DECODING THE NPAS IN WORKING CAPITAL LOAN: A SURVEY

(With special reference to Urban Co-operative banking organizations' in selected districts of Odisha)

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ABSTRACT

Efficient financial resource management requires that funds deployed should give them good returns along with timely repayment of principal amount. Defaults limit the recirculation of funds there by upsetting the financial planning of banks. The present paper is an attempt to examine the causes of NPAs in working capital loans of Urban Co-operative banks. For this borrowers are surveyed through questionnaires made for the purpose, causes analyzed and suggestions made to overcome the problem. As per CMIE data for November 2010 the percentage of NPAs to total advances is 21.82%. This is substantial rise as compared to previous years.

***Keywords**: NPAs, Working Capital loan, Total Score, Ideal score & Least score*

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INTRODUCTION

The word NPA is not something new to the bankers. It is regular but disguised loan asset. As everyone knows, a portion of loan assets may become NPA. An asset becomes non-performing when it ceases to generate income for the bank. Prior to 31st March, 2004 a non-performing asset was defined as a credit facility in respect of which the interest or installment of principal has remained *past due* for a specified period of time which was four quarters. Due to the improvements in payment and settlement system, recovery climate, up gradation of technology in the banking system, etc, it has been decided to dispense with *past due concept*, with effect from March 31st 2004. Accordingly, as from the date, a non-performing asset (NPA) is an advance where:

- Interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of tern loans.
- The account remains out of order for a period or more than 90 days, in respect of an overdraft/ cash credit (OD/ CC).
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
- Interest and /or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose and
- Any amount to be received remains overdue for a period of more than 90 days.

WORKING CAPITAL

The concept of working capital is much confusing in the business circle. It is very unfortunate; there is much disagreement among financiers, accountants, businessmen and economists as to the exact meaning of the term working capital. According to few, working capital means current assets. For some others, it is an excess of current assets over current liabilities. Some authors prefer to call circulating capital in place of working capital. It is true that there is much disagreement as to the exact meaning of the term but both the concepts are useful in business. One may be termed as quantitative aspect and other, qualitative aspect of working capital. The concept of working capital is very important in every business because the term is commonly used for the capital required for day-to-day working. A business cannot invest whole of its capital in long term assets. It may be possible, the ratio of the fixed capital and working capital may differ for indifferent business depending upon its nature and volume but it is quite impossible to have no working capital to meet its day to day obligation.

The problems involved in managing the working capital are quite different from those in managing fixed capital because the fixed assets are acquired to retain them in the business over a period of time hence time factor is crucial as a decision variable. But as far as decision making process is concerned it is similar to long term capital as both entail an analysis of the effects of risk and profitability.

PERMANENT OR FIXED WORKING CAPITAL

It represents that part of capital which is permanently locked up in the current assets to carry out the business smoothly. This investment in current assets is of the permanent nature will increase as the size of business expands. Examples of such investments are – Investment required to maintain the minimum stock of raw materials, work-in-progress, finished products, loose tools and equipments. It also requires the minimum cash balance to be kept in reserve for the payment of wages, salaries and all other current expenditure throughout the year. It includes

- ✓ **Regular working capital**: It is the minimum amount of liquid capital needed to keep up the circulation of the capital from cash to inventories, to receivables and again to cash. This would include sufficient minimum bank balance to discount all bills, maintain adequate supply of raw materials.
- ✓ **Reserve margin or cushion working capital:** it is the excess over the needs or regular working capital that should be kept as reserve for contingencies that may arise at any time. These contingencies includes rising prices, business depression strikes, special operations such as experiments with new products etc

VARIABLE WORKING CAPITAL

This working capital changes with increase or decrease in the volume of business. It may also be subdivided into

- ✓ **Seasonal working capital**: The working capital required to meet the seasonal liquidity of the business is known as seasonal working capital
- ✓ **Special working capital**: It is that part of variable working capital which is required for financing the special operations such as extensive marketing companies, experiments with the products or method of production and carrying of special jobs etc.

NEED OR OBJECTS OF WORKING CAPITAL:

The need for working capital cannot be over emphasizes. Every business needs to some amount of working capital. The need for working capital arises due to the time gap between production and realization of cash from sales. There is an operating cycle involved in sales and realization of cash. There are time gaps in purchase of raw materials and production. Production & sales and sales with realization of cash. Thus, working capital is needed for the following purposes:

- ✓ For the purchase of raw materials, components and spares.
- ✓ To pay wages and salaries
- ✓ To incur day-to-day expenses and overhead costs such as fuel, power and office expenses.
- ✓ To meet the selling costs as packing, advertising etc.
- ✓ To provide the credit facilities to the customers.
- ✓ To maintain inventories of raw materials, work-in-progress, stores and spares and finished goods.

