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A STUDY ON NPA MANAGEMENT IN COOPERATIVE BANKS IN INDIA: CAUSES AND REMEDIAL SOLUTIONS

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ABSTRACT

Non -Performing Assets (NPA) is an indicator of the health, performance and credit risk of the bank. Non-Performing Assets are one of the major concerns for co-operative Banks in India. A High level of NPAs suggest high probability of a large number of credit defaults that affect the profitability and net-worth of co-operative banks and also erodes the value of the asset. The problem of NPA is not only affecting the co-operative bank but also the whole Indian economy As the level of NPAs to total credit increases the liquidity risk also increases. Thus reduction of NPAs is essential to speed up the growth and profitability of banks. The NPA problem is the result of monitoring overdues to various factors like weak monitoring, poor credit appraisal system, loan waiver scheme and mis-utilization of loan etc. The strong co-operative banking is important for successful country's economy. This paper deals with understanding NPAs and major causes for an account becoming Non-performing in co-operative banks and its remedial measures.

KEY WORDS: NPA Management ,Cooperative bank

INTRODUCTION

NPA has become a very vital area for any bank. Turning account as NPA erodes the profit and at subsequent stage, if not controlled the capital also. In awarding gradation to the banks by RBI and the statutory auditors, NPA is the most important determining factor. As per RBI guidelines, the asset classification and provisioning is required to be done correctly. Cooperatives banks have played an important role in the socio –economic development of rural masses. A small beginning was made with the enactment of first Cooperative Credit Societies Act in 1904 and now the cooperative system has completed a century. At present, there are more than 5 lakh cooperative societies which have deeply penetrated in the rural economy. The short term and long-term cooperative banking structure has met the demand for agriculture and allied agriculture credit needs of the farmers in India. The short-term cooperative banking structure consists of 32 State Cooperative Banks (SCBs) at the State level, 367 District Central Cooperative Bank (DCCB) at the District level, and 93816 Primary Agriculture Cooperative Societies/Banks (PACBs) at the village level. Here, the DCCBs being the middle tier between SCBs and PACBs, occupy a position of strategic importance.

Since 1912 the co-operative credit institutions have been playing a pivotal role in the financial system of the economy. The co-operative banking system fills in the gaps of banking needs of small and medium income groups not adequately met by the public and private sector banks and supplements the efforts of the commercial banks in mobilizing savings and meeting the credit needs of the local population.

STATEMENT OF THE PROBLEM:

The Co-operative credit institutions have been facing innumerable prominent problems. Huge administrative expenses and lack of management skill of the employee are the major problems of the co-operative banks in India. This is because of lack of training and education to the employees. They are expected to provide better services on par with the nationalized banks and even better than them.

Competition is another force that makes the problem more acute. Emergence of the private banks including the foreign banks made the accesses to banking services easier than before especially to the urban people. It makes the competition stiffer than before at least to retain the people who have been banking with the co-operative banks. However co-operative banks have had an edge over others in terms of their nearness with the customers. It is necessary for them to provide efficient services and also to win the confidence of the shareholders, depositors and the common public by making their financial position lucrative. But the prevailing situation reveals a different condition.

Poor performance is recovery of loans and sanction of loans without proper security, changing government policies relating to the sanction and recovery of loans given to the people attitude of the debtors also pose a major hurdle to the growth and development of cooperative banking system in India.

OBJCECTIVES OF THE STUDY:

The present study was undertaken with the following objectives:

1. To understand the concept of NPA and classification of asset as per RBI guidelines.

2. To analyze the reasons for NPA.

3. To analyze the management of NPA in cooperative banks.

DEFINITION OF NON PERFORMING ASSETS:

A Loan Assets becomes non-performing when it ceases to generate income to the Bank. These NPA have well defined credit weakness that jeopardize the liquidation of debts and may characterize by the distinct possibilities that the Banks will sustain same loss. Non-performing assets be defined for various types of credit facilities or advances are as under.

(a) In case of term loan (other than agriculture Loan), either interest and/or installment of principal dues remain 'overdue 'for a period more than 90 days as on the date of Balance sheet in 31 March 2005.

(b) In case of running account such as cash credit or over draft (Other than agricultural loan), the accounts remains 'out of order' continuously for a period more than 90 days during the year ending on 31st March, 2005.

