Analysis and Management of the Non Performing assets in Madhya Pradesh Financial Corporation
(2005-06 to 2010-11)

A

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CERTIFICATE

This is to certify that the work entitled *"**Analysis and Management of the Non Performing Assets in Madhya Pradesh Financial Corporation (2005-06 to 2010-11)**"* is a piece of research work done by ***Mrs. Neha Garg*** under my guidance and supervision for the degree of Doctor of Philosophy of Devi Ahilya Vishwavidyalaya, Indore (M.P.) India. That the candidate has put in an attendance of more than 200 days with me.

To the best of my knowledge and belief the thesis:

1. Embodies the work of the candidate herself.
2. Has duly been completed;
3. Fulfills the requirements of the ordinance relating to the Ph.D. degree of the University, and
4. Is up to the standard both in respect of contents and language for being referred to the examiner?

Date: 13.01.2016

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DECLARATION BY THE CANDIDATE

I declare that the thesis entitled "***Analysis and Management of the Non Performing Assets in Madhya Pradesh Financial Corporation (2005-06 to 2010-11)***" is my own work conducted under the supervisor of **Dr. Rajendra Sharma** at centre **P.M.B. Gujarati Commerce College**, approved by Research Degree Committee. I have put in more than 200 days of attendance with the supervisor at the center.

I further declare that to the best of my knowledge the thesis does not contain any part of any work which has been submitted for the award of any degree either in the University or in any other University/Deemed University without proper citation.

Besides this-

1. I have successfully completed the course work of one semester as per UGC- Regulation 2009 norms.

2. I have also given a pre-Ph-D. Presentation and successfully incorporated the changes suggested on the basis of feedback and comments received.

3. I have also published one research paper in a ISSN/referred journal from the research work of the thesis and has produced an evidence of the same in the form of acceptance letter/or the reprint.

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This is to certify that **Prof. Neha Garg, Assistant Professor, Annie Besant College, Indore (M.P.)** is registered as a Research Scholar in the recognized Research Centre of the College. According to new ordinance of Devi Ahilya Vishwavidhayala, Indore No. 18, a Pre-Ph.D Presentation (Viva-Voce) on topic **"ANALYSIS AND MANAGEMENT OF THE NON PERFORMING ASSETS IN MADHYA PRADESH FINANCIAL CORPORATION (2005-06 to 2010-11)"** was organized in our Research Centre of the College on **21-12-2015, Monday** at 11.00 AM. Her presentation was good.

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Ph.D. Course Work

Subject:- Commerce

Faculty:- Commerce

This is to certify that Ms./Mr. *Neha Garg* son / daughter / wife of *Mr.Rahul Garg* has successfully completed the Ph.D course work conducted at *School Of Commerce* from *January-2013* to *May-2013.* The Ph.D course work is as per UGC Regulation 2009 and Ph.D Ordinance of the University. The Credits and the grades earned by the candidate are as follows:

Sno	Course Title	Credits	Grade	Credits X Grade
1.	Research Methodology	5	B+	40
2.	Computer Applications	3	B+	24
3.	Review of Literature	3	B+	24
4.	Comprehensive Viva-Voce	4	C+	24
	Total	15		112.00

Semester Grade Point Average(SGPA): 7.47 Percentage : 70.85
(Percentage Marks =8.4 XSGPA+8.1)

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Place: Indore (M.P.) **Mrs. Neha Garg**

Date: 13.01.2016

PREFACE

After independence need was felt very strongly for the economic development of the country. The existing financial arrangement was incapable of coping with the burgeoning financial requirement of upcoming enterprises. The Indian capital market was ill equipped for providing the needs of long term finance. Then the government at the time adopted the concept of development banking and various all India level financial institutions have been established in various parts of the country.

All Indian financial institution could not fulfill the demands of the small and medium scale enterprises to some extent. In order to cope up with this problem Government decided to set up state financial corporation to cater to the financial requirement of the small and medium sized industrial concerns, particularly when normal banking accommodation is not available. At present 18 SFCs are there in India; MPFC is one of them.

MPFC plays an important role for the industrial development of the state. The corporation is engaged in providing financial assistance to various MSME as well as Commercial Real Estate (CRE) projects. The lending business by its very nature involves various risk such as credit risk, liquidity risk, interest risk, market risk, operational risk and management risk. Apart from these risks the very important risk is loan recovery. The sound financial position of a financial institution depends upon the recovery of loans or its level of Non-performing assets (NPAs).

The study "Analysis and Management of the Non performing assets in Madhya Pradesh Financial corporation (2005-06 to 2010-11)" presents the position of NPA in MPFC. The present study aims to analyzed the causes of NPA in MPFC and problem faced by MPFC due to NPA. The analysis of the NPA of MPFC is very important because, non performing assets not only affect the financial performance but credibility too.

This study is divided into seven chapters.

Chapter -1 provides brief knowledge about research methodology, objective of research, review of literature, scope and limitations of the study and statistical tools used for the study.

Chapter – 2 comprises a brief introduction of MPFC, establishment of MPFC, organization and management of MPFC, offices of Madhya Pradesh Financial Corporation, vision and mission of the Organization, objectives of MPFC, functions of MPFC, schemes of MPFC, departments of MPFC, sources of MPFC.

Chapter -3 deals with the brief introduction of NPA, origin of concept of NPA, meaning, definition, Indian economy and NPAs, Types of NPA, RBI norms for NPA has explained in brief.

Chapter -4 gives brief introduction of loans and advances in MPFC and detailed analysis of data collected done along with their interpretation on various aspects of the study like key operation area of MPFC, classification of loans and advances in MPFC, and position of NPA in MPFC etc.

Chapter-5 comprises causes or general reason for assets become NPA, reasons for emergence of NPA in the context of MPFC, impact of NPA and problems due to NPA in MPFC.

Chapter -6 gives brief introduction of Management of Non performing assets, recovery mechanism and management of NPA in MPFC has done.

Chapter-7 deals with core findings, conclusion of the research and constructive suggestion and scope for future research.

Bibliography discusses all the authors and their works which are duly acknowledged.

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CHAPTER -1

RESEARCH INTRODUCTION

Chapter - 1

Research Introduction

1.0 Introduction:-

Industrial development assumed significant importance in ensuring rapid growth of the underdeveloped and undeveloped countries. For the industrial development of any nation requires, among other factor, a well developed capital market with efficient financial intermediaries viz. Bank, Insurance companies, underwriting institution, investment trust, finance corporation etc that can channelize loan able funds into industrial investment.[1] In the success of industrialization, capital providing sources keeps specific place.

In today's competitive era, Finance is pre-requisite for all commercial and industrial activities. It is very essential for the establishment, organization & development of any business and industry. It may say that finance is the life blood of the Industry; no industry can survive in the absence of uninterrupted flow of finance. The finance and industry are the two sides of the same coin. The industrial development begins and new opportunities for investment are generated through finance.[2]

In order to provide medium and long-term credit to industrial unit, central Industrial Financial Corporation (IFCI) was set up under the Industrial Finance Corporation Act 1948. The main objective is to provide credit to those undertaking which fall outside the normal banking activity. The state governments also expressed their desire to set up similar corporations in the state to supplement the activities of the Industrial

[1] Ahuja, B.N., Mahinder.S, "Financial Management – Theories & Principles", pp. 306

[2] Raul. Rajanikanta, "Industrial Finance in India", pp.1

Financial Corporation. The main objectives of state governments shall be provide financial assistance to small and medium scale industries within the state but outside the activities of central financial corporation. The State Financial Corporation Bill passed by the both houses of parliament received the assent of the president on 31st October 1951. It came on the statute book as *"The State Financial Corporation Act, 1951."* [3]

The State Financial Corporation act 1951 empowered the each state and union territory to established State Financial Corporation with a view to provide financial assistance to small and medium scale industries. The area of operation of each State Financial Corporation (SFC) is within the state in which it established, but in some exceptional cases the activities may be extended to neighbor's state or union territory if there is no State Financial Corporation. (Maharashtra State Financial Corporation's activities extended to Goa, Daman & Diu). SFC provides loan to sole trading concern, partnership firm, private limited companies and public limited companies. But loan period is maximum up to 20 years. Besides providing the loan to small and medium scale organization SFC also engaged in the various activities to assist the entrepreneurs to undertake the programme of diversification, expansion, modernization etc. currently it also offering various facilities like

a) Consultancy, **b)** Merchant Banking, **c)** Equipment Leasing, **d)** Debenture trust ship etc. It acts as an agent of state government, central government, IFCI and any other financial institution if it became necessary.

At present there are 18 State Financial Corporations in India. Out of these 17 were set up under State Financial Corporations Act (SFCs) 1951. The Tamil Nadu Industrial Investment Corporation Ltd established in 1949 under the companies act as Madras Industrial Investment Corporation, also

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[3] http://www.osfcindia.com/download/sfcact1951.pdf

functions as SFCs.[4] Industrial development and SFCs are very close to each other and SFCs are playing an important role for overall industrial development of the country.[5]

The Madhya Bharat Financial Corporation came into existence on 1st July 1955 but later with the reorganization of the states it was known as Madhya Pradesh Financial Corporation.

Madhya Pradesh Financial Corporation incorporated in the year 1955, dated June 30, under the State Financial Corporation Act, 1951 (NO LXIII of 1951) it works under the control of the Board of Directors, consisting of representatives from State government, SIDBI, RBI, Scheduled Banks, Insurance companies, cooperative banks and other shareholders. It is the premier institution of the state engaged in providing financial assistance and related services to small and medium sized industries. Also it is registered as category I merchant banks with Securities Exchange Board of India and set up a separate merchant banking division in the name of MPFC capital markets.[6] It offers various types of financial schemes and provides loan to sole trading concern, partnership firm, private limited companies and public limited companies etc. so that every organization can access their financial assistance as per their needs and requirement. Their main objective is to provide financial assistances to Micro, Small and Medium Enterprises (MSMEs).

SFC's plays an important role for the industrial development of the country. The corporation is engaged in providing financial assistance to various MSME as well as Commercial Real Estate (CRE) projects. The lending business involves various types of risk such as credit risk, liquidity

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[4] Desai Vasant,"The Dynamics of Entrepreneurial Development and Management", Himalaya Publishing House. pp.510

[5] Kanrar Susanta, "State Financial Corporation and Industrial Development: A study with special reference to Rajasthan Financial Corporation", International Journal of Research in Computer Application & Management, Vol No.2, ISSUE No.8 (August). pp.112-117

[6] www.mpfc.org

risk, interest risk, market risk, operational risk and management risk. Apart from these risks the very important risk is recovery of loan and dues. The sound financial position of a financial institution depends upon the recovery of loans or its level of Non-performing assets (NPAs).

Non-performing assets (NPAs) has came to light as an alarming threat to the banking industry since over a decade in our country. It sends disturbing signals on the sustainability of the affected banks. Hence, it has been considered to be most challenging problem being faced by the banks and financial sectors. The positive results of the chain of measures affected under Banking reforms by the Government of India and RBI in terms of the two Narasimhan Committee Reports in this contemporary period have been neutralized by the ill effects of this surging threat.[7]

NPAs are those loans given by a bank or financial institution where the borrower defaults or delays in interest or principal repayment. For a financial institution, NPA or bad debts is usually a loan that is not producing income and all those assets which generate periodical income are called as performing assets. In other words, when a borrower could not pays their dues in the form of principal and interest for a period of 180 days then assets is classified as nonperforming assets. However, with effect from March 2004, default status would not be given to a borrower if dues are not paid for 90 days. However, if any credit facility given by financial institution to a borrower becomes Non performing, then the financial institution will have to treat the credit facilities granted to that borrower as non performing without having any regard to the fact that there may still exist certain credit having performing status. [8]

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[7] Krishna Chaitanya V."Causes for non performing assets in public sector banks" available at http://www.indianmba.com/Faculty_Column/FC56/fc56.html

[8] Rani Chanchal, "Evalution of various techniques used by the Public sector bank for the management of Non performing assets." International Journal of Research in Economics and Social Science, Vol-3,Issue 1(Jan. 2013), pp. 46 - 47

With an aim of moving towards the international best practices and ensuring greater transparency, a standard criterion of '90 days' overdue norm was fixed for identification of NPA from the financial year ending March, 2004 in the Indian financial system. Thus, as per present convention, a non-performing asset refers to a loan or an advance where:

- in respect of a term loan, interest and/or installment of principal remain overdue for a period of more than 90 days;
- in respect of an Overdraft/Cash Credit (OD/CC),the account remains 'out of order' for a period of more than 90 days;
- in the case of bills purchased and discounted, the bill remains overdue for a period of more than 90 days;
- in the case of an advance granted for agricultural purposes, interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years and;
- in respect of other accounts, any amount to be received remains overdue for a period of more than 90 days.

A loan granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons, with effect from 30 September 2004.[9]

A loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season, with effect from 30 September 2004.[10]

"Out of Order" status:-

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases, where the outstanding balance in the principal operating

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[9] Agrawal O.P., "Modern Banking of India", Himalaya Publishing House, pp.- 279

[10] Pathak, Bharti V, "The Indian Financial System Market, Institutions and Services" Second Edition pp. 600

account is less than the sanctioned limit/drawing power, but there no credits continuously for 180 days (to be reduced to 90 days, w.e.f. 31 March 2004) as on the date of balance sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Overdue:-

Any amount due to the bank under any credit facility is'overdue' if it is not paid on the due date fixed by the bank.[11]

Non-performing assets (NPAs) are those assets that do not produce any income for the banks or financial institution. It has ever been a major concern for the bank, promoters and Government. Management of NPAs has been a significant aspect for financial institution or corporation and has always drawn the attention of their officers. Accumulation of NPAs in the Balance sheet of a financial corporation always affects the profitability and solvency of a corporation.

