



# ANALYSIS OF DEBT RECOVERY METHODS AND TOOLS ADOPTED BY INDIAN BANKING SECTOR WITH SPECIAL REFERENCE TO PNB IN GORAKHPUR

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## Abstract

*This research examines the structure of loans recovery instrument in Indian Banking Sector with special reference to Punjab National Bank. Loan recovery methodology in Indian banks is basically bifurcated into preemptive methodology to keep the growth in non-performing advances and corrective procedure to recoup the defaulted debts through lawful, administrative and non-lawful measures. Paper conceives a 5-E Early Warning System for preemptive methodology and to anticipate advance slippages and talks about all the accessible corrective measures and vital apparatuses in detail. The research includes talk on non-performing assets development in Indian Banking area and soak increment in arrangements. The significance and need of loan recovery and recovery methods are also examined.*

**Keywords:** 5-E early warning signal, Corrective measures, Loan Recovery Strategy, non-performing assets.

## INTRODUCTION

Debt recovery framework is a significant fragment of execution of banking institutions as it holds a convincing job in ensuring that the noteworthy target of banks is to issue advances that result in the favored result in making overall revenue more than the credits provided. It is evident that the presence of Debt recovery system guarantees that the borrowers repay their debts. Debt recovery methods are characterized as each one of those apparatuses and systems utilizing which a bank endeavors retrieve the amount of loans provided. In the idea of Debt recovery, the idea of non-performing assets assumes an exceptionally pivotal job. In this manner we have to comprehend about Non-Performing assets. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFESI) Act, 2002 characterized Non-Performing Assets (NPAs) as “ an asset or account of the borrower, which has been classified by a bank or financial institution as substandard,



doubtful, or loss assets in accordance with the direction and guidelines relating to asset classification issued by RBI". A non-performing asset is a debt for which the interest as well as principle amount has been due for more than 90 days. There is detailed classification of the Non-Performing asset which divides it into 3 categories: (Shreya, 2012)

- i. **Sub-Standard Assets:** A sub-standard assets is one which has been classified as an NPA for a period not exceeding 12 months. In such case the net worth of the borrower/guarantor or the current market value of the securities charged is not enough to ensure recovery of the dues to the bank in full.
- ii. **Doubtful Assets:** An asset would be classified as doubtful if it has remained in the sub-standard category for a period of at least 12 months.
- iii. **Loss Assets:** A loss asset is one where loss has been identified by the bank or the internal or external auditor but the amount has not been written off wholly or partly.

Table showing total amount of NPA of Punjab National Bank (in crore)

Category	31.03.2016	31.03.2015
Sub-Standard	25546.99	12622.30
Doubtful – 1	16844.79	5769.83
Doubtful – 2	10751.83	5262.39
Doubtful – 3	803.97	1214.12
Loss	1870.75	826.22
Total NPA (Gross)	55818.33	25684.86

(Source: PNB Annual Report 2015-16)

It is to be noticed that there is a drastic increase of approximately 117.31% in the gross non-performing assets of the Punjab National Bank which clearly signifies that there is a big need in the debt recovery methods of the bank. To tackle such situation the bank should analyze that in what ways they are lagging in the debt recovery methods due to which the amount of NPA has increased in such a manner.

Some of the common debt recovery tools and methods adopted by the Punjab National Bank are preventive measures and curative management. The former includes early warning signals, financial warning signals, management related warning signals, baking related signals, willful defaulters, etc and the latter includes onetime settlement schemes, debt recovery tribunals, securitization and SARFAESI Act, etc. After conducting a quick interview with PNB employees it was found that the process which is followed for debt recovery is as follows: firstly a notice by the bank is sent to the borrower, if he does not responds to the notice sent by the bank then an employee is sent to the field in order to meet the borrower. If the borrower does not pay his debt even after the meeting then a legal notice is sent to him in order to carry out legal actions against him. If the bank has any collateral security for the loan given then the banks sells the same in order to recover the debt advanced to the party.

