

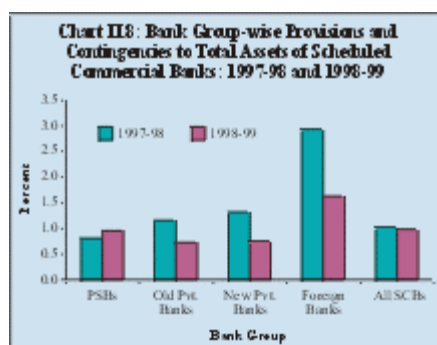
Developments in Commercial Banking

3. Financial Performance of Scheduled Commercial Banks

Foreign Banks

2.40 Total assets of foreign banks⁴ as at end-March 1999 constituted 8.1 per cent of the total assets of all SCBs. The operating profits of foreign bank group declined by 23.8 per cent from Rs.2,544.5 crore in 1997-98 to Rs.1,939.6 crore in 1998-99. The ratio of operating profits to total assets declined by 1.38 percentage points from 3.91 per cent in 1997-98 to 2.53 per cent in 1998-99. The decline in operating profits of foreign banks during the year could be attributed to the substantial increase in operational costs, i.e., interest expended (23.2 per cent) and operating expenses (33.6 per cent). During 1998-99, the operating profit ratio of these banks was higher than the SCBs' ratio of 1.47 per cent. The provisions and contingencies showed a decline of 1.31 percentage points from 2.94 per cent in 1997-98 to 1.63 per cent in 1998-99 ([Chart II.8](#)). The ratio of net profits to total assets of these banks declined from 0.97 per cent in 1997-98 to 0.90 per cent in 1998-99 ([Table II.15](#)).

2.41 On the cost side, the ratio of intermediation cost to total assets increased from 2.97 per cent in 1997-98 to 3.37 per cent in 1998-99. An analysis of cost structure of the SCBs indicates that the intermediation cost ratio of foreign banks at 3.37 per cent is higher than that of all SCBs (2.65 per cent). The wages and automation expenses accounting for a major share in operating expenses led to its increase during the year. The spread of foreign bank group at 3.47 per cent in 1998-99 is higher than the spread of all as well as the sub-groups of SCBs ([Chart II.9](#)). However, it is important to note that out of forty four banks, four banks *viz.*, Citibank, ANZ Grindlays Bank Ltd., Standard Chartered Bank, and Bank of America NT&SA, accounted for 52.4 per cent, 71.8 per cent, and 87.5 per cent in total assets, operating profits, and net profits of this group respectively. Appendix [Tables II.6 \(A\)](#), [II.6 \(B\)](#), [II.6 \(C\)](#), [II.6 \(D\)](#), [II.6 \(E\)](#), [II.6 \(F\)](#), [II.6 \(G\)](#), [II.6 \(H\)](#) provide bank-wise details of certain financial indicators of foreign banks in India.



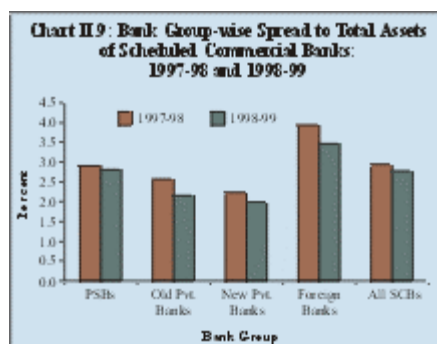


Table II.14: Financial Performance of New Private Sector Banks for the years 1997-98 and 1998-99

Item	(Rs. crore)			
	1997-98	1998-99	Variation of	
			Column (3) over (2)	
			Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	3,015.07	4,130.49	1,115.42	36.99
	(100.00)	(100.00)		
i) Interest Income	2,395.21	3,540.88	1,145.67	47.83
	(79.44)	(85.73)		
ii) Other Income	619.86	589.61	-30.25	-4.88
	(20.56)	(14.27)		
B. Expenditure (i+ii+iii)	2,615.55	3,733.44	1,117.89	42.74
	(100.00)	(100.00)		
i) Interest Expended	1,819.79	2,776.94	957.15	52.60
	(69.58)	(74.38)		
ii) Provisions and Contingencies	340.04	287.23	-52.81	-15.53
	(13.00)	(7.69)		
iii) Operating Expenses	455.72	669.27	213.55	46.86
	(17.42)	(17.93)		
<i>of which : Wage Bill</i>	79.57	119.72	40.15	50.46
	(3.04)	(3.21)		
C. Profit				
i) Operating Profit	739.56	684.28	-55.28	-7.47
ii) Net Profit	399.52	397.05	-2.47	-0.62
D. Total Assets	25,844.94	38,530.87	12,685.93	49.08
E. Financial Ratios (per cent) \$				
i) Operating Profit	2.86	1.78	-1.08	-
ii) Net Profit	1.55	1.03	-1.52	-
iii) Income	11.67	10.72	-0.95	-

iv) Interest Income	9.27	9.19	-0.08	-
v) Other Income	2.40	1.53	-0.87	-
vi) Expenditure	10.12	9.69	-0.43	-
vii) Interest Expended	7.04	7.21	0.17	-
viii) Operating Expenses	1.76	1.74	-0.02	-
ix) Wage Bill	0.31	0.31	0.00	-
x) Provisions and Contingencies	1.32	0.75	-0.57	-
xi) Spread (Net Interest Income)	2.23	1.98	-0.24	-

Notes : 1. \$ Ratios to Total Assets.

