

A Comparative Study of Non Performing Assets in Indian Banking Industry

by

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Abstract. 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. 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 in the banking system. In the background of these developments, this study strives to examine the state of affair of the Non performing Assets (NPAs) of the public sector banks and private sector banks in India with special reference to weaker sections. The study is based on the secondary data retrieved from Report on Trend and Progress of Banking in India. The scope of the study is limited to the analysis of NPAs of the public sector banks and private sector banks NPAs pertaining to only weaker sections for the period seven (7) years i.e. from 2004-2010. It examines trend of NPAs in weaker sections in both public sector and private sector banks. The data has been analyzed by statistical tools such as percentages and Compound Annual Growth Rate (CAGR). The study observed that the public sector banks have achieved a greater penetration compared to the private sector banks vis-à-vis the weaker sections.

Key words: old private sector banks, new private sector banks, credit risk.

JEL classification: E50

1 Introduction

Banking industry is a major sector of the economy that has achieved renewed focus after financial sector reforms and the entry of private sector banks. This sector is the foundation of modern economic development and linchpin of development strategy. It forms the core of the financial sector of an economy. Through mobilization of resources and their better allocation, commercial banks play an important role in the development process of underdeveloped countries. Commercial banks improve the allocation of resources by lending money to priority sector of the economy. These banks provide a meeting ground for the savers and investors among various indicators of financial stability, banks' non-performing loan assumes critical importance since it reflects on the asset quality, credit risk and efficiency in the allocation of resources to productive sectors. A common perspective is that the problem of banks' non-performing loans is ascribed to political, economic, social, technological, legal and environmental

In present times, banking in India is fairly mature in terms of supply, product range and reach. But reach in rural India still remains a challenge for the public sector and private sector banks. The Reserve Bank of India is mainly concerned with providing finance to weaker section of society, development of priority sectors and providing credit under differential rate of interest scheme. After reforms in 1991, the entry of many private players has been permitted. Post liberalization demand PSB's to compete with well diversified and resource rich private banks and to provide fine funded services and unique products to suit customers need. PSB's have already sacrificed a lot of their profits for achievement of social objectives. Due to cut throat competition and technology, the PSB's are thinking to improve productivity and profitability which is essential to survive in a globalised economy.

The future of PSB's would be based on their capability to continuously build good quality assets in an increasingly competitive environment and maintaining capital adequacy and stringent prudential norms. Consolidation and competition may be key factors impacting

the nationalized banks in the future. Due to reforms, it has been felt that there is a need not only to increase in profits but also reduction in nonperforming assets (NPA's) of banks.

It is in this context the study has undertaken an empirical analysis for evaluating the non-performing loans of public sector banks and private sector banks with special reference to weaker sections.

2 Review of Literature

There are numerous empirical studies conducted on the issue of Non performing Assets of commercial banks in India as well as abroad. Present review deals with the empirical studies conducted in Indian context on Non performing Assets in weaker sections of public sector banks and private sector banks. Some of the notable studies in this field are as following

Amandeep (1991) attempted to estimate profit and profitability of Indian Nationalized banks and to study the impact of priority sector lending, credit policies, geographical expansion, industrial sickness, competition, deposit composition, establishment expenses, ancillary income, spread and burden on bank profitability. For this purpose, trend analysis, ratio analysis and regression analysis were used.

Swamy (2001) studied the comparative performance of different bank groups since 1995-96 to 1999-2000. An attempt was made by researcher to identify factors which could have led to changes in the position of individual banks in terms of their share in the overall banking industry. He analyzed the share of rural branches, average branch size, trends in bank's profitability, share of public sector assets, share of wages in expenditure, provision and contingencies, net non performance assets in net advances, spread, has been calculated. He concluded that in many respects nationalized public sectors banks much better than private banks, even they are better than foreign banks.

Rituparna Das (2002) performed a research on Managing the Risk of Non Performing Assets in

the Small Scale Industries in India. In this article the researcher tries to seek a solution to the problem of NPA in the small scale industries under the present circumstances of banking and insurance working together under the same roof. What is stressed in this article is the pressing need of the small-scale entrepreneur for becoming aware and educated in modern business management holding a professional attitude toward rational decision making and banks have to facilitate that process as a part of the credit policy sold by them.