This paper involves the details of various tools and methods that are used by Punjab National Bank for the recovery of the debts and how effective those tools and methods are, moreover this paper deals with how those methods and tools could be made more effective and what new tools could be used by Punjab National Bank to reduce the amount of NPA in the bank.



### OBJECTIVE

For the fulfillment of the needs of this research paper, following objectives are defined:

- ✚ To know about the prevailing debt recovery methods adopted by PNB
- ✚ To get an insight about the effectiveness of methods of debt recovery in PNB.

### LITERATURE REVIEW

(Sethi, 2011) pointed out that the problem of non-performing asset is very dangerous for banks as this decreases the goodwill as well as the financial condition of the banks. In order to reduce the problem of non-performing assets, RBI and the government of India has set up targets for the banks to decrease the amount of NPA rather than only focusing on increasing the profits. She provided 2 major strategies for debt recovery which are preventive management and curative management. Under preventive management she says that a bank should thoroughly analyze the customers before providing them loans and the curative management defines what to do after the loan is categorized as non-performing asset.

(Sharma, 2011) stated in their study that Banks ought to comply with the RBI standards and give offices according to the standards, which are not being trailed by the banks. While the client must be given provoke administrations and the bank officer ought not to have any dread on brain to give the offices according to RBI standards to the units going wiped out. Banks ought to give credit at the lower loan fee also, training credits ought to be given easily without much documentation. Every one of the banks must give advances against offers. Reasonably managing the clients, more commitment from the representative of the bank. The staff ought to be helpful, neighborly and must be fit for comprehension the issues of clients.

(Ravi, 2015) argued that a high number problems with the prevailing legal structure for resolving insolvencies and debt recoveries in India as it multi layered framework. India's patchwork of insolvency laws that each applies to a different class of stakeholders or processes has resulted in parallel proceedings, conflicts between different statutes and uncertainty for creditors over their recovery. He also argued that, apart from the multi-layered legal framework, various factors to do with the law and its implementation have caused major delays in insolvency proceedings, particularly when it comes to winding up and liquidation. These include the reluctance of courts to issue winding up orders and their willingness to allow debtors to explore rescue and rehabilitation even when such an approach may no longer be feasible. Further, there is a need to have an effective legal framework to control the liquidation process post-issuance of the winding up order which is when the greatest delays often occur.

(Shreya, 2012) Banks are advised to take into account the following specific considerations while engaging recovery agents: Agents in these guidelines agencies engaged by the banks and the employees of the concerned agencies. Banks should have a due diligence process in place for engagement of recovery agents, which should be so structured to cover, amongst others individuals involved in the recovery process. The due diligence process should generally conform to the guidelines issued by RBI. Banks may decide the periodicity at which re-verification of antecedents should be resorted to ensure due notice and appropriate authorization, banks



should inform the borrower the details of recovery agency firms / companies while forwarding default cases to the recovery agency.

**(Ayuma, 2016)** The study concluded that the presence of bounced cheques is important to determine the transaction of the borrower for performance of the bank, the credit department checks for active and dormant accounts to facilitate the debt recovery technique, the bank ensures that the lender has retained his account for a long period of time with the bank to be considered for a loan and the increase in the number of transactions made influences the debt recovery hence increased performance, this concurs with the supplier customer-supplier relationship theory which implies that debt recovery techniques is a significant aspect of the performance of financial institution whereby debt repayment is a matter of association between the creditor and debtor and the continuation of mutual interests in terms of gains for both parties as stated by. On the effect of guarantors on Performance of financial institutions, the study concluded that account conduct of the guarantors is a significant factor affecting loan repayment and performance, the collateral value of the guarantor influences the performance of the institution, the institution checks the repayment history of the guarantor to offer loan to the borrower and the character of the guarantor influences the shares of the institutions, this concurs with the expected utility theory proposed by which postulates that in the presence of risky outcomes, a lender could use the expected value criterion as a rule of choice to make sure that their debts are recovered. Some people would be averse to risk enough preferring the sure thing, although it has a less expected value, while other less risk averse people would still choose the riskier, higher-mean lender to the borrower.

