CHAPTER I
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The banking system, one of the pillars of the Indian economy, is moving towards greater stability and efficiency after its deregulation. There has been a phenomenal expansion in geographical coverage, effective credit delivery, and accelerated savings and investments of the people. The introduction of innovative and diversified product and services, coupled with mechanization and computerization, has made banking a vital part of our life. Needless to say, every person is a beneficiary of banking services. However, the system is not free from weaknesses. Greater transparency, stringent conditions for disclosure of assets and liabilities, adequate capitalization and tighten prudential norms are needed to rid the system of its defects. Strong prudential norms are necessary not only to align the Indian banking system with international best practices, but also for macroeconomic stability and efficient conduct of monetary policy. \(^1\) The Government of India, therefore, set up a high level Committee under the chairmanship of M. Narasimham to examine all aspects relating to structure, organization function and procedure of the financial system in India. The Committee submitted its Report in November 1991. The prudential norms for income recognition, asset classification and provisioning for the advances portfolio of banks, introduced by the Reserve Bank of India (RBI) in a phased manner, as per the recommendations of the committee and in line with the international best practices spearheaded the financial sector reforms, geared at strengthening the entire banking sector including the co-operative banks. In order to achieve greater financial stability and operational efficiency prudential norms were implemented in co-operative banks.
They had to follow an objective policy of income recognition based on the record of recovery rather than any subjective considerations. Their assets had to be classified on the basis of objective criteria. Besides, provisioning had to be made on the basis of classification of assets based on the period of which the asset remained non-performing/overdue, as also the availability of security and its realizable value. With the introduction of prudential norms, the health code based systems for classification of advances have ceased to be used.

The bankers and regularity authorities in India – the Reserve Bank of India (RBI)/National Banks for Agriculture and Rural Development (NABARD)—have thought in the interest deregulation regime, stressing asset liability management with the objective of improving yields of banks. However, the presence of NPAs in the bank's portfolios has made the situation volatile. The problem of NPAs could not be surmounted even after a decade of Banking Sector Reforms.

The laissez-faire economy and planned economy, which marked, mankind's march towards economic prosperity were too narrow in their objectives. Co-operation emerged as a resultant system of the economy, a "synthesis combining the desirable qualities of the laissez-faire and the planned economy".² Co-operatives, offering a moral value above and beyond purely economic conditions of individual gain were initially formed by the economically poor, who conducted ordinary business of life to achieve the common economic objective of the participants. Co-operatives, thus, evolved not just as a legal organization but also as a moral force emphasizing concern for common man. Later it has become the tool of economic development in all countries of the world.
With the dawn of the co-operative movement in India a century ago to the pioneering efforts of Sir Frederick Nicholson and the passing of the Co-operative (Credit) Societies Act in 1904, co-operative societies were started to eradicate the indebtedness of the people and to accelerate the pace of agriculture production in India. With the rapid growth of co-operative societies the purview of the Act was widened to include all credit and non-credit co-operatives. Thus, the need for co-operative banks in order to provide financial support, led to establishment of co-operative banks.

The co-operatives could not thwart the role of usurious moneylenders and the non-institutional agencies, which still held their sway even after five decades of co-operation. They accounted for more then 80 per cent of rural debt.  

In order to erase all the inherent discrepancies in the system and to strengthen it, the co-operative credit system was subjected to severe scrutiny by various committees: "No credit system has been subjected to as much experimentation at the dictate of those outside the system as the co-operative system has been." Adhering to the recommendations of various committees, co-operatives are growing from strength to strength.

Co-operative credit system has been recognized as the most suitable system to rejuvenate the economic fabric of rural India. "It may be regarded as axiomatic that the rural base, no form of credit organization will be sustainable except the co-operative credit society." The co-operatives are eminently suited to achieve the desired social and economic changes in rural India.  

The Planning Commission observed in 1999 that, "our policy has been and continues to be arranged for the supply of agriculture credit through co-operatives." Stressing the suitability of co-operative credit system at the rural base, the Report of the Banking Commission, 1972,
In India co-operative banking structure consists of two segments—one dealing with short and medium-term credits and the other with long-term credit. The three-tier federal system which has come into existence in the short-term and medium-term co-operative credit structure in every state is federal in character, with the Primary Agriculture Credit Societies (PACS) at the village level (bottom-tier), the Central Co-operative Bank covering the entire state at the apex level. The long-term credit structure consists of the State Co-operative Agriculture and Rural Development Banks (SCARDB) and the Primary Co-operative Agriculture and Rural Development Banks (PCARDB).

