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IMPACT OF NON-PERFORMING ASSETS IN INDIA IN THE PHASE OF NATIONALISATION OF BANKS

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NATIONALISATION OF BANKS

Government decided to nationalize 14 major commercial banks on 19th July, 1969. All commercial banks with a deposit base over Rs.50 crores were nationalized. It was considered that banks were controlled by business houses and thus failed in catering to the credit needs of poor sections such as cottage industry, village industry, farmers, craft men, etc. The second dose of nationalisation came in April 1980 when banks were nationalized. Nationalisation is basically the takeover of the ownership of the bank by the government. Though social control is different from the nationalisation. In nationalisation the control and ownership both are taken up by the government while in the social control the ownership does not rest with the government. Social control implies restricted freedom to the bankers; it imposes duty on the banks to credit the rural areas in pursuance to the social welfare.

MAIN OBJECTIVE OF NATIONALISATION OF BANKS:

- **CONTROLLING PRIVATE MONOPOLIES:**-It removed the control of the industrialists from the banks. Before the nationalisation many banks were controlled by the private individuals and the corporate families which lead to the monopoly. Nationalisation helped in checking the monopoly to ensure a continuous supply of credit to the socially desirable sections.
- It ensures the use of bank credit for the productive purpose.
- **PRIORITY SECTOR LENDING:** Credit was given to the priority sector which was neglected before the nationalisation. By opening new branches and by taking the control over the banks has helped to give credit to the needy people.
- It encouraged the new entrepreneurs.
- It provided adequate training as well as reasonable terms of service to bank staff.

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- The nationalisation of banks aims to spread the banking habits of the people who are living in rural or remote areas which contribute to the large population of the country (like people engaged in the business of agriculture).
- It also helped in decreasing the imbalance created between the urban and the rural areas.²

- **DIRECTED CREDIT AND NPA**

If we take an example in which borrowers are industrialist and the farmer. The bank who wants to earn profit by high interest rate and lending more shall go to the one who can pay high interest rate but in case of India who concentrated lending practices in favour of priority sector which was farmers and the rural area with less interest rate led the bank crisis and the financial crisis.

Directed credit was a policy of the government of India to direct certain percentage of the credit to important and prior sector of the economy that government felt disadvantaged by the banking system.³

Directed credit has its origins in the “social control” policy of the government in 1967. At this time, it was felt that banks were engaged largely in financing the industries and the high income businesses without giving any attention to the needs of the agriculture and other needy sectors. Government had the idea to finance the small ventures and agriculture sector. Social control was first theory of the government to make it mandatory for the banks to provide credit to certain sectors. However, this policy is widely viewed as ineffective and one of the motivations behind the bank nationalisation of 1969 was its ineffectiveness. After 1969, the government mandated that 33% of all credit extended by banks be reserved to strategic sectors of the economy. And since banks have more choices in which they lend to, economic theory tells us that banks will have less NPAs (Non Performing Assets) and greater profits.

After nationalisation banks went in the government sector. Ordinarily political strengths pressurized them. banking could not done on expert and moral grounds. It came about into lower proficiency and poor gainfulness of banks. Numerous public sector banks severely endured because of the political impedance. It was found in managing the laons. It eventually brought about tremendous non-performing asects (NPA) of these banks and wastefulness.

² M L Tannan, *Banking: Law and Practice* 306 .(Lexis Nexis, Nagpur, 23rd edn, 2010)

³ Mark Miller, “Political economy of directed control”, *available at* http://ccs.in/internship_papers/2002/30.pdf (last Modified on April 4, 2016)

Since bank nationalisation in 1969, banks have performed very poorly from an economic point of view. According to S L Rao, “the country’s banking system became a playground for political interference with loan ‘melas’ and loan write offs, and consequent decline in the quality of assets of the banks and financial institutions.” In the year 1993/1994, nonperforming assets comprised 22% of banks loan portfolios. And in 1995, 50% of all NPAs were invested in priority sectors, while banks were only required to lend 40% of available funds to priority sectors. Since the government was creating artificial distortions in the market for loanable funds, economic theory tells us that this will lead to inefficient investment. Truth be told, this is precisely what we watch. For the Indian economy in general, the normal rate of profit for assets in the period 1985-1990 was a negligible 15%, which is entirely poor by global models. As banks are the essential vehicle for giving venture reserves, we can absolutely expect that a bank worried with its own particular budgetary execution would diminish the quantity of non-performing assets and along these lines upgrade the productivity of assets.