2. Figures in brackets are percentage shares to the respective total.

Table II.15: Financial Performance of Foreign Banks in India for the years 1997-98 and 1998-99

Item	1997-98	1998-99	(Rs. crore)	
			Variation of	
			Absolute	Percentage
1	2	3	4	5
A. Income (i+ii)	8,697.53	9,719.02	1,021.49	11.74
	(100.0)	(100.0)		
i) Interest Income	6,783.09	7,857.13	1,074.04	15.83
	(77.99)	(80.84)		
ii) Other Income	1,914.44	1,861.89	-52.55	-2.74
	(22.01)	(19.16)		
B. Expenditure (i+ii+iii)	8,067.56	9,025.65	958.09	11.88
	(100.00)	(100.00)		
i) Interest Expended	4,222.29	5,200.57	978.28	23.17
	(52.34)	(57.62)		
ii) Provisions and Contingencies	1,914.57	1,246.24	-668.33	-34.91
	(23.73)	(13.81)		
iii) Operating Expenses	1,930.70	2,578.84	648.14	33.57
	(23.93)	(28.57)		
<i>of which : Wage Bill</i>	618.72	769.86	151.14	24.43
	(7.67)	(8.53)		
C. Profit				
i) Operating Profit	2,544.54	1,939.61	-604.93	-23.77
ii) Net Profit	629.97	693.37	63.40	10.06
D. Total Assets	65,097.71	76,623.13	11,525.42	17.70
E. Financial Ratios (per cent) \$				
i) Operating Profit	3.91	2.53	-1.38	-
ii) Net Profit	0.97	0.90	-0.07	-

iii) Income	13.36	12.68	-0.68	-
iv) Interest Income	10.42	10.25	-0.17	-
v) Other Income	2.94	2.43	-0.51	-
vi) Expenditure	12.39	11.78	-0.61	-
vii) Interest Expended	6.49	6.79	0.30	-
viii) Operating Expenses	2.97	3.37	0.40	-
ix) Wage Bill	0.95	1.00	0.05	-
x) Provisions and Contingencies	2.94	1.63	-1.31	-
xi) Spread (Net Interest Income)	3.93	3.47	-0.46	-

Notes : 1. \$ Ratios to Total Assets.

2. Number of banks for 1997-98 and 1998-99 are 42 and 44 respectively.

3. Figures in brackets are percentage shares to the respective total.

Off-Balance Sheet Activities of Scheduled Commercial Banks

2.42 The off-balance sheet activities of SCBs include the activities relating to the forward exchange contracts, guarantees and acceptances, endorsement, etc. The off-balance sheet exposures of SCBs have shown a decline of 3.4 per cent from Rs.4,74,094 crore in 1997-98 to Rs.4,57,855 crore in 1998-99. The off-balance sheet exposure (contingent liabilities) as a proportion to the total liabilities of all SCBs has also declined by 11.4 percentage points from 59.6 per cent in 1997-98 to 48.2 per cent in 1998-99. Such decline in off-balance sheet exposures can be attributed to the discernible decline in the proportion of forward exchange contracts by 10.0 percentage points from 45.2 per cent in 1997-98 to 35.2 per cent in 1998-99.

2.43 An intra-sectoral analysis indicates that as a proportion to total liabilities, the highest decline in the off-balance sheet exposures (contingent liabilities) was found in the case of foreign banks (79.6 percentage points from 367.6 per cent in 1997-98 to 288.0 per cent in 1998-99), followed by new private sector banks (30.4 percentage points from 113.5 per cent in 1997-98 to 83.1 per cent in 1998-99), old private sector banks (7.6 percentage points from 31.8 per cent in 1997-98 to 24.2 per cent in 1998-99), and public sector banks (4.3 percentage points from 28.9 per cent in 1997-98 to 24.6 per cent in 1998-99). The decline in such off-balance sheet exposure of all bank groups is mainly attributed to the decline in the proportion of forward exchange contracts in their respective total liabilities. The proportion of forward exchange contracts in total liabilities, declined by 76.9 percentage points (from 328.3 per cent in 1997-98 to 251.4 per cent in 1998-99) in the case of foreign banks, 28.0 percentage points (from 89.4 per cent in 1997-98 to 61.4 per cent in 1998-99) in case of new private sector banks, 8.1 percentage points (from 25.3 per cent in 1997-98 to 17.2 per cent in 1998-99) in case of old private sector banks and 2.9 percentage points (from 16.8 per cent in 1997-98 to 13.9 per cent in 1998-99) in case of public sector banks ([Table II.16](#)) ([Chart II.10](#)).

2. Autonomy granted by the Government of India to PSBs is subject to fulfilling the following criteria: 1. Positive net profits for the last three years. 2. Capital Adequacy Ratio of more than 8 per cent. 3. Net NPA level below 9 per cent of the net advances. 4. Minimum owned funds of Rs.100 crore.

