CHAPTER - 1

INTRODUCTION
1.1 Introduction

Co-operative Banks and Regional Rural Banks are the kingpin of rural economic activities and development. Co-operative and Regional Rural Banking in India had evidenced growth since 1904 and 1975 respectively. These banks are expected to support economically backward section of the society especially in rural areas. Institutionalization of rural credit in India commenced with the passing of Co-operative Societies Act in 1904. It has been subsequently strengthened with the nationalization of 14 major commercial banks in 1969 and other 8 in 1980 and established Regional Rural Banks (RRBs) in 1975, restructuring the erstwhile Agricultural Refinance Corporation into National Bank for Agricultural and Rural Development (NABARD) at apex level in 1982 and entry of private sector banks in 1990s. Presently India has a robust rural financial system comprising of, 31 State Co-operative Banks (St.CBs) with 953 branches; 370 District Central Co-operative Banks (DCCBs) with 13000 branches; 92,432 Primary Agricultural Credit Societies (PACSs) at village level; 20 State Co-operative Agricultural and Rural Development Banks (SCARDBs) with 823 branches and 697 Primary Co-operative Agricultural and Rural Development Banks (PCARDBs) and 46,126 branches of Commercial Banks (CBs) including 57 RRBs with 19,082 branches. At the end of 31st March 2014, these institutions have provided ground level credit facilities amounting to ₹7,23,225 lakh, out of which Co-operative Banks provided ₹1,18,422 lakh; RRBs provided ₹83,307 lakh and CBs provided ₹5,21,496 lakh to help rural peoples’ easy access to credit.¹

In fact, rural financial institutions or banking has not been scientifically organized and upgraded to handle the ever increasing failure of borrowers to fulfill its contractual obligations by not paying the interest or installments in time. Loan which happens to be the basic and primary income earner for the bank is consider being the core assets of a bank. This core assets turns to be a Non-Performing Assets (NPAs) when the interest and principal
of an installment due on account remains unpaid for more than 90 days. In the process, the NPAs have had a negative influence on the maintenance of required capital adequacy ratio, mobilization of deposits, deployment of credit and investment, operational viability and financial sustainability of the banking system directly affecting the country’s productivity of resources and overall economic development. Hence there is need for a concentrated effort of all to recover bad loans and arrest fresh accretion of NPAs. The biggest challenge that the rural banking institution now faces is management of NPAs.

1.2 Background of the Study

Indian economy is basically a rural economy. Development of rural economy intends the development of weaker sections of the society constituted by small farmers, marginal farmers, agricultural labourers, rural artisans, etc. The main aim of rural development is to bring about a positive change in the life of the weaker sections in rural areas, and it requires, among other things, some supplementary services like credit extension, marketing and the like, in a co-ordinate way. Credit is the key driver of economic progress. It is the basic need for every sector of the economic and rural sector is no exception to this phenomenon. The major objective of an economy is to improve the quality of life and to raise the standard of living of the rural people. According to Census 2011, 68.84% populations are residing within the rural India itself, five out of six are dependent on agriculture. Rural development is a strategy to improve the economic and social life of a specific group of people, the rural poor includes small and marginal farmers, landless and the poorest among those who seek livelihood in the rural areas. The main aim of rural development in our country is, therefore, to transform the socio-economic life of the country’s rural population living below the poverty line in the rural areas. Numerous studies have brought out from time to time regarding the exploitative character of the money-lenders. In the report of the Expert Committee on Consumption Credit, the money-lender also exploits the poor borrowers through advance contract for tide sale of output only through him which, in turn, he gets output at lower price than the borrower could have obtained, if he sells output directly in the market.