Prashanth K. Reddy (2002) in his research paper on the topic, "A comparative study of Non performing Assets in India in the Global context" examined the similarities and dissimilarities, remedial measures. Financial sector reform in India has progressed rapidly on aspects like interest rate deregulation, reduction in reserve requirements, barriers to entry, prudential norms and risk-based supervision. The study reveals that the sheltering of weak institutions while liberalizing operational rules of the game is making implementation of operational changes difficult and ineffective. Changes required to tackle the NPA problem would have to span the entire gamut of judiciary, polity and the bureaucracy to be truly effective. This paper deals with the experiences of other Asian countries in handling of NPAs. It further looks into the effect of the reforms on the level of NPAs and suggests mechanisms to handle the problem by drawing on experiences from other countries.

Amitabh Joshi (2003) conducted a survey on "Analysis of Non-Performing Assets of IFCI Ltd". The study found that Profitability and Viability of Development Financial Institutions are directly affected by quality and performance of advances. The basic element of Sound NPA Management System is quick identification of Non-performing advances their containment at minimum levels and ensuring that their impingement on the financials is at low level. Excessive reliance on Collaterals has led Institutions to long drawn litigations and hence it should not be sole criteria for sanction. Banks should manage their exposure limit to few

borrower(s) and linkage should be placed with net owned funds for developing control over high leverages of borrower level. Study also revealed that exchange of credit information among banks would be immense help to them to avoid possible NPAs. Management Information system and Market intelligence should be utilized to their full potential

Chandrashekhar and Ray (2005) show that public sector banks have increasingly opted for investment in risk-free returns of government securities, their share in total earning assets rising from 26 to 33 percent during the 1990s. This trend has been reversed in the 21st century.²⁷ But there is no doubt that enforcement of stringent prudential norms, capital adequacy stipulations, setting up of the Board for Financial Supervision (BFS) and pressure to reduce NPAs have made banks so risk-averse that they have reduced their exposure to private loans with even a modest risk of non-recovery

Tamal Datta Chaudhuri (2005) examined the “Resolution Strategies for Maximizing Value of Non-Performing Assets (NPAs)”. The article indicates that declining capital adequacy adversely affects shareholder value and restricts the ability of the bank/institution to access the capital market for additional equity to enhance capital adequacy. So, if a resolution strategy for recovery of dues from NPAs is not put in place quickly and efficiently, these assets would deteriorate in value over time and little value would be realized at the end except may be its scrap value. The purpose of this paper is to indicate the various considerations that one has to bear in mind before zeroing on a resolution strategy and provides a State - Resolution - Mapping (SRM) framework. However, the paper has not specifically discussed about the various resolution strategies that could be put in place for recovery from NPAs, and in particular, in which situation which type of strategy should be adopted.

Isaac K. Otchere (2005) conducted a study on the performance of privatized banks in middle- and low-income countries shows mixed results

by “Competitive and Value Effects of Bank Privatization in Developed Countries”. The paper observed that private banks in developed countries have experienced significant improvements in operating performance. The improvement in performance remains significant after controlling for persistence in bank performance. A comparison of the performance of privatized banks in developed and developing countries suggests that privatization has encouraged excessive risk taking among privatized banks in developing countries, with the consequence that those banks carry large non-performing assets than their counterparts in the developed countries. They also observe that consistent with the competitive effects hypothesis, investors view privatization announcements as foreshadowing bad news for rival banks.

Sathya (2005) examined the effect of privatization of banks on performance and efficiency. The data taken was for five years (1998-2002) and it was analyzed by using difference of means test. The banking sector in India includes domestic banks (privately owned, partially privatized banks, fully PSB's) as well as foreign banks, and objective of this study is to study the impact of privatization on the banking firms. It was concluded that partially privatized banks have performed better as compared to fully PSB's in respect of financial performance and efficiency. Partially privatized banks have continued to show improved performance and efficiency in the year after privatization

Ved Pal and Malik (2007) in their empirical paper examined the difference in financial characteristics of public, private and foreign sector banks based on factors such as profitability, liquidity, risk and efficiency. Sample of 74 Indian commercial banks consisting of 24 public sector, 24 private sector and 23 foreign banks was taken for the period of 2000- 2005. Multinomial regression analysis was used and results revealed that foreign banks proved to be high performer in generating business with a given level of resources and they are better equipped with managerial

practices and in terms of skills and technology. Foreign banks were more consistent with market system as reflected in terms of net interest margin. The public banks emerged as the next best performer after foreign banks. There were giving a higher return on equity in comparison to foreign and private banks. It was high performer in economizing their expenses which was reflected from expense rate and efficiency ratio. The private sector banks emerged with a better use of resources as compared to PSB's.

