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Effects of increase in Agri NPAs of Banking & Recovery Mechanism

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Abstract

Banking sector plays an indispensable role in economic development of a country through mobilization of savings and deployment of funds to the productive sectors. Poor recoveries are going to block huge funds in non-performing assets and it compelled bankers to consider recovery as a key performance area. This article mainly deals with the concept of NPAs, its effects and causes for an account becoming non-performing, concept of loan waiver. The general objective of the study is to go to the region having more number of Agri NPAs and gain more information regarding the existing NPAs.

Key words: *Banking sector,* challenges, *economic development*

Introduction

A well-built banking sector is significant for a prosperous economy. The crash of the banking sector may have an unfavorable blow on other sectors. A banker shall be very cautious in lending, because banker is not lending money out of his own capital. A major portion of the money lent comes from the deposits received from the public and government share. At present NPA in the banking sector is debate topic because NPA is increasing year by year particularly in nationalized banks [1].

Indian Banking Sector

The banking sector in India is currently passing through an exciting and challenging phase. The reform measures have bought about sweeping changes in this vital sector of the country's economy. In the1970's and 1980's the Indian banking industry was marked by a high degree of regulation[2]. In India due to the social banking motto, the problem of bad loans did not receive priority from policy makers initially. However, with the reform of the financial sector and the adoption of international banking practices the issue of NPAs received due focus. Thus, in India, the concept of NPA came into the reckoning after reforms in the financial sector were introduced on the recommendations of the Report of the Committee on the Financial System (Narasimham, 1991) and an appropriate accounting system was put in place[3].

In 1991 the government of India (GOI) established a nine-member committee on financial systems, under the chairmanship of Mr.N.Narsimha to evaluate the systemic banking problems. The Narsimham committee report published towards the end of 1991, containing far reaching recommendations for the banking sector.This report formed the basis for the sector's reforms, which were undertaken in parallel with the overall economic reforms of the 1990's.

Concept of Non-Performing Assets

Over the few years Indian banking, attempts to integrate with the global banking has been facing lots of hurdles in its way due to certain inherent weakness, despite its high sounding claims and lofty achievements. In a developing country, banking is seen as an important instrument of development, while with the demanding Non-Performing Assets (NPAs), banks have become burden on the economy. Non-Performing Assets are not merely non remunerative, but they add cost to the credit Management. The fear of Non-Performing Assets permeates the psychology of bank managers in entertaining new projects for credit expansion. Non-Performing Assets is not a dilemma facing exclusively the bankers; it is in fact an all pervasive national scourge swaying the entire Indian economy[4].

Non-Performing Asset is a sore throat of the Indian economy as a whole. The Indian banking sector has been facing serious problems of raising Non-Performing Assets (NPAs). Like a canker worm, NPAs have been eating the banking industries from within, since nationalization of banks in 1969. NPAs have choked off quantum of credit, restriction the recycling of funds and leads to asset-liability mismatches.

Problem with Increase in NPAs

1. Owners do not receive a market return on their capital. In the worst case, if the bank fails, owners lose their assets. In modern times, this may affect a broad pool of shareholders.

2. Depositors do not receive a market return on savings. In the worst case if the bank fails, depositors lose their assets or uninsured balance. Banks also redistribute losses to other borrowers by charging higher interest rates. Lower deposit rates and higher lending rates repress savings and financial markets, which hampers economic growth.

3. Non-Performing loans epitomize bad investment. They misallocate credit from good projects, which do not receive funding, to failed projects. Bad investment ends up in misallocation of capital, labor and natural resources. The economy performs below its production potential. Non-Performing loans may spill over the banking system and contract the money stock, which may lead to economic contraction. This spillover effect can channelize through illiquidity or bank insolvency;

(a) When many borrowers fail to pay interest, banks may experience liquidity shortages. These shortages can jam payments across the country,

(b) Illiquidity constraints bank in paying depositors e.g. cashing their paychecks. Banking panic follows a run on banks by depositors as part of the national money stock become inoperative. The money stock contracts and economic contraction follows.