3. Bareilly Corporation Bank Ltd. was placed under moratorium on March 8, 1999 and was

subsequently amalgamated with the Bank of Baroda w.e.f. June 3, 1999. The figures for this bank are as on March 8, 1999.

4. During the year, the following changes took place relating to the number of foreign banks in India. The Commercial Bank of Korea stopped doing banking business in India w.e.f. January 1, 1998. Its licence was cancelled on May 18, 1999 and went outside the purview of Banking Regulation Act, 1949 on May 22, 1999. Accordingly, the figures of this bank for the year 1998-99 are not included in this Report. Hanil Bank has been excluded from the Second Schedule to the Reserve Bank of India Act, 1934, vide Reserve Bank of India notification dated August 28, 1999. The British Bank of Middle East has been excluded from the Second Schedule to the Reserve Bank of India Act, 1934, vide Reserve Bank of India notification dated September 25, 1999. Three new foreign banks came into existence and these include (a) Bank Muscat International (w.e.f. 9.9.1998), (b) Morgan Guaranty Trust Company of New York (w.e.f. 24.12.98), and (c) K.B.C. Bank N.V. (w.e.f. 15.02.1999).

Developments in Commercial Banking

4. Non-Performing Assets

2.44 While the non-performing assets (NPAs) of PSBs showed a marginal decline, an increase was witnessed in all other bank groups. During the year 1998-99, number of PSBs with net NPAs upto 10 per cent increased by one to 18 and the number of banks with net NPAs in the range of 10 per cent to 20 per cent declined by one to 8 with one bank continuing to show NPAs above 20 per cent ([Table II.17](#)). The number of old private sector banks with the net NPAs below 10 per cent was 17 as against 21 in 1997-98; those above 20 per cent were 3 as against nil in the last three years. In the case of foreign banks, those with net NPAs upto 10 per cent declined from 34 to 27 over the year and those above 20 per cent stood at 3 as against 2 in the last year. The number of foreign banks with net NPAs ranging between 10 to 20 per cent increased to 11 from 6 in the preceding year ([Table II.18](#)).

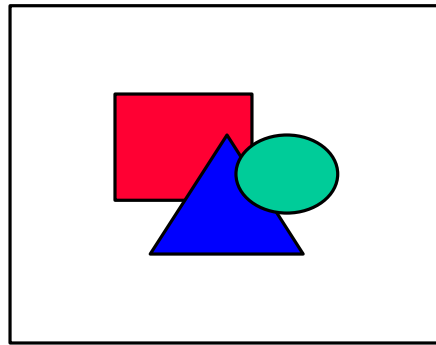


Table II.16: Off-Balance Sheet Exposure of Scheduled Commercial Banks in India: 1997-98 and 1998-99

Item	(Rs. crore)									
	State Bank Group			Nationalised Banks			Public Sector Banks			
	1997-98	1998-99	Variations	1997-98	1998-99	Variations	1997-98	1998-99	Variations	10
1. Forward exchange contract	37,614.53	42,572.15	13.18	71,455.44	64,608.26	-9.58	1,09,069.97	1,07,180.41	-1.73	
	(16.15)	(14.89)	-1.26	(17.15)	(13.34)	-3.81	(16.79)	(13.91)	-2.88	

2. Guarantees given	16,757.13 (7.20)	17,670.05 (6.18)	5.45 -1.02	23,259.33 (5.58)	24,321.51 (5.02)	4.57 -0.56	40,016.46 (6.16)	41,991.56 (5.45)	4.94 -0.71
3. Acceptances, endorsements, etc.	16,848.35 (7.24)	16,564.52 (5.79)	-1.68 -1.44	22,044.29 (5.29)	23,570.69 (4.87)	6.92 -0.42	38,892.64 (5.99)	40,135.21 (5.21)	3.19 -0.78
Total Contingent Liabilities	71,220.01 (30.59)	76,806.72 (26.86)	7.84 -3.72	1,16,759.06 (28.02)	1,12,500.46 (23.22)	-3.65 -4.80	1,87,979.07 (28.94)	1,89,307.18 (24.58)	0.71 -4.37

	New Private Sector Banks			Old Private Sector Banks			Foreign Banks			All SCBs		
	1997-98	1998-99	Variations	1997-98	1998-99	Variations	1997-98	1998-99	Variations	1997-98	1998-99	Variations
	11	12	13	14	15	16	17	18	19	20	21	
1. Forward exchange contract	23,099.92 (89.38)	23,663.40 (61.41)	2.44 -27.96	13,890.47 (25.27)	11,233.17 (17.17)	-19.13 -8.10	2,13,699.30 (328.27)	1,92,645.03 (251.42)	-9.85 -76.86	3,59,759.66 (45.23)	3,34,722.01 (35.20)	-1
2. Guarantees given	3,148.90 (12.18)	4,116.01 (10.68)	30.71 -1.50	2,044.18 (3.72)	2,540.44 (3.88)	24.28 0.16	13,062.20 (20.07)	14,154.24 (18.47)	8.36 -1.59	58,271.74 (7.33)	62,802.25 (6.60)	
3. Acceptances, endorsements, etc.	3,081.48 (11.92)	4,223.39 (10.96)	37.06 -0.96	1,559.49 (2.84)	2,062.93 (3.15)	32.28 0.32	12,529.12 (19.25)	13,909.63 (18.15)	11.02 -1.09	56,062.73 (7.05)	60,331.16 (6.34)	
Total Contingent Liabilities	29,330.30 (113.49)	32,002.80 (83.06)	9.11 -30.43	17,494.14 (31.83)	15,836.54 (24.21)	-9.48 -7.62	2,39,290.62 (367.59)	2,20,708.90 (288.04)	-7.77 -79.54	4,74,094.13 (59.60)	4,57,855.42 (48.15)	-1

Notes : 1. Figures in brackets are percentages to Total Assets.