(c) In case of bills purchased and discounted, if the bills remain overdue and unpaid for a period more than 90 days during the year ending on 31st March, 2005.

(d) In case of other loan facilities, any amount to be received remains overdue' for a period more those 90 days during the year ending in 31st March 2005.

(e) Since advances to Tea industry is considered/governed by the norms as applicable for agricultural advance (Madhulkar committee Report) such accounts will be considered as NPA if interest and/or installment of principal remain overdue for two crop seasons (as tea is considered as short duration crop by IBA end also by the SLBC, west Bengal).

State Govt. granted advances (Sanctioned on or before 31.3.2000) will be classified as NPA if interest and installment remain unpaid beyond 180 days as on 31.3.2005 and 90 days as on 31.03.2006 onwards, irrespective of whether the guarantee is invoked or not. Date of NPA however will be considered from the original date of irregularity though the identification will be made w.e.f. 31.03.2005 and accordingly the asset classification of such advances will be made based on age of irregularity/delinquency in the account. Asset classification and provisioning there against should be decided on the basis of value of security charged to the Banks state Govt. guaranteed advances, sanctioned on or after 01.04.2000, will be treated at par with other advances.

(g) Advances backed by central Govt. guarantee will be classified as NPA only after 90 days of repudiation of the guarantee by the Govt. when the same is invoked.

(h) In case of agricultural Loan, the identification norms are stipulated on the basis of periodicity of the crop grown as detailed here under.

Short duration crop (up to 12 months); loans guaranteed for short duration crops will be treated as NPA of the installment of the principal or interest remains unpaid for two crop seasons beyond the due date. Long duration crops (beyond 12 months) a loans guaranteed for long duration crop will be treated as NPA if the installment of the, principal or interest there on remains unpaid for one crop season beyond the due date. All the above prescriptions of crop loan (for identification of NPA) would also be applicable for a term loan mutates mutandis.

INCOME RECOGNITION:

Banks recognize income including interest income on advances on accrual basis. That is, income is accounted for as and when it is earned. The prima-facie condition for accrual of income is that it should not be unreasonable to expect its ultimate collection. However, NPAs involves significant uncertainty with respect to its ultimate collection. Considering this fact, in accordance with the guidelines for income recognition issued by the Reserve Bank of India (RBI), banks should not recognize interest income on such NPAs until it is actually realized.

CLASSIFICATION OF BANK ADVANCES:

Reserve Bank of India (RBI) has issued guidelines on provisioning requirement with respect to bank advances. In terms of these guidelines, bank advances are mainly classified into:

Standard Assets: Such an asset is not a non-performing asset. In other words, it carries not more than normal risk attached to the business.

Sub-standard Assets: It is an asset which remains non- performing for a period not exceeding 12 months with effect from 31st March 2005.

Doubtful Assets: Asset that has remained NPA for a period exceeding 18 months is a doubtful asset.

Loss Assets: Here loss is identified by the banks concerned or by internal auditors or by external auditors or by Reserve Bank India (RBI) inspection.

In terms of RBI guidelines, as and when an asset becomes a NPA, such advances would be first classified as a substandard one for a period that should not exceed 12 months and subsequently as doubtful assets. It should be noted that the above classification is only for the purpose of computing the amount of provision that should be made with respect to bank advances and certainly not for the purpose of presentation of advances in the bank balance sheet. The Third Schedule to the Banking Regulation Act, 1949, solely governs presentation of advances in the balance sheet.

Banks have started issuing notices under the Securitization Act, 2002 directing the defaulter to either pay back the dues to the bank or else give the possession of the secured assets mentioned in the notice. However, there is a potential threat to recovery if there is substantial erosion in the value of security given by the borrower or if borrower has committed fraud. Under such a situation it will be prudent to directly classify the advance as a doubtful or loss asset, as appropriate.

PROVISIONING REQUIREMENT OF BANK ADVANCES :

As and when an asset is classified as an NPA, the bank has to further sub-classify it into sub-standard, loss and doubtful assets. Based on this classification, bank makes the necessary provision against these assets. Reserve Bank of India (RBI) has issued guidelines on provisioning requirements of bank advances where the recovery is doubtful. Banks are also required to comply with such guidelines in making adequate provision to the satisfaction of its auditors before declaring any dividends on its shares. In case of loss assets, guidelines specifically require that full provision for the amount outstanding should be made by the concerned bank. This is justified on the grounds that such an asset is considered uncollectible and cannot be classified as bankable asset.