OBJECTIVE OF THE STUDY

- ➢ To study the factors responsible for NPA of working capital loan
- ➢ Studying the problem in relation to working capital loan
- ➢ To give suggestions to overcome the problem of NPA on working capital loans

RESEARCH UNIVERSE AND METHODOLOGY

With reference to the selection of the research universe the state of Odisha has been selected with specifications to the compulsions of the geographical territory, linguistic boundary, and administrative settlement commonness. Odisha is an Eastern Indian state, the state boundaries are on the Bay of Bengal Sea. South- Andhra Pradesh, West – Chhattisgarh and Jharkhand, North- West Bengal having a total area of 1,55,707 Square Kilometers with total population of 36,706,920 (as per Indian census survey-2001) , population density 236 per Square Kilometers, Sex Ratio 972 literacy rate of 63.61%. The state is comprising of 30 districts (Administrative Divisions) and 58 Sub-Divisions.

SAMPLING PLAN

In support to the objective of the research there is a primary research through questionnaire administration method in the field through stratified random sampling method covering the state through regional, geographical, economic, cultural, lingual and settlement wise and to analyze the data and derive results from it percentage method used. This method is easy to use and taken as suitable method to compare.

Area	*Questionnaire served*	*Response*	*Percentage response*
Khurda District	100	67	26.38
Puri District	100	54	21.26
Cuttack District	100	71	27.95
Ganjam District	100	62	24.41
	400	254	100

LIMITATIONS OF THE STUDY

- The survey is restricted to selected districts of Odisha.
- The sample is limited; it may not represent the view of all the borrowers of home loan
- The study conducted for the period of 3 months i.e.October2011-December2011, and not conducted for the extended period of time.

REVIEW OF LITERATURE

The academic literature has mostly dealt with determinants of banking crisis, which is the most severe consequence of bad loans in a banking system.

Gonzalez –Hermosillo (1999) analyzed the role of microeconomic and macroeconomic factors in five episodes of banking system problems in the US. The paper found that low capital equity and reserve coverage of problem loans ratio are the leading indicators of banking distress and failure[1]

Demirguc- Kunt and Detagiache (2000) employed a multivariate logic framework to develop an early warning system for banking crisis and a rating system for bank fragility[2]

Beck, Demirguc-Kent and Levine (2005) examined the inter link between the bank concentration and banking system fragility. The paper concluded that higher bank concentration is associated with lower probability of banking crisis. Moreover, institutions and regulations that facilitate bank competition are associated with less banking system fragility.[3]

Fernandez de Lis, Martinez-Pages and Saurina (2000) found that GDP growth , bank size and capital had negative effect on the NPAs while loan growth , collateral, net interest margin, debt equity , market power and regulation regime had a positive impact on NPAs[4]

Bloem and Gorter (2001), NPAs may be caused by wrong economic decisions or by plain bad luck.[5]

Rajaraman, Bhaumik and Bhatia (1999) and Rajaraman & Vasistha (2002) explained variations in NPAs across Indian banks through differences in operating efficiency, solvency and regional concentration.[6, 7]

Das and Ghosh (2005) studied the association between risk-taking and productivity using data from public sector Indian banks over the period 1995-96 to 2000-01. They documented that capital to risk-asset ratio and loan growths have significant negative effects on NPAs.[8]

In another exercise, Das and Ghosh (2003) studied the determinants of NPAs in Indian public sector banks and identified macroeconomic factors such as GDP growth and microeconomic factors such as real loan growth, operating expenses, and size as a main factors associated with NPAs.[9]

Ranjan and Dhal (2003) found that terms of credit and different measures of bank size also affect the level of NPAs.[10]

Westgaard (2001) has identified different financial variables as well as other firm characteristics affecting the default probability which identified in advance can help controlling the fresh accretions in NPAs.[11]

Mukharjee (2003), Sharma (2002), Srivastava (2001) and Klingebiel (2000) discussed the sustainability model of asset reconstruction companies to solve the problem of NPAs.[12, 13, 14 &15]

Das (1999) has compared the various efficiency measures of public sector banks by applying data envelopment analysis model and concluded that the level of NPAs has significant negative relationship with efficiency estimates. [16]

Verma (1999) has concluded that high level of NPAs lead to operational failure of the banks.[17]

Berger and Young (1997) has examined the relationship between problem loan and banks efficiency by employing Granger-causality technique and found that high level of problem loans cause banks to increase spending on monitoring, working out and /or selling off these loans and possibly become more diligent in administering the portion of their existing loan portfolio that is currently performing.[18]

Gupta (1997) has also concluded that NPAs affects the profitability of banks and leads to liquidity crunch and slow down in the growth in GDP etc.[19]

