

Role of NPA Provisions in Financial Soundness and Profitability: A study on Primary Co-operative Agricultural and Rural Development Banks in Kollam District, Kerala

Jincy R Jerome¹ and Asha R Nair²

Abstract

Primary Co-operative Agricultural and Rural Development Banks (PCARDBs) means a society has an area of operation confined to a taluk and the principal object of which is to provide long-term credit for agricultural and rural development. One of the dangerous problems faced by co-operative banking is the inability of the borrower to repay their overdue interest and principal, leading to Non-performing Assets (NPA). The presence of NPA had an adverse effect on the profitability and existence of PCARDBs, but they are still surviving with the help of provisions created against NPA. Provisioning means the portion of income set aside by the bank to meet contingent losses that may arise in the event of non-recovery of loans. By analysing the data collected from the financial statements of the six PCARDBs in Kollam district, it can be understood that the growth in NPA involves the necessity of provisions which bring down the overall profitability of the bank. But if the banks are capable to create such provisions from net profit, it helps to maintain the financial soundness of banks. The study is based on the data collected from financial statements of six PCARDBs in Kollam District and the results show higher provisioning for overdue which results net loss in the financial statements of banks.

Keywords: co-operative banks, non-performing assets, provisions, Primary Co-operative Agricultural and Rural Development Banks.

Introduction

Co-operative banks are the financial entities organized by the members under the provisions of the co-operative societies act of the states united voluntarily to meet their short-term and medium term and long-term financial requirement (R.Gopakumaran Nair, N.J Shaji, 2019). They are registered under the Co-operative Societies Act, 1912 and they are regulated by RBI under the Banking Regulation Act, 1949 and the Banking Laws (Application to Co-operative Societies) Act, 1965(R. Gopakumaran Nair, N.J Shaji, 2019). A two-tier federal structure is prevailing in Kerala

state with State Co-operative Agriculture and Rural Development Bank at Apex level and Primary Agriculture and Rural Development Banks (PCARDBs) at grass root (taluk) level with the principal object to provide long term credit for agricultural and rural development (R.Gopakumaran Nair, N.J Shaji, 2019). These banks are only permitted to mobilize fixed deposits, and NABARD is the main source for finance and refinance. Presumptive value is the method of valuation adopted by PCARDBs in advancing long-term loans. Valuation is made up to four lakhs by the supervisor of the bank, four lakhs to eight lakhs by the Agricultural Officer and above eight lakhs by The Valuation

¹ Research Scholar, S D College, Alappuzha-690104

² Assistant Professor, N S S College, Pandalam

Officer in the rank of Assistant Registrar from Co-operative department. One of the vital problems faced by co-operative banking is the default in the payment of principal or interest by the borrower, leading to Non-performing Assets (NPA). The profitability of the banking sector depends on the recovery of loans on time which are disbursed to different sectors (Kiran & Jones, 2016). The banks should give more emphasis on recovery measures since the recovered amount from these NPA accounts directly contribute to the total profit of the banks as it was already provisioned by the banks according to the banking norms (Vishnu & Selvanayaki, 2018). The growth rate of PCARDBs was reasonable and satisfactory in terms of total membership and there is a negative growth rate in case of recovery of loan (Raveesha et al., 2015). The provisions should be made on the basis of classification of assets based on the period for which the assets has remained non-performing or overdue as also the availability of security and its realisable value (Thapa & Malilni, 2016). The major findings of the study conducted by Mitra (2012) on NPA management of Urban Co-operative Banks includes the bank following conservative credit policy and the interference of politicians in the organisation, lack of professional management and also the

poor resource base are the major reasons of increase in NPA. If the bank has not enough provisions against NPA and they are able to recover from defaulters, which leads to rise in gross NPA and low shareholders risk ratio denotes that the bank has failed in making provisions against NPA (Mishra, 2017). Many researchers have tried to analyse the NPA and profitability of various banks, but studies focusing on NPA provisions of PCARDBs have not been conducted yet. Therefore, an attempt has been made through this paper to study the role of NPA provision in the financial soundness and profitability of PCARDBs in Kollam district, Kerala.

