

## EFFECTIVENESS OF SARFAESI ACT, 2002 IN THE INDIAN BANKING INDUSTRY

Dr. Swati Jain, Associate Professor, School of Management, Poornima University, Jaipur

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### Abstract

The banking industry in India has been going through rapid changes and noteworthy development after nationalization of banks. In the varying circumstances of the operations and working system of banks in India, the NPAs (non-performing assets) have been a foremost difficulty being faced by them. The RBI and Government of India have taken a variety of measures to control non-performing assets. The modifications in the Banking Sector in India have brought many positive changes like, the enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 has been a benchmark reform in the banking sector of India. The securitization act has provided much desired authority to the banks in India to deal with the NPAs predominantly those bad assets (bad loans) which occur because of willful defaulting of the customers.

The majority of previous researches in India are concentrated to the general review of the non-performing assets and its management. No specific study has been conducted towards judging the impact of SARFAESI Act on the Indian Banking Industry. This research paper makes an attempt to decide whether the enactment of SARFAESI Act, 2002 is able to spread its encouraging impact on the Banking Industry of India and its impact on the level of risk management of those institutions. This research study is based on the secondary data and for data analysis; the paired t-test was used. The study establishes that NPAs in Indian Banks have been constantly reducing ever since enactment and implementation of the SARFAESI Act. The outcome also shows that SARFAESI Act, 2002 leads to growth in performance, asset quality improvement, enhancement of loan portfolio and ultimately better risk management. The study suggests that banking industry of India must continue to stay focused in their hard work to improve the non-performing assets and bad loans, to preserve the encouraging and efficient tendency of improving their asset quality.

**Keywords** - SARFAESI Act 2002, NPA, Total Advances, Asset Quality, t-test

### Introduction

The banking industry is the spine of any financial system in the world. Traditionally, the Law system in India had been quite gracious towards borrowers and notably time-consuming and incompetent. As a result, as a bank grants loan to an organization, it has very less power to bargain for the loan back or get the assets that officially securitize the loan. The Indian banking sector is constantly suffering from bad-loans, i.e. NPAs (non-performing assets). The mounting NPAs have always been a cause of distress for the whole banking industry. But the circumstances has enhanced over time. The reform measures have moreover resulted in an enhancement in the profitability and prosperity of banks. There has been a visible up-gradation in the quality of asset of banks. The Government of India has proactively commenced various actions to manage NPAs. In order to control and regulate the NPAs and speed up the recovery process, the Indian Government has set up DRTs and DATs and in the

year 2002 they enacted the SARFAESI Act, which is also called securitization act.

The foremost purpose behind the enactment of SARFAESI Act was the sale/ auction or securitization of NPAs or NPLs (Non-performing Loans) by banks and financial institutions in favor of ARCs (Assets Reconstruction Companies) registered with the RBI (Reserve Bank of India). The SARFAESI Act authorizes the banks and financial institutions to directly acquire the asset of the secured creditor, in case, of the Non-performing assets by giving direct notice, without the intervention of court. This has speeded the recovery process of the banks and helped the banking institutions to recover their bad loans, which directly reflected in the enhancement of asset quality in banks and financial institutions.

## Review of Literature

Review of Literature has revealed that non-performing assets acts like a worm and affects the working of the banking sector by decreasing its asset quality, profitability, net worth, liquidity, etc. The last decade has shown a significant change in the amount of NPA in the banking industry, i.e. it has decreased to a large extent. This is the result of various recovery tools and especially the enactment of SARFAESI Act in 2002. This act has provided much needed power to the banking industry to recover its dues from the defaulters with no interference of court. Hence, the act had an encouraging impact on the banking industry in India. But no study has been conducted to prove the resourcefulness of the act and to analyze the worth of this act as a risk management tool for the Indian banking industry. To fill this gap, the present was undertaken with an aim to prove that the SARFAESI Act has improved the Indian banking sector and acted as a risk management tool for the banks.

