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## Management of Non Performing Assets in District Co-Operative Banks in India

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### ABSTRACT

*In the present scenario, NPA has been the most vexing problem faced by bank. The Government of India and Reserve Bank of India have initiated various measures to control the NPA. In the post reform years. But banks are yet to solve the dilemma. This needs to be remedied. Lending is always associated with the credit risk, which arises out of the borrowers' default in repaying the loan in stipulated time, hence faced merger and strict action by RBI for having failed in the successfully managing their NPAs. The inflating bubble of NPA may the balance sheets of bank if they failed to prevent further slippage of NPAs by means of better credit monitoring overcome the problems of NPA.*

### INTRODUCTION

The most calamitous problem facing banks all over the world in recent time is spiraling non-performing assets (NPA's) which are affecting their viability and solvency and thus posing challenges to their ultimate survival. NPA's adversely effect lending activity of banks as non-recovery of loan installments as also interest on the loan portfolio negates the effectiveness of credit dispensation process. Non-recovery of loans also hurt, the profitability of banks. Besides, banks with high level of NPA's have to carry more owned funds by way of capital and create reserve and provisions and to provide cushion for the loan losses.

NPA's thus, make two pronged attack on the bottom — lines of times of banks, one interest applied on such assets is to be taken into account because such interest into be taken in account any on its realization unlike interest on performing assets which is taken into account on accrual basis; two banks have to make provision on NPA's from out of the income caused by them in performing assets persistently high level of NPA's in loan portfolio of banks make them fragile leading ultimately to their failure. This will shake confidence both of domestic and global investors in the banking system which will have multiplier effect bringing disaster in the economy.

Thus, managing bad loans and keeping it at the lowest possible level is critical for banks. It may be noted at this juncture that world class banks do not have NPA's of over 2% of the total portfolio' An NPA level of over 5% is indicator of poor quality of loan portfolio. With grooving competition and shrinking spreads, banks should strive to keep NPA's much below the level of 10% to make net earnings necessary for their survival and growth. The co-operative banks have played an important role in the socioeconomic development of rural masses. A small beginning was made with enactment of first co-operative societies act. in 1904 and now the co-operative systems has completed a century. At present there are more than 5 lack co-operative societies deeply penetrated in rural economy. The short term long term co-operative structure has met the

demand for agriculture and allied agriculture credit need of farmer in india. The short term co-operative banking structure consist of 30 state co-operative banks (SCBs) at the state level, 367 District co-operative banks (DCCBs) at the District level, and 93816 primary agricultural co-operative societies/bank (PACBs) at the village level. Here, the DCCBs been the middle tier between SCBs and PACBs, occupy a position of strategic information. Urban co-operative bank are small in term of size and turnover and they are primarily engage in detail banking. Like other banks, the DCCBs profitability and liquidity is threatened by increasing NPA. Even their survival is endangered.

## CLASIFICATION OF ASSET AS NON PERFORMING ASSETS

### (NPA)

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

- (a) In case of term loan (other than agriculture Loan), either interest and/or installment of principal dues remain 'overdue 'for a period more than 90 days as on the date of Balance sheet in 31 March 2005.
- (b) In case of running account such as cash credit or over draft (Other than agricultural loan), the accounts remains 'out of order' continuously for a period more than 90 days during the year ending on 31<sup>st</sup> March, 2005.
- (c) In case of bills purchased and discounted, if the bills remain overdue and unpaid for a period more than 90 days during the year ending on 31<sup>st</sup> March, 2005.
- (d) In case of other loan facilities, any amount to be received remains overdue' for a period more those 90 days during the year ending in 31<sup>st</sup> March 2005.
- (e) Since advances to Tea industry is considered/governed by the norms as applicable for agricultural advance (Madhulkar committee Report) such accounts will be considered as NPA if interest and/or installment of principal remain over due for two crop seasons (as tea is considered as short duration crop by IBA end also by the SLBC, west Bengal).

State Govt. granted advances (Sanctioned on or before 31.3.2000) will be classified as NPA if interest and installment remain unpaid beyond 180

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

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

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

Short duration crop (up to 12 months); loans guaranteed for short duration crops will be treated as NPA if the installment of the principal or interest remains unpaid for two crop seasons beyond the due date.

Long duration crops (beyond 12 months) a loans guaranteed for long duration crop will be treated as NPA if the installment of the, principal or interest there on remains unpaid for one crop season beyond the due date.