2. The variations relating to the 'amounts' indicate the percentage variation in 1998-99 over 1997-98.

3. The variations relating to the 'percentage to Total Assets' given in brackets indicate the simple change in such figures during 1998-99 as compared to 1997-98.

Table II.17: Distribution of Net NPAs by Number of Public Sector Banks: 1995 to 1999

Net NPAs/ Net Advances	(Number of banks)				
	End-March				
	1995	1996	1997	1998	1999
1. Upto 10 per cent	2	19	17	17	18
2. Above 10 and upto 20 per cent	15	6	9	9	8
3. Above 20 per cent	10	2	1	1	1

Table II.18: Distribution of Net NPAs by Number of Indian Private Sector Banks and Foreign Banks in India: 1996 to 1999

Net NPAs/ Net Advances	(Number of banks)			
	End-March			
	1996	1997	1998	1999
Old Indian Private Sector Banks				
1. Upto 10 per cent	22	22	21	17
2. Above 10 and upto 20 per cent	3	3	4	5
3. Above 20 per cent	Nil	Nil	Nil	3
New Indian Private Sector Banks				
1. Upto 10 per cent	9	9	9	9
2. Above 10 and upto 20 per cent	Nil	Nil	Nil	Nil
3. Above 20 per cent	Nil	Nil	Nil	Nil

Foreign Banks in India @

1. Upto 10 per cent	30	36	34	27
2. Above 10 and upto 20 per cent	1	1	6	11
3. Above 20 per cent	Nil	2	2	3

Notes: @ Number of banks having nil NPAs for 1996, 1997, 1998 and 1999 were 12, 16, 14 & 9 respectively. For 1999, 3 banks' NPAs are not available.

2.45 An analysis of NPAs of different bank groups showed that with the exception of public sector banks (PSBs), the other bank groups (i.e. private sector and foreign banks) witnessed increases during 1998-99 ([Table II.19](#)). In the case of PSBs, marginal decline in NPAs ratio was mainly aided by an increase in the share of standard assets and commensurate declines in the shares of doubtful and sub-standard assets ([Table II.20](#)). However, the declining trend of NPAs of SCBs witnessed till the year 1997-98 could not be sustained in 1998-99. The gross NPAs to total assets of SCBs, however, declined from 6.4 per cent in 1997-98 to 6.2 per cent in 1998-99 and net NPAs to net total assets also declined from 3.0 per cent in 1997-98 to 2.9 per cent in 1998-99.

Public Sector Banks

2.46 An analysis of NPAs of different bank groups indicate that PSBs hold larger share of NPAs. During the year 1998-99, the level of gross NPAs to gross advances declined from 16.0 per cent in 1997-98 to 15.9 per cent in 1998-99 facilitated by a marginal reduction in sub-standard and doubtful assets and concomitant increase in standard assets. The share of standard assets to gross advances increased from 84.0 per cent in 1997-98 to 84.1 per cent in 1998-99. Similarly, net NPAs to net advances declined from 8.2 per cent in 1997-98 to 8.1 per cent in 1998-99. However, in absolute terms, both gross and net NPAs registered substantial increases. While gross NPAs increased from Rs.45,653 crore in 1997-98 to Rs.51,710 crore in 1998-99 ([Table II.19](#)), net NPAs moved up from Rs.21,232 crore in 1997-98 to Rs.24,211 crore in 1998-99. The gross NPAs as a fraction of total assets declined from 7.0 per cent in 1997-98 to 6.7 per cent in 1998-99 and net NPAs, as a percentage to total assets declined from 3.3 per cent in 1997-98 to 3.1 per cent in 1998-99. Further details are given in Appendix [Tables II.7A](#) and [II.7B](#).