Thomas P. Ferguson (2007) conducted a research on "Observations on the Securitization of Non-Performing Loans in Russia". Asset securitization is a burgeoning trend in Russia as companies burdened by poor credit ratings seek access to capital at lower costs than they would be allowed in traditional equity or debt markets. Study indicates that securitization of these bad loans has not occurred in Russia at the levels one might expect. This has been due to both a relatively small amount of loans that under-perform as well as legal and regulatory impediments that have discouraged investors and lenders alike. The study has been conducted to examine the expansion of consumer credit in Russia and the circumstances under which it is occurring indicate that the level of non-performing loans is due to rapidly increase and as the rationale for maintaining the impediments that stand in the way of securitizing these loans is being re-examined, those impediments are being scaled back to make way for market participants to engage in such securitizations. Thus, this article anticipates a significant rise in the level of non-performing loans, which will be logically paired with an increased interest of Russian lenders in securitizing these assets.

Usha Arora, Bhavna Vashisht & Monica Bansal (2009) in the research on "An Analytical Study of Growth of Credit Schemes of Selected Banks" analyzed and compared the performance (in terms of loan disbursement and non-performing assets) of credit schemes of selected banks for the last five years. This paper is divided into two parts. In the first part, bank-wise as well as year-wise comparisons are done with the help of Compound Annual Growth

Rate (CAGR), mean and standard deviation; and in the second part, a positive relationship is found between total loan disbursement and total NPA O/S of selected banks with the help of a correlation technique. The study found a positive relationship between total loan disbursement and total Non-Performing Assets Outstanding (NPA O/S) of selected banks.

There are many studies that have measured the efficiency of banks the world over however, very few studies have evaluated the performance of Indian banks. The brief review of the literature is used to formulate theoretical analysis of non-performing loans undertaken in the present study. This study is designed for analyzing Nonperforming Assets in weaker sections of public sector banks and private sector banks in India.

3 Objectives of study

The present study is based upon the macro approach to analyze Nonperforming Assets in weaker sections of public sector banks and private sector banks specifically the objectives of the study are:

1. To study Comparison between Nationalized banks and State bank Group NPAs pertaining to weaker section
2. To analyze the Comparison between Old private sector banks and New private sector banks NPAs pertaining to weaker sections
3. To determine the Non performing Assets in weaker sections of private sector banks and public sector banks
4. To examine the Share of Nationalized banks and State Bank Group in the Total Public Sector Banks Advances and NPAs pertaining to weaker Sections
5. To Evaluate the Share of Old Private Sector NPAs and New Private Sector NPAs in the total private sector Advances and NPAs pertaining to Weaker Sections.

4 Data Base and Research Methodology

The study is analytical in nature, and the present study uses the latest available published secondary data for the years 2004-2010 compiled from Report on Trends and Progress of Banking in India, 2004-10. The scope of the study is limited to seven years data. The data has been analyzed using percentage method. The study is related to Public sector banks and private sector banks which includes nationalized banks and State Bank of India (SBI) and its associates in case of public sector banks and in case of private sector banks it includes both old

private sector banks and new private sector banks.

5 Analysis and Results

It is apparent from table 1 that advances of the banks have shown a rising trend since 2003-04 to 2009 –r 2010. The study found that the Nationalized banks advances and state bank group advances CAGR stood at 26.19 and 21.16 respectively and the NPAs CAGR showed a decline trend of -2.71 in case of Nationalized banks and – 6.13 in case of state bank group.

Table 1. Comparison between Nationalised banks and State bank Group NPAs pertaining to weaker sections

(Amount in Rs. Crores)

years	Nationalised Banks			State Bank Group		
	Advances	NPAs	Percentage of NPAs	Advances	NPAs	Percentage of NPAs
2004	23612.63	4082.56	17.29	11880.03	2623.93	22.08
2005	30,804.05	2,880.71	9.35	20,640.78	2,871.33	13.91
2006	39,807.43	3,250.59	8.17	19,663.59	1,772.63	9.01
2007	51,599.75	3,456.75	6.7	27,244.93	1,724.40	6.33
2008	63,078.89	3,330.00	5.28	36,914.99	1,975.37	5.35
2009	85,923	3,784	4.4	36,971	1,290	3.5
2010	120285.71	3,368	2.8	45540.54	1,685	3.7
CAGR	26.19	-2.71	-22.91	21.16	-6.13	-22.53