All the above prescriptions of crop loan (for identification of NPA) would also be applicable for a term loan mutates mutandis.

## **OBJECTIVE OF THE STUDY**

The present study was undertake with the following objectives.

1. Factor responsible for the NPA in the district co-operative banks.
2. Suggestions for containing NPAs in district co-operative banks.

## **FACTORS RESPONSIBLE FOR THE NPA IN THE DCB**

### **Originating factors-**

According to RBI study, dues to the banking sector are generally related to the performance of the unit/industrial segment. In a few cases the cause of NPA has been due to internal factors of the banks such as weak appraisal or follow-up loans but more often than not, it is due to factors such as management inefficiency of borrowal units, obsolescence, lack of demand, non-availability of inputs, environmental factors, etc. Wherever the unit segment is doing well the credit relationship is generally maintained except in cases of willful default/misappropriation/diversion of funds. The problems to the unit/segment arising out of various internal/external factors were felt to be originating point for NPAs in banks.

### **Internal Factors-**

Among the internal factors responsible for high level of NPAs in banks, the most important ones have been project appraisal deficiencies regarding technical feasibility, economic viability and project management deficiencies in regard to implementation, production, labour, marketing, financial and administrative. The culture of banking system in respect of permitting excess or irregular drawings to some extent even during the processing stage have also contributed to poor quality of loans and NPAs. As per the new norms if interest is not paid for two quarters, the advance is classified as NPA. If proposal for genuine enhancement remains.

pending for more than six months and the borrower has already gone ahead with implementing his projected plan, the account becomes irregular for more than six months even if higher credit assistance deserved on merits.

There have been large numbers of cases of camouflaging irregularities by routinely rescheduling repayment or granting ad hoc facilities so as to avoid slippage of loans accounts into NPAs. In effective credit monitoring and follow-up mechanism of the banks have also contributed to slippage of standard loans into bad loans. In banks greater focus is made on enhanced recovery of NPAs, which may be effective to contain NPAs in the short run, but very little efforts are made to follow-up once the loan is sanctioned. No serious efforts are made to study loan portfolio on multiple dimensions to monitor the aggregate exposure of the bank to industries, groups, regions, rating classes, etc. As a result, the banks lack any direction, which can be pursued at an individual loan level. Further, collection machinery has been found lax in most banks.

Diversion of funds mostly for expansion /diversification/ modernisation, and taking up new projects and for helping/ promoting associated concerns have been reported to be the single most prominent reason for high level of NPAs.

The wide prevalent practice among banks in India of providing working capital facility subject to annual renewal with or without enhancement has also been responsible for persistently high level of NPAs. If existing company which was performing well in the past, turns sick due to its inability to face competition or due to the changing economic and policy environment or sometimes due to inefficient management, there is no scope for the bank to withdraw the facility unless the promoters decide to close down the company or merge it with some healthy unit. The bank finds it difficult to lay hands on the security against which working capital facility was given because of inadequate legal measures.

#### **External Factor-**

The overall economic slowdown, global as well as domestic, particularly in industrial sector is one of the external forces which has adversely affected the bottom line of borrowal units and their capacity to service debt leading to slippage of standard asset into NPA. As logical consequence deterioration in asset quality, i.e., from standard to doubtful and doubtful to loss was also noticed during the last years.

Ineffective legal system is the most important factor contributing to enormously high level of NPAs in bank. Antiquated legal system, extremely slow judicial system and dismal record of enforcement machineries have contributed significantly to high level of NPAs in bank.

Commenting on the current legal system of the country, FITCHIBCA, an international rating agency, observed "The Indian Legal System is sympathetic towards the borrowers and works against the banks' interest. Despite most of their loans being backed by security, banks are unable to enforce their claims on the collateral, when the loans turn non-performing and therefore, loans recoveries have been insignificant."

According to RBI study on effectiveness of suit filing and recovery measures in banks, the prescribed procedure for recovery of debts due to banks has resulted in blocking of a significant portion of their funds in unproductive assets, the value of which deteriorates with the passage of

time. The multiple litigation opportunities available to the borrowers for delaying the verdicts/enforcement, courts being burdened, as they are, with heavy work load, coupled with the tardy decision making process in the banks, have rendered legal process less useful. Pending of significantly large number of suits speaks volumes about the recoveries made through the suit filing.