Table II.19: Bank Group-wise Gross and Net NPAs of Scheduled Commercial Banks: 1997 to 1999 (as at end-March)

Bank Groups/Years	(Amount in Rs. crore)							
	Gross NPAs				Net NPAs			
	Gross Advances	Gross NPAs	Per cent to Gross Advances	Per cent to Total Assets	Net Advances	Net NPAs	Per cent to Net Advances	Per cent to Total Assets
1	2	3	4	5	6	7	8	9
Scheduled Commercial Banks								
1997	3,01,698	47,300	15.7	7.0	2,76,421	22,340	8.1	3.3
1998	3,52,697	50,815	14.4	6.4	3,25,522	23,761	7.3	3.0
1999	4,01,253	58,554	14.6	6.2	3,70,397	27,774	7.5	2.9
Public Sector Banks								
1997	2,44,214	43,577	17.8	7.8	2,20,922	20,285	9.2	3.6

1998	2,84,971	45,653	16.0	7.0	2,60,459	21,232	8.2	3.3
1999	3,25,328	51,710	15.9	6.7	2,97,789	24,211	8.1	3.1
All Private Sector Banks								
1997	29,959	2,542	8.5	4.2	28,646	1,539	5.4	2.5
1998	36,753	3,186	8.7	3.9	35,411	1,863	5.3	2.3
1999	44,492	4,643	10.4	4.5	42,717	2,956	6.9	2.8
Old Private Sector Banks								
1997	21,702	2,325	10.7	5.2	20,832	1,385	6.6	3.1
1998	25,580	2,794	10.9	5.1	24,353	1,572	6.5	2.9
1999	29,105	3,773	13.0	5.8	27,692	2,332	8.4	3.6
New Private Sector Banks								
1997	8,257	217	2.6	1.3	7,814	154	2.0	1.0
1998	11,173	392	3.5	1.5	11,058	291	2.6	1.1
1999	15,387	871	5.7	2.3	15,025	623	4.1	1.6
Foreign Banks in India								
1997	27,525	1,181	4.3	2.1	26,853	516	1.9	0.9
1998	30,972	1,976	6.4	3.0	29,652	666	2.2	1.0
1999	31,433	2,201	7.0	2.9	29,890	607	2.0	0.8

Notes: 1. Figures are provisional.
2. Constituent items may not add up to the totals due to rounding off.

Source: 1. Returns submitted by respective banks.
2. Balance sheet of respective banks.

Table II.20: Bank Group-wise Classification of Loan Assets of Scheduled Commercial Banks: 1997 to 1999 (as at end-March)

Bank Groups/ Years	(Amount in Rs. crore)										
	Standard Assets		Sub-standard Assets		Doubtful Assets		Loss Assets		Total NPAs		Total Advances
	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount
1	2	3	4	5	6	7	8	9	10	11	12
Scheduled Commercial Banks											
1997	2,54,446	84.3	14,500	4.8	27,165	9.0	5,634	1.9	47,300	15.7	3,01,698
1998	3,01,877	85.6	17,428	4.9	27,146	7.7	6,242	1.8	50,815	14.4	3,52,696
1999	3,42,428	85.3	19,813	4.9	31,301	7.8	7,441	1.9	58,555	14.6	4,01,253
Public Sector Banks											
1997	2,00,637	82.2	12,472	5.1	26,015	10.7	5,090	2.1	43,577	17.8	2,44,214
1998	2,39,318	84.0	14,463	5.1	25,819	9.1	5,371	1.9	45,653	16.0	2,84,971
1999	2,73,618	84.1	16,033	4.9	29,252	9.0	6,425	2.0	51,710	15.9	3,25,328
All Private Sector Banks											
1997	27,417	91.5	1,370	4.6	889	3.0	283	0.9	2,542	8.5	29,959
1998	33,567	91.3	1,766	4.8	1,077	2.9	343	0.9	3,186	8.7	36,753
1999	39,848	89.6	2,655	6.0	1,584	3.6	404	0.9	4,643	10.4	44,492
Old Private Sector Banks											
1997	19,377	89.3	1,199	5.5	885	4.1	241	1.1	2,325	10.7	21,702
1998	22,786	89.1	1,402	5.5	1,068	4.2	324	1.3	2,794	10.9	25,580
1999	25,332	87.0	1,918	6.6	1,456	5.0	398	1.4	3,773	13.0	29,105
New Private Sector Banks											
1997	8,040	97.4	171	2.1	4	0.0	42	0.5	217	2.6	8,257

1998	10,781	96.5	365	3.3	9	0.1	19	0.2	392	3.5	11,173
1999	14,516	94.3	737	4.8	128	0.8	6	0.0	871	5.7	15,387
Foreign Banks in India											
1997	26,392	95.9	658	2.4	261	0.9	261	0.9	1,181	4.3	27,525
1998	28,992	93.6	1,198	3.9	250	0.8	528	1.7	1,976	6.4	30,972
1999	28,962	92.1	1,124	3.6	465	1.5	612	1.9	2,201	7.0	31,433

- Notes :
1. Figures are provisional.
 2. NPAs consist of assets including (i) Sub-standard, (ii) Doubtful, and (iii) Loss Assets. An asset becomes (i) Substandard when it is classified as NPA for a period not exceeding two years, (ii) Doubtful when it remains NPA for a period exceeding two years, and (iii) Loss when it is identified asset either by a bank or an internal or external auditors or under RBI instructions, but not written off.
 3. Constituent items may not add up to the totals due to rounding off.
- Source :
1. Returns submitted by respective banks.
 2. Balance sheet of respective banks.

2.47 Sector-wise analysis of NPAs of PSBs indicates that the share of NPAs of priority sector has declined from 50.0 per cent at end-March 1995 to 43.7 per cent at end-March 1999. This indicates marked improvements in the loan portfolio of PSBs in the category of 'priority sector' ([Table II.21](#)).

