CHAPTER –I
INTRODUCTION AND RESEARCH METHODOLOGY

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CHAPTER- I

INTRODUCTION AND RESEARCH METHODOLOGY

1.1. Introduction:

The banks are commercial organization and the main business of banking is to collect the deposits from the public and lend it to the individuals, business concerns, institution etc. The lending business is associated with risk. One of the risks in lending is the possibility of account becoming non-performing assets. Non-performing assets (NPAs) do not earn interest income and repayment of loan to bank does not take place according to repayment schedule affecting income of the bank and their by profitability.

The non-performing assets do not generate interest but at the same time require banks to make provision for such non-performing assets out of their current profit.

The term Non-Performing Assets figured in the Indian banking sector after introduction of financial sector reforms in 1992. The prudential norms on income recognition, assets classification and provisioning thereon are implemented from the financial year 1992-93, as per the recommendation of the committee on the Financial System (Narsimham Committee). These norms have brought in quantification and objectivity into the assessment and provisioning for NPAs. Reserve Bank of India constantly endeavors to ensure that prescriptions in this regard are close to international norms.

The efficiency of a bank is not always reflected only by the size of its balance sheet but by the level of return on its assets. NPAs do not generate interest income for the banks, but at the same time banks are required to make provision for such NPAs from their current output.

NPAs have an adverse effect on the return on assets in several ways-

- They erode current profits through provisioning requirements.
- They result in reduced income.
- They require higher provisioning requirements affecting profits and accretion to capital funds and capacity to increase good quality risk assets in future.
- They limit recycling of funds, set in asset liability mismatch.
The banks as per the directives of RBI classified their credit portfolio and made provisions to the quality of the assets. The latest position of non-performing assets in the scheduled commercial banks in India is given in the following table:

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross NPA</th>
<th>Net NPA</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Percentage to Gross Advances</td>
</tr>
<tr>
<td>1999</td>
<td>58722</td>
<td>14.7</td>
</tr>
<tr>
<td>2000</td>
<td>60408</td>
<td>12.7</td>
</tr>
<tr>
<td>2001</td>
<td>63741</td>
<td>11.4</td>
</tr>
<tr>
<td>2002</td>
<td>70904</td>
<td>10.4</td>
</tr>
<tr>
<td>2003</td>
<td>68717</td>
<td>8.8</td>
</tr>
<tr>
<td>2004</td>
<td>64786</td>
<td>7.2</td>
</tr>
<tr>
<td>2005</td>
<td>59373</td>
<td>5.2</td>
</tr>
<tr>
<td>2006</td>
<td>51816</td>
<td>3.3</td>
</tr>
<tr>
<td>2007</td>
<td>50486</td>
<td>2.5</td>
</tr>
<tr>
<td>2008</td>
<td>56435</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Source: Report on Trend and Progress of Banking in India 2007-08

Graph 1.1

It will thus be observed that over the years the banks have made efforts to reduce the non-performing assets, which are drain on their profitability. Management of non-performing asset is one of the important areas in banks to keep the non-performing assets under control.

Keeping in view the importance of the subject, the researcher has decided to take up topic for his research as under:
“Management of Non-Performing Assets with Special Reference to Holding Cost & Profitability”

The research involves collection of primary data on NPAs and collection of other information such as reasons for default, impact on performance, recovery procedures, problems and difficulties faced by them. It also involves study of classification by the branches along with other details such as cost of deposit, provision etc and its effect on profitability to work out the carrying cost. Further, the researcher would like to study the effect of carrying cost on profitability and suggest a system to be followed to reduce the carrying cost to reduce the loss. The researcher also intends to study the effect of compromise settlement, waiver of interest etc. on profitability, under different situations and explore further new/innovative avenues to reduce the cost and increase profitability.

1.2 Statement of Problem:

One of the important functions of banks is to maintain the quality of assets, which requires proper selection of borrower, appraisal of his/her project, adequate credit, close monitoring, supervision and follow up. In spite of this there is always risk of accounts becoming non-performing. There is therefore, need to devise suitable strategy for accounts, which have gone bad and/or classified as non-performing assets.

There is a carrying cost or holding cost for the non-performing assets as there is loss of interest, provision to be made etc. Appropriate and timely action for recovery can reduce the level of NPAs and further reduce the holding cost. This is very important from bank’s profitability point of view. The focus of this study is on reducing the level of NPAs and further reducing the holding cost by adopting appropriate strategy for recovery, compromise and write off.

1.3 Scope of the Study:

For the purpose of study, three branches of a nationalized bank have been selected; one each from urban, semi-urban and rural areas in Kolhapur district. The bank has very well spread out net work with 39 branches in the district. These branches are taking up all type of banking business irrespective of their locations in the district. However, the level of activity, type of clientele and the nature of problems as well as working conditions are different depending upon their geographical locations. It is with this in view, three
branches selected for study are, one each, from rural semi-urban and urban category to make it more comprehensive. The actual selection of the Branches, however, was done by the controlling office of the bank keeping in view the objectives of the study, representative sample for such study, availability of information at the branch, necessary cooperation, assistance and guidance from the staff at the branch. Due care was taken to select branches having normal banking business and are not exceptionally good or bad in any respect.

For the purpose of study, all the non-performing accounts at the selected branches have been scrutinized to reassess the, asset classification, provisioning made, etc. by the branch. The other details required to calculate the carrying cost were either collected or worked out from the data/figures available at the branch.

For the study of Management of NPAs by the selected branches, the information was collected from all the officials involved in management of NPAs at these branches through a specially designed questionnaire. Apart from this, officers from controlling office (including the Head of the Zone) who are responsible for monitoring and follow up were also interviewed to assess their views and note their comments. In addition to this, 7 borrowers per branch were selected randomly from the list of defaulters to assess their awareness and views on various aspects associated with the topic and related to them.

