



NPA AND RECOVERY PERFORMANCE IN BANKS: AN EXPLORATORY RESEARCH IN A RURAL CO-OPERATIVE BANK

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Abstract: The banks sanction loans to borrowers and earn interest income on it. In the recent past, co-operative banks have witnessed failures due to their high NPAs and poor recovery performance. The level of NPAs and recovery performance provide an indication about the financial health and soundness. The present paper provides an exploratory insight into the NPA position and recovery performance in the HP State Co-operative bank during the period 2006 to 2017. It has been found that NPAs impact the interest margin and capital adequacy of banks. The non-performing assets pose a grave challenge for bank managements.

Key Words: The Himachal Pradesh State Co-operative bank, recovery, interest margin, non-performing assets, capital adequacy ratio

1. INTRODUCTION

A loan sanctioned to a borrower where payment of interest or principal or both have remained outstanding for more than 90 days is termed as a non-performing asset (NPA). Such loans do not provide any income for a bank. However, it blocks the flow of funds and also the day to day liquidity position making it difficult for banks to make payments to its customers. Overall, this has an impact upon the banks performance, profitability and financial health. The intensity of the impacts however depends on how well the banks are capitalized. As banks have to lend, instances of failures in repayments remain and hence non-performing assets have come to be an integral part of banking. The problem is all pervasive, whether the banks are in nationalized / public / Private or co-operative sector. The Banks have developed various ways and means to overcome this problem with varying degrees of success. Further research would enable understanding the nuances associated with it and finding lasting solutions.

The co-operative banks are the nerve centre of economic activity in the rural areas and countryside. With increasing instances of failures and collapse of co-operative banks coming to the fore in the recent past, the RBI is restricting their business activities and clamping down on the individual banks with the objective of safeguarding and protecting the financial interest of the depositors. However, such restrictions are causing alarm among the depositors (Money Control). It has been observed that the principal cause of failure is the burgeoning NPAs. The RBI has been making changes in regulation to ensure safeguarding the interest of depositors in co-operative banks. This makes the study of recovery position and NPAs even more significant.

2. OBJECTIVES

The objective of the research paper is to study and analyze the NPAs and recovery performance during the period 2006 to 2017 in the Himachal Pradesh State Co-operative bank.

3. LITERATURE REVIEW:

Research on non-performing assets in commercial and cooperative banks both in India and worldwide has evinced special focus and attention among bankers, students, research scholars, analysts and policy makers given its widespread implications and ramifications.

- (a) **Keeton and Morris** (1987) in their research study in US banks found that some banks have a tendency to take greater risks by lending to customers whom they know will probably not repay leading to higher defaults and loan losses.
- (b) **Berger and Deyoung** (1997) examined the relationship between quality of loans, cost efficiency and capital of banks and found that when loans which are problematic in nature increase, they pave the way for increase in costs of management for the banks.
- (c) **Wheelock and Wilson** (2000) examined the factors leading to bank failures and acquisitions in the United States of America for the period 1984 to 1993 and observed that banks which have less capital, poor quality of credit portfolio, low earnings and inefficient management face greater risk of failure.
- (d) **Fofack** (2005) studied non-performing assets in sub Saharan Africa in the last decade of the 20th century and found that loan impairment was particularly high in the agricultural sector and increase in NPAs caused asset deterioration and capital erosion in banks.
- (e) **Soni and Heda** (2014) examined the relationship between NPAs, net profits and advances in public sector banks in India from 2009 to 2013. They observed that NPAs cause loss to shareholders, affect profitability and image of the banks.
- (f) **Sengupta and Vardhan**(2017) in their research study found that the crucial factor for resolution of NPAs is the speed at which they are resolved. They suggested incentivizing banks to identify their loan losses earlier.
- (g) **Sahni and Seth** (2017) observed that banks should not only prevent new accounts from slipping into NPAs but they should initiate measures to recover NPAs which have already been classified. The government departments should help in recovering overdue amounts in government sponsored schemes.
- (h) **Kumar et al.**(2018) observed that non-performing assets weakens the financial strength of banks, drains capital and affects profitability.
- (i) **Sushmitha and Nagaraja** (2020) conducted a study on co-operative banks for the period 2008 to 2018 and found that the state co-operative and urban cooperative banks had made significant improvements in the management of their non-performing assets. The GNPA which stood at 12% (2008-09) had declined to 4.7% (2017-18).

4. CONCEPT OF NON-PERFORMING ASSETS (NPA)

The RBI introduced the income recognition and assets classification (IRAC) norms also called the prudential norms in commercial and public sector banks during 1992-1993 and in State Co-operative banks in the year 1996-97.

