

# Role of Lok Adalat in managing Non-Performing Assets in Scheduled Commercial Banks

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**Abstract:** *The issue of Non- Performing Assets (NPA), the root cause of the recent global financial crisis has been drawing the attention of the policy makers and academician's. The Indian banking system has undergone significant transformation following financial sector reforms. It is adopting international best practices with a vision to strengthen the banking sector. The Indian banking sector has been facing serious problems of raising Non - Performing Assets (NPAs). The NPAs growth has a direct impact on profitability of banks. Several prudential and provisioning norms have been introduced, and these are pressurizing banks to improve efficiency and trim down NPAs to improve the financial health of the banks. In the background of these developments, this study strives to examine the performance of different recovery channels with special focus on Lok Adalats in public sector banks in India. The data has been analyzed by statistical tools such as percentages, Compound Annual Growth Rate (CAGR) and analysis of variance (ANOVA). The study observed that the performance and number of cases referred to Lok Adalat are significantly low compared to the other recovery channels.*

**Key Words:** *Non - Performing Assets, Profitability, Scheduled Commercial banks, CAGR.*

## 1. INTRODUCTION:

The assets of the banks which don't perform (that is – don't bring any return) are called Non Performing Assets (NPA) or bad loans. Bank's assets are the loans and advances given to customers. If customers don't pay either interest or part of principal or both, the loan turns into bad loan. According to RBI, terms loans on which interest or installment of principal remain overdue for a period of more than 90 days from the end of a particular quarter is called a Non-performing Asset. However, in terms of Agriculture / Farm Loans; the NPA is defined as under: For short duration crop agriculture loans such as paddy, Jowar, Bajra etc. if the loan (installment / interest) is not paid for 2 crop seasons, it would be termed as a NPA. For Long Duration Crops, the above would be 1 Crop season from the due date.

Lok - Adalat means, 'People's Court'. "Lok" stands for "people" and the term "Adalat" means court. Lok – Adalat is a system of alternative dispute resolution developed in India. "Lok Adalat" is defined as a "forum where voluntary effort aimed at bringing about settlement of disputes between the parties is made through conciliatory and pervasive efforts".

The Indian Banks' Association (IBA) has been issuing guidelines to member institutions for taking up of cases for settlement through Lok Adalats. There are certain advantages in using the forum of Lok Adalats by banks and financial institutions in compromise settlement of their NPAs. There is no court fees involved when fresh disputes are referred to it. It can take cognizance of any existing suit in the court as well as look into and adjudicate upon fresh disputes. If no settlement is arrived at, the parties can continue with court proceedings. Its decrees have legal status and are binding. It has, therefore, been decided that with a view to making increasing use of the forum of Lok Adalats to settle banking disputes involving smaller amounts. Cases involving an amount up to Rs.5 lakh may be referred to Lok Adalats. The matter of raising the amount up to Rs.10 lakh has been taken up with the appropriate authority.

Lok Adalats function by amicably settling disputes that are pending in a court of law or at a pre- litigation stage. They have statutory status under the Legal Services Authorities Act, 1987 and have powers similar to those vested in a civil court. All awards are binding on all parties and can not be appealed. According to RBI guidelines, banks can use Lok Adalats to recover loans up to Rs 20 lakh. Additionally, cases of cheque bouncing as well as motor insurance disputes are also understood to have been taken up. Apart from Lok Adalats, banks can recover loans through the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act) and the Debt Recovery Tribunals (DRTs).

## 2. RECOVERY CHANNELS:

Some measures are designed to maximize the NPAs recoveries in Indian banking. The Central government and RBI have taken steps for controlling incidence of fresh NPAs and creating legal and regulatory environment to facilitate the recovery of existing NPAs of banks. They are:

### 2.1. One Time Settlement Schemes

This scheme covers all sectors sub – standard assets, doubtful or loss assets as on 31st March 2000. All cases on which the banks have initiated action under the SRFAESI Act and also cases pending before Courts/DRTs/BIFR, subject to consent decree being obtained from the Courts/DRTs/BIFR are covered. However cases of willful default, fraud and malfeasance are not covered.