## Objectives

- To study the efficacy of SARFAESI Act in enhancing the loan portfolios and improving the performance of banking industry.
- To study the impact of SARFAESI Act on asset quality of Indian banks.
- To analyze the SARFAESI Act as risk management tool for Indian banks.

## Hypothesis

Based on literature review and previous studies related to the securitization act, the following Hypotheses have been formulated for authentication of this research:

**Null Hypothesis ( $H_{01}$ ):** SARFAESI Act does not enhance the institutions' loan portfolios, liquid securities i.e. investments and has not helped the banking industry to maintain a steady performance.

**Alternate Hypothesis ( $H_{a1}$ ):** SARFAESI Act has enhanced the institutions' loan portfolios, liquid securities i.e. investments and has helped the banking industry to maintain a steady performance.

**Null Hypothesis ( $H_{02}$ ):** SARFAESI Act does not improve the asset quality of the banking institutions and has not helped the banking institutions in better risk management.

**Alternate Hypothesis ( $H_{a2}$ ):** SARFAESI Act has improved the asset quality of the banking institutions and has helped the banking institutions in better risk management.

## Research Methodology

### The study

As the concept of risk management in the emerging scenario is quite new, the present research is

both exploratory and descriptive in nature. This paper employed the Ex Post Facto research design to compare two periods i.e. before the enactment of SARFAESI Act and after the enactment of SARFAESI Act. The model for the study was structured in a way to bring out whether the SARFAESI Act has a positive impact on the banking industry.

The study being comprehensive one covers all the three sectors (public, private and foreign) of Indian Banking Industry. To test the above mentioned hypothesis few parameters have been selected. Loans and Advances (LA), Investments (INVT), Profit after Tax (PRFT) for  $H_{01}$  and Gross NPA as a percentage of Gross Advances (GNPAGA), Net NPA as a percentage of Net Advances (NNPANA), Gross NPA as percentage of Total Assets (GNPATA), Net NPA as percentage of Total Assets (NNPATA), Net Worth (NETW) and Capital Adequacy Ratio (CAR) for  $H_{02}$ . Variable AF is used to represent the values after the enactment of SARFAESI Act and BF is used to represent the values before the enactment of Act.

### Sample

The Indian banking industry comprises various commercial banks. Currently there are 21 public sector banks, 21 private sector banks and 41 foreign banks. The purposive sample is taken from the banking industry. The scope of the present study is restricted to the 21 Public sector banks, 12 private sector banks and 25 foreign banks as these banks were in existence in 2002 and 2016.

### Tools used for Data Collection and Analysis

The present research mainly depends upon secondary data collected from various sources i.e., Reports on trends and progress of banking in India, annual reports of the public and private sector banks, statistical tables relating to banks in India for the period of eleven years from 2001-02 (before enactment of Act) to 2015-16 (after the enactment of Act). The data analysis has been done through SPSS using paired t-test.

### Results and Discussions

$H_{01}$  Stands Rejected and  $H_{a1}$  is accepted

The null hypothesis is rejected in case of public sector banks, private sector banks and foreign banks, looking at the t-test result of public sector banks (**Refer Table 1, 2 & 3**), LA, INVT, PRFT  $t_c = 4.273, 5.199$  and  $3.240$  respectively  $> t_c = 2.064$ . This result shows that there is a significant difference in the amount of loan and advances, investment, and profit before the enactment of SARFAESI Act and after its enactment. This result is further strengthened with the 2-tailed significance value of 0.00, 0.00 and 0.003 for LA, INVT and PRFT  $< 0.05$  level of significance.

The t-test result in case of private sector banks (**Refer Table 4, 5 & 6**) shows that there is significant difference in the amount of loans and advances, investment and profit in case of Pre SARFAESI Act and Post SARFAESI Act as the LA, INVT, PRFT  $t_c = 8.114, 7.917$  and  $2.559$  respectively  $> t_c = 2.145$ . This result is further supported with the 2-tailed significance value of 0.00, 0.00 and 0.023 for LA, INVT and PRFT  $< 0.05$  level of significance.