The IRAC norms provide for classification of loans into four categories, on the basis of age of overdues. These categories are:

- (i) **Good / Standard Assets:** There are normal risks linked to every business. The loans that do not disclose any problem, are being operated as per conditions laid down in sanction and the recovery is coming regularly are standard assets.
- (ii) **Sub-Standard Assets:** The loans in which repayments are overdue for more than 90 days but not exceeding 3 years are called sub-standard assets.
- (iii) **Doubtful Assets:** A loan is classified as doubtful if repayments to the bank in it have remained overdue for a period exceeding 3 years.
These are sub categorized as under:
 - (a) **Doubtful-I:** Doubtful upto 1 year i.e. accounts in which repayments have remained overdue for greater than 3 years but upto 4 years. Such accounts have remained NPAs up to 4 years.
 - (b) **Doubtful-II:** Doubtful for > than 1 year but upto 2 years i.e. accounts in which repayments have remained overdue for more than 4 years but upto 6 years.
 - (c) **Doubtful-III:** Doubtful for > than 3 years i.e. repayments are overdue and accounts are NPAs for more than 6 years.
- (iv) **Loss Assets:** Those assets in which loss is identified by the Bank / auditor but the amount of loss is yet to be written off wholly or partly.

The credit portfolio of a bank comprises of standard, sub-standard, doubtful and loss assets. If we subtract the standard loans from the credit portfolio, the remaining loans i.e. sub-standard, doubtful and loss assets form the non-performing assets (NPAs) of a Bank. For the purpose of assessing the real financial position, the NPAs are further grouped into gross non-performing assets (GNPA) and net non-performing assets (NNPA). These ratios are important indicators of the financial health / soundness of banks. RBI stipulates benchmark of <5% GNPAs and 0% NNPA's. These are briefly explained here under:

- (i) Gross Non-Performing Assets (GNPA): It comprises of sub-standard, doubtful and loss assets.

$$\text{Gross NPA ratio\%} = \frac{\text{Gross NPA}}{\text{Total Advances}} \times 100$$

- (ii) Net Non-Performing Assets (NNPA) ratio = GNPA – provisions / Total loans - provisions

The IRAC norms provide for income recognition in NPA accounts on realization basis i.e. the borrower account is debited with interest and credit is given to profit and loss account only on actual receipt of such amount from the borrower. The banks do not to charge any interest on any NPA accounts and take it to income account. In standard accounts, income is realized on accrual basis i.e., the interest is debited to the borrowers account as per the prescribed periodicity and credit is given to profit and loss account without waiting for the borrower to deposit the scheduled amount of installment. Further, in order to safeguard and provide a cushion to bear the losses, if any, in case of future eventualities, the banks have to make provisions out of their current profits in lieu of the non-performing assets.

5. RESEARCH METHODOLOGY

The study is descriptive and exploratory in nature based upon secondary data on NPAs and recovery obtained from the balance sheets and annual reports of the bank. The NPAs of 199 branches located in urban, semi urban and rural areas in six districts of Himachal Pradesh i.e. Mandi, Shimla, Kinnaur, Bilaspur, Sirmaur and Chamba was collected, compiled, tabulated and analyzed.

6. ANALYSIS OF RESULTS

6.1 Position of Gross NPAs

The NPAs of the HP State co-operative bank increased from ₹ 9107.71 lakhs to ₹ 27344.11 lakhs during the period of study. The table 1 below depicts the year over year growth in gross advances vis-à-vis gross NPAs through the period 2006 to 2017. It was observed that the assets quality witnessed a deteriorating trend during the period. In fact, the gross advances grew at a rate of 16.62% whereas the gross NPAs increased at the rate of 10.47%. The trend showed that bank was able to arrest the increase in NPAs in %age terms but in real terms, the NPAs increased although after 2014 the bank was able to contain the increase.

Table 1: Comparative position of gross advances & GNPA's

(amount in ₹ lakh)

March Ended	Gross Advances	YOY Growth	Gross NPA	YOY Growth
2006	78563.86	-	9107.71	-
2007	107605.22	36.97%	12402.89	36.18%
2008	124769.70	15.95%	14982.77	20.80%
2009	139752.94	12.01%	19685.55	31.39%
2010	164441.30	17.67%	21731.84	10.39%
2011	221043.13	34.42%	27514.73	26.61%
2012	236166.69	6.84%	29788.88	8.27%
2013	265374.87	12.37%	29724.30	-0.22%
2014	302313.69	13.92%	31313.22	5.35%
2015	359175.55	18.81%	30968.15	-1.10%
2016	436150.47	21.43%	28967.56	-6.46%
2017	475826.58	9.10%	27344.11	-5.60%
Average Growth		16.62%		10.47%

The decline in NPAs in %age terms could be attributed to substantial augmentation in loans and advances outstanding which increased from ₹302313.69 lakhs at the end of March 2014 to ₹475826.58 lakhs at the end of March 2017 as the GNPA's declined marginally from ₹31313.22 lakh to ₹27344.11 lakhs during the same period. The emergence of fresh NPAs breaks the flow of cash which reduces the quantum of funds available for further lending.