### 2.2. Lok Adalats

Lok Adalat institutions help banks to settle disputes involving account in “doubtful” and “loss” category, with outstanding balance of Rs. 5 lakh for compromise settlement under Lok Adalat. Debt recovery tribunals have been empowered to organize Lok Adalat to decide on cases of NPAs of Rs. 10 lakh and above. This mechanism has proved to be quite effective for speedy justice and recovery of small loans. The progress through this channel is expected to pick up in the coming years.

### 2.3. Debt Recovery Tribunals (DRTs)

The Debt Recovery Tribunals have been established by the Government of India under an Act of Parliament (Act 51 of 1993) for expeditious adjudication and recovery of debts due to banks and financial institutions. The Debt Recovery Tribunal is also the appellate authority for appeals filed against the proceedings initiated by secured creditors under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act.

### 2.4. Securitization and SARFAESI Act

Securitization is considered an effective tool for improvement of capital adequacy. Securitization can also help in reducing the risk arising out of credit exposure norms and the imbalances of credit exposure, which can help in the maintenance of healthy assets. The SARFAESI Act intends to promote Securitization, pool together NPAs of banks to realize them and make enforcement of Security Interest Transfer. The SARFAESI Act - 2002 is seen as a booster, initially, for banks in tackling the menace of NPAs without having to approach the courts.

## 3. REVIEW OF LITERATURE:

Many published articles are available in the area of non - performing assets and a large number of researchers have studied the issue recovery channels of NPA in banking industry. A review of the relevant literature has been described.

Kumar (2013) in his study on A Comparative study of NPA of Old Private Sector Banks and Foreign Banks has said that Non - performing Assets (NPAs) have become a trouble and headache for the Indian banking sector for the past several years.

Gupta (2012) in his study A Comparative Study of Non - Performing Assets of SBI & Associates & Other Public Sector Banks had concluded that each bank should have its own independence credit rating agency which should evaluate the financial capacity of the borrower.

Kaur K. and Singh B. (2011) in their study on Non - performing assets of public and private sector banks (a comparative study) studied that NPAs are considered as an important parameter to judge the performance and financial health of banks.

## 4. OBJECTIVES OF THE STUDY:

- To study the status of Non Performing Assets of Indian Scheduled Commercial Banks in India.
- To study and compare the performance of Lok Adalat with other recovery channels.

## 5. LIMITATION OF THE STUDY:

The important limitations are as follows:

- The study of non - performing assets of SCBs is limited from 2007-2008 to the end of the financial period 2014 - 2015.
- The entire NPA data is collected from Reserve Bank of India publications.

## 6. SCOPE OF THE STUDY:

The study has the following scope

- The study helps to analyze the performance of Lok Adalat.
- The study could suggest new measures for managing present and future NPAs effectively.

## 7. SOURCES OF DATA:

The data collected is mainly secondary in nature. The sources of data for this article include the literature published by Indian Banks and the Reserve Bank of India, various magazines, Journals, Books dealing with the current banking scenario and research papers.

## 8. METHODOLOGY OF STUDY:

For our study, we have considered Non Performing Assets in Scheduled Commercial Banks which includes public sector banks, private sector banks and foreign banks which are listed in the Second Schedule of the Reserve Bank of India Act, 1934. The study is based on secondary data. RBI Report on Trend and Progress of Banking in India for various years, websites and a book on banking has been referred during the study. The present study has been conducted to identify and confirm the recovery aspects made in SCB. The data used in the present analysis is confined to the period between the years 2008 to 2015. The data obtained has been analyzed using appropriate descriptive and inferential measures specifically testing of hypothesis.

**Gross Non-Performing Assets (GNPAs):** Gross NPA is the sum of all loan assets that are classified as NPA as per RBI guidelines. Gross NPA Ratio is the ratio of gross NPA to gross advances (loans) of the bank.