In case of foreign banks also, the t-test result (**Refer Table 7, 8 & 9**) shows that there is significant difference in the values of the two paired variables as the LA, INVT, PRFT  $t_c = 2.969, 2.879$  and  $2.256$  respectively  $> t_c = 2.064$ . This result is further supported with the 2-tailed significance value of 0.07, 0.08 and 0.033 for LA, INVT and PRFT  $< 0.05$  level of significance.

In all the three cases, the null hypothesis stands rejected and therefore, we accept the alternate hypothesis, i.e. the SARFAESI Act has significant contribution in enhancing the bank's loan portfolios, liquid securities i.e. investments and has helped the banking industry to maintain a steady performance.

$H_{02}$  Stands Rejected and  $H_{a2}$  is accepted

The null hypothesis is rejected in case of public sector banks, private sector banks and foreign banks, looking at the t-test result of public sector banks (**Refer Table 10, 11 & 12**), GNPAGA, NNPNANA, GNPATA, NNPNANA, NETW, CAR  $t_c = 10.025, 8.742, 9.438, 8.232, 4.531$  and  $3.582$  respectively  $> t_c = 2.064$ . This result shows that there is a significant difference in the amount of Gross NPA to Gross Advances, Net NPA to Net Advances, Gross and Net NPA to Total Assets, Net Worth and Capital Adequacy Ratio of the banking industry before the enactment of SARFAESI Act and after its enactment. This result is further strengthened with the 2-tailed significance value of 0.00, 0.00, 0.00, 0.00, 0.00 and 0.002 for GNPAGA, NNPNANA, GNPATA, NNPNANA, NETW and CAR  $< 0.05$  level of significance.

The t-test result in case of private sector banks (**Refer Table 13, 14 & 15**) shows that there is significant difference in the amount of Gross NPA to Gross Advances, Net NPA to Net Advances, Gross and Net NPA to Total Assets, Net Worth and Capital Adequacy Ratio in case of Pre SARFAESI Act and Post SARFAESI Act as the GNPAGA, NNPNANA, GNPATA, NNPNANA, NETW, CAR  $t_c = 6.271, 6.130, 6.449, 8.208, 5.426$  and  $2.190$  respectively  $> t_c = 2.145$ . This result is further supported with the 2-tailed significance value of 0.00, 0.00, 0.00, 0.00, 0.00 and 0.46 for GNPAGA, NNPNANA, GNPATA, NNPNANA, NETW and CAR  $< 0.05$  level of significance.

In case of foreign banks also, the t-test result (**Refer Table 16, 17 & 18**) shows that there is significant difference in the values of the two paired variables as the GNPAGA, NNPNANA, GNPATA, NNPNANA, NETW, CAR  $t_c = 8.489, 2.849, 2.738, 2.673, 3.345$  and  $2.522$  respectively  $> t_c = 2.064$ . This result is further supported with the 2-tailed significance value of 0.00, 0.009, 0.011, 0.013, 0.003, and 0.019 for GNPAGA, NNPNANA, GNPATA, NNPNANA, NETW and CAR  $< 0.05$  level of significance.

In all the three cases, the null hypothesis stands rejected and therefore we accept the alternate hypothesis, i.e. the SARFAESI Act has improved the asset quality of the banking institutions and has helped the institutions in better risk management.

## Conclusion

The establishment of SARFAESI Act, 2002 has consequently smoothened the system for full-fledged execution and practice of securitization in India, particularly by the Indian banks from year 2000 onwards. Credit risk for banks increases where there are high incidences of non-performing loans and the study establishes that NPA in Indian Banks have been constantly declining ever since accomplishment of the SARFAESI Act 2002, therefore, the securitization act has led to significant reduction credit risk of the banks in India. The results also indicates that SARFAESI Act, 2002 helps in enhancing performance, improvement in asset quality, improvement of loan portfolio and eventually improved risk management. The study suggests that Indian banks should maintain focus on their efforts to recover their NPAs and NPLs, to uphold the encouraging and successful development of enhancing their asset quality.