Asset classification

Performing assets (Yielding assets) – It includes standard assets and stressed assets and non-overdue accounts, plus accounts overdue but not classified under NPA.

Non-Performing Assets (Not Yielding/ Ceased to yield income) – Accounts in which interest and / principal installment remain unpaid for a period of over 90 days in other loans and 360 days in direct agriculture loans. NPA is further classified into three types based on the age of overdue and recoverability. Substandard asset, Doubtful asset and Loss asset.

Table 1: Classification of assets

Assets	Agricultural loan	Non- agricultural loan	Provisioning
Performing assets (standard and stressed)	Overdue above 360 days to six months	Overdue upto 90 days	0.25%
Sub standard	361 days – 36 months	91 days – 36 months	10%
DA 1	36 – 48 months	36 – 48 months	20%
DA 2	48 – 72 months	48 – 72 months	30%
DA 3	Above 72 months	Above 72 months	50%
Loss assets	Irrecoverable		100%

Source: Secondary data

(DA – Doubtful Assets)

$$NPA = \text{Substandard amount} + DA\ 1 + DA\ 2 + DA\ 3 + \text{Loss Asset}$$

$$\text{Gross NPA}\% = \frac{\text{Total Impaired Asset}}{\text{Total Loan Outstanding}} \times 100$$

Objectives of the study

- To analyse NPA provisions and profitability of PCARDBs in Kollam district, Kerala.
- To understand the role of NPA provisions

- in the financial soundness of the bank.
- To study the trends of gross NPA from March 2017 to March 2020.

applicable to any other type of cooperative banks.

Methodology

Limitations of the study

- The study is limited to the functions of six PCARDBs in Kollam District (Kerala).
- The study of Non-performing Assets and its provisions is done on the basis of loans and advances outstanding and interest due on loan of PCARDBs.
- The result of the study may not be

There are six PCARDBs in Kollam district. Secondary data relating to NPA and its provisions were collected from the financial statements of the six PCARDBs in Kollam District from March 2017 to March 2020 studied and tabulated for the study.

Analysis and Discussion

Role of NPA provisions in Financial Soundness and Profitability

Table 2
Analysis of Gross NPA (Amount in lakhs)

Particulars	Gross NPA			
	MARCH 2017	MARCH 2018	MARCH 2019	MARCH 2020
PCARDB Sasthamcotta	494.31	540.43	540.43	726.70
PCARDB Pathanapuram	210.65	163.20	185.19	265.44
PCARDB Kollam	536.42	585.28	726.80	864.68
PCARDB Punalur	263.06	303.01	363.92	533.40
PCARDB Kottarakkara	724.21	817.14	1002.96	425.22
PCARDB Karunagapally	410.59	420.48	421.68	476.26

Source: Financial statements of concerned banks

The table 2 shows the gross NPA of PCARDBs in Kollam district from the year 2017 to 2020 and it is clear that the Gross NPAs has been increasing year by year.

Analysis of NPA provisions and profitability (Amount in lakhs)

Table 3: *Sasthamcotta Primary Co-operative Agricultural and Rural Development Bank Q373*

Particulars	MARCH 2017	MARCH 2018	MARCH 2019	MARCH 2020
Loans and advances outstanding	8587.21	7937.79	7197.93	6749.52
Overdue loan	2747.84	2698.58	2163.76	2484.33
Provision for overdue loan	494.31	540.43	540.43	726.70
Interest due on loan	925.88	1034.91	1094.78	1190.47
Overdue interest	796.81	909.69	906.78	1095.08
Provision for overdue interest	796.81	909.69	906.78	1095.08
Net loss	717.00	854.22	845.95	1300.78

From the table 3 it is clear that the loans and advances outstanding is decreasing from 2017 to 2020. Net loss increasing year by year and full provision provided for overdue interest in the year 2020. The table reveals that the total provision (726.70 + 1095.08 = 1821.78 lakhs) is greater than the net loss in the year 2020, and the excess provision Rs. 521 lakhs indicate the financial soundness of the bank and it can achieve profit through the aggressive collection of overdue.