In the present Indian work culture, finding rules, regulations and interpretation of rules delay action or deny sanction have become very common. There are a number of cases of wrong claims of government agencies or references to courts by filing legal action growth of NPAs in the bank loan portfolio.

The long drawn legal process not only encourages the incidence of NPA but also prolong their existence by placing a premium on default.

### **SUGGESTIONS FOR CONTAINING NPA IN DCB**

Owing to overgrowing level of NPAs in banks posing serious danger to the survival and stability of the entire banking system, strategic measures- both at the micro and macro levels- along the following lines have to be taken to effectively contain the magnitude of NPAs in the loan portfolio of the banks.

So as to reduce the level of NPAs in the loan portfolio bank has to embark upon strategic plan to prevent the occurrence of the NPAs and stoppage of health accounts into bad loans. This calls for crystal clear policy guidelines in respect of credit appraisal and monitoring on the one hand, streamlining credit assessment and supervision procedures and strengthening the appraisal and monitoring cell, on the other.

Existing credit evaluation process is not adequate and focused and the staff handling the job is not endowed with required skills and expertise. It is, therefore, imperative to bring about radical change in credit evaluation process to ensure an in-depth appraisal focused on risks inherent in the proposal and to lead to a credit rating of the potential borrower. Based on financial statements and their in-depth appraisal and physical checking of stocks, the bank should develop suitable model to assess health and repaying capacity of the credit applicants.

Serious attention needs to be paid to monitoring of the loans sanctioned by the bank. It would, there for, be imperative for these banks to take effective measures to reduce their NPAs to the maximum possible extent, Not only reduction in NPAs even up gradation in the quality of such assets would help the banks to improve their bottom lines because the provision already made can be transferred to the income head in cases of up gradation of NPA's keeping in view the desired goal, management of NPA's would have the following three specific objectives:-

- (1) Improving the quality of NPA's to a performing status so that income on such assets is recognized.
- (2) Upgrading the status of the asset so as to reduce the provisioning requirements.
- (3) Clearing the balance sheet of loss assets and also unsecured position of doubtful assets;

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ultimately leading to improvement on capital adequacy ratio.

The following methods could be considered for achieving the above objectives:

- (a) Recovery
- (b) Rephasement
- (c) Compromise
- (d) Rehabilitation **in** case of viable units
- (e) Merger/acquisition
- (f) Calling up the advance, if unviable
- (g) Filling of civil suits
- (h) Lodging claims with DICGS/ECGS
- (i) Write off.

#### **(a) Recovery**

This is easier said than done, on going efforts have to be made by functionaries at each level to show perceptible results. Each functioning has to tackle the subject in his own way, viz., persuasion pressurizations, frequent interaction at appropriate levels, showing sympathy treating the borrowers a friend etc. At the organizational level, all accounts where interest has not been collected should be reviewed at periodical intervals by appropriate authorities, lest the time and energy is tittered away in following up and recovering small amounts monitoring should be focused at critical branches having concentration of high value NPAs

recovery performance of all concerned officials should be critically evaluated and outstanding performance should be appropriately recognized. Irregular accounts need to be more actively followed up with a view to containing the damage before the irregularity blows out of proportion in case of frequent over drawings in an account, the position should be reviewed and suitably enhanced limits should be considered/ sanctioned on merits.

The existing recovery mechanism should be adequately strengthened and Assets Recovery officers should be appointed.

#### **(b) Rephasement**

All terms loans which have become substandard or doubtful assets in account of non-realisation of interest or non repayment of installment should be immediately taken up for review and the repayment should be rescheduled. Although such a measure does not ipso facto upgrade the quality of asset, such assets satisfactory conduct of the account as per the rescheduled repayment programme for of years will be moved upwards such rephasement should be done on the basis of estimated funds flow in consultation with the borrower so that the rephased repayment programme is meticulously adhered to and the assets is upgrade in due course.

#### **(c) Compromise**

The mechanism for setting outstanding dues through compromise is a strategy of recent origin. In the process of setting the dues through compromise, several factors need to be examined in

detail. It is not possible to lay down any straight jacket formula for arriving at any compromise. Negotiating in this regard is to be handled skillfully on the basis of relative strengths of the borrower and the banker.

