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NON PERFORMING ASSETS - A STUDY OF SELECTED RURAL BANKS IN INDIA

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ABSTRACT
Regional rural Banks plays a vital role in the agriculture and rural development of India. The RRBS have more reached to the rural area of India, through their huge network. The success of rural credit in India is largely depends on their financial strength. RRBs are key financing institution at the rural level which shoulders responsibility of meeting credit needs of different types of agriculture credit in rural areas. At present, most of the regional rural banks are facing the problems of overdue, recovery, nonperforming assets and other problems. Therefore, it is necessary to study financial performance of RRBs in India. This paper attempts to analyze the current status of RRBs in India. The study is diagnostic and exploratory in nature and makes use of secondary data. The study finds and concludes that NPA is the root cause of the global financial crisis that we observed recently. The world is still trying to recover from the after-effects of the crisis. Regional Rural Banks plays a key role as an important vehicle of credit delivery in rural areas with the objective of credit dispersal to small, marginal farmers & socio economically weaker section of population for the development of agriculture, trade and industry .But still its commercial viability has been questioned due to its limited business flexibility, smaller size of loan & high risk in loan & advances. Rural banks need to remove lack of transparency in their operation which leads to unequal relationship between banker and customer. Banking staff should interact more with their customers to overcome this problem. Banks should open their branches in areas where customers are not able to avail banking facilities. In this competitive era, RRBs have to concentrate on speedy, qualitative and secure banking services to retain existing customers and attract potential customers.
KEYWORDS- *Regional Rural Banks, Key Performance Indicators, Growth Rate, Rural Economy, NABARD.*

1. INTRODUCTION-

Regional Rural Banks have been in existence for around 36 years in the Indian financial scene. The institution of Regional Rural Banks (RRBs) was created to meet the excess demand for institutional credit in the rural areas, particularly among the economically and socially marginalized sections. The Banking Commission (1972) recommended establish an alternative institution for rural credit and ultimately Government of India established Regional Rural Banks as a separate institution basically for rural credit on the basis of the recommendations of the Working Group under the Chairmanship of Shri M.

Narashimham. In order to provide access to low-cost banking facilities to the poor, the Narashimham Working Group (1975) proposed the establishment of a new set of banks, as institutions which "combine the local feel and the familiarity with rural problems which the cooperatives possess and the degree of business organization, ability to mobilize deposits, access to central money markets and modernized outlook which the commercial banks have". Subsequently, the Regional Rural Banks were setup through the promulgation of RRB Act of 1976. The RRBs Act, 1976 succinctly sums up this overall vision to sub-serve both the developmental and the redistributive objectives. The RRBs were established "with a view to developing the rural economy by providing, for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas, credit and other facilities, particularly to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs, and for matters connected therewith and incidental thereto". Their equity is held by the Central Government, Concerned State Government and the Sponsor Bank in the proportion of 50:15:35 respectively.

The banking industry has undergone a sea change after the first phase of economic liberalization in 1991 and hence credit management came into picture. The primary function of banks is to lend funds as loans to various sectors such as agriculture, industry, personal and housing etc. and to receive deposits. Receiving deposit involves no risk, since it is the banker who owes a duty to repay the deposit, whenever it is demanded. On the other hand lending always involves much risk because there is no certainty of repayment. In recent times the banks have become very cautious in extending loans, the reason being mounting non-performing assets. Non-performing assets had been the single largest cause of irritation of the banking sector of India. Earlier the Narasimha committee-I had broadly concluded that the main reason for the reduced profitability of the commercial banks in India was given importance to priority sector lending. The committee had highlighted that priority sector lending was leading to the building up of non-performing assets of the banks and thus it recommended it to be phased out. Subsequently, the Narasimha committee-II also highlighted the need the zero non-performing assets for all Indian banks with international presence. A major portion of the money lent comes from the deposits received from the public. These deposits are mostly repayable on demand. Therefore while sanctioning credit the banker should appraise the project reasonably or else it leads to the non-repayment of loans and advances. Most of the banks today in India are facing the default risk wherein some part of the profit is reserved for covering the non-performing assets.