**(Vyas, December 2016)** stated that The Corporate Debt Restructuring (CDR) Mechanism is a voluntary non-statutory system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA) and the principle of approvals by super-majority of 75% creditors (by value) which makes it binding on the remaining 25% to fall in line with the majority decision. The CDR Mechanism covers only multiple banking accounts, syndication/consortium accounts, where all banks and institutions together have an outstanding aggregate exposure of Rs.10 Crores and above. It covers all categories of assets in the books of member-creditors classified in terms of RBI's prudential asset classification standards. Even cases filed in Debt Recovery Tribunals/Bureau of Industrial and Financial Reconstruction/and other suit-filed cases are eligible for restructuring under CDR. The cases of restructuring of standard and sub-standard class of assets are covered in Category-I, while cases of doubtful assets are covered under Category-II. S4A stands for Scheme for Sustainable Structuring of Stressed Assets. Under S4A, banks can convert up to 50% of a company's loans into equity. The option of such a debt equity swap can be done if the lenders feel that the operations could be turned around after the restructuring. Any project which has commenced commercial operations and has an overall exposure of more than Rs. 500 Crores can avail this new scheme, provided the bankers are convinced that the project can service the debt in the longer run. This can be established by conducting feasibility studies for determining whether or not a turnaround is possible.



(Olokoyo, 2018) revealed that the overall loan recovery strategies (careful consideration of loan application, regular visits to customer’s shop and house, use of litigation and use of collateral) used by banks have a significant effect on customer relationship. This denotes that the choice of recovery strategies employed can be adapted to retain the borrowing customers. The following recommendations are hereby made by the study; banks should put policies in place that will stipulate the strategy of loan recovery to be adopted in different situation as this have significant impact on loan payment and load default among customers, banks should also come up with reward and punishment system on their staff concerned with customer relationship and it is also recommended to the banks to leverage the good relationship between them and their customers to facilitate ease of loan recovery.

### RESEARCH METHODOLOGY

This Project work is primarily Qualitative in nature with emphasis on exploration and investigation to reach to a conclusion. This project work is basically quantitative data in order to establish facts thus stated in this work. The Research Design Used in this project work is primarily *Descriptive* and *Analytical* in nature. The Research technique used to complete this study is *Qualitative* in nature supported by adequate amount of *Quantitative* Data in order to establish the facts thus stated in this work.

Data used in this study is mainly *secondary* in nature collected from the various published sources such as:

- ✚ Annual report of Punjab National Bank
- ✚ Official website of RBI
- ✚ Official website of PNB
- ✚ Various other published sources.

### FINDINGS

#### Debt recovery methods adopted by Punjab National Bank

Preemptive Strategies	Corrective Strategies
<p><b>Early Warning Signals (EWS)</b>  <b>The 5-E Framework</b></p> <ol style="list-style-type: none"> <li>1. <b>Economic Warnings</b> Financial and economic distress signals</li> <li>2. <b>Enterprise Warnings</b> Operational Warnings</li> <li>3. <b>Executorial Warnings</b> Managerial Warnings</li> <li>4. <b>Exchequer Warnings</b> Banking Signals</li> <li>5. <b>Extraneous Warnings</b> External Warning Signals</li> </ol>	<ol style="list-style-type: none"> <li>1. <b>Legal Measures and Strategic Tools</b> <ul style="list-style-type: none"> <li>• Civil Remedies</li> <li>• Recovery through Debt Recovery Tribunals</li> <li>• SARFAESI Act 2002</li> <li>• Lok Adalats</li> <li>• Asset Reconstruction Companies and Sale of NPAs.</li> <li>• Bankruptcy and Insolvency Code</li> </ul> </li> <li>2. <b>Regulatory Measures and Strategic Tools</b> <ul style="list-style-type: none"> <li>• Central Repository of Information on Large Credits (CRILC)</li> <li>• Special Mention Accounts (SMA)</li> <li>• Joint Lenders Forum (JLF)</li> <li>• 5/25 Mechanism</li> <li>• SDR (Strategic Debt Restructuring)</li> <li>• Corporate Debt Restructuring</li> <li>• S4A Mechanism</li> <li>• Penal action against willful defaulters and deliberate non-payment</li> </ul> </li> <li>3. <b>Other non-legal measures</b> <ul style="list-style-type: none"> <li>• One-time Settlement (OTS)</li> <li>• Recovery Camps</li> </ul> </li> </ol>