MPFC plays an important role in the development of industry in the state of Madhya Pradesh. MPFC provides loan on large scale and some part of these loans cannot be recovered, so it becomes Non Performing Assets. NPAs adversely influence undoing activity of financial corporation as non recovery of loan installment and interest on the loan portfolio negates the credit dissension process. Non recovery of loans also hurts the profitability of banks or financial corporations. Besides, Banks or financial corporations with high level of NPA's have to carry more own funds by way of capital & create reserve and provisions and to provide cushion for the loan losses. NPA is a double edged weapon, these make two pronged attack on the bottom lines of banks or financial corporations: One interest applied on such

[11] Bansal, Anshu, "A study on Recent Trends in Risk Management of Non performing Assets by Public Sector Banks in India." Journal of Information & Operation Management, Vol.-3, Issue 1, 2012, pp. 51

assets is not taken into account because such interest is to be taken into account only on its realization. Two banks or financial corporation have to make provisions for the NPA's from the income earned by them on Non Performing Assets [12]. Presently high level of NPA's makes financial institutions or Corporations forgive leading ultimate to their failure. Due to accumulation of high NPA, MPFC was facing acute shortage of funds to meet its repayment obligation increasing business value requirement of funds for retiring high interest bearing bonds & non availabilities of funds. This is a matter of great concern, therefore Management of NPAs assumes significant for credit management of financial corporation.

1.1 Review of literature:-

Review of literature is important part of the scientific research it enables the researcher to understand the different aspects of the study or the problem to be investigated. It is also helpful to review all the available relevant literature in order to design the study in a meaningful way. The topic of my study is "Analysis and Management of the Non performing assets in Madhya Pradesh Financial Corporation". On this background a brief review of literature on Non performing assets and State Financial Corporation is taken in the following pages. So, review of literature can be divided into two parts i.e.

a. Review of literature related to Non performing assets

b. Review of literature related to State Financial Corporation

a. Review of literature related to Non performing assets:-

Following are the review related to Non performing assets are:

[12] Rani Chanchal, "Evalution of various techniques used by the Public sector Bank for the management of Non performing assets." International Journal of Research in Economics and Social Science, Vol-3,Issue 1(Jan. 2013).ISSN- 2249-7382. pp. 46 -47

1. Article issued by RBI in RBI Bulletin (1999), in the year 1999, the Reserve Bank of India has conducted a study on the banks. For this study they cover 800 top NPA accounts in 33 banks to determine the contributing factors for the high level of NPAs in such banks (RBI Bulletin, July 1999). In this study it has been found that the proportion of problem loans in case of Indian banking sector always been very high. The problem loans of these banks, in fact, formed 17.91 percent of their gross advances as on March 31, 1989. This proportion did not include the amounts locked up in sick industrial units. Therefore, the proportion of problem loans indeed was higher. However, after introduction of prudential norms the NPAs of Indian Banks declined to 17.44 percent as on March 31, 1997. In case of many of the banks, the decline in ratio of NPAs was mainly due to proportionately much higher rise in advances and a lower level of NPAs accretion after 1992.

It has been observed from the study that the major factors which were responsible for accounts became NPA are diversion of funds for expansion, diversification, modernization, undertaking new projects and for helping associate concerns. This is coupled with recessionary trend and failure to tap funds in the capital and debt markets, business failure (product, marketing, etc.), strained labor relations, inappropriate technology/technical problems, inefficient management , natural calamities, product obsolescence, price escalation, recession input/power shortage, accidents, Government policies like changes in excise duties, pollution control orders, etc. The RBI report concluded that in banking sector, reduction of NPAs should be treated as a national priority issue to make the Indian banking system stronger, resilient and geared to meet the challenges of globalization.[13]

[13] www.rbi.org

2. Bidani S.N. (2002), in his book titled, "Managing Non performing asset in Banks" stated that NPA are the smoking gun which threatens the stability of Indian Banks. This is a definitive book. In this book, the author highlighted that banks are concerned with their heavy NPA portfolio which erodes their profitability and are taking all possible steps to reduce NPA. Banks have achieved a reasonable degree of success to bring down their existing NPAs, but due to slippage of standard accounts into NPA category the overall position of the banks continued to deteriorate. He observed that the main factor responsible for rise in NPA includes willful defaults by the borrower, competition faced by local industries from multinational companies, slump in capital market, slow economic & industrial growth, financial indiscipline, lack of support to the borrowers from the banks at the time of the need etc. In this book the author has made an effort to deal with the practical aspect of the problem of management of NPAs in it's entirely, right from stage of their identification till the recovery of dues in such accounts.[14]

3. Namboodiri T.C.G. (March 2002), conducted a study on "NPA – prevention is better than cure". In his study, he pointed out the problem of NPA in Indian Banks. He observed about some important basic points such as 5Cs (character, capital, capacity, conditions, collateral), 6 Ms (man, money, machine, material, market, men) & 7 Ps (product, project, purpose, place, people, policies, profit) while appraising a credit proposal that a banker has to apply. He concluded that these 18 points plays a significant role in credit risk management & it can be used for SWOT analysis of the venture before financing.[15]

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[14] Bidani S.N., "Managing Non performing assets in Banks", Vision Book, New Delhi, 2001.

[15] Namboodiri T.C.G., "NPA – Prevention is better than cure", Vinimaya National Institute Of Bank Management, Vol. XXII (3):pp 19-23

4. Jain Vibha (2007), in her book titled "Non-performing Assets in Commercial Banks" examined the various aspects relating to NPAs in commercial banks for the period of 1997 to 2003. She found that in Public sector banks the problem of gross & net NPA is more acute. It was found from the analysis that the amount of gross & net NPA has increased in the new private sector banks & foreign banks during the period of study. The study concluded that new private sector banks & foreign banks failed to prevent the fresh generation of NPAs in the period of study where as PSBs & old private sector banks were able to reduce it.[16]

5. C. Chandrakant (2007), conducted a study on "Non performing assets in Karnataka State Financial Corporation -A case study of Gulbarga Division". The main objective of his research study was to assess the impact of NPA on KSFC. He suggested from their study that better credit risk management is an effective tool in resolving the issue of NPAs.[17]

6. Karunakar M., Vasuki K.and Saravanan S., (2008), in their study titled on "Are non - Performing Assets Gloomy or Greedy from Indian Perspective? " described the concept of NPA, the factors contributing to NPA, the magnitude of NPA, reasons for high NPA and impact of NPA on Indian banking operations. They observed the problem of losses and lower profitability of public and private sector banks. They also discussed in their paper about capital to risk weighted assets ratio of public sector banks, management of credit risk, consequences of NPA and measures to control the menace of NPAs. NPAs and liability mismatch in Banks and financial sector depends on how various risks are managed in their business. It was

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[16]. Jain Vibha, "Non-performing Assets in Commercial Banks", Regal Publications, New Delhi, 2007. Taken from Jagdish R. Raiyani and Gaurav Lodha, " Evolution of Non Performing Asset: An empirical analysis" Indian Journal of Applied Research , Vol. 1, Issue 3, December 2011.

[17] Taken from: Hosmani.A.P. and Jagadish Hudagi, "Unearthing the Epidemic Of Non-Performing Assets - A Study with reference to Public Sector Banks in India", International Journal of Multidisciplinary Research, Vol.1 Issue 8, December 2011. pp.447-459.

found from the study that the problem of NPAs can be tackled by proper credit assessment and risk management mechanism. They also suggested that it is better to avoid NPAs at the nascent stage of credit consolidation by putting in place of rigorous and appropriate credit appraisal mechanisms.[18]

7. Goyal Kanika (2010), in her paper titled "Empirical study on Non-Performing Assets Management of Indian Public Sector Banks" described the management of NPAs by Indian public sector banks, trends of NPAs; quality of assets; health of several loan assets; sector wise NPAs etc. during the period of 7 years from 2002-03 to 2008-09. Different types of statistical tools like descriptive statistics, correlation, regression analysis, one-way ANOVA, and post-hoc Turkey HSD procedure were applied for testing the hypothesis. From the analysis, it was found that increased in Gross and Net NPAs in absolute terms and enhanced asset quality of banks. It also found that the assets have proficiently managed by the public sector banks. The researcher observed through their study that NPA's is increased in the agriculture sector is a matter of great concern. The study concluded that the prudential and provisioning norms and other initiatives taken by regulatory bodies has pressurized banks to improve their performance, and consequently resulted into decreases of NPA and it also improve the financial health of the Indian banking system.[19]

8. Prasad Bhavani G.V. & Veena (2011), conducted a study on "NPAs reduction strategies for commercial banks in India". In their study they described the concept of NPAs, magnitude of NPA and major causes for an account becoming non-performing and strategies for managing NPA in

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[18] Karunakar M., Vasuki . and Saravanan S., "Are Non - Performing Assets Gloomy or Greedy from Indian Perspective?" Research Journal of Social Sciences, Vol.3, 2008, pp.4-12.

[19] Goyal Kanika, "Empirical Study of Non-Performing Assets Management of Indian Public Sector Banks" Asia Pacific Journal of Research in Business Management, Vol.1, No.1, October 2010., pp.114-131.

Indian banks. They concluded that the problem of NPA can be tackled only with proper credit assessment and risk management mechanism.[20]

9. Hosmani A.P. and Jagadish Hudagi (2011), in their study titled "Unearthing the epidemic of Non-performing Assets -A study with reference to Public Sector Banks in India" described the concept of Non performing assets, causes of the problem and its remedial measures in public sector banks in India during the period of five years. The study is empirical and descriptive in nature. Different statistical tools were applied for analysis of data and testing the hypothesis like Average, ANOVA, correlation and comparative percentage analysis. It has been observed that there was a lack of commitment towards the work by the bank employees & political involvement in the administration. From the analysis, it was found that the categories of NPAs as a percentage to loan assets are recorded a decline trend over the study period. It is also found that there is slight improvement in the asset quality reflected by decline in diverse NPA percentage. The study concluded that NPA is an important parameter for assessing financial performance of banks in terms of profitability, liquidity and economies of scale in operation and banks have to take timely action against degradation of good performing assets.[21]

10. Kaur Kamalpreet and Singh Balraj (2011), in their paper titled "Non-Performing Assets of Public and Private Sector Banks (A Comparative Study)" described the meaning of NPAs, factors contributing to NPAs, magnitude of NPAs, reasons for high NPAs and their impact on Indian banking operations. They consider that the Non-performing assets

[20] Prasad Bhavani G.V. & Veena D.(2011), " NPAs reduction strategies for Commercial Banks in India", International Journal of Management and Business Studies. Vol.1, Issue 3, September(2011), pp. 47-53

[21] Hosmani.A.P and Jagadish Hudagi, "Unearthing the Epidemic Of Non-Performing Assets -A Study with reference to Public Sector Banks in India" International Journal of Multidisciplinary Research, Vol.1 Issue 8, December 2011, pp.447-459.

are one of the major concerns for banks in India. It has been found from the study that increase in the level of NPAs involves the necessity of provision which affect the profitability and net-worth of banks and it also wrecks the value of the assets. They also discussed in their paper about capital to risk weighted assets ratio of Public and Private sector banks, management of credit risk and measures to control the menace of NPAs. It has been found through the study that the extent of NPA is comparatively higher in public sectors banks. They suggested that NPAs have to be scheduled to improve the efficiency and profitability of banks in India. [22]

11. Aggarwal Sandeep and Mittal Parul (2012), in their paper titled "Non - Performing Assets: Comparative Position of Public and Private Sector Banks in India", they analyzed the comparative position of nonperforming assets of selected public and private sector banks in India for the period of 10 years. Data has been collected by the researcher from various secondary sources and analyzed with descriptive statistics and ANOVA. The study reveals that PNB and HDFC banks are found superior in management of NPAs as compared to SBI and ICICI and private sector banks are much comfortable and efficient as compared to public sector banks.[23]

12. Mujawar Manzil Makbul and Patil P.B. (2012), conducted a study on "Management of NPA – A case study of Kallappanna Awade Janata Sahakari Bank ltd, Ichalkaranji". In this study, they made an attempt to understand how efficiently the NPA has been managed by Kallappanna Awade Janata Sahakari Bank ltd during the period of the study. For analysis of data different statistical tools were applied like arithmetic mean, standard

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[22] Kaur Kamalpreet and Singh Balraj, "Non-Performing Assets of public and private sector Banks (A comparative study)", South Asian Journal of Marketing & Management Research, Vol. No.3,December, 2011, pp.54-72.