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**Public Sector Banks**  
**Table 1: Statistics of Paired Samples**

		Mean	N	Standard Deviation	Standard Error Mean
Pair 1	AFLA	124306.8092	21	146698.01887	29339.60377
	BFLA	18927.7080	21	23484.55473	4696.91095
Pair 2	AFINVT	49652.9088	21	56602.14595	11320.42919
	BFINVT	17847.5784	21	27322.18518	5464.43704
Pair 3	AFPRFT	.9788	21	.28547	.05709
	BFPRFT	.7080	21	.33639	.06728

**Table 2: Correlations of Paired Samples**

		N	Correlation	Significance
Pair 1	AFLA & BFLA	21	.996	.000
Pair 2	AFINVT & BFINVT	21	.975	.000
Pair 3	AFPRFT & BFPRFT	21	.104	.621

**Table 3: T-Test result of Paired Samples**

		Paired Differences					t	df	Significance (2-tailed)
		Mean	Standard Deviation	Standard Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	AFLA – BFLA	105379.1012	123320.35159	24664.07032	54474.9619	156283.2405	4.273	20	.000
Pair 2	AFINVT – BFINVT	31805.3304	30588.16291	6117.63258	19179.1573	44431.5035	5.199	20	.000
Pair 3	AFPRFT – BFPRFT	.2708	.41795	.08359	-.0983	.4433	3.240	20	.003

**Private Sector Banks**  
**Table 4: Statistics of Paired Samples**

		Mean	N	Standard Deviation	Standard Error Mean
Pair 1	AFLA	1800617.2667	12	828680.02114	213964.26141
	BFLA	241329.2000	12	175672.92592	45358.55443
Pair 2	AFINVT	1097279.7333	12	474407.82033	122491.57250
	BFINVT	219997.6000	12	183399.94567	47353.66235
Pair 3	AFPRFT	.6527	12	.69569	.17963
	BFPRFT	.4907	12	.51765	.13366

**Table 5: Correlations of Paired Samples**

		N	Correlation	Significance
Pair 1	AFLA & BFLA	12	.562	.029
Pair 2	AFINVT & BFINVT	12	.428	.111
Pair 3	AFPRFT & BFPRFT	12	.961	.000

**Table 6: T-Test result of Paired Samples**

		Paired Differences					t	df	Significance (2-tailed)
		Mean	Standard Deviation	Standard Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	AFLA - BFLA	1559288.0667	744280.74716	192172.462 58	1147119.12 71	1971457.00 62	8.114	11	.000
Pair 2	AFINVT - BFINVT	877282.1333	429167.51032	110810.574 68	639617.087 9	1114947.17 88	7.917	11	.000
Pair 3	AFPRFT - BPRFT	.1620	.24522	.06331	.0262	.2978	2.559	11	.023

### Foreign Banks

**Table 7: Statistics of Paired Samples**

		Mean	N	Standard Deviation	Standard Error Mean
Pair 1	AFLA	754597.4800	25	1278605.55521	255721.11104
	BFLA	163636.7200	25	307672.04285	61534.40857
Pair 2	AFINVT	607697.4400	25	1005228.96828	201045.79366
	BFINVT	126765.9600	25	205607.95626	41121.59125
Pair 3	AFPRFT	1.9884	25	1.23289	.24658
	BPRFT	.8280	25	2.00797	.40159

**Table 8: Correlations of Paired Samples**

		N	Correlation	Significance
Pair 1	AFLA & BFLA	25	.939	.000
Pair 2	AFINVT & BFINVT	25	.859	.000
Pair 3	AFPRFT & BPRFT	25	-.214	.304

