

Non-Performing Asset and Credit Risk: an Empirical Study in Urban Co-operative Banks in Delhi

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Abstract: A Non-performing asset (NPA) is defined as a credit facility in respect of which the interest and/or installment of bond finance principal has remained 'past due' for a specified period of time. NPA is used by financial institutions that refer to loans that are in jeopardy of default. There is no doubt that increasing NPA has become a crucial concern for any bank whether it is commercial or co-operative. There are instances where many co-operative banks have faced strict action and closure from the central bank. The present paper is an attempt to study and analyse the causes of NPA in selected co-operative banks in Delhi. It studies the causes of NPA at the micro level for co-operative banks and brings out the major causes responsible for assets turning into non-performing. This paper further highlights the importance of NPA in credit Risk mitigation in Cooperative banks in Delhi. The findings of this paper will significantly contribute to the effective asset allocation to cooperative bank and help them to grow and succeed.

Key words: NPA, Credit Risk Management, Cooperative banks in Delhi.

Introduction

Banking sector is the backbone of economic development of all nations around the world. Banking is a dynamic business activity prevalent across the world. It helps in capital formation for an economy with the help of saving and investment function. Accumulation of saving and lending of money is prime function of any bank. Lending money involves risk because it is not the bank money but the depositors money who need their money back when needed. Urban Cooperative Banks in India is directly involved in farming sector and lending and borrowing practices in small town and some rural areas. They play an intermediation role amid those having resources and those requiring these resources. These UCBs are in the business of safeguarding money and other valuables for their clients. They also provide loans, credit, different payment services, investment, various insurance products and a whole range of other financial services (Leeladhar, V., 2007). Thus, their financial health status directly affects the finances of these common people which are eventually low income people.

Non-Performing Asset (NPA) shall be a loan or an advance, where Interest and /or installment of principal remain overdue for a period of more than 90 Days. This stressed assets problem plaguing Indian banking

system is well documented. Gross non-performing asset (NPA) ratio for banks is at their peak and the problem seems to show no signs of abating. The question to ask in such a scenario is how big the actual problem is and what does it entail for the banks? To give an estimate, there are nearly Rs 12 lakh crore of stressed assets in the country's banking system. These constitute nearly 15 per cent of the outstanding loan books of these banks. Of this, banks have already sold around Rs 2 lakh crore worth of such loans to asset reconstruction companies (ARCs), leaving about Rs 10 lakh crore on their own books. Taking the past experience into account, nearly 35 per cent or Rs 3.5 lakh crore of the Rs 10 lakh crore will eventually need to be marked down by banks in the form of provisions and write-offs.

These numbers reflect a massive problem which requires a concerted and strong response. The Reserve Bank of India (RBI) and the government have gone about solving this in a very phased and planned manner. They have identified that the problem is of gigantic proportions and a one-shot resolution would serve no purpose and could potentially yield disastrous consequences. The response has evolved over the couple of years through a variety of steps, each designated to further push towards a clean-up in the banking system. NPA is a double edge weapon. On one hand, it does not generate income for the banks, and at the other banks are required to make provisions for such NPAs from their current profits which also affect their future stream of profits.

Credit Risk is a measure types of risk which occurs when a borrower defaults on his obligation, or unable to pay back the sum taken or perform under the terms of the contract. Risk management (RM) is a systematic method of identifying, analyzing, assessing, treating, monitoring and communicating risk, in order to keep the organization's exposure to risk at acceptable levels. The objective of risk management is to reduce the effects of different kinds of risks related to a preselected domain to the level accepted by society. It may refer to numerous types of threats caused by environment, technology, humans, organizations and politics. On the other hand it involves all means available for humans, or in particular, for a risk management entity (person, staff, and organization). Credit risk management is crucial for the financial health of any institution and has gained focal importance after huge financial losses faced by some big international financial organizations. Thus this paper is an attempt to find the role of NPA in Credit risk management cycle.

It has been observed that when it comes to the study of Non- Performing Assets, co-operative banking sector is generally ignored which is as important as commercial banks in our country. Cooperative banks plays important role in Indian economy. Their functional structure is entirely demarcated from commercial banks. There are various types of cooperative banks (Fig.1.).

Thus, the researcher felt the need to study the causes of NPA and its role in Credit risk management with reference to Co-operative banks in Delhi.

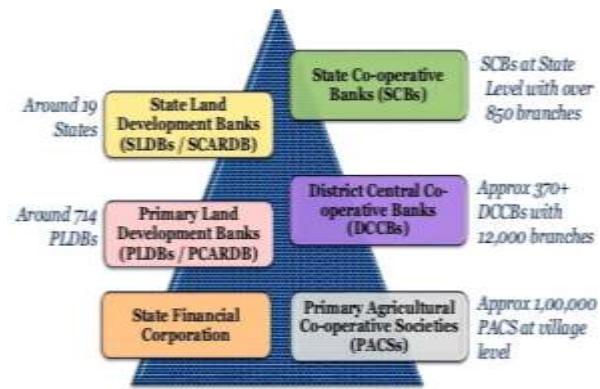


Fig. 1: Functional Structure of Cooperative Banks.