[23] Aggarwal Sandeep, Mittal Parul (2012), "Non - Performing Assets: Comparative Position of Public and Private Sector Banks in India", International Journal of Business and Management Tomorrow Vol. 2 No.1,pp 1-7.

deviation, coefficient of variance etc. It has been revealed from the study that NPA management of Bank is satisfactory and it is also found that the recovery mechanism of the banks has remained strong and satisfactory.[24]

13. Koti Kartikey, (2013), conducted a study on "Management of Non-performing assets: A Case study in Krishna Grameen Bank, Gulbarga District". The study revealed the reason for NPA's and methods that are used to control NPA's. Data has been collected for the study from manuals, annual reports of the Krishna Grameen Bank and from informal discussion with the officers and employees of the organization. It has been found from the analysis that the Net movement of NPAs were in cyclic order. It has been observed that some internal reason, external reason and borrower related reason were responsible for increase in NPAs. It also has been observed that efficient management of non-performing assets is the biggest challenge for the banks in India. He suggested that to avoid NPA appropriate steps should be taken on time like qualitative appraisal, supervision and follow up etc. He concluded that it is necessary to restructure the strategies for recovery process; this will improve bank general capabilities and meets the prudential requirements.[25]

14. Nivethitha. J and Brindha. G. (2014), in their paper titled "Management of Non performing assets in Virudhnagar District Central Cooperative Bank – An overview" described the magnitude of NPAs and the major causes of account becoming NPAs in Cooperative Banks. Data has been collected for the study from the primary as well as secondary sources. For this study, researchers adopted the sampling technique and

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[24] Manzil Makbul Munjawar and P.B. Patil, "Management of Non Performing Assets: A case study of Kallappanna Awade Janata Sahakari Bank ltd, Ichalakaranji" Indian Streams Research Journal, Vol. 2, Issue 11 December 2012. pp.1-8

[25] Koti Kartikey, "Management of non-performing assets: A Case study in Krishna Grameena Bank, Gulbarga District", Indian Journal of Research in Management, Business and Social Sciences, Vol. 1 , Issue 2, July. 2013. pp.63-67

selected 30 branches in VDCCBs by census method. They applied Garrett rank test for analysis of data and the study revealed that:

- In the opinion of branch manager highest score was awarded for the agricultural purpose & the least score to the small industries as per Garrett Ranking.
- It has been found that there was a significance difference between the branch location and the OTS scheme followed by compromise settlement scheme & so on.
- It has been found that the gross NPA ratio was increasing from 2011 onwards which affected the profitability position of VDCCBs.
- It has been found that, VDCCBs had heavy burden of risky assets upto 13.6% in the year 2010-11. But in the subsequent years they were able to control the increasing the risky assets & maintain the satisfactory performance. It was reduced by the proper provision cover extended by the banks & stood at just 5.04% in the year 2012-13.[26]

15. Pradhan Pradip Kumar (September 2014), conducted a study on "The impact of Non performing asset in the performance of Financial institution: A case study of OSFC". In this paper he finds out the correlation between selected NPA variables and performance indicators of OSFC. In this study the researcher has utilized and analyzed the essential variables having impact of NPAs on performance of the corporation. To find out the relative impact; the researcher has done the comparative study of Standard assets, Non performing assets and Net profit of OSFCs. It has been found from the study that NPA has a negative impact on profitability, liquidity,

[26] Nivethitha J and Brindha G., "Management of Non Performing Assets in Virudhnagar District Central Cooperative Bank – An Overview", Middle East Journal Of Scientific Research (July 2014), pp. 851-855

sanction and disbursement of loan and the overall performance of the Odisha State Financial Corporation (OSFC).[27]

b. Review related to State Financial Corporation:-

Following are the reviews related to State Financial Corporation are:

1. Singh (2000), in their book titled on "The role of financial institutions in the industrial development of Punjab". He observed that from amongst 18 SFCs in the country. Tamil Nadu State financial corporation with sanction of 92.41% to SSI sector & Himachal Pradesh state financial corporation with 59.6% of sanction to SSI sector were at the top & bottom of the grow respectively. The study revealed that during the year 1980 to 1984, PFC sanctioned 80% of its loan to SSI. Thus, PFC is playing a pivotal role of the industrialization of Punjab.[28]

2. Jagtap Uttam Rao (2005), in his thesis entitled "Critical evaluation of the role of MPFC in revival of SSI sick units (with special reference to Indore division)". The main objective of their research was focused on the contribution of MPFC vis-à-vis sick industrial units. His research was based on primary and secondary data. Different statistical tools were applied like average, percentage, correlation etc. In this study he described the role of MPFC in elevating the sick industrial unit of Madhya Pradesh. He observed that it is a matter of great concern that industrial growth is intimately connected with the creation of money.[29]

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[27] Pradhan Pradip Kumar, "The impact of Non performing assets in the performance of Financial Institution" – A case study of OSFC", Sai Om Journal of Commerce & Management , Vol-1, Issue 9 (September 2014). pp. 11-17

[28] Singh Parminder, "Role of Financial Institution in the Industrial Development of Punjab" Finance India, March 2000.
Taken from Rakesh Garg, Priya Gupta, "State Financial Corporations and industrial development:A case study of PFC & HFC". JBESIR, Vol. 1, Issue 6 (September 2011). pp. 69-83

[29] Dr.Uttam Rao Jagtap (2005), in his unpublished thesis (DAVV) entitled "Critical evaluation of the role of MPFC in revival of SSI sick units"

3. Dr. Jagtap Uttam & Kapse Manohar (2011), in their paper titled on "Study of Non fund based activities of MPFC- with special reference to causes of failures and problem" made an attempt to find out the causes of the failure of non fund based activities of MPFC & the problem faced by MPFC. It is found from their study that many reasons are responsible for the failure of MPFC like late entry in the business, limited range of services, wrong positioning of source outlet, lack of expertise or key person, poor follow up, no aggressive marketing study, no formal infrastructure and many others.[30]

4. Garg Rakesh and Gupta Priya (2011), conducted a study on "State Financial Corporation and Industrial development – A case study of PFC & HFC". The main objective of this study was to analyze the role of SFCs in promoting and rendering financial assistance to small & medium scale industries in their respective states i.e. Punjab & Haryana. Different statistical tools like percentages, correlation analysis, t-test and trend analysis etc were applied. It has been observed from the analysis that PFC and HFC had played a significant role in industrialization of their respective states.[31]

5. Dr. Jagtap Uttam Rao, Deo Rahul and Malu Sandeep (2012), conducted a study on "An analytical study of sanction, disbursement & recoveries of MPFC after liberalization [1991-2003]". In their study, they made an attempt to know the position of Sanction, Disbursement and Recovery of MPFC after liberalization. It was found from the study that

[30] Dr. Jagtap Uttam & Kapse Manohar (2011), "A study of Non Fund based activities of MPFC- with special reference to causes of failures and problems". International journal of Research in Commerce, Economics & Management, Vol no.1 (2011), issue 2 (june). pp. 65-68

[31] Garg Rakesh and Gupta Priya. (2011), " State Financial Corporation and industrial development – A case study of PFC & HFC ". Journal on Banking Financial services & Insurance Research – Vol.1 Issue 6(September 2011). pp. 69-83

MPFC has not done any remarkable job in the field of sanction, disbursement and recovery.[32]

6. Joshi Nishant and Dr. Sharma R.K., (2012), conducted a study on "Influence of State owned Financial Corporation on the growth of MSME in the central province of India". The main objective of their study was to examine that MPFC has played an influential role in the growth of MSME in the central province of India. For this study, researcher has collected secondary data from audited & published report of the ministry of commerce & industry and MPFC. Different statistical tools like Dicker full test, Durbin Watson lest, Regression, correlation, ANOVA etc were applied for testing the hypothesis. It is found from the study that state owned financial corporation of central province (i.e. MPFC) had played a significant role in the growth and development of MSME in the central province of India.[33]

7. Kanrar Susanta (2012), conducted a study on "State Financial Corporations and industrial development: A study with special reference to Rajasthan Financial Corporation". The main objective of this study was to find out the role played by SFCs in the development of industry & more specifically the role played by RFC. It has been revealed from the study that RFC was giving more emphasis on MSMEs sector than the other sectors and the total sanction to MSMEs sector during the period of study have been increases by year to year.[34]

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[32] Dr. Jagtap Uttam Rao, Deo Rahul, Malu Sandeep (2012) conducted a study on "An analytical study of Sanction, Disbursement & Recoveries of MPFC after liberlisation [1991-2003] ". International Journal of Research in Commerce, Economics & Management, Volume 3, No.-1, Jan-April-2012, pp. 33-43

[33] Joshi Nishant . Dr. Sharma R.K., "Influence of State owned Financial Corporation on the growth of MSME in the central province of India." International conference on Humanities, Economics and Geography (2012,) March 17-18, 2012 Bangkok. pp.206-209

[34] Kanrar Susanta (2012), "State Financial Corporations and Industrial Development . A study with special reference to Rajasthan Financial Corporation", International journal of Research in Computer application & Management Vol. 2, (2012), Issue 8 (August). pp.112-117

8. K.T. Srinivas, (2013), conducted a study on "An analysis of financial statement of Karnataka State Financial Corporation". In this study, researcher made an attempt to analyze the financial statement of KSFC and also examine the movement of NPA at KSFC. For data analysis, Ratio analysis technique was applied. It is found from the study that Net profit ratio of the KSFC was satisfactory and it has also been observed that KSFC has not taken appropriate measure to minimize their operating expenses to maximize the wealth of the KSFC. It is also revealed from the study that the percentage of NPA over the period of study was decreasing. It means the measure & policy towards recovery of NPA of KSFC was good & commendable.[35]

Based on the extensive literature review the researcher gained detailed knowledge on the concept of Non performing assets, their management and the impact of NPA on the banks profitability, liquidity and solvency. However, the researcher identified that no study has been carried out regarding Analysis and management of Non performing assets in MPFC. Thus, it becomes imperative to study on this topic.

1.2 Objectives of Research:-

Research is the systematic process of connecting and analyzing information to increase our understanding of the phenomenon under study. It is the function of the researcher to contribute the understanding of the phenomenon and to communicate that understanding to others.

The general objective of my research is to identify the causes of generation of the Non-Performing Assets (NPA) in the Madhya Pradesh Financial Corporation & thereby specifically on increasing the profits by management of the NPA through an appropriate follow up and recovery

[35]Srinivas K.T.,"An analysis of financial statement of Karnataka State Financial Corporation" International Journal of Engineering & Management Research. Vol.3, Issue 2, April 2013, ISSN 2250-0758, pp. 59-63

mechanism. Thus, specifically the research aims at providing information on the following points:

1. To highlight loans & advances trend in MPFC:-

MPFC, since its inception has completed 58 years of state wise financing to industrial sector, service sector as well as commercial real estate sector after economic reforms launched in the decade of ninety's onward. Being a Regional financial institution, MPFC has created a big portfolio of variety financing during its tenure of existence. A versatile core functioning has been observed during the working of approx. six decade. It becomes necessary to highlight its loans & advances portfolio to bring research closer to findings & results.

2. To point out the amount of NPA's in MPFC:-

Non-performing assets (NPAs) has came to light as an alarming threat to the financial corporation, since over a decade in our country. It sends disturbing signals on the sustainability of the affected financial institution. In recent time, the most calamitous problem being faced by SFC's & financial institutions is that the most of the assets becomes Non performing assets and the overdue increases time by time. It affected their viability and solvency of the financial corporation. It is the integral part of my research to point out the amount of NPA in MPFC.

3. To study the assets classification of performing and non performing assets in MPFC:-

Any financial institution can be accessed by their assets classification pattern. The quality of assets hold by a financial institution is a critical indicator of the health of any financial system. A high quality of assets reflects the level of financial institution, credit risk and efficiency in allocation of resources to productive sector. Therefore, it is necessary to study the assets classification pattern in MPFC.

4. To study the general reasons for assets become NPAs:-

Non performing assets are that thought which will never be desired by anyone neither by a borrowing institute nor by a borrower. The high level of NPAs in State Financial Corporation has been matter of great concern. The earning capacity and profitability are highly affected due to NPA. It is that evil from which every financial institution tries to escape but due to various reasons it generate out of all goodness of management. The subject of research is well associated with NPA management. Therefore, it is necessary to study the general reasons for an assets becoming NPA.

5. To find out the problems of MPFC due to NPA:-

The problem of NPA in financial institution is somewhat similar to disease in some part of the body. The ripple effect of NPA as in the case of cancer is gradually felt in all parts of the economy viz savings, investment, production employment and services etc. which adversely affected the capital formation, economic growth, fiscal deficit and inflation. Some time level of NPA goes to such level that provisioning from profit not brings perfect solution. MPFC has also faced various problems due to NPA. Therefore it is essential to find out the problems faced by MPFC due to NPA.

6. To make the suggestions to overcome the problems related to NPA:-

Every research evaluates some findings & also some root causes, which emerges through statistics of research. In this research work, researcher try to find out the reasons of NPA & the problem due to NPA in

MPFC and also drawn conclusion & give necessary suggestions to overcome the problem of NPA.

1.3 Hypothesis:–

A hypothesis is an assumption about a relation between variable. It is a tentative explanation of the research problem or a guess about the research out come. Before starting the Research, the researcher has a rather general, diffused even confused notion of the problem. It may take long time of the researcher to say what question he had been skinning answer. Hence, an adequate statement about the research problem is very important.[36]

According to the Chambers Twentieth century Dictionary, "Hypothesis is a supposition, a proposition assumed for the sake of argument, a theory to be proved or disproved by reference to facts, a provisional explanation of anything".[37]

According to Rummel and Balline, "A hypothesis is a statement capable of being tested and thereby verifies or rejected".[38]

In framing a hypothesis, the investigator must not currently know the outcome of a test or that it remains reasonably under continuing investigation. Only in such cases does the experiment, test or study of a truth of a hypothesis. If the researcher already knows the outcome, it counts as a "consequence"- and the researcher should have already considered this while formulating the hypothesis. If one cannot assess the predictions by observation or by experience, the hypothesis classes as not yet useful, and must wait for others who might come afterward to make possible the needed observations.[39]

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[36] webster definition (1968)

[37] Dr. Rao Adhitham Bhujanga, "Research Methodology for Management and Social Science" excel books . New Delhi. pp. 17

[38] Dr. Mohan S. and Dr. Elangovan R.,"Research Methodology in Commerce" Deep & Deep publication Pvt Ltd. New Delhi. 2007. pp.48

[39] http://en.m.wikipedia.org/wiki/Research

My hypotheses of this research are as below:

1. MPFC provides loans and advances. Minimum amount of some loans goes into NPA.
2. MPFC properly manages its NPA.
3. Decrease in the amount of NPA has resulted in increase the growth of MPFC.