The Central Co-operative Banks (CCBs) occupy an important position in the co-operative credit structure, as they are the central agencies in the short-term and medium-term credit structure. The CCBs, the backbone and the strongest units in the three-tier federal co-operative credit structure, perform a vital role in the development of the co-operative Movement in the entire district. The CCBs are the leaders of co-operative in the various districts, since,” they form an important link between the State Co-operative Bank and Primary Agriculture Credit Societies. The success of the co-operative credit movement largely depends on their financial strength." They "collect funds in the urban areas and direct the same through primary co-operative banks at the village level." "Besides providing funds they also advice and guide the primaries in matters of finance." Thus they aim at "developing the co-operative movement in the district, on sound lines...." Their banking business in the district builds...
the economy of the district. Thus, their yeoman service in rural credit cannot be undermined.

Their share capital is obtained from member co-operatives and the state government. Their working capital is in the form of share capital, deposits and loans borrowed from other sources. The main source of funds, however, are deposits accepted from members and non-members, including public bodies and local authorities and loans from the State Co-operative Bank, the NABARD and the State Government.

The Co-operative Societies Act 1904, had no provision for CCBs, since the rural credit societies were expected to attract substantial deposits and government loan was to make up for any deficiency. But this ideal failed because the poorly managed societies could not tap funds from the affluent and augment their capital base through the thrift of the members. Therefore, the Co-operative Societies Act was amended to include central societies also. The revised Act stimulated the establishment and growth of central financing agencies. The first CCB was started in 1910 at Ajmer in Rajasthan. However, the origin of CCBs in India may be traced to the period between 1906 to 1908. The expansion of the CCBs during the decade (1909 to 1919), the period between the end of the World War I and the beginning of World Depression was adversely affected since the economic depression led to significant increase in overdues. Reorganization and amalgamation of CCBs were done during the First Plan period after the recommendations of the All India Rural Credit Survey Committee to strengthen them.13

There are 369 CCBs in the country, with a membership of 2.347966 million. They hold a total share capital of Rs.26425.6 million and total
deposits worth Rs.491306.8 million. They have advanced total loans of Rs.4435645.1 million.\textsuperscript{14}

Initially, 12 CCBs were set up in Tamil Nadu in the year 1912 under the Co-operative Societies Act.\textsuperscript{15} But today, one district, i.e. Thanjavur alone has two CCBs. There are 23 banks in Tamil Nadu, with 4593 member PACBs. Their total share capital is Rs.393.42 crores. Their deposits amount to Rs.7320.84 crores and the total loans account for Rs.7,056.77 crores.\textsuperscript{16} The CCBs finance Agriculture Credit Societies through their resources and obtain credit from NABARD routed through State Co-operative Banks.

The Salem Central Co-operative Bank was established on January 26, 1909 at Salem. There were 1963 members with a paid-up capital of Rs.2459.99 lakhs at the end of the Financial Year 2005-06. It includes the investment by the Government of Tamilnadu to the extent of Rs.100 lakhs. There are 59 branches in and around Salem District. (At present Salem and Namakkal Districts). Among this 35 are in Salem District and 24 branches are in Namakkal District. Total deposits as on 31.3.2006 was Rs.79392.18 lakhs and loans and advances 74940.48 lakhs. Total NPA position as on 31.3.06 was Rs.6199.39 lakhs. This was 15.75 per cent of gross NPA to total loans. Net profit earned during the year 2005-06 was Rs.5,30,055.10 and reserve fund was Rs.924.52 lakhs. After the Salem District was bifurcated into Namakkal and Salem districts, the bank also was bifurcated into Namakkal District Central Co-operative Bank and Salem District Central Co-operative Bank. Presently, the latter Bank caters to the credit needs of the 9 taluks of the district through its 54 branches and 374 PACBs. The Bank caters to the credit needs of the district by providing short-term and medium-term loans through PACBs. The Bank, besides expanding its branches, monitors and guides the PACBs in rural development and offers training programmes to the members.
Salem District, predominantly agriculture in nature, also has a long history of co-operation. A brief profile of the district\(^1\) is presented below.

**LOCATION**

Salem District is one of the biggest Districts in Tamilnadu and completely land locked. It is bounded on the North by Dharmapuri District, on the south by Namakkal and Erode Districts, the Western Ghats in the West and on the East by Villupuram District. The elevation of landscape generally ranges from 500ft to 1200 ft. above MSL with the exception of Yercaud which is at 5000ft. above MSL. The geographical position of the District is Between 110\(^0\).14' and 53°N latitude and 77\(^0\).44' and 78\(^0\).50'E longitude. The temperature of the district was 37.9\(^0\) C as maximum and 20.0\(^0\) C as minimum. The District Head Quarters is centrally located in the district. The District is intersected by numerous hills. Shervroy Hills and Kalrayan Hills adorn the District with natural beauty and forest wealth.