Asset Category

Provision Required

Substandard Assets

-Secured

–Unsecured

Provision of 10% of the outstanding (denoted as code 21)

Provision of 20% of the outstanding (denoted as code 22)

Doubtful Assets

-Doubtful I

-Doubtful II

-Doubtful III Provision of 20% of realizable value of security plus 100% of the shortfall of security(denoted by code 31)

Provision of 30% of realizable value of security plus 100% of the shortfall of security(denoted by code 32)

Provision of 100% (denoted by code 33)

Loss Assets Provision of 100% (denoted by code 41)

REASONS FOR ASSETS TURNING TO NPAs

Various Studies have been conducted to analyze the reasons for NPA, whatever may be complete elimination of NPA is impossible. The reason were generally classified into two

1. Overhand component – due to environmental reasons, business cycle etc.

2. Incremental component – due to internal bank management, credit policy, term of credit etc.

There are various reasons either jointly or singly responsible for an asset becoming NPA can be classified as follows:-

Reasons from the economic side :

1. Political: Mindset regarding paradigm, proactive, fiscal responsible, major portion of NPA arise out of lending to priority sector at the dictates of politicians and bureaucrats.

2. Economic: Growth, distribution, efficient allocation of resource.

3. Social: Acceptability, mobility, education.

4. Technological: Lack of adoption of IT makes data processing difficult.

5. Legal: loan contracts are not enforceable naturally be a tendency to default.

6. Environmental: Liberalization and globalization.

Reasons from the industry side:

1. Global competition.

2. Cyclical downswing.

3. Sunset industry – industry growing slowly or declining.

4. Frequent changes in regulatory norms.

Reasons from the borrower side

1. Misconceived project.

2. Poor governance.

3. Product failure.

4. Bungling management.

5. Diversion of fund.

6. Dormant capital structure.

7. Regulator changes.

Reasons from the banking side:

1. Parameter set for functioning was deficient.

2. Lack of freedom to choose product and pricing.

3. Unexposed to international marketing methods and products.

4. Wrong lending decision.

5. Lack of Resource and poor training.

6. Lack of system and procedure.

7. Lack of ability to handle assets and liability.

8. Lack of mechanism of credit information dissemination.

9. Lack of an effective judicial system for recovery from defaulters.

10. Collateral based lending to idle assets.

11. Fixing of price and quantum of loans.

12. Lack of effective IT system and MIS.

Reasons from the loan structuring side:

1. High debt equity ratio.

2. Timing of raising equity

3. Discrepancy between rate of interest charged and realistic rate of return.

4. Inconsistency between revenue generation and the loan repayment schedule.

5. Lack of binding penal clause and performance guarantees.

6. Rising interest rate.

Reason from the security side:

There is a tendency among bank and institution to depend excessively on collateral for advancing loans. It is important to presume that if the borrower default in repaying then the security given will be helpful for recovery of loan. Clearly this logic is unacceptable. Emphasis should be on cash generation and a charge on this should be built into the loan contract through some escrow mechanism.

Reason from the regulatory side:

Frequently regulator changes can turn assets non- performing. Accounting reason like reduction in income recognition norms from 180 days to 90 days could be one reason and political related issues could be the other reason.

MANAGEMENT OF NPAs IN COOPERATIVE BANKS IN INDIA:

The problem of tackling NPAs is twofold, viz., recovery of NPAs and avoidance of slippage of standard assets to NPAs. In this regard the following strategies have to be adopted by the bank to tackle the problem of NPAs.

(i) Strengthening Pre-sanction Appraisal: At pre – disbursement stage, appraisal techniques of bank need to be sharpened. All technical, economic, commercial, organizational and financial aspects of the project need to be appraised realistically. A major cause for NPA is fixation of unrealistic repayment schedule. It may be fixed by taking into account the gestation or moratorium period, harvesting season, income generation, surplus available etc. if the repayment schedule is defective both with reference to quantum of installment and period of recovery assets have a tendency to become non-performing assets. Further DCCBs should set up an economic research wing at their Head office, which should provide a data on various types of farm and non-farm activities and rural industrious etc., required for proper appraisal of the loan

(ii) Post Sanction Supervision: At the post disbursement stage, bankers should ensure that the advance does not become NPA through proper follow up and supervision. They should also ensure both asset creation and asset utilization. Bankers can do either off-site surveillance or onsite inspection to detect whether the project is likely to become an NPA.