1.4 Research Methodology:-

Research means to experiment on the basic of the assumptions. In this research work, researcher tries to find out the problem of NPA in MPFC and drawn conclusion & suggestions also. The study is descriptive and analytical in nature; it evaluates the NPAs level in MPFC for the period of 2005-06 to 2011-12. In order to carry out the objective, data is gathered from secondary as well as primary sources. Since the study is related to financial problem of MPFC; it was obvious to rely maximum on secondary data in the published form which is extensively used for the purpose of the study. Primary and secondary data have been collected from the following sources:

- **Primary sources:** Primary data have been collected from the records available at Head office and zonal offices (Indore-I & II) of MPFC and information through discussion with managerial personnel, executives and staffs of MPFC.

- **Secondary sources:** Secondary data have been collected from the published material of the subject from the various sources of publication i.e. MPFC annual report, RBI annual reports, monthly bulletin of RBI, CAG report, AGMP report and research paper published in the journals/ magazines, IIB, NIBM, institute of charted accountant, seminars, text books, articles published in financial news papers, internet etc.

1.5 Analysis and interpretation:-

The data so collected is tabulated, charts, graphs are prepared to analyses. Appropriate financial and statistical tools like Comparative percentage analysis, Ratio analysis, Mean, Index no. and Karl Pearson coefficient of correlation(r) has been used to derive the results. And through that we got our result and also provide some constructive suggestion. Diagrams and graphs are exhibiting the data in simple, comprehensible and intelligible form.

1.6 Selection of Research topic and its justification:-

MPFC was setup under the State Financial Corporation Act 1951, with a motive to provide medium term and long term finance to medium and small industry. It plays an important role in the state of M.P. This corporation provides assistance mostly in the form of loans and advances and lending business involves various risks. The most important risk is recovery of loans and advances in proper time; if it is not so then it convert into NPA. In other words, *credit is like putting paste out of tooth paste, it is easy to get it but recovery is somewhat difficult, like putting that paste back in to the tube.*[40]

In the decade of 2000, MPFC was undergoing through an alarming stage of NPA. Due to accumulation of high NPA, MPFC was facing acute shortage of fund and it hampers the growth also. Thus, the management of Nonperforming assets was very essential in order to increase the credit worthiness of corporation, for sustaining the economic growth, for

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[40] Hosmani.A.P and Jagadish Hudagi, "Unearthing the Epidemic Of Non-Performing Assets -A Study with reference to Public Sector Banks in India" International Journal of Multidisciplinary Research, Vol.1 Issue 8, December 2011, pp.448.

increasing the business volume, to increase the welfare of employees, to maintain reputation of the corporation as well as to create job opportunities for future generation. Hence, NPA management assumes significance for credit management of financial corporation.

Therefore based on present scenario of the financial institution and literature review of research studies on financial institution it becomes imperative to do research on this topic.

1.7 Importance of the study:-

A non performing asset is the smoking gun which threatens the stability of financial institution. Today, the word 'NPA' has become a great threat for the financial institution as it does not produce any income for the banks. NPA drains off the income earned by the other performing asset by the way of paying interest to the real owner of the resources. It adversely affects the profitability, liquidity and solvency of the financial institution.

Thus, the management of NPA is the need of the hour. At present these reasons are crucial for any financial institution. Thus, present study is carried out to know management of NPA in MPFC.

As far as importance of the study is concern, without the study, one cannot identify the whole gamut of NPA in MPFC. An asset does not become NPA overnight. Thus, it becomes very important to know, how the account is becoming NPA. After identifying the reason behind the particular NPA account, one can go for a step ahead. That means for the step of how to convert into Performing Assets and how to prevent other account from becoming NPA. As far as possible, one has to exterminate the reason for NPA; it becomes very important to study NPA in brief.[41]

1.8 Scope and limitation of the research:-

At present MPFC is working with 18 offices & Branch network. After separation of Chhattisgarh, MPFC has lost a productive profitable area in the form of Raipur, Bilaspur & other productive area which are collectively called as "Dhan ka Katora". Since the separation of Chhattisgarh, MPFC also handed over a profitable portfolio to new state of Chhattisgarh. Thus, MPFC had to face a great challenge to establish itself as a self relined. My research is confined to new separated Madhya Pradesh. As the MPFC head office is situated in Indore thus information has been collected from the official of Indore Head office and Zone I &II of MPFC.

The limitations of the study are:

1. The area of study is restricted only to MPFC.
2. The study covers a period of 7 years from 2005-06 to 2011-12.
3. The deep analysis is made on Non performing assets only.
4. The percentage and averages as tool for analysis lack absolute accuracy as they are adjusted to the nearest decimal points.
5. It is based on published accounts i.e. secondary data and interview with the officer of MPFC.
6. Secondary data has been used in the research so the limitation inherent in it should be considered.

[41] CAPSTONE Project – A study of Non Performing Assets on Indian Private Banks . available at http://www.academia.edu/6561455/Capstone_Project_Report_On_the_topic_A_STUDY_OF_NON_PERFORMING_ASSETS_IN_INDIAN_PRIVATE

1.9 Chapters outline:-

The present study aims at wider coverage both conceptually and financially of various aspects of Madhya Pradesh Financial Corporation. The study is divided into 7 chapters as stated below:

Chapter -1: Research Introduction:-

This chapter deals with brief introduction of the subject and outlines the research methodology.

Chapter - 2: Introduction of MPFC:-

This chapter deals with introduction of MPFC, establishment, organization and management of MPFC, offices of Madhya Pradesh Financial Corporation, vision and mission of the Organization, objectives of MPFC, functions of MPFC, schemes of MPFC, departments of MPFC, sources of MPFC, positional share capital of MPFC, ISO 9001-2000 Awarded to MPFC.

Chapter -3: Theoretical Background of Non performing assets:-

This chapter deals with the brief introduction of NPA, origin of concept of NPA, meaning, definition, Indian economy and NPAs, Types of NPA, RBI norms for NPA has explained in brief.

Chapter -4: Loan given by MPFC and position of NPA:-

In this chapter gives brief introduction of loans and advances in MPFC and detailed analysis of data collected done along with their interpretation on various aspects of the study like key operation area of MPFC, classification of loans and advances in MPFC, and position of NPA in MPFC etc.

Chapter -5: Problems due to Non performing assets:-

This chapter deals with the introduction, causes or general reason for assets become NPA, reasons for emergence of NPA in the context of MPFC, impact of NPA and problems due to NPA in MPFC.

Chapter -6: Management of Non performing assets:-

This chapter gives brief introduction of Management of Non performing assets, recovery mechanism and management of NPA in MPFC has done.

Chapter -7: Findings, conclusion and suggestions:-

This chapter deals with core findings, conclusion of the research, testing of hypothesis, constructive suggestion and scope for future research.

CHAPTER- 2

INTRODUCTION TO MADHYA PRADESH FINANCIAL CORPORATION

Chapter 2

Introduction to Madhya Pradesh Financial Corporation

2.0 Introduction:-

In today's competitive era, finance is pre-requisite for all commercial and industrial activities. It is very essential for the establishment, organization & development of any business and industry. It may say that Finance is the life blood of the Industry; no industry can survive in the absence of uninterrupted flow of finance. The finance and industry are the two sides of the same coin. The industrial development begins and new opportunities for investment are generated through finance.[1]

In India some Specialized Financial Institutions have been setup to provide industrial finance at both central & state level. The list of such as follows:

All India Financial Institution: (AIFIS)[2]

1. **Term lending institutions:-**
   - **A.** Industrial Finance Corporation of India (IFCI)
   - **B.** Industrial Development Bank of India (IDBI)
   - **C.** Industrial Credit and Investment Corporation of India (ICICI)
   - **D.** Industrial Investment Bank of India (IIBI)
   - **E.** Export-Import Bank of India (EXIM Bank)
   - **F.** Tourism Finance Corporation of India (TFCI)

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[1] Raul, Rajanikanta, "Industrial Finance in India", pp. 1

[2] Gomez Clifford, "Financial Market, Institutions & Financial Services" Prentice- Hall of India private ltd. New Delhi, pp. 358-359

2. **Refinance Institutions:-**

   A. National Bank for Agriculture & Rural Development (NABARD)

   B. Small Industries Bank of India (SIDBI)

   C. National Housing Bank (NHB)

3. **Investment Institutions:-**

   A. Life Insurance Corporation of India. (LIC)

   B. General Insurance Corporation of India (GIC)

   C. Unit Trust of India (UTI)

4. **State level Financial Institution:-**

   A. State Financial Corporation (SFC)

   B. State Industrial Development Corporation (SIDC)

State Financial Corporation (SFC):-

Problems of finding financial resource are more awful in the case of small and medium sized industrial concerns than the large sized industrial concerns. This is so because the cost of floating new issues proved more dangerous for the former, as compared with the later. Further, the small and medium sized industrial concerns find it more difficult to demonstrate their credit worthiness due to the distinct organizational and operational characteristics. Thus, in an underdeveloped economy, like India special arrangement is required to be made for financing such enterprises. These problems are found to be all the more rigorous.

There was a great need aroused for the evolution of some machinery to meet the financial requirement of small & medium sized industrial concerns at the regional (provincial) level had been recognized in India long ago. The Lucama acknowledged by the Indian Central Banking enquiry committee was reported in 1931 (it is said that this was an echo of a similar view expressed by Macmillan Committee in U.K. in 1930-31). While speaking in the central legislature on the motion to refer IFC bill to select committee, the then Finance Minister Shri Shanmukham Chetty disclosed that the need was felt for the evolution of some machinery to provide financial assistance to small and medium sized industrial concerns at the provincial level. He also revealed that he would persuade the provincial Governments to set up corporation similar to IFC for industrial finance. With the establishment of Finance Corporation at the provincial level broadly, three factors seem to have inspired the government to proceed quickly

Firstly: IFC's activities were confined to large sized public limited companies and cooperatives.

Secondly: The arrangements where under the state governments provided loans to the private sector industrial concerns were found to be greatly inadequate in view of the quantity quality and range of Industrial finance required and

Thirdly: Precedence for the simultaneous existence of two complementary institutions for financing small and medium sized and large sized industrial concerns could be found.

Accordingly, the government of India after Consultations with the provincial Government and the Reserve Bank of India introduced the State Financial Corporation Bill in parliament in December 1950 and the bill was enacted in 1951. The SFC act comes into force on August 1, 1952.[3]

The Punjab Government was the first[**] to establish a SFC on the 1st Feb. 1953 followed by the other State Governments. Now 18 SFC, exist

[3] Dagli, Vadilal,"Financial Institutions of India" pp.269

** This is besides Madras Industrial Investment Corporation which was subsequently declared as on par with SFC's.

today – 16 in as many states of the country and one each in the union territories of Himachal Pradesh & Delhi.

2.1 Establishment of MPFC:-

In order to provide medium and long-term credit to industrial unit, central Industrial Financial Corporation (IFCI) was set up under the Industrial Finance Corporation Act 1948. The main objective is to provide credit to those undertaking which fall outside the normal banking activity. The state governments also expressed their desire to set up similar corporations in the state to supplement the activities of the Industrial Financial Corporation. They also expressed that the state corporations be established under special statute in order to make it possible to incorporate in the constitution, necessary provision in regard to majority control by the government, guaranteed by the state government in regard to the payment of the principal. The State Financial Corporation bill was introduced in the parliament in order to implement the views expressed by the state government. The bill provides that the state government may, by notification in the official gazette, establish a financial corporation for the states. A financial corporation was set up in every state under the provision of State Financial Corporation Act 1951. It came on the statute book as *"The State Financial Corporation Act, 1951."*[4]

At present there are 18 State Financial Corporations in India. Out of these 17 SFCs were set up under State Financial Corporations Act (SFCs) 1951. In 1949, Tamil Nadu Industrial Investment Corporation Ltd was established under the companies act as Madras Industrial Investment Corporation, also functions as SFCs.[5] Industrial development and SFCs are

[4] http://www.osfcindia.com/download/sfcact1951.pdf

[5] Malhotra J.S.and Dr. Gupta S.L., "Management of small scale industries".pp.167

very close to each other and SFCs are playing an important role for overall industrial development of the country.[6]

On 1st July 1955, the Madhya Bharat financial corporation came into existence but later, the reorganization of the states took place on 1st November 1956 and it was known as Madhya Pradesh Financial Corporation.

