Chapter - 1

INTRODUCTION AND RESEARCH DESIGN

Introduction

For decades, the co-operative institutions in India have been playing a decisive role in financing the requirements of farmers. The institutional structure involved in this endeavour owes its origin to the Report of the Macalgan Committee appointed by the then British Government in 1914 to study the position, working and development of the co-operative sector. The Committee recommended the setting up of four-tier structure of co-operative institutions for meeting the rural credit requirements. The structure comprised of (i) Primary Agricultural Credit Societies (PACs), (ii) District Central Co-operative Banks (DCCBs), (iii) Provincial Apex Co-operative Banks now called the State Co-operative Banks (SCBs) / State Co-operative Apex Banks and (iv) Supervisory Societies the role now played by the NABARD.

The PACs are located in rural areas and have direct access to the farmers. Located in villages, they are at the grass-roots level of the rural credit delivery system. The management is constituted by the elected representatives of the farmers and is aware of who is who in the village. It needs no training in feeling the pulse of each individual farmer having an abode of his own in the village. By providing crop loans and medium term loans at reasonable rates of interest, the PACs have succeeded in releasing the farmers from the clutches of the unscrupulous and exploitative village money-lenders charging exorbitant interest rates. Such a safety net thrown open on the farmers by the PACs has enabled the farmers to reduce the cost of production, improve the capacity to wait for better prices for sale of their produce and thereby to enhance their bargaining capability. The PACs have made it possible for the farmers to enjoy a better standard of living and to lead a life of dignity and respect among the fellow villagers.

The DCCBs act as support base for the PACs in taking care of the financial requirements of the farmers. Where the fundamentals of a DCCB are strong, the PACs can function smoothly and without any hindrance. If a DCCB becomes sick for one reason or the other, the PACs coming under its area of operation have nowhere to go for meeting their
financial needs as most of them are not financially independent but very much dependent on the DCCB. The failure of a DCCB thus leads to the collapse of the rural economy of the concerned district. DCCBs serve as a friend, philosopher and guide of the PACs as regards agricultural credit.

The SCB serves as an apex institution in a State for refinancing the agricultural credit to DCCBs in the State. The membership of a SCB is comprised of DCCBs in the State and its management is constituted by the elected representatives from the DCCBs.

The National Bank for Agriculture and Rural Development (NABARD) was established in 1982 to take over the functions of the RBI as regards agricultural credit. It was thus carved out of RBI to be a specialised institution to ensure orderly development, regulation and monitoring of SCBs and DCCBs. The NABARD acts mainly as a regulator of the SCBs and DCCBs. It also serves as a refinancing institution for SCBs. The NABARD is thus an essential constituent of the agricultural credit.

The funds that flow from NABARD to the PACs through SCBs and DCCBs have paved the way for economic decentralisation in favour of rural economy. In the absence of such an institutional structure of co-operatives for agricultural credit resources of the country would have flowed in other directions at the expense of the village economy. Consequently, there would have been concentration of credit in non-agricultural sector at the cost of agricultural sector. The orderly economic development of a country envisages the balanced development of agriculture, industry, tertiary or service sectors. Neglect or starving of any one sector does not augur well for the health of the economy.

Need for the Study

The health of a bank depends on the quality of the assets it has at any given time. It is not only the possession that matters but also the how these assets are deployed in avenues bringing in maximum income to the bank at minimum risk and cost. For a DCCB, there is one more object to fulfil in the deployment of money in assets i.e., to maximise the socio-economic benefits to the farmers through the PACs.
The acceptance of deposits and lending of money are the purposes for which a bank is established. Accordingly, in the liabilities side of a bank's balance sheet the deposits accepted, being the prime source of funds, occupy second to none position. As regards the application of funds, on the assets side of the same balance sheet, the position of loans and advances given would be supreme.

The deposits can be serviced by timely payment of interest and repayment of amount of deposit to the depositors on due date. The share capital being another source of funds, also needs to be serviced by payment of reasonable rate of dividend at the end of every financial year. Still another source of funds being the loans from co-operative banks must also be serviced by timely payment of interest and repayment of amount of loan to the lending co-operative banks on due date. The servicing of deposits, share capital and loans from co-operative banks would be possible only if the assets are better managed.