2. REVIEW OF LITERATURE:-

A number of studies have been conducted to see the functioning and performance of regional rural bank in the country. The literature available in the working and performance of RRBs in India is a little limited. The literature obtained by investigators in the form of reports of various committees, commissions and working groups established by the Union Government, NABARD and Reserve Bank of India, the research studies, articles of researchers, bank officials, economists and the comments of economic analysts and news is briefly reviewed in this part. Some of the related literatures of reviews are as follows. NABARD (1986) published "A study on RRBs viability", which was conducted by Agriculture Finance Corporation in 1986 on behalf of NABARD. The study revealed that viability of RRBs was essentially dependent upon the fund management strategy, margin between resources mobility and their deployment and on the control exercised on current and future costs with advances. The proportion of the establishment costs to total cost and expansion of branches were the critical factors, which affected their viability. The study further concluded that RRBs incurred losses due to defects in their systems as such, there was need to rectify these and make them viable. The main suggestions of the study included improvement in the infrastructure facilities and opening of branches by commercial banks in such areas where RRBs were already in function. In the year 1989 for the first time, the conceptualization of the entire structure of Regional Rural Banks was challenged by the Agricultural Credit Review Committee (Khusro Committee), which argued that these banks have no justifiable cause for continuance and recommended their mergers with sponsor banks. The Committee was of the view that "the weaknesses of

RRBs are endemic to the system and non-viability is built into it, and the only option was to merge the RRBs with the sponsor banks. The objective of serving the weaker sections effectively could be achieved only by self-sustaining credit institutions." The Committee on Financial Systems, 1991 (Narasimham Committee) stressed the poor financial health of the RRBs to the exclusion of every other performance indicator. 172 of the 196 RRBs were recorded unprofitable with an aggregate loan recovery performance of 40.8 percent. (June 1993). The low equity base of these banks (paid up capital of Rs. 25 lakhs) didn't cover for the loan losses of most RRBs. In the case of a few RRBs, there had also been an erosion of public deposits, besides capital. In order to impart viability to the operations of RRBs, the Narasimham Committee suggested that the RRBs should be permitted to engage in all types of banking business and should not be forced to restrict their operations to the target groups, a proposal which was readily accepted. This recommendation marked a major turning point in the functioning of RRBs.

The contemporary literature on banking efficiency spells out two distinct approaches to measure efficiency (1) accounting measure (2) economic measure. Accounting measure refers to the use of various financial ratios that focus on one or more outputs and their relevant inputs to measure the performance of a banking unit. The financial ratio approach has been widely used by the researchers and working groups/committees to analyze the performance of RRBs. Most of the studies on the performance evaluation of RRBs concentrated on the banks in particular state/region. Some of the studies are: Singh (1992) analyzed the performance of RRBs banks in Punjab. Prasad (2003) evaluated the performance of RRBs in India. Moreover, Pati (2005) developed the performance of RRBs in the north-east region. The study of Bagchi and Hadi (2006) concentrated on the performance of regional rural banks in West Bengal. Few studies also exist in the literature which concentrated on the efficiency of a single regional rural bank. Some of the studies conducted so far are: Sudhaker et al., (1984) evaluated the performance of Cauvery Grameen Bank in Mysore district; Parmar (1986) assessed the performance of Banaskantha Mehsane Grameen Bank in Gujarat; Sangwan (1988) analyzed the performance of Chattanja Grameen Bank in Andhra Pradesh; Jagadeesha et al., (1990) evaluated the performance of Tungabhadra Garmeen Bank in Karnataka. Further, Hosamani (2002) explored the performance of Malaprabha Garmeen Bank in Karnataka and Yadappanvar and Nath (2003) assessed the performance of Aurangabad and Jalna Grameen Bank in Maharashtra. Though financial accounting ratios are simple to use and relatively easy to understand, but their use to measure bank performance is plagued by various problems. As a precautionary measure, regulatory frame works (such as CAMEL rating) based on these ratios has been put in place in most of the supervisory systems across the globe. Further, Sherman and Gold (1985) noted that financial ratios do not capture the long-term performance. This measure also helps in the analysis of bank's performance in terms of individual parameters determining the overall efficiency level as it is difficult to precisely measure the efficiency of banks.