Kaveri (1995) has also examined the impact of NPAs on profitability by taking profit making and six loss making banks and concluded that loss making banks maintained higher NPAs in the loan portfolio which led them to show losses.[20]

Respondents' perception with regard to NPAs on working capital loan/ Hypothesis

To measure the perception level of the participants with regard to NPAs on working capital loan the various variables identified as willful default, unforeseen domestic problems, low income generation from project undertaken, misutilization of funds, dispute among partners/ distributors, inefficient management, business competition, marketing problems of the products, technology problem, lack of fund management expertise, lack of adequate capital, wrong identification of beneficiary, inaccurate pre-sanction security and appraisal, target oriented approach to lending by the banks, absence of credit information sharing among different financial institutions, delay in disbursement of credit facility, weak monitoring ,inadequate infrastructure facility, inadequate law to take inappropriate action and delay in project implementation. In this regard scores have been assigned as +3,+2,+1,0 and -1 for the responses of the respondents " Strongly agree", " Agree", " Neutral", " Disagree" and " Strongly disagree" respectively. Final scores for each feature are calculated by multiplying the number of response by the weights of the corresponding response.

CALCULATION OF RESPONDENTS' PERCEPTION: IDEAL AND LEAST SCORES

Ideal scores are calculated by multiplying the number of respondents in each category with (+3) and product with total number of attributes. Least scores calculated by multiplying the number of respondents in each category with (-1) and the product with number of attributes in the questionnaires.

Table-4: Ideal score and least scores

Category	*Equation*	*Ideal score*	*Equation*	*Least score*
Khurda District	20x3x67	4020	20x-1x67	-1340
Puri District	20x3x54	3240	20x-1x54	-1080
Cuttack District	20x3x71	4260	20x-1x71	-1420
Ganjam District	20x3x62	3720	20x-1x62	-1240

FINDINGS OF THE STUDY

Response of respondents

Variables	*Aggregate Score of the respondents*			
	Khurda District	*Puri District*	*Cuttack District*	*Ganjam District*
Willful default	152	147	189	145
Unforeseen domestic problems	142	131	160	126
Low income generation from proje undertaken	142	143	159	123
Misutilization of funds	159	125	172	132
Dispute among partners/distributors	137	126	160	147
Inefficient management	162	124	161	133
Business competition	130	131	157	127
Marketing problem of the products	137	135	144	125
Technology problems	143	121	153	137
Lack of fund management expertise	162	145	187	158
Lack of adequate capital	164	122	175	134
Wrong identification of beneficiary	137	123	157	134
Inaccurate pre-sanction security and appraisal	134	138	150	148
Target oriented approach to lending by th bankers	142	124	154	152
Absence of credit information sharing amor the financial institutions	140	120	173	140
Delay in disbursement of loan amount	150	126	171	127
Weak monitoring	157	126	169	131
Inadequate law to take appropriate action	141	121	146	126
Delay in project implementation	139	119	126	144
Government interference and its policy	135	127	140	129
Total score	2905 (72.26%)	2574 (79.44%)	3203 (75.19%)	2718 (73.06%)
Ideal score	4020	3240	4260	3720
Least score	-1340	-1080	-1420	-1240
Number of respondents	67	54	71	62

Source: Annexure A,B,C &D

INTERPRETATION

The total score for the respondents of Khurda District, Puri District, Cuttack District and Ganjam District are 2905, 2574, 3203 and 2718 respectively as against the ideal scores for the same are 4020, 3240, 4260 and 3720. However, in no case the total scores near to the least score. This shows the hypothesis which considered holds good. The percentages of total score to ideal score are more in case of the respondents of Puri District with 79.44% followed by Cuttack District with 75.19%, for Ganjam District it is 73.06% and same for the Khurda District it is 72.26%.

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Annexure-A(67)						
Variables	***Perception level of Khurda District respondents***					
	Strongly agree	***Agree***	***Neutra***	***Disagre***	***Strongly disagree***	***Score***
	3	***2***	***1***	***0***	***-1***	
Willful default	43	10	6	5	3	152
Unforeseen domestic problems	40	12	3	7	5	142
Low income generation from proje undertaken	39	13	5	4	6	142
Misutilization of funds	46	11	3	3	4	159
Dispute among partners/distributors	36	14	6	6	5	137
Inefficient management	49	9	2	2	5	162
Business competition	35	7	15	6	4	130
Marketing problem of the products	37	10	11	4	5	137
Technology problems	39	12	6	6	4	143
Lack of fund management expertise	51	6	2	3	5	162
Lack of adequate capital	50	8	2	3	4	164
Wrong identification of beneficiary	42	7	5	5	8	137
Inaccurate pre-sanction security ar appraisal	36	11	8	8	4	134
Target oriented approach to lendir by the bankers	40	10	7	5	5	142
Absence of credit information sharir among the financial institutions	38	13	6	4	6	140
Delay in disbursement of loan amount	44	8	5	7	3	150
Weak monitoring	47	11	0	3	6	157
Inadequate law to take appropria action	42	9	5	3	8	141
Delay in project implementation	41	6	10	4	6	139
Government interference and its polic	37	8	11	8	3	135

