An Empirical Study on the Role of Recovery Mechanisms in the Indian Banking Sector

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Abstract

Loan and advance repayment on time is one indicator of a bank's performance. Banks are currently dealing with an increase in the number of non-performing assets. It not only reduces bank productivity, but it also has an impact on bank liquidity and competitiveness. The country's legal system has been a major impediment to banks' efforts to reduce their NPAs. Proper recovery mechanisms are essential for recovering these bad loans. This paper tries to analyze the role of recovery mechanisms like Debt Recovery Tribunals (DRTs), LokAdalats and the SARFAESI Act, 2002 in recovering the amount of non-performing assets in Indian scheduled commercial banks. This study is based on secondary data gathered over ten years from RBI publications. After conducting the analysis, the results revealed that the SARFAESI Act is the most effective recovery method followed by debt recovery tribunals in resolving the issue of stressed assets. Due to their low recovery rate, LokAdalats have little impact in dealing with NPAs. This study concludes that to maintain the financial stability of Indian banks, the government and bank regulatory authorities should take various strong measures to address the problem of stressed assets.

Keywords: [Banks, Non-performing assets, LokAdalats, DRTs, SARFAESI]

Introduction

A nation cannot achieve the required economic growth without a robust and effective banking industry. However, the problem of stressed assets in the banks is becoming more and more complicated in the modern period, and as a result, the banking sector is suffering. Reducing the amount of non-performing assets (NPAs) is urgently needed to strengthen the financial health of the Indian banking sector. The main duties of a bank are loaning money and accepting deposits. The elimination of all non-performing assets is not feasible due to the fundamental nature of the banking industry. Therefore, the number of NPAs can be decreased by the bank with the aid of effective credit risk management and recovery channels. A bank should get their money back before the loan turns into an NPA. Because once they become NPAs, recovering them will be expensive for the bank, increasing operational costs and decreasing profitability.

Meaning

According to RBI (Master Circular DBOD No. BP.BC/20/21.04.048/2001-2002), An asset becomes non-performing when it ceases to generate income for banks". In other words, if interest or principal installments are past due and underpaid for a period longer than 90 days, the asset should be considered a non-performing asset.

A strong and appropriate recovery mechanism is crucial for the recovery of non-performing loans. LokAdalats, onetime settlement schemes, SARFAESI Act, DRTs, Insolvency and Bankruptcy code, corporate debt restructuring scheme, credit information bureau, assets reconstruction companies (ARCs), and recovery through private agencies are some loan loss recovery mechanisms. But the most commonly used mechanisms are DRTs, Lok Adalats and SARFAESI in recovering the amount of NPAs in Indian Banks.That's why this paper tries to analyze the role of recovery mechanisms in the Indian banking sector to know whether they work upto the mark or not.

The paper further proceeds as follows. Section 2 provides a review of the available literature. Section 3 presents the objective. Section 4 specifies the research hypotheses. Section 5 elaborates on the research methodology. Section 6 shows the results and discussion. Finally, Section 7 concludes.

Literature Review

This section provides a review of some existing literature that examines the role of recovery channels of NPAs of banks. A review of the literature on these studies is shown below.

Siraj and Pillai (2012) assess the management of NPAs

and discuss the efficacy of different recovery management strategies in Indian Banks, in particular DRT, LokAdalats, and SARFAESI Act. The empirical findings indicated that during the period, the SARFAESI Act and DRTs were primarily responsible for the improvement in NPA recovery. The SARFAESI Act gave recovery management the much-needed impetus, as can be seen from the report.

Selvarajan and Vadivalagan (2013) examined the management of NPAs in priority sector advances and offered corrective actions to address the NPA issue. The findings suggested that a quick recovery system and an efficient credit appraisal system are useful in resolving this issue. **Jain and Shaardha (2016)** examined the effectiveness of the SARFAESI Act, Debt Recovery Tribunal in curbing the problem of stressed assets in Indian banks. The study span is from 2008 to 2014 and the secondary data is taken from RBIs' annual reports, research papers, newspapers etc. ANOVA test and Tukey HSD post-hoc test is used for data analysis purpose. The results showed that there is no significant variation found in the cases admitted to these statutory bodies and the two recovery channels DRT and SARFAESI Act, 2002 do not show differences in curbing the problem of non-performing assets. **Thomas and Vyas (2016)** studied the loan recovery mechanisms of Indian banks. The paper has divided the recovery mechanisms into two parts: (1.) Preemptive strategies and (2.) Corrective strategies. Preemptive strategies consisted of 5-E Early Warning Signals (EWS). The five Es were economic warning which included financial distress; enterprise warning which means operational warning; executional warning; exchequer warning which includes banking signals and extraneous warning. These were the factors that were taken into consideration before sanctioning loans. Corrective strategies include after loan sanctioning mechanisms. It consists of legal, non-legal and regulatory mechanisms such as SARFAESI Act, 2002; Insolvency and Bankruptcy Code, 2016; National Company Law Tribunal, Debt Recovery Tribunals etc. **Kumar et al. (2017)** examined the effectiveness of various recovery methods such as the SARFAESI Act 2002, LokAdalats, and DRTs for recovering the amount of non-performing assets. The study span is from 2008 to 2016 and the secondary data is taken from RBI publications, journals, newspaper articles etc. ANOVA technique is used for data analysis. The results showed that there is significant variation among the performance of the SARFAESI Act, DRTs, and LokAdalats regarding the recovery of non-performing assets. In this study,