The geographical area of the district is 5205.30 sq kilometers. It has 4 revenue divisions-Attur, Sankari, Mettur and Salem and it is divided into 9 taluks viz., Attur, Mettur, Omalur, Sankari, Salem, Yercaud, Ganagavalli, Idappadi and Valapadi. The District, as a whole comprises of 3 municipalities viz., Idappadi, Attur and Mettur and one Corporation(Salem) and 385 village panchayats with 646 Revenue Villages. The District is also having 34 Town Panchayats and 20 Panchayat Unions. Total number of revenue firkas are 42. Salem District occupies the ninth rank among Districts in Tamil Nadu with regard to size.

Salem District occupies fourth rank among districts in Tamilnadu with regard to population. The total population of the district is 3016346 as per 2001. Census of which 53.64 per cent settled in rural and 46.35 per cent in urban areas. Out of a total population of 3016346, 1563633 are male and
1452713 are female. In this 1626162 live in rural area and 1390184 live in urban area.

The crops grown in the district can be conveniently grouped into two categories, viz., the cereals and pulses which come under food crops and other commercial crops. It could be perceived that 72.4 per cent of the total sown area in the district represent food crops and the principal cereal crops of the district are paddy, varagu, cholam, ragi, to name a few. The chief commercial crops of the district are groundnut, sugarcane, gingelly, etc. Bananas, mangoes and jackfruits are the important fruits cultivated in the district. The district occupies first place in the state in the area under mango cultivation. Internationally Salem is well known for mangoes.

STATEMENT OF THE PROBLEM

Banking business is exposed to various risks such as credit risk, liquidity risk, interest risk, market risk, operational risk, and management risk. But credit risk stands out as the most detrimental of them all. The risk of erosion in asset value due to simple default or non-payment of dues by the borrowers is credit risk or default risk.

Non-performing Assets (NPAs) are not a new development in banks today. Since the dawn of banking business, banks and financial institutions have been facing the problem of loans and investments proving difficult in recovery and turning out to be bad assets, where not only interest could not be recovered from the borrowers but on numerous occasions even the principal had to be compromised or written-off. The level of NPAs in the loan portfolio of banks is an evidence of their exposure to credit risk. Default of credit leads to NPAs in the loan portfolio of the banks. After the implementation of the prudential norms in 1999-2000, the level of NPAs
has been increasing in the CCBs. The gross NPAs of CCBs in Tamil Nadu had been Rs.113,853.73 lakhs in 2002-2003.²¹

At the macro-level, alarming degrees of NPAs have a detrimental effect on the economy. A high level of NPAs or loss, eliminating fully or partially the banks' capital could cause significant banking crisis or banking distress. Banking crisis will exist in the country if the level of NPAs touches 10 per cent of GDP.²² Though the banking reforms spearheaded by the Narashimham Committee have been proceeding in a phased manner in the country, the high level of NPAs poses a serious hurdle in pushing through the reforms.²³

At the micro-level, NPAs jeopardize the financial position of the bank, the borrowers and subsequently, the rural economy. Specially, NPAs affect profitability, liquidity, and solvency of the bank. Continuous decline in profitability due to increase in NPAs would ultimately jeopardize the viability of the bank. Mounting NPAs reduce the interest spread of the bank.²⁴ The presence of NPAs in the bank balance sheet corrodes the average earnings from loan assets and total assets.²⁵ The interest spread, an indicator of the operating profitability, declines due to NPAs, since the interest income on NPAs cannot be accrued due to prudential regulations and provision also has to be created for NPAs from the operating profits. A large amount of managerial time and manpower would have to be spent on monitoring the accounts in default, adding avoidable costs to transaction costs of lending operations, increasing the burden of the bank. Thus the profit margin would be reduced further.

The presence of NPAs leads to increase in real interest rates.²⁶ The real interest rate (the difference between nominal rate of interest and the expected rate of inflation, at a realistic level) has to be kept low so that
borrowers do not pay a high price and depositors have an incentive to save, as a measure of deregulation. But in India, structural rigidities in the form of high intermediation costs and NPAs have been responsible for higher real interest rates. The loss of income from NPAs not only brings down the level of income of the banks but also hinders them from quoting finer Prime Lending Rates (PLR). Thus, the foremost concern of banks is how best to reduce the share of NPAs to total advances and also the level of NPAs, though they are familiar with non-payment risks.

The loan portfolio with NPAs reduces the liquidity position of the credit institution. Loans classified as NPAs affect the interest of both the borrowers and the credit agency. When the resources deployed by the CCBs and PACBs are locked up as NPAs and overdues respectively, the credit agencies are impaired from obtaining refinance from the apex lending agencies. Their capacity to undertake fresh lending is impaired, adding woe to existing resource constraints. The lending capacity of the banks is adversely affected due to their inability to recycle the resources or to raise more resources form higher financing agencies. Any liquidity crisis in co-operative banks will subsequently hinder capital formation in agriculture, which will decelerate economic development, since they play a major role in rural lending.