Analysis and Interpretation

The information is collected from the framers in Prathapa singharam village,Ghatkesar, RR District . The reason for selecting of that particular village is having more number of agri NPAs. A questionnaire was prepared and was asked to the farmers in that particular village.

All the farmers grow only Paddy. In a particular year they grow 2 crops of Paddy. Every crop require minimum amount of 20000 . Since three crops farmers were suffering from losses.

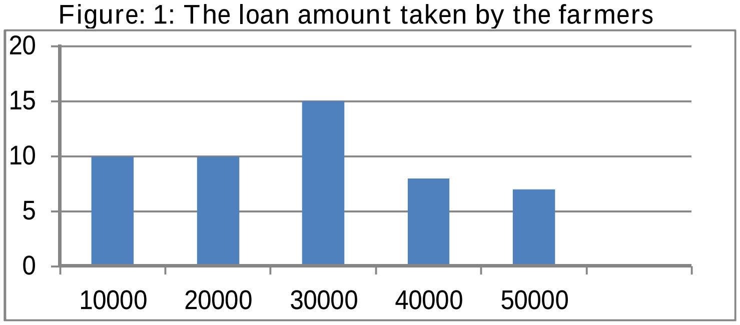
The crops are effected due to Natural Calamities like fall of the stones, insect, improper water facilities, Insufficient current.

The amount of loans taken by the farmers

In 50 farmers 45 farmers are below poverty line. All the farmers have taken loans from the Cooperative bank situated in Ghatkesar. The loan is ranging from 20000 to 50000. The farmers who are taken 30000 are more.

The Documents taken by the banks are the Pass Books. No other document is taken by the bank. The loan amount will be allocated to the farmers based on the Number of acres of land each farmer is having. For one acre 20000 is given by the bank. They should pay the interest for every Six months. If the loan amount is not paid for every six months interest is compounded. Until the previous loan is paid new loan are not sanctioned. Other farmers have not got any benefit of the Loan waiver. Most of the farmers were not paying their interest properly.

Figure: 1: The loan amount taken by the farmers



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Few of the farmers not paying their interest or the loan amount even though they have got profits. Few of them are paying regularly. Few of them who are paying have stopped paying because they are waiting for the loan waiver by the new government. 68% have not paid their loans, 1% have paid, 10% have partly paid and 20 % have stopped paying.

The cooperatives have never suggested them the crop insurance while taking the loan. No farmer is having the knowledge about crop insurance. From above pie diagram it is clear that most of the farmers have stopped paying and waiting for Loan waiver.

Out of 50 only 3 of them have got the benefit of the Loan waiver of the interest amount 5 years back. No farmer is happy with loan waiver done by the government. They say it has never benefited them. It has only restricted to news and papers. If the farmer do not pay the interest amount for every six months, the field officer with in one month of the nonpayment send the notices. If the farmers do not respond for the notice the field after 15 days of the notice directly meet the farmers whose loans are due and pressurizes them to pay the loans.

But farmers do not respond to the notices and Give the reasons for nonpayment of installments. Another problem is that most of the farmers are taking the loans and giving the land for the lease to the other farmers. The farmers are not actually using the amount for the agricultural activities. They are investing the amount on other activities. 40% for agriculture purpose,10% for personal purposes and 46% for other activities.

They are showing the loss suffered by the farmers who has taken the lease of the land as their loss and claiming the benefit of loan waiver. This one of the reason for increase in the Agri NPA's. They are aware about the loss caused if loan amount is not paid to the bank. But still they do not pay the loans.

Factors effecting increase in NPA's

Of all above the majority of the NPAs were due to the political factors which were impacting a lot, present government liberality about the farmers and the opponent political party promises of crop loan waiver schemes. These factors were mainly deepened into the farmer's perception to do not pay until the next government formation.

The next one is the crop failure due to the climatic conditions and demographic factors .In the last season climatic conditions weren't favored the farmer's perception which leads to crop failures and losses occurred. Last factor is the health.