Source: Report on Trend and Progress of Banking in India 2004 - 2010

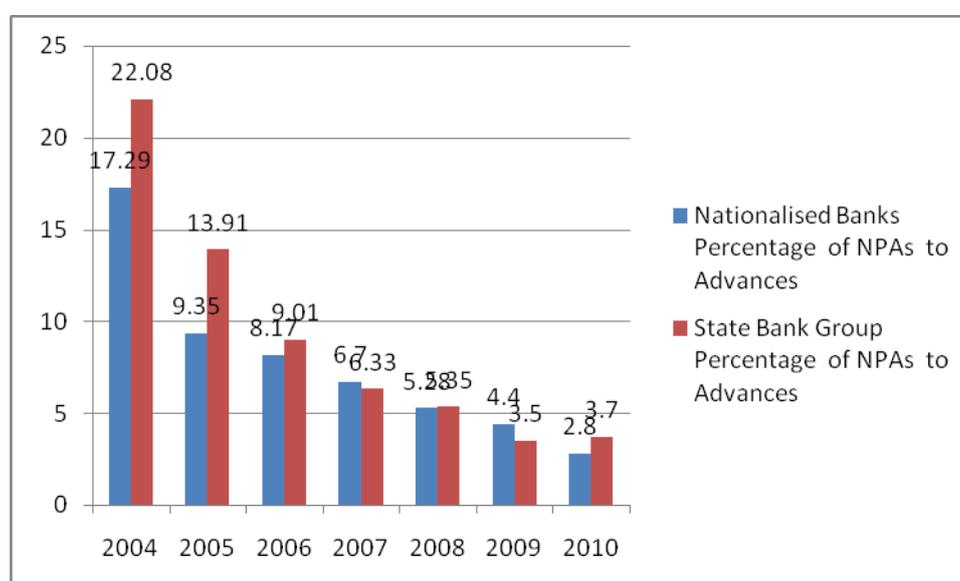


Figure 1. Comparison between Nationalized banks and State bank Group percentage of NPAs pertaining to weaker sections

Table 2. Comparison between Old private sector banks and New private sector banks % of NPAs pertaining to weaker sections

(Amount in Rs. Crores)

years	Old Private Sector Banks			New Private Sector Banks		
	Advances	NPAs	% of NPAs	Advances	NPAs	% of NPAs
2004	1228.4	155.47	12.66	51.46	0.05	10.29
2005	1501.62	207.97	13.85	79.75	0.01	0.01
2006	2,366.10	267.26	11.3	566.24	8.93	1.58
2007	2,416.93	149.3	6.18	1,445.25	0.01	0.01
2008	3,305.40	116.79	3.53	1,726.17	0.25	0.01
2009	5,538	77	1.4	9,514	14	0.1
2010	9800	98	1.0	16000	32	0.2
CAGR	34.54	-6.38	-30.42	127.04	151.7	-43.05

Source: Report on Trend and Progress of Banking in India 2004 – 2010

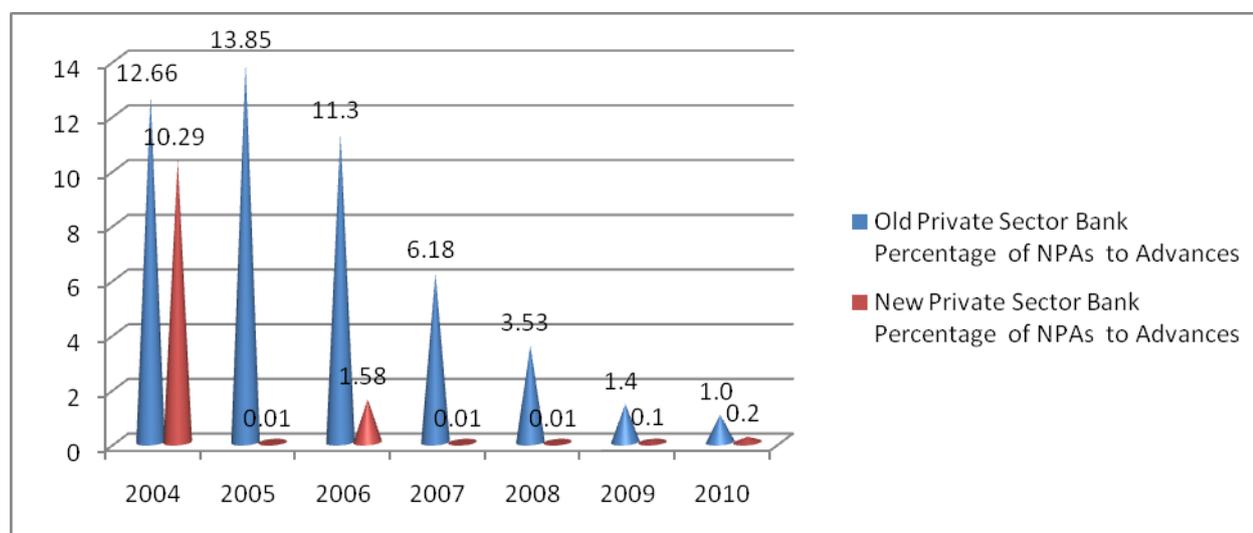


Figure 2. Comparison between Old private sector banks and New private sector banks % OF NPAs pertaining to weaker sections