Among various other aspects of performance of the co-operative banks, the recovery performance is the major eligibility criterion for co-operatives to obtain refinance from the apex bank. However, NPAs impair their capacity to obtain refinance. Recoveries also serve as an indicator of the quality of lending since repayments are expected from out of incremental income generated by productive use of loans. The increase in the quantum of NPAs would outdo the actual expansion of credit in real money terms.
As a defaulter, the borrower is cut off from any access to credit from institution. The borrower's productive enterprise is affected. A much higher price has to be paid for any informal source of credit. Thus, the agriculturist and other related enterprises suffer on account of non-availability of adequate credit supply for investment and working capital.

Decline in the profitability and liquidity ultimately affects the solvency position of the co-operative banks. Hence, a probe into the effect of NPAs on the profitability, liquidity and solvency is the need of the hour.

In the three-tier structure, the Central Bank is responsible for curbing the overdues at the primary level. The statutory and non-statutory powers in respect of supervision and control over the societies and the leadership along the local standing and knowledge of local conditions are expected to help in prompt recovery of loans. The Central Banks are indeed best suited to supervise and control the societies, ensuring among other things prompt recovery of loans from the latter. Hence, a study of the recovery management would shed light on the issue.

One of the important limitations of the federal character of co-operative credit structure is that the working of primary societies undermines the capacity of the organization at the immediate higher level to work actively. This problem is manifested more in the field of short-term co-operative credit. Heavy overdues at the primary level turn the societies dormant, creating a difficult situation for central banks to channel fresh credit. The NPA level in the CCBs increases simultaneously. Hence, it is imperative to curb overdues at the primary level. Delinquency of co-operative credit is due to default, both willful and non-willful. However, willful default is identified as the main reason for mounting overdues.
Hence, a probe into the factors leading to default would enable the reduction of overdues at the primary level, and for NPAs at the CCB level.

The prudential norms of Income Recognition and Asset Classification (IRAC) have been stipulated for CCBs only since 1999. Therefore, there are very few studies in the field of NPAs in CCBs. This study seeks to fill this research gap. Thus, this study has been undertaken to study NPAs and their effect on profitability, liquidity, and solvency and also probe into the default of co-operative credit which causes NPAs at the CCB level.

**REVIEW OF LITERATURE**

Banking regulatory authorities, policy makers and researchers alike are interested in research on NPAs. Since prudential norms have been implemented in co-operative banks only from 1999-2000, the study of NPAs in co-operative banks is a relatively new field of study. Hence, literature of empirical studies on the subject is limited. However, delinquency of co-operative credit is the object of enquiry for many committees and researches.

A brief review of these studies is presented here. Since very few studies have been done on NPA in co-operative banks, the studies on (i) Co-operative credit (ii) Effect of overdues and NPAs (iii) Recovery and (iv) Factors influencing non-payment of dues, have been reviewed.

Naik, et al., (1991) while reviewing the role of credit co-operatives in rural development within Andhra Pradesh has concluded that co-operatives were the most suitable institution for loan disbursement in the area.36
Segynola (1992) has stated that the impact of the co-operative societies in Nigeria was mainly in the areas of mobilization / allocation of resources, diversification of rural economy, the provision of items of wealth, and the distribution of manufactured goods to members.\textsuperscript{37}

Kislev et al., (1993) study has revealed that co-operative credit supported intensive development of the family farm sector in Israel. But mutual liability encouraged over-borrowing when possible and could not be forced when needed.\textsuperscript{38}

Teklu (1993) has considered the failure of co-operative credit program in western Sudan. It was due to the inadequacy of its strategy with regard to the rural population's broad income diversification strategy, and failure to provide protection from entitlement and consumption risks.\textsuperscript{39}

A study done by Varma and Reddy (1997) has showed that the agricultural credit through DCCBs and PACS had grown in terms of coverage and growth of economy of Andhra Pradesh after re-organization.\textsuperscript{40}

Sourindra Bhattacharjee (1996) concluded that improving the total gross margin was the most important route for increasing the profitability of the co-operatives.\textsuperscript{41}

Murty and Durga (1998) while studying equity and efficiency of co-operative credit, found that efficiency and recovery were related. Efficiency also suffered because the recovery of loans was very poor.\textsuperscript{42}

A study by the Office of the Comptroller of Currency (OCC) of United States in 1988 found that poor asset quality was a major factor responsible for the failure of 98 per cent of the banks. Hence, reduction in gross NPAs was desirable.\textsuperscript{43}
Prem Sharma (1998) opined that in the aftermath of the Financial Sector Reforms, the co-operative banks had to meet the challenges of the financial sector reforms by competing with Public Sector Banks and Private Sector Banks in mobilization of deposits, savings and advancing of loans to tone up their functional effectiveness and attain capital adequacy norms. 44