6.2 Recovery Performance

Recovery of credit is one of the most important aspects to ensure continuity of fund flow. Non recovery of loans along with interest as per repayment schedule fixed leads to overdue which is described as an amount due to the bank in lieu of availing any loan / credit facility which remains unpaid on the due date fixed by the bank. The monthly EMI constitutes demand of the loan. The equated monthly installment consists of both principal and interest and has to be repaid each month. Initially the interest component in the EMI is greater in comparison to the principal but with passage of time, if payments are regularly made, then the interest component decreases and the principal amount increases. The amortization schedule drawn for the period during which the loan with interest has to be repaid depicts the component of principal and interest in respect of each installment to be repaid by the borrower.

6.2.1 Position of Overdues

In an ideal situation, the demand and recovery are equal. As there will be no overdue amount, there will be no NPAs. But in reality, this ideal situation does not always exist. The demand and recovery are not evenly matched, in many instances, leading to overdue amount and subsequently NPAs.

Table 2 Comparative position of overdue

Sr.No	Year	Demand	Recovery	Overdue	Recovery %age
		(A)	(B)	(A-B)	
1	2005-06	10590.39	7650.28	2940.11	72.24%
2	2006-07	13808.45	10502.26	3306.19	76.06%
3	2007-08	17015.70	13238.45	3777.25	77.80%
4	2008-09	27084.01	23150.54	3933.47	85.48%
5	2009-10	25312.30	20253.43	5058.87	80.01%
6	2010-11	42239.78	28300.90	13938.88	67.00%
7	2011-12	41124.74	29565.31	11559.43	71.89%
8	2012-13	47149.62	35873.82	11275.80	76.09%
9	2013-14	51504.17	40551.33	10952.84	78.73%
10	2014-15	54367.73	44000.43	10367.30	80.93%
11	2015-16	54039.65	44210.82	9828.83	81.81%
12	2016-17	37012.34	29180.80	7831.54	78.84%

The table 2 above shows that the overdue amount increased from ₹2940.11 lakh (2005-06) to ₹13938.88 lakh (2010-11). The overdue amount jumped up significantly to ₹13938.88 lakh from ₹5058.87 lakh during 2009-10. However, it started declining since then and stood at ₹ 7831.54 lakh as on 31st March 2017 (FY 2016-17). The recovery %age during the period of study ranged between 67% & 85%. The bank worked towards reducing down overdue during 2011-12 to 2016-17 with some success reducing overdue to ₹7831.54 lakh (2016-17).

The recovery %age consistently remained in the mid-seventies during the period under review with the result that the overdue amount continued to build up leading to increase in NPAs. The recovery %age declined significantly from 80.01% during 2009-10 to 67% during 2010-11 which caused substantial jump in the overdue amount from ₹5058.87 lakh during 2009-10 to ₹13938.88 lakh during 2010-11. The bank was not able to monitor the repayments in its loan and advances portfolio and hence the recovery percentage remained below the required benchmark of 100%. The table also shows that the banks efforts to boost its recovery during financial years i.e., 2011-12 to 2016-17 have succeeded as recovery increased during these years and there was lower overdue.

6.2.2 Position of recovery against Non-Performing Assets

The recoveries against NPAs constitute an important approach for reducing NPAs. Recovering the overdue amount leads to recovery of the NPAs. Hence, every bank targets recovery of NPAs to reduce its bad assets. From the table 3 it is observed that each year, the Bank made an endeavour to target the overdue in order to reduce its NPAs. The recovery against gross NPAs ranged from 10.55% to 27.83% (2006 to 2017). In absolute terms, the recovery ranged from ₹960.44 lakh in 2005-06 to ₹8062.69 lakh in 2015-16. The recoveries increased every year except during the financial year 2010-11 when it declined in comparison to the previous financial year 2009-10.