The study observed that the CAGR in advances and NPAs of old private sector banks is 34.54 and -6.38 whereas in the case of New private sector banks It found that the CAGR in case of advances is 127.04 and NPAs is 151.7 which is very high as compared to old private sector banks. There was a mix trend in case of new private sector banks NPAs i.e. from 2003- 2004 to 2004 – 2005 the NPAs reduced in absolute terms and in percentage terms but in the year 2005 2006 the NPAs increased in both the terms i.e in absolute terms as well as in percentage terms, again during the year 2007 it decreased

to 0.01 in both absolute terms as well as in percentage terms. Later on, from the year 2008 to 2010 the NPAs increased in both the terms i.e in absolute terms as well as in percentage terms It is observed that despite increase in nonperforming assets (NPAs) in absolute terms during the year, asset quality of new private sector banks improved in the past few years as reflected in the decline in the ratio i.e. NPAs as percentage of advances, Hence, it can be stated that as a whole there is improvement in the asset quality of new private sector banks.

Table 3. Comparison between public sector banks and private sector banks NPAs pertaining to weaker sections
(Amount in Rs. Crores)

years	Public Sector Banks			Private Sector Banks		
	Advances	NPAs	% of NPAs	Advances	NPAs	% of NPAs
2004	35,492.66	6,706.49	18.9	1279.86	155.52	12.15
2005	51,444.83	5,752.04	11.18	1581.37	207.98	13.15
2006	59,471.02	5,023.22	8.45	2,932.34	276.19	9.43
2007	78,844.69	5,181.15	6.57	3,862.18	149.31	3.87
2008	99,993.88	5,388.00	5.39	5,031.57	117.04	2.33
2009	1,22,894	5,074	4.1	15,052	91	0.6
2010	165826.2	5,053	3.0	25800	130	0.5

Source: Report on Trend and Progress of Banking in India 2004 – 2010

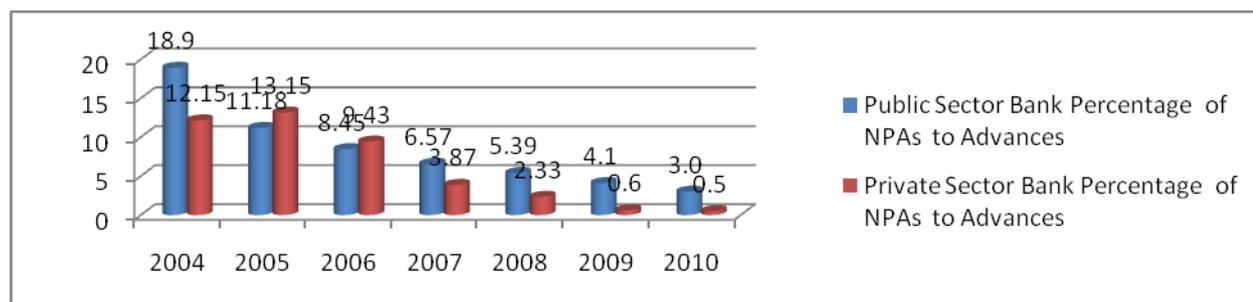


Figure 3. Comparison between public sector banks and private sector banks NPAs pertaining to weaker sections

The above study examines that achievements of the private sector banks in case of advances to weaker sections are as low as compared to that of public sector banks. Advances of the public sector banks in absolute term have increased from Rs 35492.66 crores in 2003-04 to Rs 165826.2 crore in 2009-10. And that of private sector banks increased from Rs1279.86 crores in 2003-04 to Rs25800 crores in 2009-10. The NPAs of the public sector banks in absolute terms have decreased from Rs 6706.49 crores in

2003- 04, to Rs 5053 crores and in the case of the private sector banks it has decreased from Rs 155.52 crores in 2003-2004 to Rs130 crores in 2009-2010. The NPAs in absolute terms have decreased by 24.66% percent in public sector banks and 16.41% in private sector banks in the year 2009-10 over 2002-03. The NPA ratio for weaker sections for public sector banks was higher at 3.0 per cent than 0.5 per cent for private sector banks at end-March 2010.