Credit is needed in all the sectors such as agriculture, industry, trade and services for their day to day activities and also for growth and progress. Credit is considered as an important
instrument for agriculture and rural development. It is available to the villagers from two types of broad sources, viz. the institutional and non-institutional are as follows:

The institutional source of credit includes Co-operative Banks, Regional Rural Banks, Commercial Banks, Central and State Government Agencies while the non-institutional sources of credit consist of mainly money-lenders, merchants, commission agents, landlords, relatives etc.\(^5\) Within the multi-agency system of rural financial institution in India, Commercial Banks, Regional Rural Banks (RRBs) and Co-operative Banks play a pivotal role for the economic development of India? Like other states of India, in West Bengal, these Rural Financial Institutions (RFIs) are performing their role in achieving the stated objective of sustained rural development of the state.

The present rural financial infrastructure in India comprises of a very wide variety of formal, semi-formal and informal financial service providers, each with distinctive cultures and characteristics. The numbers of organizations and agents are very substantial, e.g., over 30,000 rural and semi-urban branches of commercial banks, nearly 14,000 rural and semi-urban branches of Regional Rural Banks, just over 1,00,000 primary cooperatives at the village level, 1,000 NGO-MFIs, twenty MFIs registered as companies as well and over 20,00,000 Self-Help Groups (SHGs). Even more numerous are the myriad of informal agents constituting a great range of financial service providers across the country.\(^6\) Based on the All Indian Debt Investment Survey (AIDIS) 2002, 111.5 million households had no access to formal credit. It also showed that 17 million households were indebted to money-
lenders. The Arjun Sengupta Report on financing enterprises in the unorganized sector has pointed out that only 2.4 million out of 58 million units in this sector (with investment of less than ₹25000) have got credit from Commercial Banks. The AIDIS 2002 also showed that lower the asset class or income, higher the degree of exclusion. These findings are corroborated by Invest India Incomes and Savings Survey (2007). The survey showed that 32.8% of households had borrowed from institutional sources and 67.2% had borrowed from non-institutional sources. The survey also found that 70 per cent of earners in the annual income bracket of more than ₹4,00,000 borrowed from institutional sources as compared with only 27.5 per cent in the case of earners in the income bracket of less than ₹50,000. 7

Of the underprivileged sections of the society—farmers, small vendors, agriculture or industrial laborers, people engaged in unorganized sector, unemployed people, women, children, old people and the physically challenged—only 40 per cent of the people have a check in account, 20 per cent have taken life insurance products, 0.6 per cent have taken non-life insurance products, only 2 per cent have access to credit cards. Geographically, only 5.2 per cent of the country’s villages have a bank branch.8 Despite the vast network of rural branches, only 27 per cent of the total farm households are indebted to formal sources; of them, one-third also borrow from informal sources. There are parts of the country where more than 95 per cent of the farm households do not get any credit from institutional or non-institutional sources. Apart from the first that exclusion itself is large, it also varies widely across regions, social groups and assets holdings. The poorer the group, the greater is the exclusion. There is evidence that farm debt is increasing much faster than farm incomes and the larger issue of the overhanging debt stock, as distinct from credit flow+, has not even been on the agenda except of a few State governments.9 According to National Sample Survey Organization (NSSO) data in the situation assessment survey on “Indebtedness of Farmer households” (2003), 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households do not access credit, either from institutional or non-institutional sources. Further, only 27% of total farm households are indebted to formal sources.10
1.3 Significance of the Study

Banking is the life blood of any economy. In India banking has three types of sectors, which provide finance to different sectors, i.e. public sector, private sector and co-operative sector. Co-operative and Regional Rural Banks play a pivotal role in providing financial services to common man in semi-urban and rural areas to meet the short-term, medium-term and long-term credit needs. A small depositor or a small borrower feels comfortable in dealing with the local staff of Co-operative and Regional Rural Banks than to the staff of nationalized public sector and private sector banks. The Co-operative and RRB are also regulated by the Reserve Bank of India (RBI). They are governed by the Banking Regulation Act, 1965 and RRB Act, 1975. These banks were traditionally centered on communities, localities workplaces groups. Today, their scope of operations has widened considerably. If Co-operative and RRBs go in liquidation due to abnormal increase of NPA not only customers and staff members of that particular bank will suffer but all other rural credit institutions also get a major setback. NPAs are leading to severe damage to the reputation of entire sector which is very important for the maintenance of economic development of our country. NPAs reflect natural waste of any economy.