**Table 9: T-Test result of Paired Samples**

		Paired Differences					t	df	Significance (2-tailed)
		Mean	Standard Deviation	Standard Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	AFLA - BFLA	590960.7600	995281.36184	199056.27237	180128.8058	1001792.7142	2.969	24	.007
Pair 2	AFINVT - BFINVT	480931.4800	835181.44975	167036.28995	136185.5214	825677.4386	2.879	24	.008
Pair 3	AFPRFT - BFPRFT	1.1604	2.57133	.51427	.0990	2.2218	2.256	24	.033

### Public Sector Banks

**Table 10: Statistics of Paired Samples**

		Mean	N	Standard Deviation	Standard Error Mean
Pair 1	BFGNPAGA	11.4132	21	4.51467	.90293
	AFGNPAGA	2.0812	21	.67495	.13499
Pair 2	BFNNPANA	6.3416	21	3.05070	.61014
	AFNNPANA	1.0056	21	.39422	.07884
Pair 3	BFGNPATA	5.0868	21	1.92471	.38494
	AFGNPATA	1.2568	21	.38979	.07796
Pair 4	BFNNPATA	2.6668	21	1.21804	.24361
	AFNNPATA	.6272	21	.24105	.04821
Pair 5	AFNETW	10943.5208	21	12645.31649	2529.06330
	BFNETW	2054.4936	21	2935.62080	587.12416
Pair 6	AFCAR	13.3512	21	.95574	.19115
	BFCAR	11.3232	21	2.74155	.54831



**Table 11: Correlations of Paired Samples**

		N	Correlation	Significance
Pair 1	BFGNPAGA & AFGNPAGA	21	-.135	.519
Pair 2	BFNNPANA & AFNNPANA	21	.062	.769
Pair 3	BFGNPATA & AFGNPATA	21	-.173	.407
Pair 4	BFNNPATA & AFNNPATA	21	.012	.955
Pair 5	AFNETW & BFNETW	21	.974	.000
Pair 6	AFCAR & BFCAR	21	.079	.707

**Table 12: T-Test result of Paired Samples**

		Paired Differences					t	df	Significance (2-tailed)
		Mean	Standard Deviation	Standard Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	BFGNPAGA – AFGNPANA	9.3320	4.65437	.93087	7.4108	11.2532	10.025	20	.000
Pair 2	BFNNPANA – AFNNPANA	5.3360	3.05176	.61035	4.0763	6.5957	8.742	20	.000
Pair 3	BFGNPATA – AFGNPATA	3.8300	2.02897	.40579	2.9925	4.6675	9.438	20	.000
Pair 4	BFNNPATA – AFNNPATA	2.0396	1.23882	.24776	1.5282	2.5510	8.232	20	.000
Pair 5	AFNETW – BFNETW	8889.0272	9808.05576	1961.61115	4840.4608	12937.5936	4.531	20	.000
Pair 6	AFCAR – BFCAR	2.0280	2.83097	.56619	.8594	3.1966	3.582	20	.002

**Private Sector Banks**

**Table 13: Statistics of Paired Samples**

		Mean	N	Standard Deviation	Standard Error Mean
Pair 1	BFGNPAGA	12.8447	12	6.64885	1.71673
	AFGNPAGA	1.6353	12	1.05440	.27224
Pair 2	BFNNPANA	8.3307	12	4.85009	1.25229
	AFNNPANA	.6440	12	.21656	.05591
Pair 3	BFGNPATA	5.7273	12	2.85850	.73806
	AFGNPATA	.8360	12	.62844	.16226
Pair 4	BFNNPATA	4.0293	12	1.72192	.44460
	AFNNPATA	.3490	12	.26271	.06783
Pair 5	AFNETW	2258.7193	12	1471.93316	380.05151
	BFNETW	295.5687	12	249.79822	64.49762
Pair 6	AFCAR	16.2800	12	14.21579	3.67050
	BFCAR	9.8473	12	5.96120	1.53918