Private Sector Banks

2.48 During 1998-99, NPAs of private sector bank (both old and new private sector banks) witnessed significant increases affected by the substantial decline in standard assets. A similar trend was seen in the case of the foreign bank group. While gross NPAs of all private banks increased from 8.7 per cent during 1997-98 to 10.4 per cent during 1998-99, the net NPAs to net advances indicated an increase from 5.3 per cent during 1997-98 to 6.9 per cent during 1998-99. Also another concern is the increase in the share of NPAs to total assets. The gross NPAs to total assets increased from 3.9 per cent in 1997-98 to 4.5 per cent in 1998-99 and that of net NPAs to total assets rose from 2.3 per cent during 1997-98 to 2.8 per cent during 1998-99. Further details are given in Appendix [Tables II.7C](#) and [II.7D](#).

Old Private Sector Banks

2.49 Among the private sector bank group, the NPAs of old private sector bank group showed higher increases during 1998-99 mainly due to significant declines in standard assets. The 'standards assets' to total advances declined from 89.3 per cent in 1996-97 to 89.1 per cent in 1997-98 and further to 87.0 per cent in 1998-99.

2.50 The gross NPAs to total advances of old private sector bank group increased from 10.9 per cent in 1997-98 to 13.0 per cent in 1998-99. Similarly, net NPAs to net advances also increased from 6.5 per cent in 1997-98 to 8.4 per cent in 1998-99. Another concern is the increasing share of NPAs to total assets during the year. The gross NPAs to total assets of old private sector bank group moved up from 5.1 per cent during 1997-98 to 5.8 per cent during 1998-99. Likewise, net NPAs to total assets increased from 2.9 per cent in 1997-98 to 3.6 per cent in 1998-99.

New Private Sector Banks

2.51 During 1998-99, the new private sector bank group had the smallest share of NPAs but showed substantial increases in NPAs. Besides, new private sector banks maintained the highest

share of 'standard assets' to total advances than all other banking groups even though it has indicated a decline during the year. The gross NPAs to total advances of new private sector bank group increased from 3.5 per cent in 1997-98 to 5.7 per cent in 1998-99 mainly effected by the marginal declines in standard assets. In regard to the share of net NPAs to net advances of new private sector banks, it increased from 2.6 per cent in 1997-98 to 4.1 per cent in 1998-99. The gross NPAs to total assets also increased from 1.5 per cent in 1997-98 to 2.3 per cent in 1998-99. Like wise, the net NPAs to total assets also increased from 1.1 per cent in 1997-98 to 1.6 per cent in 1998-99.

Foreign Banks

2.52 During 1998-99, the NPAs of foreign bank group were on the rise as a result of steady decline in standard assets. The share of standard assets to total advances has come down from 95.9 per cent in 1996-97 to 93.6 per cent in 1997-98 and further to 92.1 per cent in 1998-99. The gross NPAs to total advances increased from 6.4 per cent during 1997-98 to 7.0 per cent during 1998-99. In respect of the share of net NPAs to net advances during 1998-99, it is the lowest among various bank groups. The share of net NPAs declined from 2.2 per cent in 1997-98 to 2.0 per cent in 1998-99. The gross NPAs as a percentage of total assets witnessed decline from 3.0 per cent during 1997-98 to 2.9 per cent during 1998-99 and net NPAs to total assets also declined from 1.0 per cent during 1997-98 to 0.8 per cent during 1998-99. Further details are given in Appendix [Tables II.7E](#) and [II.7F](#).

Table II.21: Sector-wise NPAs of Public Sector Banks: 1995 to 1999

Bank Group	(Rs. crore)			
	Priority Sector	Non-priority Sector	Public Sector	Total
1	2	3	4	5
March 1995				
1. SBI	6,966 (52.5)	5,495 (41.4)	809 (6.1)	13,271 (100.0)
2. Nationalised Banks	12,242 (48.7)	12,366 (49.2)	507 (2.0)	25,114 (100.0)
3. PSBs (1+2)	19,208 (50.0)	17,861 (46.5)	1,316 (3.4)	38,385 (100.0)
March 1996				
1. SBI	7,041 (53.7)	5,263 (40.1)	816 (6.2)	13,120 (100.0)
2. Nationalised Banks	12,065 (45.6)	13,804 (52.2)	595 (2.3)	26,464 (100.0)
3. PSBs (1+2)	19,106 (48.3)	19,067 (48.2)	1,411 (3.6)	39,584* (100.0)
March 1997				
1. SBI	7,247 (50.4)	6,291 (43.8)	829 (5.8)	14,368 (100.0)

2. Nationalised Banks	13,527 (46.3)	15,050 (51.5)	632 (2.2)	29,209 (100.0)
3. PSBs (1+2)	20,774 (47.7)	21,341 (49.0)	1,461 (3.3)	43,577 (100.0)
March 1998				
1. SBI	7,470 (48.1)	7,390 (47.6)	662 (4.3)	15,522 (100.0)
2. Nationalised Banks	13,714 (45.5)	15,717 (52.2)	700 (2.3)	30,130 (100.0)
3. PSBs (1+2)	21,184 (46.4)	23,107 (50.6)	1,362 (3.0)	45,653 (100.0)
March 1999(P)				
1. SBI	8,318 (44.6)	9,668 (51.9)	655 (3.5)	18,641 (100.0)
2. Nationalised Banks	14,289 (43.2)	17,940 (54.3)	841 (2.5)	33,069 (100.0)
3. PSBs (1+2)	22,607 (43.7)	27,608 (53.4)	1,496 (2.9)	51,710 (100.0)

Notes : 1. * Revised to Rs.41,661 crore.