(iii) Special Mentions Accounts: The DCCBs were suggested to introduce a new assets category between standard and substandard for their own internal monitoring and follow-up. In line with international best practices but keeping in view the local requirements, assets may be transferred to this category once the earliest signs of sickness/irregularities are identified by the early alert system. Special mentioned accounts are not classified as NPAs. This would help the DCCBs to look at the problems right from the beginning.

(iv) Recovery Camps: The recovery caps should be organized frequently in rural areas. Government should ask the local revenue authorities to extend the full cooperation to the DCCB/PACBs in organizing such recovery camps.

(v) Recovery Cell: DCCBs should set up independent recovery and legal cell at their head office manned by well-qualified and competent law officers with adequate supporting staff for effective monitoring of recovery of accounts.

(vi) Incentives to the Honest Repayment: Incentives can be given to honest repayers to create a better climate for repayment. The possibility of honoring best loaner and best employees during cooperative weak celebrations can be chalked out.

(vii) Management information System: Proper steps should be taken to computerize all DCCBs and PACBs within the district connected to the State Cooperative Bank. It makes monitoring loan accounts more effective and efficient. DCCBs should create a database of their NPA portfolio on well- designed formats to provide meaningful inferences, which would help in evolving effective strategies as well as account specific action plan for preventing slippage of performing assets in to NPA.

(viii) Lok Adalats: Lok Adalats have gained importance over period of time as a forum to settle the disputes/settlements among the parties. Lok Adalats may prove to be advantageous for the banks because long pending cases could be immediately taken up for settlement.

NABARD has issued guidelines to cooperative banks for compromise settlements of dues through Lok Adalats. For the recovery of commercial banks' loans, the Lok Adalats have proved a very good agency for quick justices and settlement of dues. So, DCCBs should approach Lok Adalats for settlement of their claims against the borrowers covering under the chronic NPAs.

(ix) Role of Government Agencies: Since 1904 Cooperatives Banks have been extending financial assistances to the various classes of the people under priority sector lending schemes including those belonging to weaker sections. The bulk of loan assistances provided by the banks under priority sector pertain to the programs sponsored by the state Governments. As such, the Government Department /Organizations could play a vital role in creating right recovery climate, which in turn, facilitate DCCBs to reduce their NPAs. Government should not announce any waiving schemes or loan melas. This approach of the Government spoils the banking environment. Government should also introduce the Model Act in all states so as to ensure better support from the members.

(x) Creating Loyal Members: Members of the cooperatives are the owners and the users of the institutions. The financial health of PACBs depends on members loyal to the bank in the form of repaying the loan obligations within the due date. The mind-set of the members to wait for loan waivers and lethargy to reply the loan should be eradicated through effective member education programmes which may create loyal cooperators, which in turn will reduce the NPAs at gross root level.

(xi) Personal Touch with the Borrowers: The growth of NPAs consumes the precious time of the staff for preparing a large volume of turns and statements relating to substandard, doubtful and loss assets, preparing proposals for filling of suits, monitoring legal action, compromise and write off etc. so, DCCBs should take some measures to gain personal touch with the customers through effective customer relationship management.

CONCLUSION:

An asset becomes non-performing when it ceases to generate income for a financial institution. A non- performing asset does not yield any return but it incurs a cost by eating into earnings made by banks. NPAs are caused as a result of various internal and external factors. The internal factors included weak credit appraisal, weak credit monitoring, directed lending to priority sector without adequate security preference to loan maximization etc. The external factors that causing NPAs include loopholes in legal machinery, natural calamities, change in government policy etc. Thus, NPA is not a disease but a symptom of the disease of indiscipline and short term approach that has plagued the banking industry like other spheres of our society. Effective training, proper attention to periodical inspection in terms of quality' of coverage and corrective actions, enlightened supervision over credit, legal reforms etc. should go a long way in reducing NPAs. The issue of NPAs is intimately connected with the overall stability of the financial system and needs to be recognized for concerted and multi-pronged efforts. The reduction of NPAs should be treated as a national priority item so as to make the Indian banking system stronger, resilient and geared to meet the challenges of globalization.

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