SARFAESI Act is found to be effective among recovery channels in solving this problem of stressed assets. **Ghaloth (2019)** investigated how non-performing loans affect bank profitability and their recovery processes. According to the study, banks should enhance their credit risk management procedures in order to lessen this issue, and the SARFAESI act has proven to be the most efficient approach.

Objective of the Study
This paper tries to analyze the role of recovery mechanisms like Debt recovery Tribunals, LokAdalats and SARFAESI Act, 2002 in recovering the amount of non-performing assets in the Indian Banking sector.

Hypothesies
H1: There is a significant difference in the cases referred to recovery mechanisms (LokAdalats, DRT, SARFAESI Act).
H2: There is a significant difference regarding % of NPAs amount recovered through recovery mechanisms (SARFAESI Act, DRTs, LokAdalats).

Research Methodology
Data
The data for the study is taken from secondary sources including journals, RBI's annual reports of "Trend and Progress of banking in India", "Statistical Tables related to banks in India" and various other secondary sources. The study period from 2008 to 2019 is taken into consideration for analysis purposes.

Analytical Tools
To check the validity of the hypothesis welch test was used to identify a statistically significant difference in the role of recovery channels. When a statistically significant difference was found Games – Howell post hoc test was used to better identify the differences with the help of IBM SPSS software version 20.

Results and Discussions
This section contains a detailed analysis of the paper. The collected data were analyzed using descriptive statistics, Levene test, welch test, and the Games –Howell post hoc test to test the hypothesis.
Table 1 displays descriptive statistics. The same sample size and different mean values are shown by all three categories of recovery channels where LokAdalats showed the highest mean value (2115723.36) and DRT showed its least value (21446.27) in comparison to the

other two categories. The table clearly shows that LokAdalats has the highest number of NPAs cases referred to as compared to the other two channels. Considering these results, it is necessary to determine whether or not the variation in mean scores of recovery mechanisms is significant.

Table 1: Descriptive Analysis

	N	Mean	Std. Deviation	Std. Error
LokAdalats	11	2115723.36	1569496.471	473220.991
DRTs	11	21446.27	14044.541	4234.589
SARFAESI	11	150914.45	56560.796	17053.722
Total	11	762694.70	1310601.901	228146.507

Source: Author's Calculations

The Levene test (Table 2) demonstrates that the assumption of variance homogeneity is not met ($p<0.05$) in the case of the number of cases referred. As a result, the Welch test is applied to determine whether there is a significant variation in the number of NPA cases referred to recovery channels. However, the Welch test [Welch's F $(2,14.106) = 35.202$, $p =.000$] in Table 3 indicates that the mean values of NPAs cases referred to these recovery channels differ. It implies that the null hypothesis is not accepted (Sig. <0.05), and the results show that there is a significant disparity in the number of cases admitted to recovery channels (LokAdalats, DRTs, SARFAESI).

Table 2: Test of Homogeneity of Variances

Number of Cases Referred			
Levene Statistic	df1	df2	Sig.
83.804	2	30	.000

Source: Author's Calculations

Table 3: Robust Tests of Equality of Means

Number of Cases Referred			
Welch Statistic	df1	df2	Sig.
35.202	2	14.106	.000*

Source: Author's Calculations
Note: Significant at *0.05 level

In addition to getting the significant result from the welch test we ran the Games – Howell post hoc test in (Table 4) to look at multiple comparisons which helped in identifying which categories of independent variables (recovery channels) differed from each other. In this paper Games–Howell post hoc test is applied. The analysis reveals that LokAdalats significantly differ from the Debt Recovery Tribunals and the SARFAESI Act. Debt Recovery Tribunals are also statistically distinct from SARFAESI Act.

Table 4: Games – Howell Post Hoc Results

(I) Recovery Channels	J) Recovery Channels	Mean Difference (I-J)	Std. Error	Sig.
Lok Adalats	DRT	2094277.091*	473239.93	.003
DRT	SARFAESI	-129468.182*	17571.601	.000
Lok Adalats	SARFAESI	1964808.909*	473528.179	.005

Source: Author's Calculations
Note: Significant at *0.05 level

Table 5: Descriptive Analysis

NPAs Amount Recovered				
	N	Mean	Std. Dev	Std. Error
Lok Adalats	11	4.91	2.773	.836
DRT	11	19.73	22.236	6.704
SARFAESI	11	25.55	7.992	2.410
Total	33	16.73	15.959	2.778

Source: Author's Calculations

Table 5 displays descriptive statistics. The same sample size and different mean values are shown by all three categories of recovery channels where SARFAESI showed the highest mean value (25.55) and LokAdalats showed its least value (4.91) in comparison to the other two categories. The table clearly shows that SARFAESI has the highest number of NPAs amount recovered as compared to the other two channels. Considering these outcomes, it is necessary to determine whether or not the variation in mean values of recovery mechanisms is significant.