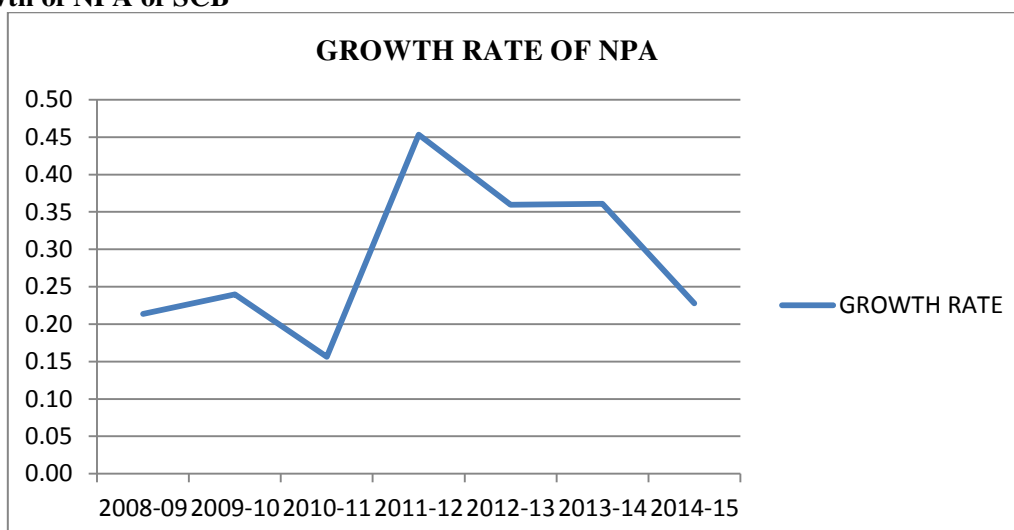
### Analysis & Interpretation:

**Table 1: Table showing Gross NPAs of different categories of Banks**

(In Millions)						
Year	SBI Group	Private sector banks	Nationalized banks	Foreign banks	Total	Growth rate of NPA in %
2007-08	154780	129974	249743	28594	563091	-
2008-09	184139	169266	265431	64445	683281	0.21
2009-10	235325	176400	363948	71336	847009	0.24
2010-11	303928	182406	442230	50687	979251	0.16
2011-12	482144	187678	690476	62966	1423264	0.45
2012-13	627785	210705	1016830	79771	1935091	0.36
2013-14	798169	245424	1474474	115650	2633717	0.36
2014-15	735085	341062	2049595	107708	3233450	0.23

Source: Different annual reports of RBI

**Chart 1: Growth of NPA of SCB**



From the above table it is clear that the growth the Gross Non-Performing Assets are very high from 2011 onwards. There was consistency in between the years from 2007 to 2011. When the prudential norms were introduced by the RBI (Reserve Bank of India) in the year 2013, the growth of the NPAs is countable. In 2007 it is only 2.3% and it was increased to 4.2% in the year 2015.

**Table 2: Showing NPAs recovered by SCBs through Lok Adalats (in Billions)**

Item	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
No. of cases referred	1,86,535	5,48,308	7,78,833	6,16,018	8,40,691	16,36,957	91,31,199
Amount involved	21.42	40.23	72.35	52.54	66	232	887
Amount recovered	176	96	112	151	4	14	43
% of amount recovered	8.2	2.4	1.55	2.87	6.1	6.2	4.8

Source: Different annual reports of RBI

**Table 3: Calculation of CAGR**

Particulars	No. of cases	Amount involved
CAGR	91.26%	86%

The above table is showing CAGR of number of cases involved and amount involved under Lok Adalats during the study period of 2008 to 2015. 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 shown a rate cumulative annual growth rate of 91.26 % and amount involved with cumulative growth rate of 86%. However, if we look at the amount recovered by Lok Adalats during the study period, it shows a wave movement and then it shows improvement from 2010 to 2014, but it is much less than the other recovery channels. Due to its inefficiency in recovering, the amount involved in NPAs, the commercial banks resorting to others means of recovery.

## 9. HYPOTHESIS:

Ho: There is no significant difference in the percentage of recovery by recovery channels with reference to the banks taken for study.