Lending is one of the core activities of a bank. Acceptance of deposits is necessary to keep the lending in place. But lending includes uninsurable risk. Being the major income earner of a bank, the lending is indispensable for its survival. Without lending a bank incurs a loss turning its operations into red. Hence, the management of loans and advances given is most important for its survival and growth. The best managed bank is one whose loans and advances given are recovered with interest in time. The timely recovery of loans and advances given with interest signifies the health of a bank. The percentage of loan recovery is the indicator of the profitability and financial soundness of a bank. While the higher percentage of loan recovery serves the twin purposes of ensuring the bank's survival and assuring its growth, the lower percentages move the bank in opposite direction.

DCCBs are indispensable for attaining the ideals of development of rural economy. They are the instruments for maximising the socio-economic benefits to the farmers through the PACs. In the past, a DCCB used to operate only in the area of financing agricultural credit requirements by refinancing loans to PACs including crop loans and medium term loans. In the course of time, loan portfolio of many DCCBs became diversified to include loans other than loans to co-operatives including housing loans, vehicle loans, gold loans, deposit loans, kisan credit card, consortium loans, self help group loans, industrial term loans and industrial working capital loans.
In recent years, the DCCBs are facing the problems of cut-throat competition from the commercial banks in respect of farm and non-farm sector advances, inadequately trained staff, absence of professional management, inability to adjust promptly to the changed market conditions because of archaic rules and regulations, political influence, bureaucratic interference and at the top the problem of NPAs. While other problems do not threaten the survival of a DCCB, the problem of NPAs if left unchecked, can bring about the DCCB’s downfall and eventual extinction. Hence, a need was felt by the researcher to go into the details of different dimensions of NPAs at the DCCB level.

Review of Earlier Studies

The concept of NPA was introduced by the RBI in the year 1993 based on the recommendations of Narasimham – I Committee 1991 on financial sector reforms in accordance with the internationally accepted norms. Earlier, the concept of NPA was implicit part of the RBI introduced Health Code System implemented by the banks in 1985. Under the Health Code System, the banks were required to classify the loan accounts into doubtful, recalled, suit filed and decreed. The banks were also required to make adequate provisions in respect of such accounts. The NPA concept presently in vogue, is relatively of recent origin and the literature on the theme is certainly inadequate. A review of important literature on the concept of NPA is made in the following paragraphs.

In 2002, Shri S.N. Bidani retired Deputy General Manager, Punjab National Bank has written a book entitled “Managing Non-Performing Assets in Banks”. The author’s rich experience in project appraisal for several years in the bank has enabled him to present a realistic ins and outs of the menace of NPAs. In particular, the book contains an analysis of the causes of slippage of loan accounts into NPA category, the required pre-sanction appraisal and post sanction monitoring and efficient recovery mechanism to be put in place. In the end, author presented the strategies and action points for reduction of NPAs.

The Federation of Indian Chambers of Commerce and Industry, New Delhi, has published a booklet entitled “Bank NPAs – Need for a New Perspective” based on an
extensive study of the problem of NPAs in Public Sector Banks including the State Bank of India and nationalised banks. The study mainly covers a period of two years 1997-98 and 1998-99. An indepth survey of NPA management in Public Sector Banks conducted during the study highlights the originating factors for NPAs and suggests the remedial measures. The study throws the recovery mechanism in Public Sector Banks in a poor light.

Nachiket Mor, the Executive Director and Bhavna Sharma, the Economist of the ICICI Bank Limited presented a paper entitled “Rooting Out Non-Performing Assets” at the “First Annual Conference on Money and Finance in the Indian Economy” held at the Indira Gandhi Institute of Development Research, Mumbai in January, 2003. The authors are of the strong opinion that the NPAs do not originate mainly from the systemic issues (e.g., directed lending) as is generally believed. But instead, individual level issues are the main causes of NPAs. According to the authors, in order to root out the NPAs, it is necessary to first deal with the micro level issues at the level of individual as otherwise the problem of NPAs may resurface again.