The study takes into account 15 cooperative banks where three branches of every bank were considered to study the causes of NPA. The banks selected for the study are Delhi Nagrik Sehkari Bank Ltd., Indraprastha Sehkari Bank Limited., Innovative Co-operative Urban Bank Ltd., Jain Co-operative Bank Ltd., Jamia Co-operative Bank Ltd., National Urban Co-operative Bank Ltd., Ramgarhia Co-operative Bank Ltd., The Citizen Co-operative Bank Limited., The Janata Co-operative Bank Ltd., The Kangra Co-operative Bank Ltd., The Keshav Sehkari Bank Ltd., The Khattri Co-operative Urban Bank Ltd., The Vaish Co-operative Adarsh Bank Ltd., The Vaish Co-operative Commercial Bank Ltd., The Vaish Co-operative New Bank Ltd. Delhi.

The study is based on primary data. An exploratory study, it primarily highlights the causes of NPA in cooperative banks during appraisal, sanction and disbursal and post disbursal stage. Primary data was collected with the help of a structured standard questionnaire. The primary Data was collected from Branch managers; zonal heads, department heads were the major respondents. Data collected have been analyzed with the help of Friedman test in order to study the most important causes of non-performing assets in banks as perceived by the cooperative bankers.

Objectives and Methodology

Some of the underlying objectives of the study are as follows.

1. To discuss the theoretical framework of Non-Performing Assets in cooperative banks in Delhi.
2. To understand the causes of NPA during appraisal, sanction and disbursal and post disbursal stage at the micro level in cooperative banks in Delhi.
3. To understand the Role of NPA in Credit Risk Management cycle in cooperative banks in Delhi.

Findings

1. Appraisal Stage:

The primary data was analyzed especially for appraisal stage. For statistical analysis, Friedman's Chi-Square test was conducted to find if there is any significant role of Credit Appraisal Stage in NPA.

Variables & Measurement

Respondents of Cooperative Banks were offered 13 common causes of NPA during appraisal stage and were asked to tell the extent to which they agree or disagree over these causes being prominently responsible for NPAs using a 5- point Likert scale (5= Strongly Agree, 4= Moderately Agree, 3= Undecided, 2 = Moderately Disagree, 1= Strongly Disagree). Level of Significance: $\alpha = 0.05$ was maintained throughout the study.

Hypothesis

H₀: There is no difference in the importance that the Cooperative Banks attach to the causes of NPA during Appraisal Stage.

H₁: There is significant difference in the importance that the Cooperative Banks attach to the causes of NPA during Appraisal Stage.

Friedman's Mean Analysis

S.No.	Parameters	Mean Rank
1	Submission of unrealistic project by the borrower.	8.28
2	Deliberate attempt of loose appraisal.	2.35
3	Lack of critical presentation appraisal.	7.31
4	Preparation of incorrect loan repayment schedule activity.	6.38
5	Incorporation of improper assessment of experience of the borrower or to pursue his capacity or the business.	7.61
6	Non-Availability of reliable market to study to the credit officer.	7.34
7	Reliance on provisional/ unaudited data as submitted by the borrower to Bank.	5.67
8	Lack of network/ information system amongst branches/ banks enabling borrowers to enjoying banks funds from more than one bank.	5.28
9	Non-availability of skilled/trained staff in credit department.	5.31
10.	Absence of right to select good borrowers by the credit department.	1.68

11	Fear of staff accountability on account turning NPA in future in the mind of credit officer at the time of appraisal.	6.97
12	Fraudulent approach of borrowers.	9.54
13	Fraudulent and irresponsible attitude of bank officials.	1.59

S.No.	Test Statistics	
1	N	50
2	Chi-square	184.214963
3	Df	12
4	Asymp. Sig.	.000

Friedman Test Observation: $\chi^2(12)=184.214963$, P=0.0245, N=50

Inference

Since the *P* value is less than level of significance (0.05). The null hypothesis is rejected. And it is therefore concluded that there is significant difference in the importance cooperative banks attach to the causes of NPA. We refer to the table ranks to understand the most prominent causes. Fraudulent approach of borrowers (9.54) is the strongest cause of NPA as perceived by cooperative banks followed by Submission of unrealistic project by the borrower (8.28), Incorporation of improper assessment of experience of the borrower or his capacity to pursue the business activity (7.61), Non availability of reliable market study to the credit officer (7.34) and so on. Thus the study concluded that fraudulent approach of borrowers in the ways possible is main causes of NPA in Cooperative banks in Delhi.