## **PREEMPTIVE MEASURES**

### **1. Economic Warnings (Financial and economic distress signals)**

1. Missed payment of loan installment
2. Continuous irregularity
3. LC/BG invocation or devolvement
4. Constraint in working capital position
5. High Debt Equity Ratio
6. Erosion in topline and bottom-line
7. Negative EBITDA
8. Negative Net Profits
9. Negative Gross Profit Ratio despite higher sales
10. Higher levels of non-operating expenses ratio

### **2. Enterprise Warnings (Operational Warnings)**

1. Low Capacity Utilization
2. Missing payroll commitments
3. Missing fixed expenses commitments
4. Erosion in customer base
5. Labor Issues, Strikes
6. Changes in expansion plans
7. Selling fixed assets
8. Stock margins either very high or very low

### **3. Executional Warnings (Managerial Warnings)**

1. Evidence of fund diversification
2. Deteriorated bank customer relationship
3. Selling equity or changes in ownership structure
4. Frequent changes in key managerial positions
5. Unrelated and high risk diversification
6. Window Dressing of managerial reports
7. Disputes arising in management family

### **4. Exchequer Warnings (Banking Signals)**

1. Requests for undue increase in working capital limits
2. Requests for restructuring and extension in credit line
3. Delinquency in repayments
4. Operating accounts maintained with other banks
5. Reduced transactions in operating accounts
6. Delinquency in submission of statements
7. Payments to unrelated parties
8. High value money transfer to relatives/friends
9. Dis-honour of cheques

### **5. Extraneous Warnings (External Warning Signals)**

1. Economic slowdown and recession
2. Changes in technology
3. Policy changes
4. Entry of new/increased competition
5. Natural disaster
6. Sunset on industry
7. Regulatory changes
8. Changes in customer preferences
9. Man-made disaster