According to the Report of the Agriculture Credit Review Committee (1989) overdues prevented recycling of funds, impaired refinance eligibility and productivity of co-operative banks. Nearly 26 per cent of the resources deployed by the credit agencies for the agriculture sector were locked up in overdues and were not available for recycling. At the institutional level, the clogging of overdues had severely impaired the eligibility of the credit agencies, for refinance from NABARD. As a defaulter, the borrower is cut off from any access to credit from institutions. This affects his productive enterprise. 45

The Tarapore Committee on Capital Account Convertibility (CAC) laid down that 5 per cent level of NPAs in banks is an important milestone to be reached for full convertibility. 46

According to the comparative study of NPA by Sathyanarayana (1988), the NPA in Venezuela, Mexico, Thailand, Brazil, Japan, Taiwan, Colombia, Chile, Korea, Argentina, Indonesia, Malaysia, Hongkong, USA, and Singapore indicated that except in Latin America the NPA levels were in single digit (6 per cent to 7 per cent). India compared unfavourably in the international arena, as India had the highest proportion of NPAs (14.45 per cent) among the 16 countries in 1994-1995. 47

Sudhakar Patra (1998) revealed that the Boudh CCB in Orissa was not successful in making profit due to non-repayment of loans in time. 48
Phadnis (1999) justified the Narasimham Committee's observation that asset quality was very poor in direct lending, since around 48 per cent of NPAs were in priority sector advances group. 49

According to Samal (2002) NPA overhang was due to defects in legal processes like prolonged / delayed legal system, absence of proper legal framework for non-payment of bank's dues. 50

The Report of the Rural Banking Enquiry Committee (Thakurdas Committee) (1949) concluded that proper follow-up action was very essential. Banks have to maintain close contacts with the borrowers, keep track of the end-use of funds lent to the borrowers effective recovery of advances as per the repayment schedule. 51

The Report of the Study Group to frame guidelines for follow-up of bank credit (Tandon Committee) (1979) framed guidelines for monitoring and follow up of bank credit. It suggested norms for holding raw materials, stock in process, finished goods, receivables and bills purchased and discounted. 52

The Report of the Working Group to Review the System of Cash Credit (Chore Committee) (1979) stressed the need to strengthen the monitoring system and suggested simplification of the information system proposed by the Tandon Committee. 53

The Report of the Committee on Mechanization in Banking Industry (Rangarajan Committee) (1983) emphasizes that mechanization was the first step to recovery management. 54

The Report of the Committee of Top Executives (1987) stressed that close efforts on the part of banks to monitor end-use of funds would result in increased productivity of the borrowers. 55
Ottonlenghi, et al. (1993) perceived that arbitration in co-operative societies in Israel was too prolonged and the intervention of the courts in arbitration by the Registrar were the major problems of arbitration. 56

Gopalakrishnan (1996) suggested that the bad effect of Debt Relief Schemes should be erased from the minds of borrowers. 57

According to Jain et al., (1996) the loan waiver schemes had succeeded in redemption of old dept but recovery of fresh loans was a major problem faced by the co-operative farm credit sector in Madya Pradesh. 58

Shollapur (1996) study on the Belgaum DCCB in Karnataka state showed that more than fifty per cent of the PACBs remained uninspected. Inadequacy was phenomenal even in passing the credit collection to the CCB. 59

The Working Committee (1999) on NPAs considered write-off, compromise, one time settlement for recovery of NPAs. It recommended compromise model for the recovery of NPAs as the most effective mechanism. However both write-off and compromise are steps to be taken with caution and due monitoring. 60

RBI study (1999) stated that banks were required to closely monitor the operations of the borrowal units. In respect of accounts where the classification of asset worsens, banks were required to take prompt steps to recover the dues and staff accountability was required to be examined. Special emphasis was given on monitoring of large NPA accounts, also on reduction of NPAs, through upgradation, recovery, and compromise settlements. 61
Lopoyetum (2000) held that there was a direct and positive relationship between period of default and cost of default by the defaulters.\textsuperscript{62}

Rao (2002) suggested declaring default of bank loans as criminal offence and punishment be awarded along with financial recovery, authorizing seizure agencies and giving them a legal status to recover loans.\textsuperscript{63}

The following studies were about the factors influencing the default of co-operative credit which increases overdues at PACB level and increases the level of NPAs in the CCBs and SCBs.