Under the State Financial Corporation act, 1951 (NO LXIII of 1951), the Madhya Pradesh Financial Corporation was incorporated on 30 June, 1955. It is the premier institution of the state which provides financial assistance and related services to small and medium sized industries. It works under the control of the board of directors, consisting of representative from state govt. SIDBI, RBI, Scheduled Banks, Insurance companies, cooperative banks and other shareholders. In the last quarter of the financial year 1994-95, a new Division of MPFC was set up named as CAPITAL MARKET DIVISION. It is also registered as category I merchant banks with Securities Exchange Board of India (SEBI).[7]

2.2 Organization and Management of MPFC:-

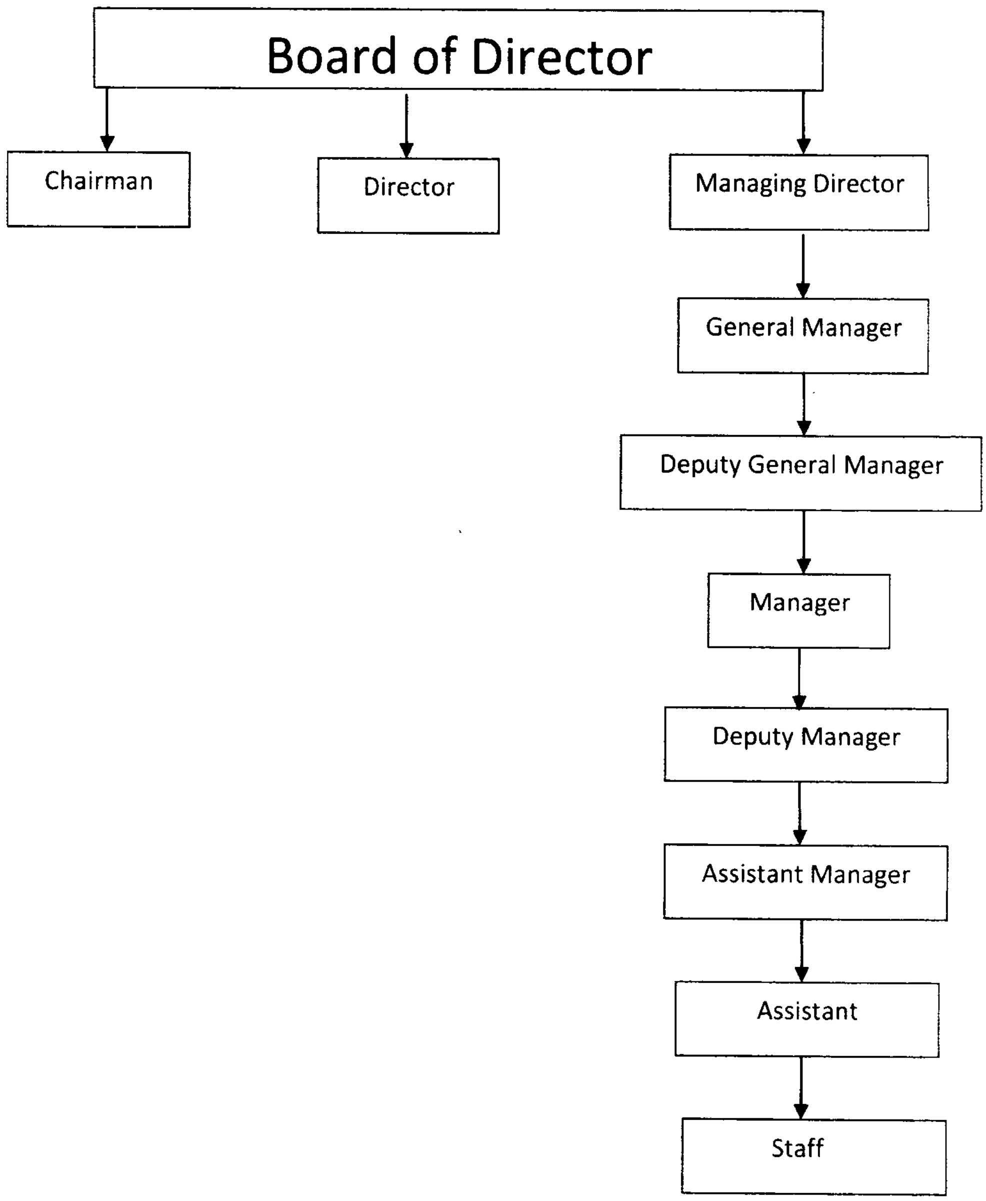
Section 9 of the State Financial Corporation act has explained regarding the management of the financial corporation. The State Financial Corporation act provides that the supreme authority for the management and conduct of the business of the financial corporation shall vest in the Board of Directors, which acts with the help of an executive committee and a Managing Director.[8]

[6] Kanrar Susanta, "State Financial Corporation and Industrial Development: A study with special reference to Rajasthan Financial Corporation", International Journal of Research in Computer Application & Management, Vol No.2, ISSUE No.8 (August). pp.112

[7] www.mpfc.org

[8] Shrivastava, R.M., " Management of Indian Financial System" pp. 388

MPFC Organizational Setup



Source: Information provided by the employees of the corporation

Management of MPFC:-

1. Board of Directors:-

According to section 10 of the State Financial Corporation act 1951, each SFC is managed by a Board of Directors consisting of ten members-three nominated by the state government. One by the reserve bank of India, One by Industrial Finance Corporation, One elected to represent the scheduled Banks, One the cooperative banks, one the public, one the other financial institutions while the last is the managing director appointed by the state government. The chairman is one of the ten directors, but excluding the managing director, his term of office being two years. Thus, out of ten members of the board of directors of State Financial Corporation, the state government, Reserve Bank & IFC jointly nominated appoints six.[9]

Table No.2.1

Board of Directors of MPFC

As on 31st March 2012

Shri Ajay Nath	IAS	Chairman
Shri Rajesh Chaturvedi	IAS	Director
Shri Rishi Dwivedi		Director
Shri G. Sampath Kumar		Director
Shri Ashok Kumar Tewari		Director
Shri Sanjay Dubey	IAS	Managing Director

Source: Annual Report 2011-12 of MPFC .pp.2

2. Managing Director:-

According to sec. 17 of SFC Amendment Act 2000, Managing Director occupies the pivotal position in financial corporation. He shall be appointed in consultation with the small industries bank, by the state government, Managing Director shall be a whole time officer of the financial corporation. And he shall be performing such duties as the board by regulations, entrust or delegate to him. The managing director shall hold

[9] Saxena, R.M. " Development Banking in India" pp. 127

office for such term not exceeding three years as the state government may specify and shall be eligible for re-appointment.[10]

3. Chairman:-

According to sec 15 (1) of the State Financial Corporation (Amendment) act 2000, state that the small industries bank shall, in consultation with the state government nominate a director as a chairman of the board for such period not exceeding three years and on such terms and conditions as the small industries bank may specify. The chairman shall not be a whole time director unless he is also appointed the function as the managing director.[11]

4. Executive Committee:-

The Board is assisted in its work by an executive committee, which consist of the managing director who act as the chairman of the committee and three directors- two directors elected by the nominated directors and one elected by the elected directors.[12]

According to sec 20 (1) of the act , subject to such general or special director as the board may from time to time give, the executive committee may deal with any matter within the competence of the board.[13]

Generally the executives committees have the authority to sanction loan up to Rs. 500 lacs to Rs.1000 lacs to industrial units. They also approve minor items of expenditure.

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[10] SFC Amendments Act 2000

[11] SFC Amendments Act 2000

[12] Shrivastava R.M.. "Management of Indian Financial Institution" pp. 389

[13] http://www.osfcindia.com/download/sfcact1951.pdf

* Subs. by Act 43 of 1985, Sec 14, for "One or more advisory committee or committees" (w.e.f. 21/08/1985)

5. Advisory Committee:-

According to sec 21 of the State Financial Corporation act 1951, The Financial corporation may appoint* (one or more committee or committees consisting wholly of directors or wholly of other persons or partly of directors and partly of other persons) for the purpose of assisting the financial corporation in the efficient discharge of its functions and in particular, for the purpose of securing , that those functions are exercised with due regard to the circumstances and conditions prevailing in and the requirement of particular areas or industries.[14]

6. Recovery committee:-

This committee takes necessary decision on the cases of Reschedulement, one time settlement scheme of loan cases. It also has the right to sale those units which are taken over by the corporation and whose due amount is more than 50 lacs Rs.

2.3 Offices of Madhya Pradesh Financial Corporation:-

Offices of Madhya Pradesh Financial Corporation is divided into following parts:

1. Head Office :-

Head office of MPFC is situated in Indore being the commercial capital of Madhya Pradesh.

Head Office

"Finance House"

AB Road, Indore 452001 (MP)

[14] http://www.osfcindia.com/download/sfcact1951.pdf

2. Branch Office:-

MPFC has 18 branches out of which 10 field offices & 8 Business Development Centre.

3. Field Offices: -

MPFC has 10 field offices in Dewas, Ratlam, Indore zone – I, Indore zone- II, Bhopal, Jabalpur, Gwalior, Delhi, Ujjain and Satna.[15]

4. Business Development Centre:-

The corporation was facing serious competition from commercial bank in the year 2004-05, particularly on account of lower interest rate being offered by the commercial bank to the entrepreneurs. So, it was decided that MPFC should strengthen its presence in the areas where the banks are not present or even if present they are not much active. Accordingly, certain new Business Development Centre was opened in the backward area of the state.

With the opening of these new BDC's, the corporation has successfully attracted additional business from the small entrepreneur. As a result the number of concern assisted was increased. On the other hand, MPFC moved a step forward in fulfilling its authorization of providing assistance in the backward areas. In addition to this, the MPFC also increased its standard portfolio in the developed area of the state.[16] At present few BDCs of MPFC are Harda, Indore urban – I, Indore urban – II, Rewa, Sagar, Sendhwa, Khandwa, Katni & Shahdol.[17]

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[15] Annual Report of MPFC 2011-12, pp.61
[16] Annual Report of MPFC 2004-05 ,pp.7-8
[17] Annual Report of MPFC 2011-12, pp.61

2.4 Vision and Mission of the Organization:-

Vision:-

Being the premier state level financial institution, the vision of the corporation is to provide financial assistance by way of short term / long term loan to the small and medium scale sector and service industries and thereby helping in industrial development of the state as well as generation of employment opportunities.

Mission:-

1. **Role towards customers:-**

To provide financial assistance to the borrowers in SME sector by designing appropriate schemes to suit their specific needs in the most viable and cost effective manner.

2. **Role towards Employees:-**

   i) To upgrade skills of the human resources of the corporation on a regular basis by providing them effective trainings for improving their efficiency and for their career development.

   ii) To provide them the best human resource development practice.

3. **Role towards the Government:-**

   i) To make and implement schemes as per government policies for industrial development of the state.

   ii) To reduce dependence on the govt. for resources and at some point aim to pay dividends also.

   iii) To make it the best corporation of its kind in the country based on relevant criteria.

   iv) To ensure transparency for employees & customers.

4. **Role towards Quality Optimization:-**

To ensure that quality is given prime importance in all activities of the corporation since quality is universally recognized as a major competitive factor. All products & process of corporation shall reflect this concern.[18]

2.5 Objectives of MPFC:-

The M.P. Finance Corporation has been established mainly for the purpose of giving financial help to small and medium scale industries. The main objectives of MPFC are as follows:

Long term:-

- **i)** To create customer friendly environment so as to attract/retain good customers by developing fast track financing schemes to suit their financial requirements.
- **ii)** To create awareness amongst entrepreneurs about latest developments in the SME sector.
- **iii)** Handholding of SMEs- To establish long lasting relationship.
- **iv)** To make each Business Development Centre (BDC) a profit centre and self reliant.

Short term:-

- **i)** To provide term loans to small and medium enterprises particularly to first generation entrepreneurs.
- **ii)** Encouraging development of ancillaries of the medium scale and the small scale enterprises, such as auto components, food processing, steel and steel products, information and print media, chemicals and fertilizers, etc.

[18] "Memorandum of Understanding 2009-10"

iii) To provide term loan assistance for establishment of green field projects in small and medium sectors in back-ward and rural areas of the state with a view to ensure balanced regional growth across the length and breadth of the state.

iv) To spread credit flow in the backward areas & small town by extending reach of the corporation through BDC's.

v) To diversify the lending risk by laying more emphasis on smaller loan & increasing the number of borrowers.

vi) To streamline the processes for quick disposal of loan proposal.[19]

2.6 Functions of MPFC:-

The main function of the corporation is to provide loans to small & medium scale industries engaged in the manufacture, preservation or processing of goods, mining, hotel industry, generation or distribution of power, transportation, fishing, assembling, repairing or packaging articles with the aid of power etc. The following are the functions of the corporation are:

1 Corporation is authorize to provide medium &long term industrial loans to prospective new and existing industrialist and thus it increases the industrial production in the state of M.P.

2 It provides financial assistance to public limited companies, cooperative societies, private limited companies, partnership firm, joint Hindu families & sole proprietorship concerns.

3 It gives guarantee on behalf of industrial concern and it also guaranteed deferred payment due from any industrial concern in connection with purchase of capital goods in India.

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[19] "Memorandum of Understanding 2009-10"

4 The corporation is authorized to underwrite the share of public limited companies but does not directly subscribe to the shares or stock of a company nor does it grant loans or advances on the security of its own shares.

5 The corporation underwrites the issue of stock, shares, bonds or debenture by the industrial concern subject to their being disposed off within 7 yrs.

6 It acts as an agent of the central government or state government or the industrial finance corporation of India in respect of any business with an Industrial concern in respect of loans sanctioned to them.[20]

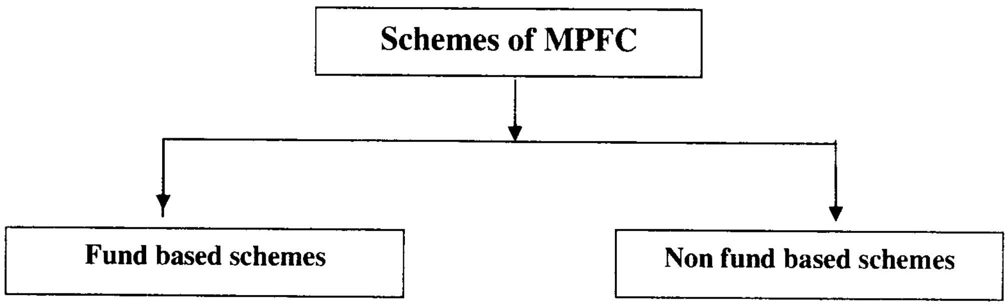
2.7 Schemes of MPFC:-

Madhya Pradesh industrially is one of the most backward states in India. Industries here tend to be traditional, low-tech and small scale or natural resources based, such as textile soya and cement. There are some exceptions to be sure, such as a few large scale public sector companies in telecommunication and petroleum and a large number of private companies in the automobile industry. But there is a major issue that relates to the economic development of the state that is source of finance for industries. There are many sources but MPFC is also working well in this field.

The financial assistance provided by MPFC to industries in M.P., is formulated through various schemes popularly known as schemes of financial assistance. Each scheme is differ from others in its nature, extent and duration of assistance needed. In addition, MPFC provides non – fund based services like merchant Banking, project appraisal etc. In view of the changing business needs and related aspects, all the schemes are reviewed

[20] Sharma Rajendra, "Entrepreneurship Development". pp.151

from time to time and hence intended customers/ borrowers are advised to contact any of the MPFC officers for the schemes prevailing. A number of schemes for providing financial assistance and services to industries, professional and other business associates have been successfully introduced by the corporation[21]:



Funds Based Schemes[22] –

Fund based scheme of MPFC are available for selling up industrial/business venture within the state of M.P.