P Provisional.

2. Figures in brackets are percentages to the total.

3. Constituent items may not add up to the totals due to rounding off.

NPAs: A Cross-Country Comparison

2.53 Containment of NPAs within a tolerable level is very important for enhancing confidence in the banking sector and for ensuring the contribution of the sector to macroeconomic stability. This is evident from the cross-country analysis of NPAs and on this attention has been focussed since about the middle of 1980s ([Box II.3](#)).

Box II.3: NPAs: A Cross-Country Comparison

Since the mid-eighties, banking crises have come to the forefront of economic analysis. Situations of banking distress have quickly intensified and in the process, have become one of the main obstacles to stability to the financial system. According to Lindgren *et.al.*(1996), 73 per cent of the member countries of the International Monetary Fund's (IMF) experienced at least one bout of significant banking sector problems from 1980 to 1996. More importantly, such crises have resulted in severe bank losses or public sector resolution costs. As Caprio and Klingebiel (1996) observe, such costs amounted to 10 per cent or more of GDP in at least a dozen developing country episodes during the past 15 years. Recent studies by Honohan (1996) provide the estimated resolution costs of banking crises in developing and transition economies since 1980 are pegged at US \$ 250 billion and reinforce this view.

Such intensity of banking crises has raised the question as to the reasons why such crises occur? Several arguments have been raised in the literature, including, among others, volatility in market environment, the increased leverage of banks, connected lending practices and regulatory forbearance in the face of political economy considerations. However, all these arguments seriously compromise on the objectivity in credit assessment, which has often been

instrumental in building-up of the non-performing assets (NPAs) of banks. The accumulation of NPAs is exacerbated by the weaknesses in the accounting, disclosure, and legal framework. In many developing countries, accounting conventions are not rigorous enough to prevent banks and their borrowers from concealing the true size of their NPA portfolio. Often bad loans are made to look good by additional lending to troubled borrowers (“ever-greening”). If loan classification is dependent only on the loan payment status-without regard to the borrower's credit worthiness or to the market value of collateral-then the potential delay in recognizing bad loans can be considerable. And if non-performing loans are systemically understated, loan-loss provisions are apt to be too low, and bank net income and capital will be systemically overstated. Without accurate information on the true financial condition of banks, it is difficult for private investors or supervisors to monitor and discipline errant banks.

Studies have reported that the publicly reported figures on non-performing loans gave little hint of banking crises in Chile and Colombia in the early 1980s. Hausman and Rojas-Suarez (1996) observe that, on the eve of banking difficulties, reported ratios of non-performing to total loans in several Latin American economies were much lower in relation to the size of the subsequent banking problems. In some of the developing countries of the Asia Pacific Economic Co-operation (APEC) forum, a loan is classified as non-performing only after it has been in arrears for at least six months. One-third of total loans in Argentina's public sector banks were non-performing at the end of 1994. Of US \$ 20 billion in non-performing loans in the December 1994 portfolio of Banespa-owned by Sao Paulo state of Brazil-more than half was owed by the State. Sheng (1996) cites one South-East Asian country that, until recently, allowed loans that had not been serviced for more than three years to be treated as performing. Mexican banks' planned transition to international accounting standards is expected to double the amount of past-due loans reported (Goldstein, 1996). However, recent loan classification guidelines for the Asian economies reveal that they are gradually moving towards compliance with international best practice (Table 1).

Once problem loans are identified, adequate loan-loss provisions must be established. But studies suggest that guidelines in many developing countries are unclear, weak or altogether absent. For example, as of August 1995, a group of transition economies (Armenia, Azerbaijan, Georgia, Tajikistan and Ukraine) did not have regulations obliging banks to make provisions for problem loans. Where there are such guidelines, there appears to be wide variation in coverage across countries. Figures of provisioning-coverage ratios (i.e., the ratio of loan-loss reserves to non-performing loans) for a sample of developing countries in the early 1990s reveal that, on average, the developing countries with the highest share of non-performing loans tend to be the ones with the lowest provisioning coverage ratios, although there are a few exceptions (e.g., Argentina and Malaysia) where coverage in the face of a high non-performing loan share is quite conservative (Table 2).

