sector Banks have to fulfil political assurances which divert them from their business model of security of depositor's interest, earning more profit and distributing loan to only economically sound lenders. Private Sector Banks have advantage that they have few restrictions but they are new in the field and high risk, high return approach may be harmful if applied without proper necessary measures. More AAG of NPAs of Private Sector Banks posed a serious consideration of review of loan disbursement policy making, implementation and control. Problem of NPAs have negative impact on overall profitability of Public and Private Sector Banks. Identification, measurement and control of risk that is related to NPAs are need of the hour to compete international banks, which are awaiting more licences from RBI to get revenue from Indian customers with their innovative products and practices.

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