A. Normal Term Loan: -

MPFC provides financial assistance to new industrial units for creation of fixed assets, such as land, factory, building, plant & machinery, electrical installation etc. and for modernization, diversification, expansion and replacement of equipment etc. to existing units. Period of assistance provided by MPFC depends upon merits of the case ranging between 5 to 8 years. The maximum limit of assistance to non corporate sector is Rs. 200 lacs and for corporate sector is Rs. 500 lacs.

Financial assistance is provided to new industrial units. It is also provided to Hotels, service Industries, Research & Development activities and setting up of various facilities for industries.

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[21] www.mpfc.org

[22] www.mpfc.org

B. Equipment Finance:-

MPFC provides financial assistance for acquiring identifiable and new items of plant & machinery, equipment etc. This scheme is available to those industrial concerns that are in existence for at least 4 years, who are earning profit/ declaring dividend on its share for preceding two years and who are not in default to institution/ banks in payment of their dues and having overall debt equity ratio not more than 2:1 are eligible to get financial assistance under this scheme.

The maximum amount available is 77.5% of the cost of the machine – restricted to 90.00 lacs per proposal.

C. Asset credit scheme:–

Financial Assistance provided under the scheme is available to existing concerns having at least two years of profitable operations for purchase of equipment for the purpose of expansion, modernization and diversification and /or for replacement of equipment. Medical equipment, energy saving systems, vehicles and other equipment for manufacturing and service industry are also eligible under the scheme. Upto 100% of the cost of the equipment can be financed under the scheme with a minimum of Rs. 25.00 lacs and maximum of Rs. 500.00 lacs. A debt equity ratio of including the assistance under the scheme should be 1:1. The assistance under the scheme is available for 3 to 5 years and is repayable in monthly/quarterly installment.

D. Short term Loan:-

This scheme is provided by MPFC to those concerns which are the profit for the last 4 years, having working capital limits sanctioned by any other commercial bank, having regular account with MPFC or other Financial Institution and having debt equity ratio of not more than 1:1 and current ratio not less than 1:5:1 are eligible to get financial assistance under the scheme. This scheme has been designed to cater the short term requirement of funds for working capital purposes due to peak season needs or for fulfillment of specific order or job enhancement of working capital limits pending up to bank etc.

The minimum assistance provided under the scheme is Rs.2.00 lacs and maximum Rs. 100.00 lacs and it shall be repayable within 12 months. The rate of interest applicable for the scheme is 13.50 %. In case of default, penalty @ 2% p.a. is levied for the period and amount of default.

E. Working Capital Medium terms Loans:-

Terms loan is provided under this scheme by MPFC to part finance long term/medium term working capital requirement of the industrial units. It is provided to those industries who are having last 3 years profitable operations and having good track record with institution/banks. MPFC borrowers whose fixed assets are mortgaged with MPFC and those who are not MPFC borrowers but intend to offer all their existing fixed assets by way of mortgage as primary security can avail assistance under the scheme. If the unit has availed working capital assistance from bank, MPFC normally shall not have any charge on the current assets of the units. The assistance under the scheme is repayable in 3 to 5 years. Minimum Loan as may be provided under this scheme is of Rs. 2.50 lacs and maximum loan of Rs. 500.00 lacs.

F. Electro Medical Equipments:-

Financial assistance under this scheme is available for purchase of new electro medical and other equipments. It is provided to private practioners having MBBS, BDS or physiotherapist or equivalent qualification. The assistance under the scheme shall be repayable within 6 years.

G. Scheme for Hospital/Nursing Home:–

Term loan is provided for establishment of new hospital/nursing homes or expansion/modernization of existing hospital/nursing homes intending to provide concessional facilities for patients from low income groups with minimum 10 beds are eligible under this scheme. Hospital/Nursing home should have full time service of at least one post graduate doctor with M.D./M.S. or like qualification. Items covered under the scheme are land and building, equipment for diagnosis, treatment and monitoring air conditioner for O.T. and ICU, office equipment, Kitchen facilities, ambulance and preliminary and per operative expenses etc.

H. Scheme for Qualified Professionals: –

Under this scheme, term loan is provided to qualified professional in the field of management, accountancy, medicine, architecture engineering etc. especially term loan is available for those who are setting up their own professional practice/consultancy venture for the first time. The cost of the project under the scheme should not exceed Rs. 10.00 lacs of which land/building should not be over 50% of the total outlay. Assistance under this scheme is also available to existing/established firms for acquiring additional equipment, repayable within a maximum period of 5 years.

I. Hire purchase portfolio management scheme:–

Under this scheme the corpus amount is provided to existing reputed finance companies who are engaged in the business of provided hire purchase loan against motor vehicles (HMVs and LMVs) equipment viz dumpers, excavators, construction and mining equipment etc. are also covered under the scheme.

Under the scheme, the assisted finance company enters into a memorandum of understanding with MPFC. Subsequently, it gets individual agreement executed between the vehicle operator and MPFC, whenever the corpus fund is used. The corpus fund assistance is a onetime assistance and needs to be utilized within a specified period. All risk of finance under the scheme is to be undertaken by such assisted finance company.

J. Schemes for loan Replenishment: –

Assistance under this scheme is provided only to MPFCs existing profit making borrowers with good track record of repayment (at least three due installment of loan should have been paid in time). It is available for the purchase of further machineries and extension of factory building for the existing line of activity. The limit of assistance is upto the extent of loan already repaid by them till the date of application. Minimum loan amount considered under the scheme is Rs. 2.50 lacs & maximum loan is Rs. 75.00 lacs and repayable within a maximums period of 5 years.

K. Scheme for quick finance for D.G. sets:–

A scheme for financing D.G. (Diesel Generator) set has been introduced, with a view to tie over the problem faced by the entrepreneurs/ industrialist due to frequent power failure/cut. Assistance is provided under this scheme to all existing industrial units. However, assistance to projects under implementation may be considered on merits. Under the scheme upto 90% (60% for second hand) of the cost of D.G. sets (invoice value) subject to maximum of Rs. 50.00 lacs, loans can be considered. Assistance under the scheme is repayable within a maximum period of 5 years. The rate of interest applicable is same as the normal lending rates. In case of default, penalty @ 2.00% per annum is levied for the period and amount of default.

L. Finance for Marketing Activities:–

Assistance under this scheme is provided to existing SSI/Medium scale industries, profit making industrial units with good track record, with Financial Institutions/Banks for the purpose of meeting capital expenditure on marketing campaign, acquisition of mobile sales van, setting up/renovations of showroom, ware house, marketing office for marketing products of industrial concerns, acquisition of ISI, ISO and /or other certification, development of infrastructure like setting up of permanent exhibition centre, industrial complex like garments, software etc. are also eligible. Assistance under this scheme is available for a minimum period of 2 years and maximum period of 5 years. Minimum amount of assistance is Rs. 10.00 lacs with a maximum of Rs. 50.00 lacs.

M. Scheme for financing Miscellaneous fixed assets:–

Financial assistance provided by this scheme is available for acquisition of Miscellaneous Fixed Assets (MFAs) to meet the cost of purchase of vehicles in the name of the company, the cost of office automation/equipments, the cost of construction/ acquisition of the office premise / guest house for the company.

Financial Assistance shall be provided to existing assisted concerns or companies who have availed minimum Rs. 200 lacs from the corporation, and repaid at least 25% of the total loan disbursed to the them, who earned profits for last two years and who having positive net worth, and at last that have a good track record with the corporation.

The assistance under this scheme is available for a minimum period of 3 years and maximum 8 years and the amount of minimum loan provided under this scheme is Rs. 5.00 lacs and maximum Rs. 50.00 lacs. The loan shall be repayable in 3 to 8 years.

N. Scheme for Medical Professionals:–

Any medical professional who holds minimum qualification of MBBS/BDS is eligible for getting financial assistance under this scheme. Financial assistance shall be considered to meet the cost to purchase premises/ chamber/flat to set up clinics/consultation chambers, and /or cost of medical equipments, infrastructure/ furnishing, computers, office automation system, ambulance, car./van, interior decoration etc. The loan under this scheme shall repayable within 2 to 6 years.

O. Liquid fund scheme:–

The short term funds are provided under this scheme to cater the liquid funds requirement for the project. All micro, small and medium scale enterprises are eligible who are in operations for last two years, who are in profit for last two years and who are regular with MPFC/ Banks.

The minimum loan amount provided under the scheme is Rs. 5.00 lacs and maximum loan amount is Rs. 240.00 lacs. Minimum security margin is 25% on primary assets and it is repayable within a maximum period of 12 months.

P. Composite Loan:–

Assistance under the scheme is available for procurement of equipments or working capital or both. It is granted to artisans, village & cottage industries, and small scale industries in the tiny sector (which is located in areas other than metro Politian areas), involving utilization of locally available natural resource and / or human skills. Maximum amount of loan upto Rs. 2.00 lacs is granted and no upfront fee is levied under the scheme. Repayment of such loan should be done within 10 years, with an initial moratorium of 12-18 months (both for interest and principal).

Q. Commercial Complex:–

The financial assistance provided under this scheme is for construction of commercial complex including show rooms and sales outlets. Loan is provided under this scheme is for purchase of land and construction of commercial complex within the state of M.P. With the prior approval of the corporation; sale of shops, showrooms or any portion of complex shall be permissible. The proceeds shall be deposited in the loan account of the borrower as per terms of agreement. The minimum cost of project should be Rs. 10.00 lacs. The promoters are required to contribute 50% of total cost of project. In case of companies net worth should not exceed Rs. 10.00 crores MPFC will hold the first charge by mortgaging assets i.e. land & building, shop premises, saleable part of commercial complex. The loan should be repaid in 5 years, including a maximum of 2 years moratorium.[23]

Non fund based schemes:–

Non fund based scheme of MPFC are available throughout India.

a). Appraisal for Public issue:-

The project appraisal of the companies going for public issue is taken up by well qualified and professionally competent officers. MPFC has been in project financing for five decades and has developed relevant expertise backed with rich data to take up project appraisal of public issue proposals.

b). Underwriting of Public/Right Issue:–

Underwriting of shares and debentures for public/right issue is undertaken on the strength of the company, prospects of the issue and the prevailing state of the capital market. The corporation also assists in arranging underwriting commitments both from institution and private underwriters.

c). Public Issue Management:–

Issue management services are provided acting as lead managers, co-lead managers, advisor to the issue etc. MPFC can also assist in public issue subscription through its wide network of brokers, sub-brokers and other

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[23] www.mpfc.org

market intermediaries built up over the years and it's zonal and branch spread all over the state.

d). Project Report Preparation:-

Project reports are prepared based on latest information of technology and market survey of products. Reports are prepared for technology oriented projects and of innovative items.[24]

e). Credit syndication:–

Services are provided by the corporation for credit syndication with other financial institution/banks/finance companies in respect of term loans/lease finance/working capital etc.

f). Corporate Advisory Services:–

MPFC also provides corporate advisory service including management system, Project services forming consortium tie-ups, technical assistance etc.

g). Training of Finance Students:–

MPFC provides training and counseling services are provided to the MBA students by helping them in choosing the topics, providing training on project appraisal and other functions of the corporation, report writing skills etc. Duration of programme is 4 to 8 weeks.[25]

2.8 Departments of MPFC:-

Department is a specialized functional area within an organization or a division, such as accounting, legal, marketing, planning and so on. Generally every department has its own manager and chain of command.

[24] Dr. Jagtap Uttam Rao & Kapse Manohar (2011), "A study of Non Fund based activities of MPFC- With special reference to causes of failures and problems". International journal of Research in Commerce, Economics & Management, Vol no.1 (2011), issue 2 (june). pp. 66

[25] www.mpfc.org

MPFC has classified its various activities and has designed these activities to various departments.[26] It has the following departments[27]:-

1. **Management Information System (MIS):–**

MIS department perform the following functions -

a) Data entry, sending and receiving mails, upload and download the information and performs all the work related to computer in the corporation.

b) It furnishes information to government department of industries and commerce.

c) To resolve & reply the letters and annexure in stipulated time period forwarded by public information officer/assistant public information officer or appellant officer under RTI Act 2005.

d) It furnishes performance report of the corporation to SIDBI on monthly, quarterly & annual basis.

2. **Administration Department:–**

It performs the following functions:

a) Works pertaining to the services of officers and employees of the corporation like recruitment, transfer and promotion, screening the work of employees of their service period and perform all functions related to staff welfare.

b) Court cases related to establishment and all the matters related to it.

c) To organize training and development programme for the officers and employees of the corporation.

d) Works pertaining to maintenance of office equipment, building air conditioning, generators, transport, vehicle, furniture, computers, communication system etc.

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[26] Gupta Sanjay kumar, "An internship report on Financial analysis of KSFC". Department of Management Central University of Karnataka. pp.66

[27] MPFC Booklet

e) Sending information about the department to the government and other departments.
f) To organize departmental inspection time to time.
g) Procurement of office equipment, stationary & consumables.
h) Resolve the problem relating to their department.
i) Organize meeting of board of directors & other committees,

3. Accounts Department:-

This department performs all the function pertaining to accounts are-

a) To prepare all kinds of bills & this department is concerned with passing the various bills.
b) This department deals with consolidation of accounts of all the branches.
c) It is also concerned with preparation of P&L account and balance sheet and annual report of the corporation
d) Accounting related to loans sanctioned to the units
e) Maintained records of all type of loans and advances, audit and investigation reports.
f) To maintain passbook of general provident fund.
g) To resolve the work related to CAG & PAC.
h) Work related to income tax & professional tax of employee & other tax of the corporation.