Table 4. Share of Nationalized banks and State Bank Group in the Total Public Sector Banks Advances and NPAs pertaining to weaker Sections

(Amount in Rs. Crores)

Years	Nationalized Banks		State Bank Group		Public Sector Banks	
	Advances	NPAs	Advances	NPAs	Advances	NPAs
2004	23612.63(66.53)	4082.56(60.87)	11880.03(33.47)	2623.93(39.13)	35492.66 (100)	6706.49 (100)
2005	30.804.05(59.88)	2880.71(50.08)	20640.78(40.12)	2871.33(49.92)	51444.83(100)	5752.04(100)
2006	39807.43((66.94)	3250.59(64.71)	19663.59(33.06)	1772.63(35.29)	59471.02(100)	5023.22(100)
2007	51599.75(65.44)	3456.75(66.72)	27244.93(34.56)	1724.4(33.28)	78844.69(100)	5181.15(100)
2008	63078.89(63.08)	3329.72(61.80)	36914.99(36.92)	2058.41(38.20)	99993.88(100)	5388.13(100)
2009	85923(70)	3784(75)	36971(30)	1290(25)	1,22,894(100)	5074(100)
2010	120285.71(72.54)	3368(67)	45540.54(27.46)	1685(33)	165826.24(100)	5053(100)

Source: Report on Trend and Progress of Banking in India 2004 – 2010

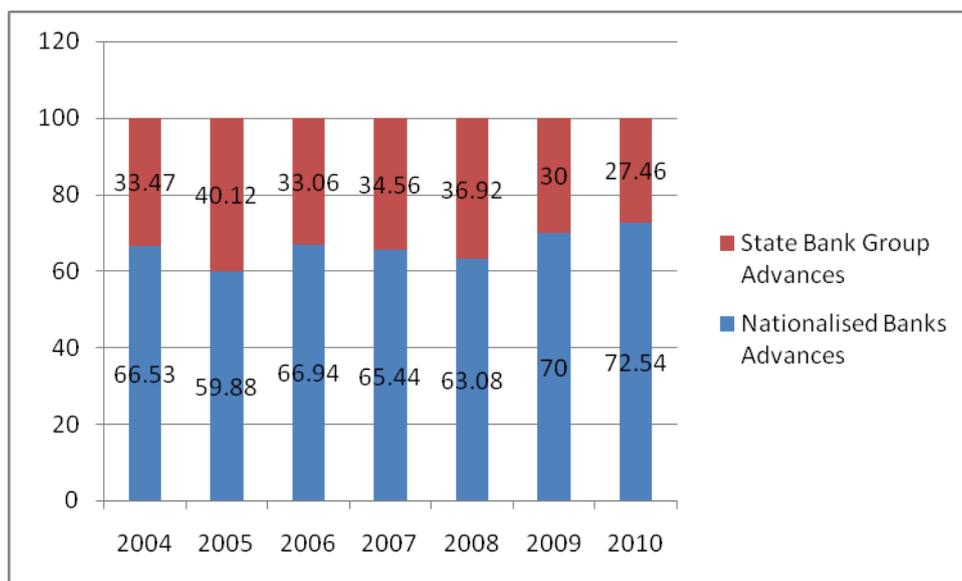


Figure 4 A. Share of Nationalized banks and State Bank Group in the Total Public Sector Banks Advances pertaining to weaker Sections.

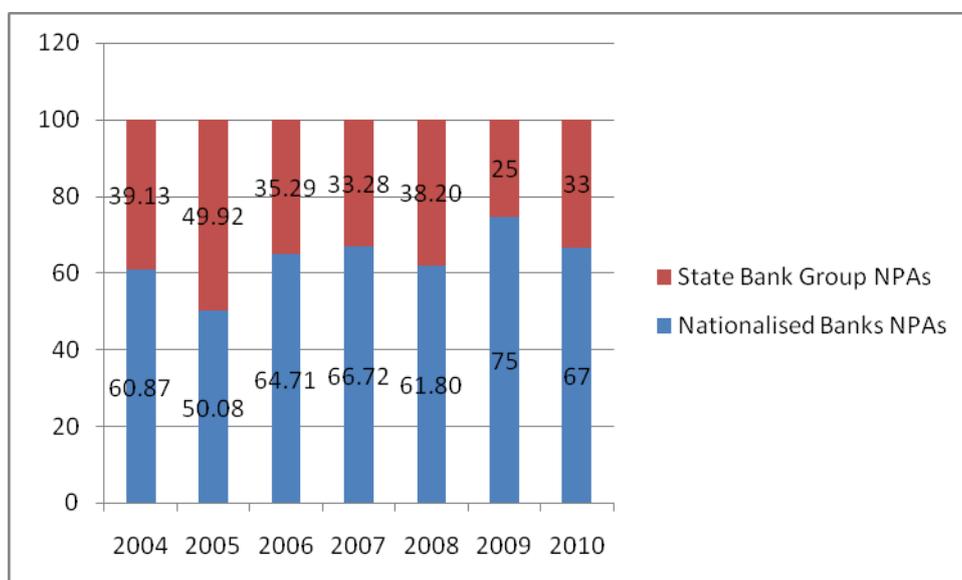


Figure 4 B. Share of Nationalized banks and State Bank Group in the Total Public Sector Banks NPAs pertaining to weaker Sections