The Report of the Committee on Co-operation in India (Maclegan Committee)(1914) stated that “unless loans are repaid punctually, cooperation is both financially and educationally an illusion.”\textsuperscript{64}

The Report of the Central Banking Enquiry Committee (1931) found that the intention prevailing among the borrowers not to repay co-operative credit while having the capacity to repay was the cause for overdues.\textsuperscript{65}

The Report of the All India Rural Credit Survey Committee (1954), found that defective lending policies were the cause for overdues.\textsuperscript{66}

The Report of the All India Rural Credit Review Committee (1969), stated that overdues were a common problem both in developed and under-developed areas and found that the bulk of overdues were caused by big farmers.\textsuperscript{67}

The Report of the All India Rural Credit Review Committee (1972) strongly stated that overdues were rising since co-operative credit was short of standards of timeliness, adequacy and dependability.\textsuperscript{68}
RBI's Study Team on Overdues (1974) estimated that more than three-fourths of the overdues were due to willful default. Faulty lending policies, failure to link credit with marketing, lack of will on the part of management to take strong action against recalcitrant and willful defaulters, lack of financial discipline and apathetic of some of the State Governments towards creating an environment conducive and congenial to repayment of dues were the causes for overdues.69

Dadhich (1977) specifically threw light on willful default. He found that there was strong association between repayment and caste, crops grown, fertilizer utilization, occupational pattern and irrigation. The main causes found for willful default were re-lending practices, which enabled to make profit out of the interest margins.70

The RBI conducted a special study in 1978, which made it clear that the accumulation of overdues was largely due to willful default and partly due to irregular lending, lack of supervision, indifferent recovery efforts, inaction against defaulters, unnecessary interference of State Governments in the recovery of the credit, domination by the vested interest of politicians and the elite.71

The CRAFICARD (1980) while endorsing the findings of the Study Team On Overdues found that in many cases the default was willful and that too it was by the big farmers.72

Kalyankar (1983) in his study on crop loan overdues of co-operative finance revealed that 60 per cent of the overdues were from 27 per cent of the big farmers who had the capacity to repay but had neither the will nor the intention to do so.74

Reddy (1988) found an association between socio-economic factors, adequate/timely credit and borrowers' repayments in Andhra Pradesh.75
The Report of the Agricultural Credit Review Committee (1989) stated that there was significant relationship between agro-climatic conditions, literacy rate, major crops grown and overdues. The Committee deduced that the general climate in rural areas was becoming increasingly hostile to recoveries due to increasing politicization of agricultural credit. The Committee viewed that inadequate loan amounts compelling the borrowers to resort to borrowings from money lenders and other informal sources of credit and fixation of due dates unrelated to the harvesting and marketing seasons and absence of linkages of credit with marketing were the main causes for overdues. 

Vaikunthe (1991) in the evaluation of the performance of the Dharwad DCCB Karnataka, found that credit utilization in non-irrigated areas was not efficient, but repayment was more regular.

Reddy's (1993) study on overdues management in Andhra Pradesh portrayed that unsound lending policy, defective appraisal, misuse and diversion, unsatisfactory marketing arrangements, lack of effective follow-up, effect of natural calamities, political considerations, write-off/waiver of interest, Government policy, sometimes, hindered the recovery even from the borrowers who raise good crop production.

Goyal, et al., (1993) conducted a study on Hisal DCCB, Haryana. The defaulted borrowers utilized a relatively larger proportion of their total earnings for consumption purposes, thereby leaving less for investment in production processes.

Lal and Singh (1993) studied the misutilization of co-operative credit in agriculture in Kukathala of Achnera block of Area district and found that marginal and small farmers i.e., weaker sections misutilized a maximum per centage of loans.
In his study on overdues of co-operative banks in the state of Haryana, India, Dhaka (1994) discovered that the inadequacy of loan was an important factor for increasing overdues over the year.\textsuperscript{81}

Kusumakara Hebbar (1994), in his study of 15 PACS in Mangalore, found that the recovery problem was more in the case of short-term and medium-term loans.\textsuperscript{82}

Balishter et al., (1998), in their study in Agra District, found out that willful default was mainly confined to medium and large farmers to the extent of over 90 per cent.\textsuperscript{83}

D.R. Reddy and M.N.R. Readdy's study showed that there was a positive relationship between asset status and debt accumulation and between the level of borrowing and willful default in Nellore District, Andhra Pradesh.\textsuperscript{84}

Lakshmi, et al., (1998), in their study on Kuttanad region in Alappuzha district, the rice bowl of Kerala, identified that marketed surplus, time of sowing and credit gap were the major characteristics that discriminated the borrowers of crop loan from into defaulters.\textsuperscript{85}

Rabi Narayan Mishra's (1998) study on the attitude towards repayment in Orissa disclosed that the per centage of defaulters in literate category was higher than that of illiterates and was the highest among the general caste borrower.\textsuperscript{86}

Namasivayam and Ranachandriaiah (2000) concluded that the productive loan as a proportion of total loan was higher for marginal farmers among non-defaulter and control groups who were utilizing loans predominantly for digging and deepening wells. The crop loan tended to be
more often misused than term loans. This may be partly due to untimely issue of loans.  