Table 4: *Pathanapuram Primary Co-operative Agricultural and Rural Development Bank Q995*

Particulars	MARCH 2017	MARCH 2018	MARCH 2019	MARCH 2020
Loans and advances outstanding	5993.75	6748.98	7661.40	8524.87
Overdue loan	408.05	310.40	339.05	457.30
Provision for overdue loan	210.65	163.20	185.19	265.44
Interest due on loan	436.99	370.19	377.19	516.92
Overdue interest	228.61	198.76	197.76	300.70
Provision for overdue interest	228.61	198.76	197.76	212.20
Net profit	1.59	1.23	4.42	1.86

The above table indicates that the loans and advances outstanding in 2020 increased as compared to previous years and a provision of Rs. 212.20 lakhs only have been created for overdue interest of Rs. 300.70 lakhs. If the bank will take this shortage in provision (Rs.88.50 lakhs) from the net profit of the year 2020, it will show a net loss in the corresponding year, which means the continued profit in financial statement not shows the actual financial soundness of the bank.

Table 5: Kollam Primary Co-operative Agricultural and Rural Development Bank Q167

Particulars	MARCH 2017	MARCH 2018	MARCH 2019	MARCH 2020
Loans and advances outstanding	9184.54	9918.42	9999.85	9430.58
Overdue loan	1102.08	1190.16	1385.58	1737.08
Provision for overdue loan	536.42	585.28	726.80	864.68
Interest due on loan	807.87	959.62	1196.44	1392.22
Overdue interest	488.99	772.93	1001.33	1185.58
Provision for overdue interest	488.99	772.93	613.06	917.51
Net loss	84.18	239.40	60.61	440.19

From the above table it is clear that the loans and advances outstanding is decreased in the year 2020 as compared to previous years. The table reveals that there is deficit in the provision for overdue interest (Rs. 268.07 lakhs) in 2020, if the bank adds this provision to net loss, it will increase the net loss to Rs. 708.26 lakhs which is less than the total provision and the bank can achieve profit through the aggressive collection of overdue.

Table 6 Punalur Primary Co-operative Agricultural and Rural Development Bank Q1644

Particulars	MARCH 2017	MARCH 2018	MARCH 2019	MARCH 2020
Loans and advances outstanding	7394.52	8099.24	8116.18	8272.21
Overdue loan	443.64	620.58	742.67	1268.34
Provision for overdue loan	263.06	303.01	363.92	533.40
Interest due on loan	692.88	701.22	738.85	1039.98
Overdue interest	407.10	417.79	463.44	631.46
Provision for overdue interest	362.08	417.79	417.79	631.46
Net Profit/Loss	4.72 (NP)	4.42 (NP)	2.67 (NP)	212.90 (NL)

The table shows an increasing tendency in loans and advances outstanding from 2017 to 2020. The bank created full provision for overdue interest in the year 2020 and showed a net loss after consecutive net profits in previous years. Total provision is greater than the net loss and which shows the financial soundness of the bank.

Table 7: Kottarakkara Primary Co-operative Agricultural and Rural Development Bank Q1511

Particulars	MARCH 2017	MARCH 2018	MARCH 2019	MARCH 2020
Loans and advances outstanding	14774.27	15330.46	15148.07	14512.47
Overdue loan	6057.34	6438.60	6704.67	7220.60
Provision for overdue loan	724.21	817.14	1002.96	425.22
Interest due on loan	1425.37	1729.41	2205.20	2439.01
Overdue interest	918.85	1338.75	1785.44	2164.98
Provision for overdue interest	918.85	1338.75	1078.54	1086.43
Net loss	238.46	496.07	221.95	1849.85

As compared to previous years, the table shows a decrease in loans and advances outstanding during the year 2020. There is a deficit in the provision for overdue interest (Rs. 1078.55 lakhs), and the total provision is less than the net loss in the year 2020. If the bank creates full provision, the loss will increase again. This bank is not in a good financial position due to ineffective financial management.