An in-depth analysis of the public sector banks shows that the public sector bank comprises of two groups i.e nationalized banks group and state bank group. These groups depicted that

over the period of study the share of nationalized banks in advances and NPAs is more than the state bank group advances and NPAs.

Table 5. Share of Old Private Sector banks NPAs and New Private Sector banks NPAs in the total private sector Advances and NPAs pertaining to Weaker Sections

(Amount in Rs. Crores)

Year	Old Private Sector Banks		New Private Sector Banks		Private Sector Banks	
	Advances	NPAs	Advances	NPAs	Advances	NPAs
2004	1228.4(95.98)	155.47(99.97)	51.46(4.02)	0.05(0.03)	1279.86(100)	155.52(100)

2005	1501.62(94.96)	207.97(99.98)	79.75(5.04)	0.01(0.02)	1581.37(100)	207.98(100)
2006	2366.1(80.69)	267.26(96.77)	566.24(19.31)	8.93(3.23)	2932.34(100)	276.19(100)
2007	2416.93((62.58)	149.3((99.99)	1445.25(37.42)	0.01(0.01)	3862.18(100)	149.31(100)
2008	3305.4(65.69)	116.79((99.79)	1726.17(34.31)	0.25((0.21)	5031.57(100)	117.04(100)
2009	5538(36.79)	77(84.62)	9514(63.21)	14(15.38)	15052(100)	91(100)
2010	9800(37.98)	98((75.38)	16000(62.02)	32(24.62)	25800(100)	130(100)

Source: Report on Trend and Progress of Banking in India 2004 - 2010

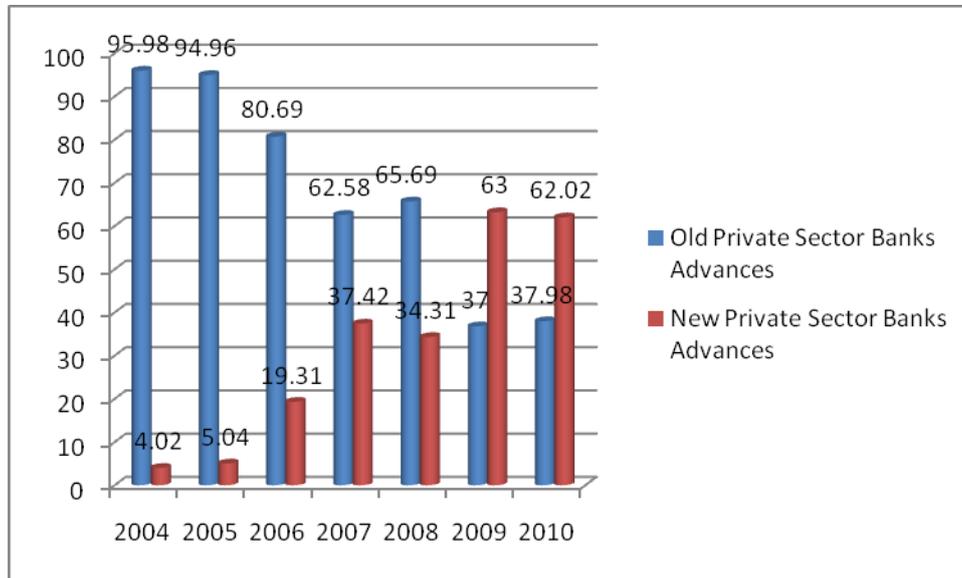


Figure 5 A. Share of Old Private Sector and New Private Sector Advances in the total private sector Advances pertaining to Weaker Sections