H1: There is significant difference in the percentage of recovery by recovery channels with reference to the banks taken for study.

**Table 4: Comparative statement of NPA recovery by various recovery channels**

year	Lok Adalats	DRT	SARFAESI ACT
2008-09	8.2	81.1	33.0
2009-10	2.4	32.0	30.0
2010-11	1.55	27.89	37.78
2011-12	2.87	17	28.6
2012-13	6.1	14.1	27.1
2013-14	6.2	9.5	26.6
2014-15	4.8	14	24.5

Source: Different annual reports of RBI

**Chart 2: NPA recovery by various channels**

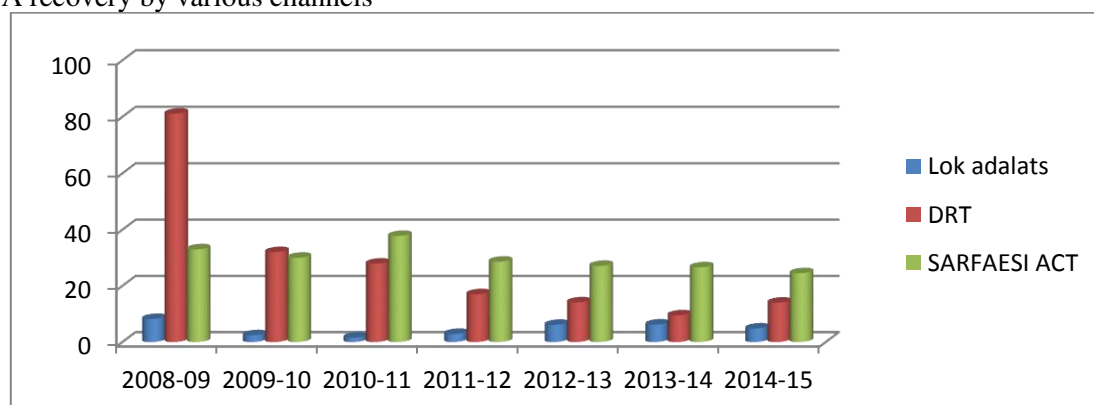


Table5: ANOVA test

source	SS	df	MS	F	P
Treatment (between groups)	2402.1839	2	1201.09	4.75	0.019868
error	5314.885	21	253.0898		
Ss/bi					
total	7717.06	23			

This is the table that shows the output of the ANOVA analysis and whether it is statistically significant difference between the percentage of recovery through various channels, Lok Adalat, DRT and SARFAESI Act 2002. It is found that the significant level is .019 ( $p = .019$ ), which is below .05 and hence therefore there is statistically significant difference in terms of percentage of recovery through various channels, Lok Adalat, DRT and SARFAESI Act 2002. Since  $P < .05$ , it means there is a statistically significant difference between the percentages of recovery in terms of Lok Adalat with DRT, Hence H1 is accepted.

## 10. CONCLUSION:

The Non-Performing Assets have always created a big problem for the banks in India. It is just not only problem for the banks but for the economy too. The money locked up in NPAs has a direct impact on profitability of the bank as Indian banks are highly dependent on income from interest on funds lent. This study shows the extent of NPA recovered by various channels with special focus on Lok Adalats. When we see the recovery aspects of NPAs in public sector banks, in spite of having various recovery channels, like Lok Adalat, DRT, SARFAESI Act 2002, this study shows that the percentage of recovery of NPAs and number of cases referred to these channels, clearly denotes that SARFAESI Act 2002 and DRT does not have larger variations of recovering the amount in NPAs. Lok Adalats function by amicably settling disputes that are pending in a court of law or at a pre-litigation stage. The study reveals that the performance of SARFAESI Act is more superior than the other recovery channels throughout the study except in the 2008-09. The study also reveals that there is significant difference in recovery by various channels. The bank management should speed up the recovery process. So the problem of NPA needs lots of serious efforts otherwise NPAs will keep killing the profitability of banks which is not good for the growing Indian economy at all.

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