Table 3: Position of recovery against NPAs (2006 to 2017)

Sr.No	Period	Gross NPA	Recovery	%age Recovery
			against NPAs	against NPAs
1	2005-06	9107.71	960.44	10.55%
2	2006-07	12402.89	1544.19	12.45%
3	2007-08	14982.77	2322.23	15.50%
4	2008-09	19685.55	3271.88	16.62%
5	2009-10	21731.84	3775.90	17.37%
6	2010-11	27514.73	2914.86	10.59%
7	2011-12	29788.88	3349.93	11.25%
8	2012-13	29724.30	5105.68	17.18%
9	2013-14	31313.22	5196.70	16.60%
10	2014-15	30968.15	6813.72	22.00%
11	2015-16	28967.56	8062.69	27.83%
12	2016-17	27344.11	6766.48	24.74%

However, the pace of recoveries again picked up, although the recovery against the NPAs really gained momentum during the financial years (2014-15 to 2016-17) years when the average recovery in NPA accounts was well over ₹75 crore each year. This impacted the gross NPAs which showed a declining trend.

6.3 Impact on Financial Margin & Capital Adequacy Ratio (CAR)

The operational efficiency and the financial soundness of a bank is gauged from ratios such as financial margin and capital adequacy ratio (CAR). The banks earn interest on their loans / assets whereas they have to pay interest to the stakeholders on their liabilities (primarily deposits) with the bank. The difference in interest earned on assets and interest paid on liabilities is described as the net interest margin (NIM). The capital to risk-weighted assets ratio more popularly known as the capital adequacy ratio (CAR) denotes the amount of capital a bank holds as a %age of its risk-weighted credit exposures.

Table 4: Comparative position of net margin & capital adequacy ratio (car) – FY ended 31 march

Sr.No.	Year	Yield on Loans & Advances	Yield on Assets	Net Margin	CAR
1	2006	8.99	7.53	1.74	-
2	2007	8.15	7.67	1.68	-
3	2008	10.19	8.83	1.28	25.17
4	2009	10.60	9.10	1.69	22.00
5	2010	10.47	8.65	1.24	16.53
6	2011	9.77	8.06	1.22	15.61
7	2012	10.66	8.62	1.30	18.21
8	2013	10.71	9.05	1.39	17.78
9	2014	10.71	9.22	1.38	18.49
10	2015	10.52	8.66	1.29	15.50
11	2016	10.52	8.63	1.30	13.54
12	2017	10.59	7.88	1.27	16.92

The objective is to ensure that banks have sufficient capital to handle a certain amount of losses. The banks need to pump in more capital to maintain its pecuniary health in the face of increasing credit exposures. Failure to have sufficient capital may lead to insolvency. The better a bank's capital adequacy ratio, the more likely it would be able to survive a financial slump or other unanticipated losses. The RBI prescribes banks to have a minimum capital adequacy ratio of 9%.

It may be seen from table 4 above that against the prescribed CAR of 9%, the capital adequacy ratio of the bank ranged from 13.54% to 25.17% which reflected a comfortable position. However, the high CAR is also an indicator of bank doing narrow banking i.e. the bank is not taking enough risks and not committing its resources towards increasing its loan portfolio. The net margin of the bank declined from 1.74 to 1.27 during the period of study depicting that it had come under severe stress. This is primarily attributed to the NPAs of the bank. Both the net interest margin and CAR have come under stress during the period of study. Both these aspects are of vital importance which depicts the financial stability and soundness of the bank. Apparently, the NPAs had an impact on the net interest margin as well as the CAR.

7. FINDINGS

- 1) The NPAs of the bank have increased in real terms where as it has declined in %age terms.
- 2) The recovery performance of the bank has improved during the period of study. The overdues of the bank have declined and its recovery against NPAs has also increased.
- 3) The non-performing assets impact the net interest margin and capital adequacy ratio of banks.
- 4) The NPAs choke the flow of funds, reduces interest income and reduces availability of funds for lending.
- 5) Recovery and NPA management are vital aspects which impact soundness and financial health of banks.

8. CONCLUSIONS

The NPAs pose a great challenge for cooperative banks. The increasing or declining levels of NPAs indicate the efficiency and efficacy of the recovery performance. The declining trend indicates that recovery measures are effective and efficient and vice versa. With sustained and continuous efforts NAs can be managed to a great extent and their impact on the financial health and soundness of banks can be reduced. The co-operative banking sector occupies a very important niche in the rural banking sector.

9. SUGGESTIONS

- (a) The co-operative banks should monitor recovery performance of each loan account throughout its life span.
- (b) They should diversify their credit portfolio and also look for augmenting their income through non fund based fee income to reduce the impact of NPAs.
- (c) They should take preventive as well as curative measures for managing NPAs i.e. measures for preventing NPAs and measures for recovery of NPAs.
- (d) Recovery measures should be continuous, sustained, dynamic and responsive to situational requirements.
- (e) Governments must provide handholding and support to co-operative banks for timely adoption and implementation of state of the art technological interventions which will augment their overall performance as well as provide latest services to its customers.

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