3. RESEARCH METHODOLOGY:-

- **Objectives:-**

- To analyze the NPA ands its mechanism to recovery particularly of rural banks in India
  Secondary research is been presumed in study.

4. FINDINGS OF STUDY:-

4.1 NPA Norms

Though the issue of NPA was given more importance after the Narasimham Committee Report (1991) highlighted its impact on the financial health of the commercial banks and, subsequently, various asset classification norms were introduced, the concept of classifying bank assets based on its quality began during 1985-86. A critical analysis to monitor credit comprehensively and uniformly was introduced in 1985-86 by the RBI by way of the Health Code System in banks. This system, inter alia, provided information regarding the health of individual advances, the quality of the credit portfolio and the extent of advances causing concern in relation to total advances. It was considered that such information would be of immense use to banks for control purposes. The RBI advised all commercial banks (excluding foreign banks, most of which had similar coding system) on November 7, 1985, to introduce the Health Code System indicating the quality (or health) of individual advances under the following eight categories, with a health code assigned to each borrowal account (source: RBI):

1. Satisfactory - conduct is satisfactory; all terms and conditions are complied with; all accounts are in order and safety of the advance is not in doubt.

2. Irregular- the safety of the advance is not suspected, though there may be occasional irregularities, which may be considered as a short term phenomenon.

3**. Sick, viable -** advances to units that are sick but viable - under nursing and units for which nursing/revival programmes are taken up.

4. Sick: **nonviable/sticky -** the irregularities continue to persist and there are no immediate prospects of regularisation and the accounts could throw up some of the usual signs of incipient sickness

5. Advances recalled - accounts where the repayment is highly doubtful and nursing is not considered worthwhile and where decision has been taken to recall the advance

6. Suit filed accounts - accounts where legal action or recovery proceedings have been initiated

7. Decreed debts - where decrees (verdict) have been obtained.

8. Bad and Doubtful debts - where the recoverability of the bank's dues has become doubtful on account of short-fall in value of security, difficulty in enforcing and realising the securities or inability/unwillingness of the borrowers to repay the bank's dues partly or wholly

Under the above Health Code System, the RBI classif ied problem loans of each bank into three categories:

i) advances classified as bad and doubtful by the bank (Health Code No.8)

(ii) advances where suits were filed/decrees obtained (Health Codes No.6 and 7)

(iii) those advances with major undesirable features (Health Codes No.4 and 5).

The Narasimham Committee (1991) felt that the classification of assets according to the health codes was not in accordance with international standards. It believed that a policy of income recognition should be objective and based on the record of recovery rather than on subjective considerations. In addition, before the Indian banks complied with the capital adequacy norms, their assets had to be revalued on a more realistic basis of their realisable value. Thus, the Narasimham Committee (1991) believed a system of income recognition and provisioning is fundamental to preserve the strength and stability of the banking system. The international practice is that an asset is treated as non-performing when interest is due for at least two quarters. In respect of such non-performing assets, interest is not recognised on accrual basis but is booked as income only when it is actually received. The committee suggested that a similar practice be followed by banks in financial institutions in India and recommended that interest on NPAs be booked as income on accrual basis. The NPA would be defined as advance, as on the balance sheet date in the following circumstances:

1. In respect of overdraft and cash credits, accounts remain out of order for a period of more than 180 days,
2. In respect of bills purchased and discounted, the bill remains overdue4 and unpaid for a period of more than 180 days,
3. In respect of other accounts, any account to be received remains past due for a period of more than than 180 days.