4. Recovery and Follow up department:-

Recovery means collection of amounts due. One of the important sources of funds for the corporation is recovery of money. It is that instrument through which the health of the corporation can be judge.[28] Head

[28]Gupta Sanjay kumar, An internship report on "Financial analysis of KSFC". Department of Management Central University of Karnataka. pp.66

office has recovery and follows up department it perform the following function:

a) Regularly monitoring the cases of sanction and disbursement of loan by the corporation.
b) Take necessary legal action in case of default like issue of legal notice to the defaulter, takeover of units, and receiving instruction from officer/committee for selling of units and prepare report for presenting in front of officers/ committees.
c) Prepare and present cases related to Reschedulment, Rephasement and Onetime settlement to the officer/committee.
d) Monitor the recovery and follow up done by the branch office and give necessary instruction to them.
e) This department is also engaged in the task of liquidating assets which are taken over as per the power conferred by SFC u/s 29 of the SFC act.
f) It ensures recovery of loan installments with interest and other applicable charges.
g) Issue RRC as per the MP Land Revenue Act to branch office & to execute the work related to Revenue Recovery Certificate (RRC)
h) To carry out all the activities related to recovery of loans such as follow up of repayment & collection of dues.

5. Legal Departments:-

Legal department acts as a catalyst and interface with various departments of the corporation in all the operational activities of the corporation; namely legal inputs for appraisal and for recovery. In case of default in repayment or breach of contract, safe custody of records, files &

securities of documents is ensured. It is one of the important departments in the organization.[29] It performs the following functions:-

a) This department scrutinizes the documents whenever an individual concern applies for loan.

b) To check all the documents related to loan of the borrower.

c) Check the securities of the borrower which are given by them against the loan.

d) This department issue legal notice & suit files against defaulter who do not pay proper interest.

e) This department acts as a representative of the corporation for those cases which are filed against corporation.

f) To execute the works pertaining to legal & judicial activities of the corporation.

6. Assets reconstruction cell / RRC cell:-

This department was set up in the year 2005-06 in order to salvage the NPA portfolio and all cases sanctioned prior to the year 1990, lying under loss category, were transferred to this cell. The main purpose of establishment of this cell is to resolve such type of cases through one time settlement scheme and reduce the level of NPA in the corporation.

It issue RRC against defaulter and under this, seized the personal assets of defaulter and the guarantor both for recovering the defaulted amount. This department is responsible for taking necessary steps on those cases which are transferred to this department.

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[29]. Gupta Sanjay kumar, An internship report on "Financial analysis of KSFC". Department of Management Central University of Karnataka. pp.66

7. **Internal Audit:-**

This department performs internal audit of zonal, regional branches and Business Development Centers of the corporation. It gives cooperation and necessary information to the government auditor time to time. This department conducts audit of corporation covering all the areas of sanction, disbursement, recovery, finance and accounts, legal documentation and general administration etc.

8. **Credit Department:-**

It collects data from the loan applicants and verifies it. It appraises the project in terms of its financial, technical, and marketing feasibility and recommends the loan based on the viability of the project.

2.9 Sources of MPFC:–

MPFC provides loans and financial assistance to industries and it is the source of finance for many industries but the corporation itself needs some amount of capital to finance. As the industries borrow from financial corporation, the corporations also borrow from the state through its many sources. Following sources are available to MPFC for the financial assistance to industrial units is:

1. **Share Capital:-**

It is one of the important sources of income to MPFC. The capital structure of SFCs is fixed by the concerned state government. Authorized share capital of financial corporation cannot be less than 50 lacs and more than 50 crore at a time. Central Government with the approval of IDBI through official gazette may extend the limit of share capital from 50 to 100 crore rupee.

Share capital of a financial corporation is divided into fully paid up share of equal value (share holding of these share is described in sub section (3) of

SFC Act, 1951). State government may determine quota of share and may subscribe to the following:-

i). State Government

ii). RBI

iii). IDBI

iv). Schedule Cooperative Bank/Insurance Company/Investment Trust

v). Others (to this category above 25% cannot be subscribe)

In the year 2011-12, total paid up capital is bearing 93.70% of state government, 6.24% SIDBI and 0.06% share holding towards others.

2. Special Capital:–

State Government may with the approval of IDBI/ SIDBI issue unsubscribed share as special capital. Amount received by this unsubscribed share is determined by state government with the approval of IDBI/ SIDBI and subscription of this special share is determined in the ratio as state government and IDBI agrees upon.

A State Financial Corporation can use special capital received from special share as directed by IDBI/ SIDBI with the consultation of state government any time, dividend of special shares cannot be more than the dividend of general shares.

3. Bonds and Debentures:–

The corporation is empowered to issue bonds and debenture to supplement their resources. To conduct business, SFC prepares Business Plan and Resources Forecast (BPRF). To extend the borrowing capacity of the industries and for the payment of their liabilities, SFC access receivables from different sources and if sources are inordinate for annual plan, SFC may issue bonds through RBI and consultation with IDBI/SIDBI. Guarantee for the payment of these bonds is required to be confirmed by the state government as described in sec.7 (1) of SFC Act, 1951. Issued bonds may subscribe to financial institution only such as IDBI, nationalized bank, insurance trust etc. and those bonds are transacted for the payment of principal and interest SFC cannot transaction bonds by its own while RBI can rationalize quota of these bonds as per BPRF prepared by SFC particularly.

MPFC also transacted series of Bonds from time to time under the power delegated by SFC Act 1951. In the year 2011-12, MPFC issued Bonds & Debentures to the extent of Rs 112.67 crore.

4. Refinance:–

Refinance is the main resource base for State Financial Corporation. IDBI and SIDBI, after 1990, provide refinance to the SFCs. Refinance is that amount which is provided by IDBI/SIDBI to SFCs as loan, at some low rate of interest and such amount borrowed by industrial unit through SFC at some higher interest rate.

MPFC continued to avail resources from SIDBI and availed Rs. 53.00 crore by way of refinance during 2011-12.

5. Loan in lieu of share capital:–

Generally the shares of special and general category are not fully subscribed to SFC, may sanction loan by state government or SIDBI (or both) to the extent of unsubscribed shares. SFCs pays interest on such loan and state government may convert this loan as share capital.

6. Loan from RBI:–

According to the provision of sec 7 (2) B SFC 1951, only SFC may avail loan from RBI. Amount of loan cannot be double than fully paid up capital of SFC at any time. Amount of such loan is payable, if asked by RBI at any time/or on/ or before 18 months from the date of availing of loan Amount of such loan from RBI is only provided.[30]

2.10 Positional share capital of MPFC[31]:-

The corporation during the year received capital contribution of Rs. 5.00 crore from the state government. The total paid up capital of the corporation as on 31/03/2012 was Rs. 35,614.29 lacs. The breakup of share holding as on 31st March 2012 was as under.

	a). Ordinary capital u/s 6(1)		**Rs. In lacs**
1.	State Government		33,267.68
2.	SIDBI		2,118.95
3.	Others		
	Schedule Banks	19.74	
	LIC/Investment Trust & Cooperative Banks	02.15	
	Individual & Others	00.15	22.04
	Total (a)		**35,408.67**
	b). Share Capital u/s 4 (A)		
1.	State Government		102.81
2.	SIDBI		102.81
	Total (b)		**205.62**

% of shareholding to total shares:

(Including loan in lieu of share capital)

a).	State Government	33,370.49	93.70%
b).	SIDBI	2,221.76	6.24%
c).	Others	22.04	0.06%
	Total	**35,614.29**	**100%**

[30] Jagtap Uttam Rao (2005), "Critical evaluation of the role of MPFC in revival of SSI sick units' ,unpublished thesis (DAVV) , Indore (M.P.)

[31] *Annual Report of MPFC 2011-12, pp. 09*

2.11 ISO 9001-2000 Awarded to MPFC:-

After inspected various activities of the Corporation.M/s Kvalitet Veritas Quality Assurance, Norway, has awarded ISO 9001-2000 certification to Madhya Pradesh Financial Corporation. They found that the Quality policy of the Corporation strive for superior customer satisfaction through continued improvement in product, process and quality to establish and maintain a quality management system, continual review of feedback from customers, offering the client excellent services, innovative products and value added services, development of human resources through training, skill up gradation and empowerment, match with the international quality standards.[32]

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[32] Annual Report of MPFC 2007-08 , pp. 7-8

CHAPTER -3

THEORETICAL BACKGROUND OF NON PERFORMING ASSETS

Chapter -3

Theoretical background of Non Performing Assets

3.0 Introduction:-

The most important duty of banking or financial institutions is granting of credit facilities for economic activities. Apart from raising resources through fresh deposits, borrowings, etc. recycling of funds received back from borrowers constitutes a major part of funding credit suspension activity. Lending is generally encouraged because it affects the funds being transferred from the system to productive purposes, which result into economic growth. However, lending also carries a risk called credit risk, which arises from the failure of borrower. NPA adversely affect the lending capacity of financial institution as non recovery of loan installments along with interest on the loan portfolio forms a major obstacle in the process of credit cycle. Thus, non recovery of loan also affects the profitability of banks or financial institutions. Besides, banks or financial institution required to maintain more owned funds by way of capital and creation of reserves & provisions to act as cushion for the loan losses. Avoidance of loan losses is one of the prerequisite of management of banks or financial institutions. While complete elimination of such losses is not possible, bank management aims to keep the losses at a low level. In fact, it is level of non-performing advances which to great extent differentiates between a good & bad bank. Rising NPAs may also have more comprehensive repercussions. [1]

[1] Agrawal O.P., "Modern Banking of India", Himalaya Publishing House, pp.- 275

Non-performing assets (NPAs) has came to light as an alarming menace to the banking industry since over a decade in our country. It sends disturbing signals on the sustainability of the affected banks. Hence, it has been considered to be most challenging problem being faced by the banks and financial sectors. The positive results of the chain of measures affected under banking reforms by the Government of India and RBI in terms of the two Narasimhan Committee Reports in this contemporary period have been neutralized by the ill effects of this surging threat.[2]

3.1 Origin of concept of Non-performing Assets:-

Different committees have tried to highlight the problem of NPA in banking sector. Tandon committee (1973) recommended that the proper quality- wise grading of advance portfolio as excellent, good, average and unsatisfactory. Then chore committee (1980) also recognized the need for close watch on the quality of loan's portfolio. Pendharkar committee (1981) recommended that the classification of loan assets into different categories on the basis of overall quality of the assets portfolio.[3] This was the starting point for the introduction of the health coding system of bank loan portfolio by the Reserve Bank of India. RBI advised to all commercial banks (excluding foreign banks most of which had similar coding in their organization) in 1985, to introduce the health code classification indicating the quality of health of individual advances into following eight categories are –

1. Satisfactors conduct is satisfactory:-

All terms & conditions are complied with all accounts are in order and safety of the advance is not in doubt.

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[2] Krishna Chaitanya V.,"Causes for Non performing assets in Public sector banks" available at http://www.indianmba.com/Faculty_Column/FC56/fc56.html

[3] Arya, Parmatam Prakash, "Economic reforms in India: From I to II generation & beyond" pp.- 460-472

2. Irregular:–

The safety of the advances is not suspected though there may be occasional irregularities, which may be considered as a short term phenomenon.

3. Sick viable:–

Advances to units which are sick but viable – under nursing and units in respect of which nursing/revival programmes are taken up.

4. Sick: Non viable/sticky:–

The irregularities continue to persist & there are no immediate prospects of regularization. The account could throw up some of the usual signs of incipient sickness.

5. Advances recalled:–

Accounts where the repayment highly doubtful and nursing is not considered worthwhile, includes where decision has been taken to recall the advance.

6. Suit filled accounts:–

Accounts where legal action or recovery proceedings have been initiated.

7. Decreed debt:–

Where decrees have been obtained.

8. Bad and doubtful debts:-

where the recovery of the banks dues has become doubtful on account of short fall in value of security, difficulty in enforcing and realizing the securities or inability/ willingness of the borrowers to repay the banks dues partly or wholly.

Under the above health code system the RBI classified problem loans of each bank into three categories

- Advances classified as bad and doubtful by the bank (health code no. 8)
- Advances were suits were filed/ decrees obtained (hocused no: 647)
- These advances with major undesirable features (H.C. No: 4&5)

The Narsimham committee (1991) felt that the classification of assets according to health codes was not in accordance with international standards.[4] It was not useful as an implementation tool, and it was characterized by an absence of an objective, transparent and uniform standard for measurement of problem advances. In 1991, Narasimham Committee submitted its first report. He gave more specific criteria for prudential norms of income recognition, assets, classification, and provisioning and capital adequacy norms. And in 1998, Narasimham committee gave its second report. He strongly opposed the merger of strong banks with weak ones as this would causes in a negative impact on the asset quality of the stronger bank because of the "contaminated portfolio" of the weak banks.[5]

Narasimhan Committee Recommendation for NPAs:-

The concept of NPAs was first time introduced in the Narsimham committee report that was tabled in the parliament on 17 December 1991. The Narsimham committee studied the prevailing financial system, identified its short comings and weakness and made various recommendations in order to make it more stable. One of the recommendations of the committee was with regard to non performing assets, their identification, disclosure and the extent of provisioning for the same. This committee examined that the prevalent accounting & disclosure

[4]Dr. D. Jagan Mohana Rao, "Management of Non performing assets problems", International Journal of Management & Business Studies. Vol-4, ISSUE 1, Jan-March 2014, ISSN: 2230-9519, pp. 40

[5]http://crackmba.com/npa-indian-perspective

practices did not always reflect the true state of affairs of banks and financial institutions. Thus the committee recommended that a policy of income recognition should be objective and based on recovery rather than on any subjective considerations. Likewise, the classifications of assets have to be done on the basis of objective criterion which would ensure a uniform and consistent application of norms. Also the provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realizable value thereof.