The NPAs in Co-operative and RRBs are growing not only due to external factors like ineffective recovery strategies, willful defaulters, lack of demand, labour problems, changes in government policies etc. but also internal factors like managerial deficiencies, inappropriate technologies, poor credit appraisal systems, absence of regular field visits etc. NPAs will become more and more complex and will affect the banks liquidity and profitability adversely. On the other, NPA which creates a bottleneck in the smooth flow of credit has an adverse impact on the economy by arresting the recycling of funds. They wear away the fiduciary role of banks, affect safety of depositors’ funds and beyond a certain points rapidly increase the risk of a run on bank deposits. The biggest challenge that the banking industry now faces is management of NPAs. Against this backdrop, study of management of NPAs by Co-operative and RRBs and comparing it with their counterparts in order to find out the grey area of their operation and to suggest the direction in which changes are necessary is of immense importance. Hence there is need for a rigorous effort of all to recover bad loans and arrest fresh accretion of NPAs. A stage has come now to think and find alternatives for recovery of NPAs.
NPAs are the important parameter in analysis of financial performance of banks. The present study is conducted with the following significances:

- The study covers only Burdwan Central Co-operative Bank Ltd. (BCCBL) and Paschim Banga Gramin Bank (PBGB) which are operating in the district of Burdwan. It does not cover other District Central Co-operative Banks and RRBs which are operating in the other district of the West Bengal.
- This study enables researcher to improve knowledge about the banking sector, specifically on account of NPAs management.
- This study also enables the banks to know its actual position on NPA management in last 9 years from 2006-07 to 2014-15, which exhaustively assess the impact of such accumulated NPAs on the performance of NPA management aspect of Co-operative and RRB sector.
- This study identifies the causes of the growth of NPA level and their management procedure with suitable technique relevant to each aspect.

At the end of the study, it incorporates necessary suggestions and recommendations in accordance with the major findings, which are expected to extend further insight towards a significant management of NPAs and the banking industry in India as a whole.

1.4 Objectives of the Study

On the basis of ‘research gap’ mentioned in Section 2.5 of Chapter - 2, the specific objective of this study is to make a comparative analysis of NPA management of the DCCB and RRB in West Bengal with special reference to the Burdwan District Central Co-operative Bank Ltd. (BCCBL) and Paschim Banga Gramin Bank (PBGB) in the district of Burdwan in terms of some financial indicators.

Specific objectives of the study are as follows:

1. To analyse the trend of the NPAs in BCCBL vis-à-vis PBGB.
2. To study the impact of NPAs on the performance of banks under the study.
3. To evaluate comparative analysis of the efficiency of NPA management of BCCBL and PBGB.
4. To make suggestions for the efficient and effective NPA management for the banks.
1.5 Hypothesis of the Study

The following hypotheses were set for this research:

1. \( H_0 \): When NPA decreases, profitability decreases.
\[ H_1 \]: When NPA increases, profitability decreases.

2. \( H_0 \): There is no significant negative relationship between NPA & liquidity.
\[ H_1 \]: There is a significant negative relationship between NPA & liquidity.

3. \( H_0 \): There is no positive relationship between NPA & IM (Involvement of Management).
\[ H_1 \]: There is a positive relationship exist between NPA & IM (Involvement of Management).

4. \( H_0 \): There is no significant association between NPA and CL (Credit Loss).
\[ H_1 \]: There is a significant association between NPA and CL (Credit Loss).