Causes for Creation of Agri Non-Performing Assets

External causes:

Natural calamities and climatic conditions**,** Recession, changes in Government policies changes in economic conditions, Industry related problems, Impact of liberalization on industries, Technical problems

Internal causes:

Internal defaulters**,** Faculty projects, Most of the project reports are ground realities, proper linkages, product pricing etc. over depended on poorly paid killed workers and technicians, Building up pressure for sanctions, Inept handling by banker's lack of professionalism and appraisal standards, Non-observance of system, procedures and non-insistence of collaterals etc, Lack of post sanction monitoring, unchecked diversions. Lack of the knowledge of the Crop insurance policies.

Impact of NPAs on profits

1. **Reduces earning capacity of the assets:** NPAs reduced the earning capacity of the assets and as a result of this return on assets get affected.

2. **Blocks capital:** NPAs carry risk weight of 100% (to the extent it is uncovered). Therefore they block capital for maintaining Capital adequacy. As NPAs do not earn any income, they are adversely affecting "Capital Adequacy Ratio" of the bank.

3. **Incurrence of additional cost:** Carrying of NPAs require incurrence of Cost of Capital Adequacy, Cost of funds in NPA's and Operating cost for monitoring and recovering NPA'S.

4. **Reduces EVA:** While calculating Economic Value Added (EVA =Net operating profit after tax minus cost of capital) for measuring performance towards shareholders value creation, cumulative loan loss provisions on NPAs s considered as capital. Hence, it increases cost of capital and reduces EVA.

5. **Low yield on advances:** Due to NPAs, yield on advances shows a lower figure than actual yield on "standard Advances". The reasons that yield are calculated on weekly average total advances including NPAs.

6. **Effect on Return on Assets:** NPAs reduce earning capacity of the assets and as a result of this, ROA gets affected.

Various Steps for Reducing NPAs

1. Prepare a loan recovery policy and strategies for reducing NPAs.

2. Create special recovery cells as head office/Zonal office/ regional office levels identify critical branches for recovery

3. Fix targets of recovery and draw time bound action programmer

4. Select proper techniques for solving the problem of each NPA

5. Monitor implementing of the time bound action plan

6. Take corrective steps when ever found necessary while monitoring the action plan and make changes in the original plan if necessary .

Recovery Measures for NPAs

- Compromise settlement schemes (OTS)
- Rescheduling
- Proceedings under the Code of Civil Procedure
- Sale of NPA to other banks

Proceeding under Code of Civil Procedure

a. For claims below Rs.10 lacs, the banks and FIs can initiate proceedings under the Code of Civil Procedure of 1908, as amended, in a Civil court.

b. The courts are empowered to pass injunction orders restraining the debtor through itself or through its directors, representatives, etc from disposing of, parting with or dealing in any manner with the subject property.

c. Courts are also empowered to pass attachment and sales orders for subject property before judgment, in case necessary.

d. The sale of subject property is normally carried out by way of open public auction subject to confirmation of the court.

Sale of NPA to other banks

a. A NPA is eligible for sale to other banks only if it has remained a NPA for at least two years in the books of the selling bank

b. The NPA must be held by the purchasing bank at least for a period of 15 months before it is sold to other banks but not to bank, which originally sold the NPA.

c. The NPA may be classified as standard in the books of the purchasing bank for a period of 90 days from date of purchase and thereafter it would depend on the record of recovery with reference to cash flows estimated while purchasing

d. The bank may purchase/ sell NPA only on without recourse basis

e. If the sale is conducted below the net book value, the short fall should be debited to P&L account and if it is higher, the excess provision will be utilized to meet the loss on account of sale of other NPA's to other bank

Conclusion

Finally it can conclude that the banks can avoid sanctioning loans to the non-creditworthy borrowers by adopting certain measures. Banker can constantly monitor the borrower in order to ensure that the amount sanctioned is utilized properly for the purpose to which it has been sanctioned. The banker should get both the formal and informal reports about the goodwill of the customer. If he had already proven as a defaulter then there is no question of sanctioning loan to him.

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