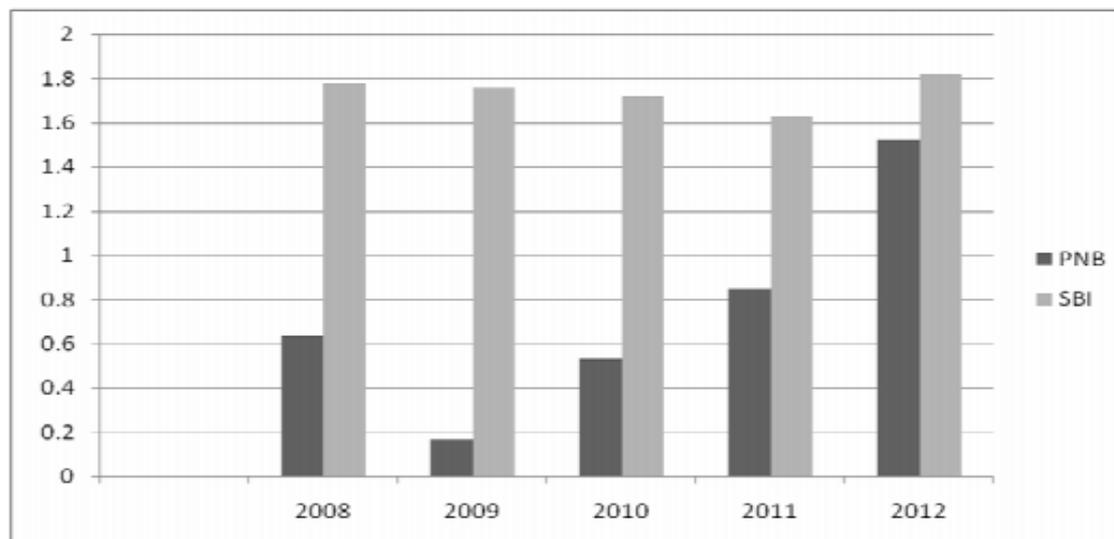


### **CORRECTIVE STRATEGY: AFTER DEFAULT STRATEGY**

Corrective Strategies are the lawful, administrative and non-statutory methods accessible at the transfer of the banks for recuperation of defaulted loans. The details of the different cures accessible are displayed underneath:

#### **❖ Legal measures and Strategic tools:**

- Civil Remedies: A typical though tedious recovery method accessible to banks and monetary foundations is recording standard/straightforward cash suit for recouping exceptional obligation/sum or is to document a synopsis suit under Code of Civil Method 1908 (Order 37). The synopsis suits are relatively discarded quicker than common suits and are relevant on all suits for recuperation of obligation/cash emerging from composed assertions and contracts. On the off chance that once the suit is established what's more, the request under suit documented cases are issued the respondent has ten days to show up under the watchful eye of the court, whenever neglected to do the court may expect the offended party's claims to be right and genuine along these lines may in like manner grant the offended party. In the event that anyway the respondent shows up under the steady gaze of the court, the court may acknowledge his/her safeguard just if the court is persuaded that it is generous to the case under thought.
- Recovery through Debt Recovery Tribunals: Under the recovery of Debts Due to Banks and Financial Institutions Act 1993, the debt Recovery Tribunals was formed. This was formed with the motive to assist the banks in adjudication of cases related to recovery of loans of amount above 10 Lakhs.
- SARFAESI Act 2002: Securitization and Reconstruction of financial Assets and Enforcement of Security Interest Act 2002 enables the banks to sell the personal assets of the borrower to recover the amount of loan. According to the section 13(4) of SARFAESI Act the banks may acquire the secured assets within 60 days of giving a notice under the act.
- Lok Adalats: Lok Adalats are organized by the Civil courts verdicts compromise amongst the parties, financial institutions and borrower in matters which may be pending in any other court of law up to a ceiling of 20 Lakhs.
- Asset Reconstruction Companies and sale of NPA: These companies are formed under section 3 of the Securitization and reconstruction of financial assets and enforcement of security interest Act 2002. The main motive of ARC is fast disposal of bad debts that are owned by the banks to clean the balance sheet. Banks dispose their bad debts to ARC and these companies recover an amount by the help of attachment liquidation and securitization.



(Net NPAs Ratio (per cent) in Punjab National Bank and State Bank of India)

#### **RECENT INITIATIVES TAKEN BY PNB**

After the Nirav Modi and Mehul Choksi fraud in the Punjab National Bank, the bank became very much sensitive regarding the doubtful and loss assets. After the fraud the Punjab National Bank had set up a different department for the management of the doubtful and loss assets of the bank namely STRESSED ASSETS MANAGEMENT VERTICAL. The task of this department is to look after the doubtful and loss assets of the bank and recover every possible loan in the prescribed manner. In the recent past the Punjab National Bank has sold its non-performing assets of approximately INR 2000 crores and has got INR 1779.18 crores from it. Still the bank faced a loss of approximately INR 221.82 crores. But the availability of these type of debt recovery tools has ensured that banks do not face the problems of NPSs in such a huge amount.

#### **CONCLUSION**

The debt recovery methods and tools adopted by Punjab National Bank have ensured that the bank does not face such huge problems related to the Non-Performing Assets and due to which there is no loss of the general public. Moreover the Preemptive measures have ensured that the banks do not provide credits to the borrowers from whom the bank has to bear or face any kind of risk. Apart from this the corrective measures have ensured that after the loans have been provided, in case of any default, what are the remedies and tools available with the bank to correct the defaults.

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