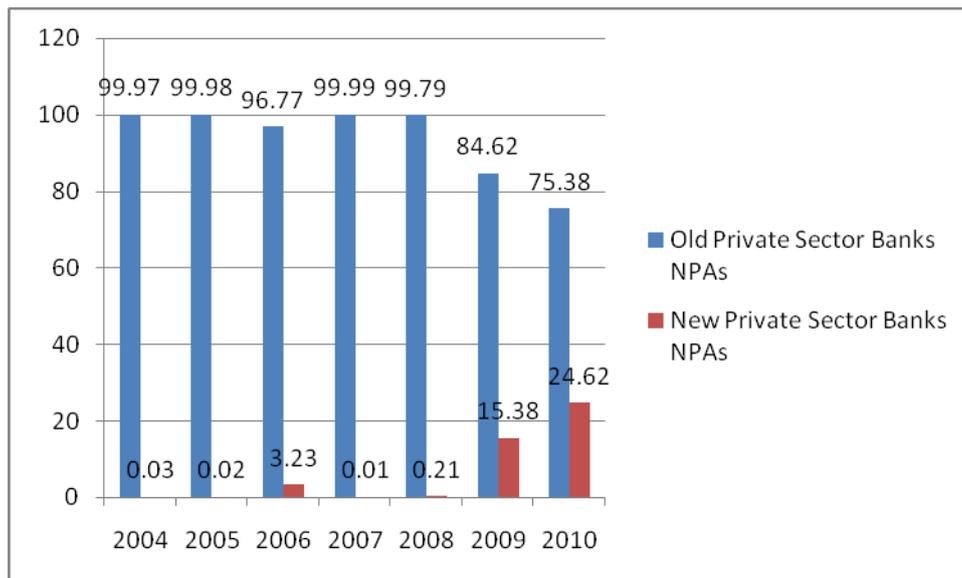


Figure 5 B. Share of Old Private Sector NPAs and New Private Sector NPAs in the total private sector NPAs pertaining to Weaker Sections

The study investigated the break wise analysis of private sector banks which comprises of both old private sector banks and new private sector

banks. This break wise analysis indicates that during the period of the study in case of advances and NPAs the share of old private

sector banks over new private sector banks is more till the year 2008 thereafter from the year 2009 the scenario has changed that is in the case of advances the share of new private sector banks is more than old private sector banks but where as in the case NPAs the share of old private sector banks is more than new private sector banks.

6 Findings

It is found on the basis of analysis of data that the asset quality of public sector banks and private sector banks improved consistently in the past few years as reflected in the decline in the ratio i.e. NPAs as percentage of advances to weaker sections from 18.9% to 3 percent in case of public sector banks and from 12.15percent to 0.5 percent

Over the period of study, it has been registered that the public sector banks have achieved a greater penetration compared to the private sector banks vis-à-vis the weaker sections.

The results from above analysis show that there is strong evidence that the statistics in the advances to the weaker section of new private sector miniscule.

7 Conclusions

The study observed that there is increase in advances over the period of the study. However, the decline in ratio of NPAs indicates improvement in the asset quality of Indian public sector banks and private sector banks. It is found on the basis of analysis that there is significant improvement in the management of nonperforming assets of the public sector banks in India. The study finally observes that the prudential and provisioning norms and other initiatives taken by the regulatory bodies has pressurized banks to improve their performance, and consequently resulted into trim down of NPA as well as improvement in the financial health of the Indian banking system

It has been observed that the banking sector in India has responded very positively in the field

of enhancing the role of market forces regarding measures of prudential regulations of accounting, income recognition, provisioning and exposure, introduction of CAMELS supervisory rating system and reduction of NPA's and up gradation of technology. But at the same time reforms failed to bring banking system at a par with international level and still the Indian banking section is mainly controlled by government as PSB's being leaders in this sphere. It is suggested that government should formulate bank specific policies and should implement these policies through Reserve Bank of India for upliftment of Public Sector Banks .Public sector banks should try to upgrade technology and should formulate customer friendly policies to face competition at national and international level.

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Author description

Dr. P. Malyadri has got 27 years of experience of Teaching, Research, Administration, Training and consultancy. A prolific writer; Dr. Malyadri has published 4 Books and 57 research papers on Banking, Rural and economic development issues in various National and International journals of repute. He has presented several research papers in around 80 National and International seminars and conferences. He is an active member in Editorial advisory boards of 31 international journals published from *Canada, USA, Taiwan, Czech Republic, Italy, Turkey, Dubai, Philippines, Bangladesh, Romania* and many others; and 3 national journals of repute. Dr. Malyadri carried out two Major Research Projects sponsored by the UGC, New Delhi. He is a recognized Research supervisor to guide M.Phil. and Ph.D. students in the Departments of Commerce and Business Management, Osmania University and was awarded 2 Ph.D.'s and 22 M. Phil.'s under his guidance. He served as Program officer of the National Service Scheme for 5 years and conducted several programs and received outstanding awards. Presently he is serving as the Principal; Osmania University affiliated college for the last 3 years. He received several outstanding awards for his academic achievements. Dr. Malyadri is State level Best Teacher awardees in the year 2008, honored by Government of Andhra Pradesh.