Table 8: Karunagappally Primary Co-operative Agricultural and Rural Development Bank Q467

Particulars	MARCH 2017	MARCH 2018	MARCH 2019	MAARCH 2020
Loans and advances outstanding	9760.51	9432.46	8887.47	8564.63
Overdue loan	2928.15	2947.64	3021.74	3168.91
Provision for overdue loan	410.59	420.48	421.68	476.26
Interest due on loan	557.40	610.23	650.51	714.70
Overdue interest	340.04	490.03	526.10	525.04
Provision for overdue interest	340.04	490.03	526.10	525.04
Net loss	206.89	218.63	182.56	178.76

The table 8 revealed that the amount of loans and advances outstanding were decreased from 2017 to 2020. The bank created full provision for overdue interest during the years. The total provision created is greater than the net loss, and it indicates the financial soundness of the bank, and it can achieve profit through the aggressive collection of overdue.

Conclusion

The money is locked up in Non-performing Assets, i.e., interest and principal are the main

source of the bank, and NPA is one of the most dangerous and important concepts of the banking system. If the NPA is not maintained properly, that is getting a serious effect on the profitability and existence of the bank.

Non-performing assets and the provisions of Primary Co-operative Agricultural and Rural Development Banks in Kollam District of Kerala are studied in detail for the given period of march 2017 to march 2020 on the basis of loans and advances outstanding and overdue loans to study gross NPA and

profitability of the banks. The above paper indicates that most of the PCARDBs in Kollam district are facing net loss due to NPA but they are still surviving with the help of provisions created for NPA. The existence of these banks is mainly rooted on the greater amount of provision created against NPA. If the bank fails to create adequate provision for NPA, it will lose financial soundness if it is in a position to earn net profit because the ultimate income of the bank is the interest.

Suggestions

The bank should maintain a proper recovery mechanism for the timely collection of overdue and for proper valuation and credit appraisal. Most of the PCARDBs are only focused on advancing loans. Alternative ways to increase profitability using miscellaneous income by the PCARDBs are effective fixed deposit mobilization and gold loan schemes and also earn income through rent by letting out the properties of bank.

Scope for further research

The study only focused on the relation between NPA provisions and the financial soundness of the bank and there is a scope for further on the basis of factors affecting NPA and its provisions in PCARDBs.

References

- ixambee. 2022. Did You Know: What is SMA, NPA, and Provisioning for NPA? | RBI Grade B 2020 Question. [online] Available at: <<https://www.ixambee.com/blog/what-is-sma-npa-and-provisioning-for-npa/>> [Accessed 18 July 2022].
- Kiran, K. P., & Jones, T. M. (2016). Effect Of Non Performing Assets On The Profitability Banks - A Selective Study. 5(2), 53–60.
- Mishra, U. M. (2017). A Study of Non-Performing Assets and its Impact on Banking Sector. *Journal for Research*, 03(01), 1–5.
- Mitra, A. (2012). Npa Management of Urban Co-Operative Banks - a Study in Hooghly District of West Bengal. *Voice of Research*, 1–6.
- R.Gopakumaran Nair, N.J Shaji, V. . A. (2019). *Basics of Co-operation*. Impress Publishers.
- Raveesha, S., Govindaraj, G., Ahmed, T., & ... (2015). Growth Rate Analysis of the Primary Co-operative Agriculture and Rural Development Bank (PCARDBs) in Karnataka, India. *Journal of Agricultural*, January. https://www.researchgate.net/profile/Raveesha_Siddaiah/publication/348590844_Growth_Rate_Analysis_of_the_Primary_Co-operative_Agriculture_and_Rural_Development_Bank_PCARDBs_in_Karnataka_India/links/600680fba6fdccdc86455cb/Growth-Rate-Analysis-of-the-Pri
- Thapa, B., & Malilni, D. (2016). Indian Streams Research Journal. *Monthly Multidisciplinary Research Journal*, VI(6), 1–5. <https://doi.org/10.9780/22307850>
- Vishnu, M. S., & Selvanayaki, S. (2018). A Comparative Analysis of Non-Performing Assets in Selected Co-operative Banks in Thrissur District, Kerala. *Madras Agricultural Journal*, 105(7–9), 352–355. <https://doi.org/10.29321/maj.2018.000159>