As mentioned earlier, the grace period was reduced and from March 1995 onwards assets for which interest has unpaid for 90 days were considered as NPAs. Provisions need to be made for the NPAs and total NPA (gross) minus the provisions is defined as net NPA. Besides providing a detailed definition of NPA, the Narasimham Committee (1991) also suggested that for the purpose of provisioning, banks and financial institutions should classify their assets by compressing the health codes into four broad groups; (i) Standard (ii) Sub-standard, (iii) Doubtful and (iv) Loss.

Broadly, sub-standard assets would exhibit problems and include assets classified as non-performing for a period not exceeding two years. Doubtful assets are those that remain as such for more than two years and include loans that are overdue for more than two years.

4.2 Impact of NPA on the operations of Rural banks in India

- **Profitability**
  NPA means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the prodigality of bank decreases not only by the amount of NPA but NPA lead to opportunity cost also as that much of profit invested in some return earning project/asset. So NPA does not affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity. Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.
- **Liquidity**
  Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for shortest period of time which lead to additional cost to the company. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.
- **Involvement of Management**
  Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now days, banks have special employees to deal and handle NPAs, which is additional cost to the bank.
- **Credit Loss**
  If a bank is facing problem of NPA, then it adversely affects the value of bank in terms of market for credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting in their money in the banks.

4.3 Recovery Mechanism of NPA for rural banks in India

The Government of India felt that the usual recovery measures like issue of notices for enforcement of securities and recovery of dues was a time consuming process. Thus, in order to speed up the recovery of NPAs, the government constituted a committee under the chairmanship of late Shri Tiwari in 1981. The committee examined the ways and means of recovering NPAs and recommended, inter alia, the setting up of 'Special Tribunals' to expedite the recovery process. Later the Narasimham Committee (1991) endorsed this recommendation, and, suggested setting up of the Asset Reconstruction Fund (ARF). It was suggested that the Government of India, if necessary, should establish this fund by special legislation to take over the NPAs from banks and financial institutions at a discount and recover the dues owed by the primary borrowers. Based on the recommendations of the Tiwari and the Narasimham Committees, Debt Recovery Tribunals were established in various parts of the country. An Asset Reconstruction Company was also established. The various measures taken to reduce NPAs include rescheduling and restructuring of banks, corporate debt restructuring and recovery through Lok Adalats, Civil Courts, Debt Recovery Tribunals and

5. CONCLUSION:-

The NPA is the root cause of the global financial crisis that we observed recently. The world is still trying to recover from the after-effects of the crisis. Regional Rural Banks plays a key role as an important vehicle of credit delivery in rural areas with the objective of credit dispersal to small, marginal farmers & socio economically weaker section of population for the development of agriculture, trade and industry .But still its commercial viability has been questioned due to its limited business flexibility, smaller size of loan & high risk in loan & advances. Rural banks need to remove lack of transparency in their operation which leads to unequal relationship between banker and customer. Banking staff should interact more with their customers to overcome this problem. Banks should open their branches in areas where customers are not able to avail banking facilities. In this competitive era, RRBs have to concentrate on speedy, qualitative and secure banking services to retain existing customers and attract potential customers. The problem of NPA has received considerable attention after the liberalisation of the financial sector in India. Accounting norms have been modified substantially and mechanisms are in place for reduction of bad loans. Our discussions with banks, however, show that such decline is mainly due to the awareness of the problem of bad loans at the bank level (Rajeev and Mahesh, 2007). It remains true that NPA jn the priority sector is still higher than that of the non-priority sector. Within the priority sector, the SSI's performance is the worst. However, even this sector has shown reduction in bad loans over time. In the process of reducing NPAs, will banks shun the poor borrowers? In this context, the self-help group model can be applied to some of the sectors to help the poor access loans and ensure repayment for the banks.

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