Ravichandran (2000) in his study in Tamil Nadu concluded that political exploitation became the major cause for delinquency, compared to other causes for overdues, viz., crop failures, increasing family expenditure, and social obligations. A significant portion of defaulters were of the opinion that Government waiving schemes was the major cause for this delinquency.  

Das’s (2002) study of Arunachal Pradesh SCB unveiled the improper utilization of loan and the insignificant repayment behavior had stood on the way of the development procedure of rural sector.

Although many literatures are available on co-operative credit recovery, default etc., very few studies have been made with reference to NPAs in Co-operative banks and the effect of NPAs. Particularly no such study has been conducted in the present study area. Hence, this study seeks to probe into the position of NPAs and the factors leading to default in the study area.

OBJECTIVES

This research has been undertaken to study the following objectives.

i. To assess the position of non-performing assets in Salem District Central Co-operative Bank.

ii. To study the effect of non-performing assets on the financial health of the bank and recovery of co-operative credit.

iii. To examine the factors for default of Co-operative credit thereby increase in Non-performing Assets.
DATA COLLECTION

This is an analytical and empirical study based on pooled data i.e., both secondary data and primary data have been used in the study. Data pertaining to Tamil Nadu have been collected from audited account statements, balance sheets and annual reports of Tamil Nadu State Apex Co-operative Bank (TNSCB). The District level data are collected from the audited records, accounts statements, balance sheets, and annual reports of the Salem DCCB. The authenticity of these data could be verified since they are from audited statements. Besides, the study has been corroborated with data from the Department of Economics and Statistics, RBI and NABARD reports, and Lead Bank reports.

The primary data used have been collected from sample respondents who were defaulters of co-operative credit. Data have been collected by means of a pre-tested, structured interview schedule. The data so collected regarding loan details, over dues, default period, land holding, cultivation, etc. have been counter-verified with the assistance of PACB officials. The details regarding farm income and expenditure have been verified with the officials of the Department of Agriculture and district level averages from the Department of Economics and Statistics. But the opinions of the respondents have been too subjective for objective verification. However, their subjectivity does not affect the validity of the findings.

PERIOD OF THE STUDY

The study covers the period from 1999-2000 to 2005-2006. The year 1999-00 has been chosen because of NPA’s have been implemented since 1999-2000 in CCB’s. A survey of the respondents has been conducted from April 2005 to June 2006.
SAMPLING DESIGN

A multi-stage sampling procedure has been adopted. Salem district in Tamil Nadu has six taluks, viz., Salem, Attur, Omalur, Sankagiri, Mettur and Yercaud. Based on the recovery performance, the taluks have been classified as taluks with high level of recovery (average rate of recovery above 90 per cent), moderate recovery (75 per cent to 90 per cent recovery) and low level of recovery (Less than 75 per cent of recovery) respectively. From each category, one taluk is selected. Attur, where recovery is low, Omalur, Sankagiri with moderate recovery and Salem with high level of recovery have been the taluks selected for the study.

Table 1.1
Taluk Wise Recovery Position
(In per centage)

<table>
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</thead>
<tbody>
<tr>
<td>Salem</td>
<td>98.67</td>
<td>97.21</td>
<td>90.25</td>
<td>91.19</td>
<td>92.41</td>
<td>96.64</td>
<td>92.62</td>
<td>94.14</td>
<td>3.05</td>
<td>3.24</td>
</tr>
<tr>
<td>Attur</td>
<td>74.31</td>
<td>46.78</td>
<td>68.50</td>
<td>67.05</td>
<td>71.52</td>
<td>90.00</td>
<td>72.33</td>
<td>70.07</td>
<td>11.81</td>
<td>16.85</td>
</tr>
<tr>
<td>Omalur</td>
<td>52.08</td>
<td>26.35</td>
<td>64.00</td>
<td>68.16</td>
<td>72.82</td>
<td>90.33</td>
<td>73.62</td>
<td>63.91</td>
<td>18.67</td>
<td>29.22</td>
</tr>
<tr>
<td>Sankagiri</td>
<td>98.06</td>
<td>65.23</td>
<td>78.54</td>
<td>87.41</td>
<td>98.85</td>
<td>92.41</td>
<td>88.90</td>
<td>87.06</td>
<td>10.96</td>
<td>12.59</td>
</tr>
<tr>
<td>Mettur</td>
<td>86.02</td>
<td>80.70</td>
<td>86.18</td>
<td>91.32</td>
<td>82.29</td>
<td>92.61</td>
<td>91.31</td>
<td>87.20</td>
<td>4.34</td>
<td>4.98</td>
</tr>
<tr>
<td>Yercaud</td>
<td>90.34</td>
<td>80.63</td>
<td>77.83</td>
<td>87.47</td>
<td>76.08</td>
<td>89.56</td>
<td>90.66</td>
<td>84.65</td>
<td>5.81</td>
<td>6.87</td>
</tr>
<tr>
<td>District</td>
<td>85.10</td>
<td>65.08</td>
<td>78.08</td>
<td>80.47</td>
<td>82.91</td>
<td>92.47</td>
<td>83.39</td>
<td>81.07</td>
<td>7.74</td>
<td>9.55</td>
</tr>
</tbody>
</table>