Table 1: Loan Classification Guidelines, 1998

Country	Classification of NPAs		Compliance with international best practices ¹
	Categories	Provisions (%)	
Indonesia	1. Current	1	Yes (3 months)
	2. Special mention	5	
	3. Sub-standard	15	
	4. Doubtful	50	
	5. Loss	100	
Korea	1. Sub-standard	20	Yes (3 months)
	2. Doubtful	75	
	3. Loss	100	
Malaysia ²	1. Unclassified	1.5	Yes (3 months)
	2. Sub-standard	20	
	3. Doubtful	50	
	4. Bad /Loss	100	
Philippines	1. Unclassified	2 ³	Yes (3 months)
	2. Esp. mentioned	0	
	3. Sub-standard	5 ⁴	

	4. Doubtful	25 ⁴	
	5. Loss	50	
		100	
Thailand⁵	1. Pass	1	Yes (3 months)
	2. Special mention		
	3. Sub-standard	2	
	4. Doubtful	20	
	5. Loss	50	
		100	

- Notes:
- As defined by the period in which loans are considered past due or non-performing (typically 90 days). For Philippines, effective May 1, 1998, on monthly installment loans.
 - Specific provisions for large loans (above RM 1 million) are made on a case-by-case basis as determined by the bank examiner. All provisions are made against the uncollateralised part of the loan.
 - Or general provision. For Philippines, 1 per cent by October 1, 1998 and 2 per cent by October 1, 1999.
 - By April 15, 1999. for sub-standard loans, the provisions are irrespective of whether the loans are collateralised or uncollateralised.
 - The new classification rules will be effective July 1, 1998, and provisioning rules, gradually over the period July 1998 to July 2000.

Source: Kochhar, K., P. Loungani and M.R. Stone (1998).

Table 2: Loan Classification Guidelines

Country	Loan loss Reserves ^a (A)	Non-performing loans (B) (percentage to total loans)	Coverage Ratio (A/B)
Hong Kong	2.2 ^b	3.1	0.7
India	-	19.5 ^c	-
Indonesia	2.6	11.2	0.2
Korea	1.5	1.0	1.5
Malaysia	9.6	8.2	1.2
Singapore	-	-	1.2
Thailand	1.7	7.6	0.2
Argentina	10.2 ^b	10.5	1.0
Mexico	3.1 ^d	14.8	0.2
Japan	1.0	3.3	0.3
United States	2.7	1.6	1.7

- Notes:
- Average 1990-94.
 - Average 1994-95.
 - Relates only to public sector banks.
 - Average 1992-94.
 - Figures may not be strictly comparable.

Source: Goldstein (1996).

There exist several policy measures that can significantly reduce the incidence of banking crises in emerging economies. Pertinent from the present point of view are effective implementation of existing restrictions on connected lending to limit undue concentration of credit risk, careful screening of loan applicants and stricter asset classification and provisioning practices. In this connection, there is a need for mechanisms that can improve the structure of incentives for bank owners, managers and creditors in the direction of bank soundness. Alongside, it is necessary to have some rule-based, prompt corrective action elements into the bank supervisory process that can enhance supervisory effectiveness amidst pressures for forbearance.

What lessons do such NPA norms hold for a country like India? In India, NPAs are defined as an advance that has not been serviced, as a result of 'past dues' accumulating for 180 days and over. In respect of the Indian banking system, due to the time lag involved in the process of recovery and the detailed safeguards/ procedures involved before write-offs could be effected, banks, even after making provisions for the advances considered irrecoverable, continue to hold such advances in their books: these are termed as Gross NPAs together with the provisions. The provision-adjusted NPAs in Indian banking system, i.e., Net NPAs constituted only 8.1 per cent of the net advances of banks as on March 1999 which are not as alarming as Gross NPAs. In line with the recommendations of the Narasimham Committee and as an endeavour to move towards international best practices, the time period for classifying an asset as NPA has progressively been reduced, while ensuring consistency with financial stability and macroeconomic policy. In this context, it is important to recognize that in many respects, asset classification norms in India are considerably tighter than the international best practices. In certain countries, an advance is considered as 'un-collectable' and classified as 'loss' asset only after it has remained past due or doubtful for a considerable length of time, whereas in India, an advance is to be classified as 'loss', the moment it is considered 'un-collectable'. Secondly, in certain other countries, the available securities are deducted from the 'doubtful' advance to arrive at the net doubtful portion, whereas in India, provision is required to be made even on the secured portion. Thirdly, while in India the provision required to be made in respect of the portion not covered by the realisable value of securities in 'doubtful' advance is 100 per cent, in other countries, it is 75 per cent or even 50 per cent. The concept of collateral also differs in as much as security of standby nature like guarantee of the promoter/third party, net worth of the promoter/guarantor is not considered as security in India. This implies that prudential norms in India are in several aspects stricter than the international best practices and the provisions made are significantly above the requirement of prudence.

It also needs to be appreciated that safety and soundness, as envisaged in the CRAR and NPA levels, are two distinct, yet inter-related aspects of banking. Banking, in the ultimate analysis, is an exercise in risk management and in an increasingly deregulated scenario where banks are increasingly resorting to non-traditional banking and off-balance sheet activities, capital is the only resource available to banks to absorb the adverse effects of any eventuality. However, capital adequacy ratios provide an effective cushion mainly in an upswing. But they might prove to be inadequate in downturns, as firms find it difficult to service their loans. As each firm tries to satisfy their capital adequacy standards, the whole system may find its strategy completely undermined, eventually resulting in a worsening of capital adequacy standards. It is therefore necessary to find out the levels of NPAs at which confidence in banking can be maintained at high levels and, at the same time, the level of CRAR needed to sustain the NPA level.

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