**Table 14: Correlations of Paired Samples**

		N	Correlation	Significance
Pair 1	BFGNPAGA & AFGNPAGA	12	-.186	.507
Pair 2	BFNNPANA & AFNNPANA	12	-.008	.978
Pair 3	BFGNPATA & AFGNPATA	12	-.017	.951
Pair 4	BFNNPATA & AFNNPATA	12	.021	.942
Pair 5	AFNETW & BFNETW	12	.361	.187
Pair 6	AFCAR & BFCAR	12	.639	.010



**Table 15: T-Test result of Paired Samples**

		Paired Differences					t	df	Significance (2-tailed)
		Mean	Standard Deviation	Standard Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	BFGNPAGA – AFGNPAGA	11.2093	6.92293	1.78749	7.3755	15.0431	6.271	11	.000
Pair 2	BFNNPANA – AFNNPANA	7.6867	4.85664	1.25398	4.9971	10.3762	6.130	11	.000
Pair 3	BFGNPATA – AFGNPATA	4.8913	2.93737	.75843	3.2647	6.5180	6.449	11	.000
Pair 4	BFNNPATA – AFNNPATA	3.6803	1.73650	.44836	2.7187	4.6420	8.208	11	.000
Pair 5	AFNETW – BFNETW	1963.1507	1401.34480	361.82567	1187.1118	2739.1895	5.426	11	.000
Pair 6	AFCAR – BFCAR	6.4327	11.37442	2.93686	.1337	12.7316	2.190	11	.046

### Foreign Banks

**Table 16: Statistics of Paired Samples**

		Mean	N	Standard Deviation	Standard Error Mean
Pair 1	BFGNPAGA	18.7600	25	8.62303	1.72461
	AFGNPAGA	2.8264	25	2.50693	.50139
Pair 2	BFNNPANA	10.4832	25	16.50629	3.30126
	AFNNPANA	1.0488	25	.94034	.18807
Pair 3	BFGNPATA	6.0816	25	9.49474	1.89895
	AFGNPATA	.7928	25	.87933	.17587
Pair 4	BFNNPATA	1.9184	25	3.15025	.63005
	AFNNPATA	.2427	25	.33643	.06729
Pair 5	AFNETW	300346.1600	25	445556.32682	89111.26536
	BFNETW	32631.8000	25	47667.99439	9533.59888
Pair 6	AFCAR	23.9644	25	22.32828	4.46566
	BFCAR	13.9888	25	11.62828	2.32566

**Table 17: Correlations of Paired Samples**

		N	Correlation	Significance
Pair 1	BFGNPAGA & AFGNPAGA	25	-.172	.411
Pair 2	BFNNPANA & AFNNPANA	25	-.025	.904
Pair 3	BFGNPATA & AFGNPATA	25	-.139	.507
Pair 4	BFNNPATA & AFNNPATA	25	.100	.635
Pair 5	AFNETW & BFNETW	25	.956	.000
Pair 6	AFCAR & BFCAR	25	.467	.019

**Table 18: T-Test Result of Paired Samples**

		Paired Differences					t	df	Significance (2-tailed)
		Mean	Standard Deviation	Standard Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	BFGNPAGA – AFGNPAGA	15.9336	9.38473	1.87695	12.0598	19.8074	8.489	24	.000
Pair 2	BFNNPANA – AFNNPANA	9.4344	16.55690	3.31138	2.6000	16.2688	2.849	24	.009
Pair 3	BFGNPATA - AFGNPATA	5.2888	9.65647	1.93129	1.3028	9.2748	2.738	24	.011
Pair 4	BFNNPATA - AFNNPATA	1.6757	3.13457	.62691	.3818	2.9696	2.673	24	.013
Pair 5	AFNETW - BFNETW	267714.3600	400211.15888	80042.23178	102515.3130	432913.4070	3.345	24	.003
Pair 6	AFCAR - BFCAR	9.9756	19.77620	3.95524	1.8124	18.1388	2.522	24	.019