The thesis entitled “Management of Non-Performing Assets in Regional Rural Banks with Special Reference to Tungabhadra Gramin Bank in Karnataka State” was submitted to the Karnataka University, Dharwad in December, 2003 for the award of the degree of Doctor of Philosophy by Dr. V. Jeelan Basha under the guidance of Dr. S.S. Hugar. The researcher has elaborately reviewed the then existing literature on NPAs in various commercial banks and financial institutions in general and Regional Rural Banks in particular. The research gives an insight into the problem of NPAs in the realm of Regional Rural Banks. The study focuses on the analysis of NPAs of Tungabhadra Gramin Bank as a whole as well as at the branch level. The research has brought out the impact of NPAs on the return and risk.

Statement of the Problem

The regulators like the RBI / NABARD have done much homework and many exercises resulting in the appointment of Expert Committees to look into the problem of NPA and to find out the much needed solution. The Narasimham - I Committee, 1991,
Narasimham - II Committee, 1998 and Andhyarujina Committee, 1999 have submitted well considered reports with valuable suggestions.

The guidelines issued by the regulators after a careful consideration of the reports of the Expert Committees concentrate more on reporting requirements as regards NPAs rather than the solution to the problem. These guidelines provide for prudential norms on income recognition, asset classification and provisioning requirements. The guidelines emphasise disclosure and presentation of information on NPA as in absence of which concealment thereof was feared. It may be the intention of the regulators to impose indirect obligation on the lenders to take steps to reduce the NPAs by laying down stringent prudential norms on them.

If the problem could be solved by reporting the NPA and meeting the provisioning requirements, the problem of NPAs would have been an extinct specie by now. But the reality is far from such a kind of utopian situation. NPA has come to stay as an unwanted guest of the lender. The unwilling host would be happy when the such a guest is gone but this does not appear to happen. The multi-dimensional growth of NPAs as it stands today, belies all expectations of the regulators and threatens the very existence of the economy of the country.

All these boil down to the fact that the efforts of the regulators are NPA disclosure-centric rather than problem-solving oriented. There are enough talks on the need to contain NPAs but a sincere effort to solve the problem is conspicuous by its absence. The problem is not so simple as to leave it as the headache of the banks. None can deny the fact that the banks are indispensable part of the civilised society. The existence of the banks is essential for all the citizens irrespective of their social and economic affiliations. In fact it is difficult to determine who are or are not the stakeholders of the existence of the banking system. Needless to say, each one of these stakeholders has a role of his own to play in contributing his thinking on tackling the problem of NPAs.

There is no panacea against the problem of NPAs. In a way, NPA is the foreteller of the difficulties, financial or otherwise. It is an indicator of the incipient sickness. Left
unchecked it will grow into a full blown disease. Remedy appears to be good at the time of its application but proves to be bad when the result comes out. Only way out appears to be proper management of assets in the form of loans and advances.

In the light of this situation, there is a need for comprehensive, multi-pronged practical approach to find ways and means to keep the NPAs under control. The efforts should be made by contributing their thinking on tackling the problem of NPA by all concerned with the economic development of the country viz., bankers, economists, accountants, industrialists, traders, natural or social scientists, academicians and all right thinking persons.

In this scenario, whatever the study is made, whatever thinking goes into the problem of NPA and its solution, whatever the interpretation is made of the situation and whatever the analysis is made, seem to be insufficient. The number of research studies on NPAs in banks is very small and the number of research studies on NPAs in DCCBs is virtually non-existent. The present study is a kind of its own to analyse the problem of NPAs of District Central Co-operative Banks with particular focus on The Kanara District Central Co-operative Bank Limited and is an attempt to find a solution to the vexatious problem of NPAs in DCCBs. Hence, the statement of the problem "Analysis of Non-Performing Assets in Banks : A Case Study of The Kanara District Central Bank Limited".

Scope of the Study

The focus of the study is on the area of NPAs of the banks in general and of the KDCC Bank in particular. The study is mainly confined to the collection and analysis of the data relating to eight years from 1997-98 to 2004-05. In some cases where the data for all these eight years are not available, the analysis is made of the data available for the last five years from 2000-01 to 2004-05. In a few cases where the available data on a subject matter for each year is voluminous, the analysis is made of the latest data.
Objectives of the Study

The main objectives of the study are:

1. To analyse the composition of NPAs.
2. To study the theoretical framework of NPAs.
3. To analyse NPAs vis-a-vis financial stability.
4. To analyse the cost of maintenance of excess NPAs.
5. To analyse the impact of NPAs on profitability.
6. To suggest possible solutions to the vexatious problem of NPAs.