2. Sanction and Disbursal Stage

Primary data was collected for NPA during Sanction and Disbursal Stage of any credit given by cooperative banks in Delhi. Collected data was statistically analyzed by Friedman's Chi-Square test to study if there is any significant difference in the importance of Cooperative banks attach to causes of NPAs during the Sanction & Disbursal Stage.

Variables & Measurement

Respondents of Cooperative Banks were offered 07 common causes of NPA during Sanction & Disbursal stage and were asked to tell the extent to which they agree or disagree over these causes being prominently responsible for NPAs using a 5- point Likert scale (5= Strongly Agree, 4= Moderately Agree, 3= Undecided, 2 = Moderately Disagree, 1= Strongly Disagree).

H₀: There is no difference in the importance that the Cooperative Banks attach to the causes of NPA during Sanction & Disbursal Stage.

H₁: There is significant difference in the importance that the Cooperative Banks attach to the causes of NPA during Sanction & Disbursal Stage.

Friedman's Mean Ranks

S.No	Parameters	Mean Rank
1	Indulgent approach to family or group connection or long standing relationship than to the project viability.	4.68
2	Political interference i.e. pressure to sanction loan.	3.28
3	Political favoritism to particular borrower in order to please politicians.	3.05
4	Undue delay in decision making in sanction of loan.	4.55
5	Undue delay in disbursements of credit facilities.	4.08
6	Disbursement of loan before the compliance of terms and conditions of sanction.	3.31
7	Incomplete and defective legal documentation.	4.09

S.No.	Test Statistics	
1	N	50
2	Chi-square	28.614
3	Df	6
4	Asymp. Sig.	0.00189

Friedman Test analysis: Observation: χ^2 (6)=28.614, P=0.0024, N=50

Inference

Since the *P* value is less than level of significance (0.05). The null hypothesis is rejected. And it is therefore concluded that there is a significant difference in the importance cooperative banks attach to the causes of NPA. We refer to the table ranks to understand the most prominent causes. Indulgent approach to family or group connection or long standing relationship than to the project viability (4.68) is the strongest cause of NPA as

perceived by cooperative banks followed by , Undue delay in decision making in sanction of loan (4.55), Incomplete and defective legal documentation (4.38), Undue delay in disbursements of credit facilities (4.08) and so on.

3. Post Disbursal Stage

This stage is a crucial stage in NPA accumulation in any banking system. Researcher collected primary data for this purpose. Collected data was analyzed by Friedman's Chi-Square test to study if there is difference in the importance Cooperative banks attach to causes of NPAs during the Post Disbursal Stage.

Variables & Measurement

Respondents of Cooperative Banks were offered 07 common causes of NPA during Post Disbursal stage and were asked to tell the extent to which they agree or disagree over these causes being prominently responsible for NPAs using a 5- point Likert scale (5= Strongly Agree, 4= Moderately Agree, 3= Undecided, 2 = Moderately Disagree, 1= Strongly Disagree).

Hypothesis

H₀: There is no difference in the importance that the Cooperative Banks attach to the causes of NPA during Post Disbursal Stage.

H₁: There is significant difference in the importance that the Cooperative Banks attach to the causes of NPA during Post Disbursal Stage.

Friedman's Ranks

S. No.	Parameters	Mean Rank
1	Unavailability of audited financial statements in time.	4.28
2	Non-submission of stock and other required periodical statements by the borrowers.	5.35
3	Negligent approach by the bank officials in regards to inspection of stock.	3.01
4	Absence of effective monitoring.	4.68
5	Lack of close supervision of loan account.	4.82
6	Delayed detection of warning signals.	4.34
7	Delay in initiating remedial measures and actions.	3.99

S.No.	Test Statistics	Statistics value
1	N	50
2	Chi-square	38.1274
3	Df	6
4	Asymp. Sig.	0.0143

Friedman Test Observation: $\chi^2(6)=38.1274, P=0.0143, N=50$

Inference

Since the *P* value is less than level of significance (0.05). The null hypothesis is rejected. And it is therefore concluded that there is a significant difference in the importance cooperative banks attach to the causes of NPA. We refer to the table ranks to understand the most prominent causes. Non submission of stock and other required periodical statements by the borrowers (5.35) is the strongest cause of NPA as perceived by cooperative banks followed by Lack of close supervision of loan account (4.82), Absence of effective monitoring (4.68) and Unavailability of audited financial statements in time (4.28) and so on.

Conclusion

NPA is measured as an important parameter to judge the reliability of banking industry. A high level of NPAs suggests a large number of credit defaults that affect the profitability and liquidity of banks. The NPA growth involves the necessity of provisions, which poorly affects the banks and its stakeholders. Identifying the causes of loans turning bad during numerous stages of disbursement of credit facilities are therefore significant for a banker.

Thus in a nut shell, it is concluded that sound appraisal and due diligence must be taken by the branch managers before sanctioning the loans to clients and a proper backcheck of their fraudulency must be thoroughly done. Effective post disbursal monitoring and control will also enhance the creditability and soundness of the banking sector.

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