1.6 Methodology of the Study

Methodology relates to plan of the study, which includes steps of data collection, processing of data and finally analysis and interpretation of data in order to draw logical inferences. Information needed for the present research is to be obtained from secondary data sources. Data from the secondary sources have been obtained for a period of nine years from 2006-07 to 2014-15. Data thus obtained have been analyzed in tune with the stated objectives of the study bringing out comparison between the Burdwan District Central Co-operative Bank Ltd. (BCCBL) and Paschim Banga Gramin Bank (PBGB) on different parameters. For analysis of data, some simple accounting and statistical tools like ratio analysis, correlation and regression analysis, trend analysis, pie chart, line chart, bar-diagrams etc. have been used and inference have been drawn accordingly.

1.6.1 Data Sources

In order to achieve the stated objectives; this study utilized both primary data and secondary data.
1.6.1.1 Secondary Data

The secondary data have been collected from various sources. The duration of the secondary data were chosen from 2006-07 to 2014-15. The main sources of the secondary data are as follows:

- Annual Reports of the DCCB, Burdwan, and St.CB, W. B.
- Annual Report of the PBGB, West Bengal
- Reports of the RBI, NABARD, Government of India (GoI) & Government of West Bengal (GoWB)
- Annual report published by the National Federation of State Co-operative Bank (NAFSCOB), Navi Mumbai.
- Report published by the National Cooperative Union of India.
- Books and Journal Articles.
- Published Financial Statement.
- Different Acts & Standards
- Seminar/Conference Papers (both published and unpublished)
- News Papers and Magazines
- Data/Information from various libraries and internet required for the study.
- Indian Development Report
- Bulletin of Indian Bank Association,
- Recommendations and Conclusions of various Committees/ Studies undertaken as well as Ph. D. thesis also.

1.6.2 Period of the Study

The present study covers a period of 9 years from 2006-07 to 2014-15. The year 2006-07 is taken as the starting year because Paschim Banga Gramin Bank (PBGB) has been established on 26th February 2007 after amalgamation of Howrah Gramin Bank, Bardhaman Gramin Bank and Mayurakshi Gramin Bank sponsored by the UCO Bank. This new entity was published 1st financial statement in the year 2006-07. To examine the degree of financial strength based on the quality of its assets, a period of nine years starting from
2006-07 to the current year 2014-15 is considered to study the sector-wise growth and management of NPAs of the BCCBL and PBGB in the district of Burdwan, West Bengal.

1.6.3 Analysis Plan
The comparative analysis employed to assess whether there is a link between the efficiency level and quantum of bad loans that exist in the banking system. The present chapter elucidates to examine the performance of BCCBL and PBGB during the period of study 2006-07 to 2014-15 through the following specific aspects of their operations:

1. To make comparative trend analysis of NPA, trend value has been calculated with the help of least square method of time series analysis. Four major indicators have been used to analyze the trend of NPA management, viz. (1) % of Gross NPA (GNPA) to Gross Loan & Advances, (2) % of Gross NPA (GNPA) to Total Assets, (3) % of Net NPA (NNPA) to Net Loan & Advances and (4) % of Net NPA (NNPA) to Total Assets.

2. To make comparative analysis regarding the effect of NPA on the performance of the banks in terms of profitability, liquidity, Involvement of Management (IM) and Credit Loss (CL) under the study, descriptive statistics, correlation statistics and Ordinary Least Square (OLS) regressions are useful. For the purpose of analysis, we have considered non-performing assets in terms of sub-standard assets, doubtful assets and loss assets as independent variables and banks’ performance indicators in terms of profitability, liquidity, involvement of management and credit loss are four dependent variables separately and formed four models for OLS regression analysis.

The comparative analysis employed various statistical tools and techniques that include:

(1) Mean, SD, CV (%) and Karl Pearson’s Correlation Coefficient (r)—to study the strength of relationship on movement of data and trend of NPA variables between BCCBL and PBGB.

(2) Trend analysis has been made through the trend value of the indicators of NPA management. The trend value has been calculated with the help of least squares method of time series analysis.
(3) Regression equation—to study the impact of NPA on banks’ performance and establish the relationship between various performance indicators and NPA, data are processed and analysed with the help of Eviews 9 software.