Source: Computed from the per centage of collection to overdues for the respective years (Appendix A)
There are a number of member PACBs of the bank. From each taluk two PACBs have been selected. Thus, 6 PACBs have been chosen from a population of 166 PACBs. PACBs maintain a register of default accounts. From the population of defaulters in the selected PACBs, 40 respondents have been selected from each of the PACB, randomly with the help of Tippet's Table of Random Numbers. Thus, 240 respondents have been chosen from the 6 PACBs representing the 3 taluks of the district.

**TOOLS USED**

Statistical and financial tools have been employed to analyse the data and inferences have been drawn. Statistical tools, such as, arithmetic mean, standard deviation, co-efficient of variation, per centage, indices, growth rate, chi-square test, modified chi-square test, Kruskal Wallis test, Friendman's test, discriminant function analysis have been used. The analysis was done with the help of SPSS programme. Financial ratios have been employed to assess the profitability, liquidity and solvency.92
The term ‘willful default’ means non-repayment of the debts when it is within the capacity of the borrower to repay but is not repaid. The calculation of repaying capacity is a matter of debate. The method of assessing the repaying capacity is not without certain limitations, e.g., factors such as size of the family, extent of indebtedness, non-farm income, fertility of the soil and efficiency of farmer’s family are not considered. The assessment of repayment capacity with due regard to size of the family, extend of current liabilities, fertility of the soil and efficiency of the farmer’s family poses a gigantic problem.

Liquidity and marketable surplus method has been used in this study to find out the repaying capacity. According to this method, repayment capacity means excess of income over expenditure. The income is computed by taking into account the following factors:

a. Previous balance (cash and kind) at the beginning of the year.

b. Net farm produce in the year

c. Borrowings in the year

d. Cash and kind receipts from sources other than cultivation during the year.

e. Realization of loans and interest, if any, during the year.

f. Money received from the disposal of any capital assets and

g. Any other receipts.
The expenditure includes the following items:

a. Household expenditure (in cash and kind) incurred during the year.

b. Farm expenses paid (cash and kind)

c. Any amount paid to creditors other than co-operatives.

d. Expenditure incurred on repairs and maintenance of assets.

e. Requirements for household and other expenditures (cash and kind) till the next harvest and

f. Reserve for contingency and liquidity.

It should however be noted here, that under this method a willful defaulter means a borrower who is left with some repayment capacity after meeting out his debts from all other sources except the co-operatives.

The attitude of the borrowers towards repayment has been studied by means of an questionnaire based on the tools used in previous studies. This has been pre-tested through a pilot study. The most expressed top ten opinions have been collected to form the questionnaire. Ordinal scaling technique on a five point scale has been used to elicit the level of agreement to the opinions stated, namely, strongly agree, agree, undecided, disagree and strongly disagree. The responses of the respondents have been quantified through mean score. Friendman’s test and Kruskal Wallis test have been used to draw further inferences.
The study assesses the position of NAPs and their effect on financial efficiency and not on the overall financial performance of the bank. The study of default of co-operative credit is confined to defaulters of short-term co-operative credit only and not to all schemes of lending.

**CONCEPTS USED NON-PERFORMING ASSET**

A credit facility in respect of which interest and / or installment of principal amount remained ‘past due’ for two quarters or more. The ‘past due’ concept has been replaced with ‘overdue’ concept from 31 March 2001.

**OVERDUE**

The term ‘overdue’ refers to the amount due for payment by the borrower but not yet repaid.

**WILLFUL DEFAULTER**

A willful defaulter is one who has repaying capacity, but neglects to repay the loan intentionally.

**LANDHOLDING**

On the basis of size of farm, the farmers are classified into four categories:

i. Marginal farmers: Farmers with landholding of less than one hectare.

ii. Small farmers: Farmers with landholding of above one hectare but less than two hectares.

iii. Medium farmers: Farmers with landholding of above two hectares but less than four hectares.
iv. Large farmers: Farmers with landholding of above four hectares.

**PLAN OF THE STUDY**

The introductory chapter includes the profile of Co-operative Banking, statement of the problem, review of literature on the subject, objectives, hypothesis, database, data sources, scope and period of the study, sampling design, data analysis, definition of terms, and limitations. The second chapter assesses the position of NPAs. The third chapter studies the effect of NPAs and recovery performance. The fourth chapter analyses the default of Co-operative credit. In this last chapter, findings, conclusion, policy suggestions, and scope for further research in this field, are proposed.
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