Research Methodology

The study needed data relating to different dimensions of NPAs in KDCC Bank and its financial performance during the period covered under the study. The data for the study are collected from primary and secondary sources. The data from primary sources have been collected by holding discussions with the concerned officials of the KDCC Bank to get clarifications regarding certain concepts.

The secondary data have been collected from the (i) Official Records of the KDCC Bank viz., Annual Reports of the KDCC Bank including Balance Sheet, Profit and Loss Account, Directors’ Report and Auditor’s Report, Returns submitted by the KDCC Bank to NABARD and Reports on NPAs from Branches to Head Office, (ii) Annual Report of the NABARD (iii) RBI Bulletins, (iv) articles in newspapers and journals on NPAs, (v) circulars on Prudential Norms on Income Recognition, Asset Classification and Provisioning Requirements issued by NABARD and (vi) treatises on NPA.

The data collected have been processed and shown in tabular forms for analysis of information. The graphical representation has been made to highlight the significant trends in NPAs. The percentages and growth rates have been extensively used.
Research Design

The Research Design comprises of the division of the study into seven chapters as follows:

Chapter- I : Introduction and Research Design

This chapter highlights the role of DCCBs in the development of rural economy and an introduction to their problem of NPAs. It emphasises the need for the study. A review of earlier studies on the problem of NPAs forms part of this chapter. Other constituents of this chapter are statement of the problem, scope of the study, objectives of the study, research methodology and research design.

Chapter - II : NPAs in Banks : A Theoretical Framework

The chapter provides a theoretical framework of NPAs, It elucidates the treatment of different types of loans and advances as NPAs, NABARD Guidelines regarding prudential norms on income recognition, asset classification and provisioning requirements. It explains the treatment of different types of assets and liabilities for the purpose of provisioning. In addition, the chapter also explains requirement of the adoption of 90 days’ norm with effect from 31-03-2006 and additional provisioning to be made with effect from 31-03-2004 for smooth transition to 90 days’ norm.

Chapter - III : The KDCC Bank : A Profile

The chapter presents a detailed profile of the KDCC Bank on whose case study this research work is centered round. It contains a chronicle of 85 years of illustrious existence of the KDCC Bank. The chapter describes the location of the KDCC Bank and its branch network. The organisational hierarchy of the KDCC Bank and its operational and financial highlights are also the constituents of this chapter.

Chapter - IV : Analysis of Composition of NPAs

The chapter includes an analysis of the trend in the position of gross advances, net advances, gross NPAs and net NPAs. It comprises of an analysis of the composition of
gross advances and gross NPAs. It includes an analysis of composition of NPAs: loan category-wise, sector-wise and branch-wise. Analysis of ageing of NPAs forms part of the chapter.

Chapter - V : Analysis of NPAs vis-a-vis Financial Stability

The chapter is devoted to analyse financial stability in the face of NPAs. It contains an analysis of the financial ratios relating to NPAs concerning overall financial position of the KDCC Bank. The main feature of the chapter is an analysis of the ratios concerning safety and stability of the KDCC Bank in the context of existing NPAs.

Chapter - VI : Analysis of Impact of NPAs on Cost and Profitability.

This chapter is earmarked for an analysis of the impact of NPAs on cost and profitability. Analysis of the financial ratios concerning incomes and expenses of the KDCC Bank in general is part of this chapter. Important constituents of this chapter include an analysis of the ratios relating to profitability and ratios having an impact on NPAs. It brings out an analysis of the impact of NPAs on cost and revenue. The highlights of this chapter consist of an analysis of the impact of NPAs on spread and return on total assets and return on shareholders' equity.

Chapter - VII : Findings and Suggestions

The last chapter presents the findings of the study followed by suggestions for reducing the NPAs and for improving the operational effectiveness in the management of NPAs.