1.4 Objectives of Study:

- To study the concept and significance of NPAs in Banks.
- To examine the guidelines issued by RBI regarding income recognition, assets classification and provisioning norms in respect of both cooperative and commercial banks.
- To review the strategies/measures adopted by banks for arrest and control of NPAs.
- To examine and study the concept of carrying/holding cost of NPAs and its effect on profitability of banks.
- Within the overall objectives mentioned above, the specific objective of the study is to examine and suggest appropriate measures to reduce the carrying cost through recovery, negotiated settlement, and legal action or write off.
1.5 Hypotheses:

- NPAs are inevitable in the business of lending.
- The bank has to incur carrying cost on NPAs.
- The holding cost of NPA increases with the age of NPAs.
- The carrying cost can be reduced by taking timely action for recovery, write off and negotiated settlement.

1.6 Research Methodology

1.6.1 Sample Design:

The researcher has selected three branches of a leading nationalized bank in Kolhapur district located at three different locations i.e. Urban, Semi Urban and Rural. Researcher has collected all the primary data from these branches. Apart from this information was collected from all the officials associated with management of non-performing assets at these branches through predesigned questionnaires followed by interview. In order to study the perception of the borrowers and their view/suggestions in the matter, 7 defaulter borrowers were selected from the list of NPAs randomly. The number was restricted to 7 only as it is very difficult to locate the defaulter borrowers and then make them talk. The number initially was decided was 5. However, the researcher could succeed in contacting 7 borrowers.

1.6.2 Data Collection:

The researcher has collected information from both the sources i.e. primary and secondary. The primary data was collected from the records available at the branches under study and the information collected through questionnaires and interview. The secondary data is collected by referring guidelines issued by Reserve Bank of India on the subject as well as the directives, instructions, strategy conveyed by the corporate office of the bank to the branches under study. Apart from this the researcher has collected information through text books, articles, research papers published in various journals/magazines or seminar particularly Indian Bank Association, RBI, IIB journals and seminar proceedings.
1.6.2.1 Primary Data:

For collecting primary data researcher has used information sheet to collect the detailed particulars required from the branches. Such as information on NPA at branch level, provision made for NPAs, Cost of deposit, Interest paid on deposit, dividend paid by bank, yield on advances, capital adequacy ratio of the bank, recovery efforts made by bank etc.

Apart from this the researcher used questionnaire, observation and discussion method for collection of primary data. For this purpose, three type of questionnaire were used, i.e. one for Branch Manager and the Staff associated with NPA management, second for defaulter borrower and the third for the officers from controlling offices. (Annexure-II)

<table>
<thead>
<tr>
<th>Samples</th>
<th>Number of Representative</th>
<th>Questionnaires</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch Manager</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Field Staff</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Borrowers</td>
<td>1200</td>
<td>21</td>
</tr>
<tr>
<td>Staff at Controlling Office/Lead District Manager/ Head of Controlling Office</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

Table 1.2
The Person has been interviewed

1.6.2.2 Secondary Data:

The secondary data have been collected from published material of the subject from the various sources of publication, i.e. Reserve Bank of India annual report, monthly bulletins of RBI, articles and research papers published in the journals of Indian Bank Association, Indian institute of bankers, National Institution of Bank Management, institute of Chartered Accountants, Books, articles published in financial newspapers and internet.

1.6.3 Use of Tools and Techniques:

Researcher has used tabular and functional analysis for data analysis and interpretation. The functional analysis includes SPSS used for the analysis and interpretation of data on NPA management. These tools and techniques consist of frequency, percentage, mean, median, mode and standard deviation but in this study only percentages have been used for interpretation. The working of
carrying cost is based on the actual figures and the details available at the 
branches under study.

1.7. Limitations of the Study:

1. The study is limited to three branches of bank in Kolhapur district and 
based on information / data available at these branches.
2. The study period is fixed for five years only since 2004 to 2008.
3. The condition was laid down by respective bank & branches not to 
disclose their permission to under take the study on the respective bank. 
Hence the present researcher has not mentioned the name of bank in this 
thesis.

1.8. Chapter Scheme

The present study is divided into seven chapters as stated below:

Chapter No 1: Introduction and Research Methodology
This chapter deals with brief introduction of the subject and outlines the 
research methodology.

Chapter No. 2: Theoretical Background of the Subject
This chapter deals with the theoretical background, definition of non-
performing assets, causes of NPAs, RBI guidelines, RBI directives relating to 
NPA classification, provision etc., identification and impact on NPAs, Recovery 
and management of NPAs practices in the banking sector.

Chapter No. 3: Review of Literature
In this chapter, a brief review of literature and research work done on various 
aspects of the subject is taken based on published material in the form of 
research papers, papers submitted in different seminars various articles on the 
topics, and other literature available.

Chapter No.4: Profile of Kolhapur District, Bank and the Branches 
Selected for Study
The chapter gives a brief account banking profile of the district along with 
profile of the bank and the branches selected for study.

Chapter No. 5: Data Analysis and Interpretation
In this chapter detailed analysis of the data collected done along with 
interpretation on various aspects of the study. The findings of the study are also 
given in detail in this chapter. The Analysis and interpretation is in two parts.
Part- A deals with Management of Non-Performing Assets and Part-B deals with the identification of carrying cost.

**Chapter No. 6: Findings and Conclusions**

The chapter deals with the core findings and conclusions of the research.

**Chapter No. 7: Suggestions and Recommendations**

This chapter presents suggestions and recommendations.

**Bibliography**

**Annexure**

**References:**

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