The Levene test (Table 6) demonstrates that the assumption of variance homogeneity is not met ($p < 0.05$) in the case of NPAs amount recovered. As a result, the Welch test is used to determine whether there is a significant difference regarding the percentage of NPAs amount recovered through various recovery channels. However, the Welch test [Welch's $F (2, 14.928) = 32.998$, $p = .000$] in Table 7 indicates that the mean scores of NPAs amount recovered through various recovery methods. It implies that the null hypothesis is not accepted (Sig. < 0.05), and the results show that there is a significant disparity regarding the % of NPAs amount recovered through various recovery channels (SARFAESI, DRTs, LokAdalats).

Table 6: Test of Homogeneity of Variances

Number of Cases Referred			
Levene Statistic	df1	df2	Sig.
5.285	2	30	.011

Source: Author's Calculations
Note: Significant at *0.05 level

Table 7: Robust Tests of Equality of Means

Number of Cases Referred			
Welch Statistic	df1	df2	Sig.
32.998	2	14.928	.000*

Source: Author's Calculations
Note: Significant at *0.05 level

Table 8: Games – Howell Post Hoc Results

(I) Recovery Channels	J) Recovery Channels	Mean Difference (I-J)	Std. Error	Sig.
Lok Adalats	DRT	-14.818	6.756	.119
DRT	SARFAESI	-5.818	7.124	.700
Lok Adalats	SARFAESI	-20.636*	2.551	.000

Source: Author's Calculations
Note: Significant at *0.05 level

In addition to getting the significant result from the welch test we ran the Games – Howell post hoc test in (Table 8) to look at multiple comparisons which helped in identifying which categories of the independent variable (recovery channels) differed from each other. The result shows that the recovery channel of LokAdalats is significantly different from SARFAESI Act. But, DRTs are not statistically different from LokAdalats. Also, there is no statistical disparity found between DRT and SARFAESI Act.

Significant differences concerning NPAs cases referred to and their recovery was observed for the recovery mechanisms. Welch test and post hoc tests (Games – Howell) were conducted to examine the differences in the effectiveness of various recovery channels. The following are the findings for each of the hypotheses:

For H1: There is a significant difference (p< 0.05) in the cases admitted to recovery mechanisms (LokAdalats, Debt Recovery Tribunals, SARFAESI). The results show that LokAdalats differ significantly from DRTs and the SARFAESI Act. DRTs are also statistically distinct from the SARFAESI Act. LokAdalats have referred the highest number of cases as compared to other channels and seems important for banks.

For H2: There is a significant difference (p< 0.05) regarding % of NPAs amount recovered through various statutory bodies (DRTs, SARFAESI Act, DRTs, LokAdalats) in the period from 2008 to 2019.The results show that LokAdalats' recovery channel differs significantly from the SARFAESI Act. However, DRTs are not statistically different from LokAdalats. There is also no statistical disparity between Debt Recovery Tribunals and SARFAESI. SARFAESI Act has the maximum % of NPAs amount recovered and performs better than the other two recovery channels.

SARFAESI Act and Debt Recovery Tribunals proved to be more effective recovery mechanisms regarding % of NPAs amount recovered as compared to LokAdalats. The analysis suggested that there is no statistically significant disparity found in the performance of both DRTs and the SARFAESI Act. This finding is consistent with the results found by (Bhatt and Panda, 2017; Jain and Shaardha, 2016; Kumar and Alam, 2020; Kumar et al., 2017).

It is also observed that LokAdalatwas found to be ineffective in the case of NPAs recovery as large numbers of cases are pending in courts. This result is in line with the findings found by Kumar and Alam, 2020.Under Lok Adalats, slow resolution of cases and incomplete repayment of loans are also the main reason for a low rate of NPAs recovery (Alamelumangai and Sudha, 2019).

Conclusion

To address the issue of NPAs, the government has implemented a variety of mechanisms, including the establishment of Lok Adalats, DRTs, and the enactment of laws such as the SARFAESI Act and the IBC Code, 2016. The research concludes that the proportion of the amount recovered is higher in the case of the SARFAESI Act when compared to other mechanisms for dealing with stressed assets. The impact of Lok Adalats on recovering NPAs is minimal due to their low recovery rate. According to the findings of the study, there are numerous reasons for the low recovery rate of NPAs, including ineffective recovery mechanisms, poor law enforcement, delays in court proceedings, and many others. This study has some significant policy implications for future policy changes to address the problem of non-performing assets as well as for bank regulators to address the deficiency in these recovery mechanisms. These recovery measures must be strengthened to boost the recovery rate and long-term financial stability of the Indian banking sector.

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