Source: Compiled from field survey

Annexure-B(54)						
Variables	***Perception level of Puri District respondents***					
	Strongly agree	***Agree***	***Neutra***	***Disagre***	***Strongly disagree***	***Score***
	3	***2***	***1***	***0***	***-1***	
Willful default	42	10	1	1	0	147
Unforeseen domestic problems	38	9	2	2	3	131
Low income generation from proje undertaken	44	6	1	1	2	143
Misutilization of funds	37	8	2	3	4	125
Dispute among partners/distributors	39	5	3	3	4	126
Inefficient management	36	7	5	3	3	124
Business competition	38	9	2	2	3	131
Marketing problem of the products	40	6	4	3	1	135
Technology problems	37	5	5	2	5	121
Lack of fund management expertise	43	8	1	1	1	145
Lack of adequate capital	38	4	3	6	3	122
Wrong identification of beneficiary	35	7	6	4	2	123
Inaccurate pre-sanction security ar appraisal	39	10	2	2	1	138
Target oriented approach to lendir by the bankers	33	11	4	5	1	124
Absence of credit information sharir among the financial institutions	35	8	3	4	4	120
Delay in disbursement of loan amoun	38	6	3	4	3	126
Weak monitoring	40	2	5	4	3	126
Inadequate law to take appropria action	37	5	4	4	4	121
Delay in project implementation	36	4	6	5	3	119
Government interference and its polic	37	5	8	2	2	127

Source: Compiled from field survey

Annexure-C(71)						
Variables	***Perception level of Cuttack District respondents***					
	Strongly agree	***Agree***	***Neutra***	***Disagre***	***Strongly disagree***	***Score***
	3	***2***	***1***	***0***	***-1***	
Willful default	54	13	2	1	1	189
Unforeseen domestic problems	48	10	3	3	7	160
Low income generation from proje undertaken	50	8	2	2	9	159
Misutilization of funds	48	13	4	4	2	172
Dispute among partners/distributors	43	14	6	5	3	160
Inefficient management	51	6	2	6	6	161
Business competition	47	5	10	5	4	157
Marketing problem of the products	40	11	8	6	6	144
Technology problems	42	9	12	5	3	153
Lack of fund management expertise	60	2	4	4	1	187
Lack of adequate capital	54	3	9	3	2	175
Wrong identification of beneficiary	49	5	6	5	6	157
Inaccurate pre-sanction security ar appraisal	41	12	8	5	5	150
Target oriented approach to lendir by the bankers	39	14	12	3	3	154
Absence of credit information sharir among the financial institutions	53	7	4	4	3	173
Delay in disbursement of loan amount	56	3	2	5	5	171
Weak monitoring	48	5	15	3	0	169
Inadequate law to take appropria action	39	11	11	6	4	146
Delay in project implementation	40	4	10	5	12	126
Government interference and its polic	41	8	7	9	6	140

Source: Compiled from field survey

Annexure-D(62)						
Variables	***Perception level of Ganjam District respondents***					
	Strongly agree	***Agree***	***Neutra***	***Disagre***	***Strongly disagree***	***Score***
	3	***2***	***1***	***0***	***-1***	
Willful default	45	6	2	5	4	145
Unforeseen domestic problems	41	3	5	5	8	126
Low income generation from proje undertaken	38	7	4	4	9	123
Misutilization of funds	42	5	3	5	7	132
Dispute among partners/distributors	47	4	2	5	4	147
Inefficient management	39	6	8	5	4	133
Business competition	37	5	10	6	4	127
Marketing problem of the products	36	11	3	4	8	125
Technology problems	40	9	4	4	5	137
Lack of fund management expertise	49	5	3	3	2	158
Lack of adequate capital	38	6	11	4	3	134
Wrong identification of beneficiary	43	5	2	5	7	134
Inaccurate pre-sanction security ar appraisal	47	3	4	5	3	148
Target oriented approach to lendir by the bankers	45	5	8	3	1	152
Absence of credit information sharir among the financial institutions	46	2	3	6	5	140
Delay in disbursement of loan amoun	42	3	2	8	7	127
Weak monitoring	38	10	2	7	5	131
Inadequate law to take appropria action	35	12	4	4	7	126
Delay in project implementation	42	9	2	7	2	144
Government interference and its polic	36	10	5	7	4	129

Source: Compiled from field survey