#### **(d) Rehabilitation**

Under this method, sick but viable unit is nursed back to health by giving a package, on the merit of the case. Once sickness is established and the bank decides to offer, a rehabilitation package or such package is approved by BIFR in case of co-operative bodies, the bank has to show sympathy, sacrifice and speed. The bank has to have a sympathetic and positive approach and provide the relief package in time. Such a package has to aim at helping unit in easing its debt burden, easing its liquidity position, improving its activity level and ultimately

improving its profitability so that the unit would be in a position to continue to serve its repayment obligations as agreed upon including those farming part of the package. According to the latest RBI guidelines, provisions would continue to be made in respect of due to the bank on the existing credit facilities sanctioned to a unit under rehabilitation package as per asset classification there of as sub-standard or doubtful asset.

#### **(e) Merger/Acquisition**

This a process under which a sick unit is merged with a healthy unit or some times a healthy unit acquires a sick unit. Apart of the consideration paid to the sick unit by the healthy unit is used to liquidate the NPA, wholly or partly very of ten banks have to make scarifies to which the deal. The merges/acquisition is especially beneficial to the healthy unit because, under section 72 A of the Income tax act, it is allowed to carry forward and set off accumulated loss and unabsorbed depreciation of the sick unit. Such benefit allowed only if the merger is approved by Govt. of India/BIFR and is in public interest. In terms of Govt. guide lines, merger is considered to be in public interest if the sick company employed at least 100 work man during the accounting year in which merger is affected and in the two preceding years or the market value of its fixed assets excluding land is not less than Rs 50 lacs on the date of merger.

In the case of merger, the NPA (i.e. the sick unit) will get immediately converted into a performing asset because it will acquire the status of the healthy unit — in fact, the sick unit will be wiped out from the books of the bank and the healthy unit will show increased outstanding Under different account-heads. This process thus gives quick relief to the bank holding the sick unit.

#### **(f) Calling Up the Advance, If Unviable**

If all attempts at reviving a unit merging it with a healthy unit fail. The bank has no option but to recall the advance and sell the assets of such on unit. In case of corporate sick unit, this course can be adopted only when BIFR decides to wind up the company. The sale of assets would how ever result in some loss for the bank but in many case the losses would

be for less if quick decision is taken in regard to such sale. The balance amount will have to be recovered from the personal assets of guarantors ultimately written off. This process also helps

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the bank to liquidate its NPA if it can secure the buyer for the asset of the unit.

**(g) Filing Of Civil Suit**

The last option available to the bank the recovering its dues from the borrower and/or the guarantors is by filling a civil suit against them. It has been seen that once a civil suit is filed the bank officials feel that their job is over. Further court generally gives the benefits of simple interest suit amount and repayment for convenient installment.

It is imperative that pending suits/certificates cases are periodically reviewed at structured meetings. Advocates with unsatisfactory tracks records should be counseled and specifically asked to pray for attachment before judgment in the courts of Law. The matter needs to be dealt with by all operating functionary with the seriousness it deserves.

**(h) Lodging claims with DICGS/ECGS**

Needless to say, all claims with DICGS/ECGS should be lodged in time.

**(i) Write Off**

When all the above methods fail to be effective in the recovery process the bank has no option but to forego the dues by writing them off such write off should ,however, be permitted as the last resort after exhausting all other remedies. The only redeeming feature of write off if that the bank get tax-exemption on account of such write off.

**CONCLUSION:**

Steps enumerated above which are only indicative and by no means exhaustive will go on a long way in reducing the NPA's this will not only considerably improve the profitability of the banks but also improve the quality of banks asset. Asset management by banks has been brought in sharp focus only recently.

It is to be admitted that in present scenario NPAs are at the core of the financial problems at the bank and hence cease less efforts have to be made to improve recovery rate. The task is two-fold one relates to realization at existing bad advances and the other relates to improved recovery performance on new lending's we have seen in detail various methods required to be adopted for this purpose in respect of existing bad advances. In particular effort should be made to ensure that assets in the sub-standard category which account for almost one third of the total NPA are restored to full performance, similarly, advances which are not NPAs but are on the threshold should be given special attention because , otherwise, these may become NPA sooner then later for the operating functionaries, including the branch manger, the line of action can be briefly summarized as —Knows the NPAs — account wise, amount wise and age wise. Decide which method will be most appropriate for each NPA.

Draw a time-banned action plan involving all the concerned officials Monitor implementation of the action plan fill a particular NPA is extinguished. It is therefore, suggested that co-operative banks should have to be more alert so as to bring only good quality assets on their



books in the competitive environment of today. The task is not easy they have to constantly upgrade their credit evaluation skills and systems in order to successfully manage their assets.

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