The former table shows two essential actualities: domestic banks have a higher extent of their assets in NPAs than outside banks and the proportion of NPAs to total asset has been declining from 1998-1999 to 2000-2001. One conceivable purpose behind the lower extent of NPAs for foreign banks is the less lending requirements are imposed on these banks. NPAs as a rate of aggregate resources has diminished over all banks for the two years taking after RBI's coordinated credit change. Lamentably, since the directed credit reforms were instituted under four years back as of mid-2002, there is lacking information to exhibit in a factually thorough way that RBI's changes have prompted less non-performing resources and more noteworthy bank benefit. In any case, the damage that directed credit did in the past is generally clear and uncontroversial. The information give a few hints that NPAs as an extent of aggregate resources are diminishing and that the rate of NPAs in the need part is diminishing, yet additional time is expected to deduce an unmistakable, causal relationship.

The government’s policy of directed credit resulted in less monitoring of repayment and loan risk on the part of Indian banks (Rangarajan, pp 113). Also, the lack of autonomy of public sector banks is often blamed for the lower profitability of these institutions. We can conclude that the high degree of non-performing assets and low productivity of capital that we observed in the Indian economy in the late 80s and early 90s was caused in part by directed credit.

- **NPA classification & settlement of issues at an early stage itself**

The first issue is relating to the classification of the non-profit assets. Some borrower have the opinion that the banks harass them under the SARFAESI act, 2002. According to them they are not wilful defaulter and even in case of default they are willing to pay the loan amount but bank classify their loan as non-performing assets even there is possibility of recovery of the payment. As there no standardised regulations relating to the rule for classifying any loan as bad loan. Though RBI has issued some guild lines in relation to this subject-matter but question is raised as to how RBI should use these guild lines to classify non-performing asset.

In a case of Andhra Pradesh high court in M/s. Sri Srinivasa Rice and Floor Mill Vs. State Bank of India⁴ held that “A wide margin of discretion is available to the respondent bank as the secured creditor, within the legislative presents of the Act, to assess and classify a debt but within the legislative framework. This Court is not constituted an appellate authority over the bank’s exercise of discretion in this area. The respondent bank, as legislatively recognized is an institution having the requisite expertise to form a commercial judgment on known principles of banking practices and procedures fertilized by R.B.I directions and guidelines to assess and classify a debt as NPA.”

In my opinion loan account delt by the banks is not mandatory for them to intimate their clients about the classification of the NPA but some of the banks do so to maintain good relations with their customers. But on some cases the banks get resort directly under section 13 of the act though bank can at this stage consider the proposal for regularization of accounts.

- **Powers of DRT:**

Under section 17 of the SARFAESI act 2002 a appeal can be preferred by the borrower if he is satisfied with the possession under section 13(4) of the said act within a prescribed time. However, courts have rightly made it clear that borrower can initiated appeal in any matter relating to the action taken by banks in pursuant to section 13but the procedural aspect and the powers of DRT is in issue. . From the stage of maintaining that ‘the DRT is supposed to only look into the procedural issues’, with the interpretation of Courts, the scope of powers of DRT under section 17 of SARFAESI Act, 2002 is significantly expanded though certain issues still requires consideration. The foremost point is the power of DRT to set aside the order of

⁴ AIR 2007 AP 252

possession and transaction including sale. the criticism here is the tribunal helps the bank to deal in the technical grounds and to deal with the customer. The procedure should be that borrower should have the privilege that tribunal will deal with banks. If the DRT is hesitant or not effective in addressing all the issues raised by the borrower in his appeal under section 17, then, the borrower will be left with no remedy and he can not also approach the Civil Court in view of section 34 and even if he approaches the Civil Court, it is very difficult to convince and maintain a Civil Suit in respect of a loan transaction where the Bank has initiated SARFAESI proceedings.

- **Sale of assets by banks:**

The main problem borrowers are facing is that they don't get fair value of their assets. Banks who took the possession of the assets are the trustee of the assets and they have the responsibility to sale the asset at the best price in the auction but due to the failure of the banks the debtors do not get the fair value of the asset and it becomes very difficult for the borrowers to fight with the banks. There may be a case where the bidder and the purchaser has paid the whole consideration and when the case comes under the court's litigation, it leads to the non-conferment of complete ownership right. If the gap between the payment of sale consideration and conferment is more the bidder or purchaser is also in trouble as he will only get a minimum interest over his investment if the Sale is finally set-aside and the Bank is asked to repay the Sale Consideration to the auction-purchaser.