(4) Index of NPA (INPA) management efficiency—to measure the extent of NPA management efficiency of banks. In this area of study, an attempt is made to fill this gap by proposing an index of NPA management efficiency (INPA). Ranking of BCCBL and PBGB is made on the basis of proposed index scores. The INPA is a multi-parameters index that captures information on various aspects of NPA management of the banks in one single digit that lies in between 0 and 1; where 0 denotes the worst NPA management while 1 is the best.

Index of Non-Performing Asset management (INPA) is then calculated for each bank by the following formula –

\[
INPA = 1 - \sqrt{\frac{(1-P_1)^2 + (1-P_2)^2 + (1-P_3)^2 + \ldots + (1-P_n)^2}{n}}
\]

For the selected parameters (which indicate lower the value, higher the performance) we follow the formula –

\[ P_i = 1 - (A_i - m_i)/(M_i - m_i) \]

Where,

\( A_i = \) Actual value of parameter \( i \)
\( m_i = \) Minimum value of parameter \( i \)
\( M_i = \) Maximum value of parameter \( i \)

The above formula ensures that \( 0 \leq P_i \leq 1 \). Higher the value of \( P_i \), higher is the relative bank’s performance in parameter, \( i \).

1.7 The Study Plan

The present study has been designed into Nine Chapters as detailed below:

**Chapter – 1: Introduction**—presents a brief introduction about rural financial institutions, co-operative banks, regional rural banks, statement of the problem,
significance of the study, objective of the study, hypothesis of the study, research methodology, data sources, tool of analysis and the study plan.

Chapter – 2: **Review of Literature**—this chapter comprises of a review of past studies in the area of research, i.e. management of NPAs. The literatures have been classified into (a) Studies on NPA in Indian SCBs and (b) Studies on NPA in DCCBs & RRBs.

Chapter – 3: **Overview of Burdwan district and Banks under the Study**—this chapter sketches the brief overview of Burdwan district and the brief profile of DCCB & RRB, profile of BCCBL & PBGB, brief performance of BCCBL & PBGB, movement of NPA variables, etc.

Chapter – 4: **NPA—Genesis, Growth and Management**—this chapter focuses on the theoretical perspective of NPA management, classification of assets, provisioning norms for NPA, factors of NPA, management of NPA, implications of NPA accounts etc.

Chapter – 5: **NPA Trend Analysis**—this chapter highlights the analysis of data and presentation of the observations. The trend of NPA in BCCBL & PBGB during the study period 2006-07 to 2014-15 is explained. Trend analysis has been made through the trend value of the indicators of NPA management. The trend value has been calculated with the help of least square method of time series analysis.

Chapter – 6: **Impact of NPAs on Banks’ Performance**—this chapter emphasises on the impact of NPA on banks’ performance and establishes the relationship between various performance indicators and NPA; data is processed and analyzed with the help of Eviews 9 software. This chapter also explains the moderating and mediating role of bank performance indicators on NPA of selected banks.

Chapter – 7: **Efficiency of NPA Management**—this chapter deals with the measurement of NPA management efficiency of banks. In this area of study, an attempt is taken to fill this gap by proposing an index of NPA management efficiency
(INPA). We rank BCCBL and PBGB on the basis of proposed index scores. The INPA is multi-parameters index that captures information on various aspects of NPA management of the banks in one single digit which lies in between 0 and 1; where 0 denotes the worst NPA management while 1 is the best.

Chapter – 8: Findings of the Study—this chapter deals with the issues emerging from the study, i.e. findings of the study.

Chapter – 9: Suggestions and Recommendations—this chapter is the ending one that put forward certain pertinent suggestions and recommendations in order to highlight how efficiently the NPA management could be made with a view to ensuring rather improved financial performance.

References

10 Reserve Bank of India (RBI), Report Of The Working Group To Review The Business Correspondent Model, Mumbai, 2009