On the basis of Narasimhan Committee recommendation, RBI has introduced, prudential norm for income recognition, asset classification and provisioning in a phased manner for the advances portfolio of the banks so as to move towards greater consistency and transparency in the published accounts.[6]

3.2 Meaning of Non-Performing assets:-

NPAs are those loans given by a bank or financial institution where the borrower defaults or delays in interest or principal repayment. For a financial institution, NPA or bad debts is usually a loan that is not producing income and all those assets which generate periodical income are called as performing assets. In other words, when a borrower could not pays their dues in the form of principal and interest for a period of 180 days then assets is classified as nonperforming assets. However, with effect from March 2004, default status would not be given to a borrower if dues are not paid for 90 days. However, if any credit facility given by financial institution to a borrower becomes non performing, then the financial institution will have to treat the credit facilities granted to that borrower as

[6]Agrawal , O.P. , "Modern Banking of India", Himalaya Publishing House, pp. 272

non performing without having any regard to the fact that there may still exist certain credit having performing status.[7]

3.3 Definition of NPA:-

According to SARFAESI 2002, NPA is an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard asset, doubtful asset and loss asset. According to RBI guideline from 31st March 2004, an asset is considered to have gone bad when the borrower has defaulted on principal and interest repayment for more than one quarter or 90 days.[8]

3.4 Indian Economy and NPAs:-

In present scenario, the three letters 'NPA' is the smoking gun which threatens the entire banking sector and business circle. The origin of the problem of swelling NPA's lies in the quality of managing credit risk by the bank &financial institutions. Undoubtedly, recession hit the highest point, globally stock markets have tumbled, the world economy has slowed down and business itself is getting hard to do. The Indian economy has been much affected due to sticky legal system, high fiscal deficit, poor infrastructure facilities, cutting of exposures to emerging markets, by FIIS etc. Further international rating agencies like, standard & poor have lowered India's credit rating to sub-investment grade. Such type of negative aspects has often out weighted positives such as increasing for ex- reserves and a manageable inflation rate. It goes without saying under such situation that banks & financial institution are no exception and are bound to face the heat

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[7] Rani Chanchal, "Evalution of various techniques used by the Public sector bank for the management of Non performing assets." International Journal of Research in Economics and Social Science, Vol-3, Issue 1(Jan. 2013). pp. 46 - 47

[8] Selvarajan B., Dr. Vadivalagan G. and Dr. Chandrasekar M.," Performance of Indian Banks with reference to Non performing Assets – An overview" International Journal of Research in Commerce and Management, Vol.-3(2012), Issue 10(October). pp.38-46

of a global downturn. One would be surprised to know that the Non-performing assets worth Rs. 1,10,000/- crores hold by the banks & financial institutions in India. Bankers have realized that they will find it difficult to survive, unless the level of NPAs is reduced drastically.[9]

3.5 Types of NPA: -

There are two types of NPA i.e. Gross NPA and Net NPA.

- **Gross NPA: -** Gross NPA are the sum total of all loan assets that are classified as NPAs as per RBI guidelines as on balance sheet date. Gross NPA reflects the quality of loans made by banks. It consists of all the non-standard assets like substandard, doubtful and loss assets.

GNPA = Substandard Assets + Doubtful Assets + Loss Assets

It can be calculated with the help of following ratio:

$$\textbf{Gross NPA Ratio} = \frac{\textbf{Gross NPAs}}{\textbf{Gross Advances}}$$

- **Net NPA: -** Net NPAs are those type of NPAs in which the bank has deducted the provision regarding NPAs. Net NPA show the actual burden of banks. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off of loans is very time consuming, the banks have to make provisions against the NPAs according to the RBI guidelines which are quite significant. That is why the difference between gross and net NPA is quite high. It can be calculated by following:

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[9] Madapana Karteek & Mohanty Debasis, "A Study on Non- Performing Assets with Reference to Banking Sector", International Journal of Research (IJR) Vol-1, Issue-6, July 2014, ISSN 2348-6848, pp. 402-403

$$\text{NET NPA Ratio} = \frac{\text{Gross NPA - provision}}{\text{Gross Advances - provision}}$$ [10]

3.6 RBI Norms for NPA:-

From the year ending 31 March 2004, with a view to moving towards international best practices and to ensure greater transparency it has been decided to adopt the 90 days overdue norm for identification of NPAs,. Accordingly w.e.f. 31 March 2004, an NPA shall be a loan or an advance where

- In respect of a term loan, interest and/or installment of principal remain overdue for a period of more than 90 days;
- In respect of an overdraft / cash credit (OD/CC),the account remains 'out of order' for a period of more than 90 days;
- In the case of bill purchased and discounted, the bill remains overdue for a period of more than 90 days;
- In the case of an advance granted for agricultural purpose, interest and/or installment of principal remains overdue for two harvest season or for a period not exceeding two half years ; and
- In respect of all other accounts, any amount to be received remains overdue for a period of more than 90 days.

A loan granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons, with effect from 30 September 2004.[11]

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[10] Bansal. Anshu. "A study on recent trends in risk management of Non performing assets by public sector banks in India." Journal of Information & Operation Management. ISSN-0976-7754. Vol.-3. Issue 1, 2012, pp. 52

[11] Agrawal . O.P. . "Modern Banking of India". Himalaya Publishing House. pp.- 279

A loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season, with effect from 30 September 2004.[12]

"Out of Order" status:-

An account should be treated as 'out of order', if the outstanding balance in the account remains continuously in excess of the sanctioned limit/drawing power. In case, where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 180 days (to be reduced to 90 days, w.e.f. 31 March 2004) as on the date of balance sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Overdue:-

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.[13]

3.7 Prudential Norms on Income Recognition, Assets classification and provisioning:-

In order to ensure greater transparency in the borrower accounts and to reflect actual health of banks or financial institutions in their balance sheet, RBI introduced prudential regulation relating to Income Recognition, Assets classification and provisioning recommended by Narsimham committee (1991) with certain modifications in a phased manner over a period beginning 1992-93. These regulations have put in

[12] Pathak, Bharti V, "The Indian Financial System Market, Institutions and Services" Second Edition pp. 600

[13] Bansal, Anshu, "A study on recent trends in risk management of Non performing assets by public sector banks in India." Journal of Information & Operation Management, ISSN-0976-7754, Vol.-3, Issue 1, 2012, pp. 51

place objective criteria for assets classification, provisioning and recognition of income, which was lacking hitherto. This change has brought in the necessary qualification and objectivity into the assessment of NPAs & the provisioning in respect of problem credits.

According to RBI guideline[14]there are three norms in NPA concept:

1. Income recognition Norm
2. Assets classification Norm
3. Provisioning Norm

1. Income recognition Norm:-

Before lying down of IRAC Norms, the Income in respect of advances was being recognized on the basis of the norms provided by MADA Committee report. For this advances an assets were classified on the basis of certain Health codes. Each health codes had different codes. Now, under the implementation of the recommendation of Narsimham committee a uniform approach has been accepted for this.

i). The policy of income recognition has to be objective and based on the record of recovery. It has been observed that internationally income from nonperforming assets (NPA) is not recognized on accrual basis but it is booked as income only when it is actually received. Therefore, the banks should not charge and take to income account interest on any NPA.

ii). Interest on advances against term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account on the due date, provided adequate margin is available in the account.

iii). In respect of fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts, the banks are required to recognize them on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.

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[14] http://www.paras.org.in/pdfs/mast_circ_irac_%20norms

iv). If the Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest has been realized.

Reversal of income:-

If any advance, including bills purchased and discounted, becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realized. It means if in the accounting period the amount of interest already charged on accrual basis then it should be reversed to the extent it remains unrecovered on the date of the classification it as NPA. This requirement is applicable to Government guaranteed accounts also.

In respect of NPAs where interest income has ceased to accrue, the fees, commission & similar income should neither be debited to the account nor credited as income & even if credited should be reversed or provided for the extent to which it is uncollected.

Leased Assets:-

In respect of leased assets, the finance charge component of finance income [as defined in 'AS 19 Leases' issued by the Council of the Institute of Chartered Accountants of India (ICAI)] on the leased asset which has accrued and was credited to income account before the asset became nonperforming, and remaining unrealized, should be reversed or provided for in the current accounting period.

Appropriation of recovery in NPAs:-

Any amount recovered towards interest in case of an account can be recognized as income, provided such credit in the account towards interest are not out of fresh or additional facilities sanctioned.

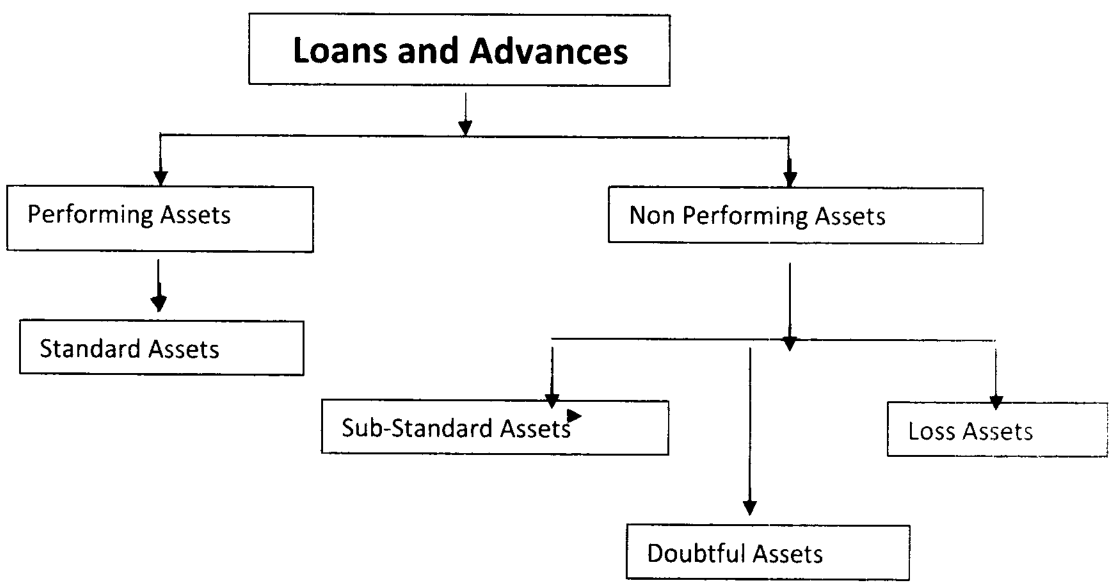
In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

Interest Application:-

On an account turning NPA, bank should reverse the interest already charged and not collected by debiting P&L account and stop further application of interest.[15]

2. Assets classification Norms as per RBI Guideline:-

As per RBI guideline banks loans and advance are to be classified into two broad categories-



Of the above standard asset are performing assets where as all the others are non-performing assets. Classification is done taking into consideration the degree of well define credit weakness & extent of

[15] http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6519

dependence on collateral security for realization of dues & period for which the assets remained in a particular category.

A. Standard Assets:-

Standard assets are performing assets; it is one which does not disclose any problem and which does not carry more than normal risk attached to the business. Such an asset should not be an NPA because here all the installment as well as interest are regularly paid. Here it is very important in the case of standard assets that the arrears of interest and the principal amount of loan do not exceeds 90 days at the end of financial year. If the amount due more than 90 days in standard assets category than it is NPA & NPAs are further needs to classify in sub-standard category.[16]

B. Sub-standard Assets:-

With effect from 31 March 2005 as per RBI notification, substandard asset is one, which has remained NPA for a period less than or equal to 12 months. In such cases, the current net worth of the borrowers/guarantors or the current market value of the security charged is not enough to ensure recovery of dues to the banks in full. In other words, such assets will have well defined credit weakness that jeopardizes the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

C. Doubtful assets:-

With effect from 2005 March 31, an asset is required to be classified as doubtful if it has remained NPA for more than 12 months. A loan classified as doubtful has all the weaknesses inherent as that classified as sub-standard, with the added characteristic that the weaknesses make

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[16]Study material of IPCC (2011), Paper 5, "Advance Accounting", ICAI, pp. 6.70

collection or liquidation in full, on the basis on currently known facts, conditions and values, highly questionable and improbable.[17]

An NPA need not go through the various stages of classification in case of serious credit impairment and such assets should be straight away classified as a doubtful/ loss asset as appropriate. Erosion in the value of security can be reckoned as significance when the realizable value of the security is less than 50% of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be, Such NPA may be straight away classified under doubtful category and provisioning should be made as applicable to doubtful assets.[18]

D. Loss Assets:-

A loss asset is one where loss has been identified by the bank or internal or external auditors or RBI inspection but the amount has not been written off wholly or partly. In other words, all those assets which cannot be recovered and of such little value that its continuance as a bank asset is not warranted although there may be some salvage or recovery value.[19]

Certain other important RBI guidelines with reference to classification of asset as substandard, doubtful, & loss category are given below:-

1. Classification of assets into sub standard, doubtful and loss categories should be done taking into account the degree of well defined credit weakness & the extent of dependence on collateral for realization of dues.

2. Bank should establish appropriate internal system to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high value of accounts. The banks may fix a minimum cut off

[17]http://www.paras.org.in/pdfs/mast_circ_irac_%20norms

[18]http://www.caclubindia.com/articles/npa-non-performing-assets-15399.asp#.VGYpxGd2HmA

[19]http://www.paras.org.in/pdfs/mast_circ_irac_%20norms

point to decide what would constitute a high value account depending upon their respective business levels. The cutoff point should be valid for the entire accounting year. Responsibility and validation levels for ensuring proper asset classification may be fixed by the banks. The system should ensure that doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per guidelines.

3. Accounting for temporary Deficiencies:-

The classification of an asset as NPA is required to be based on the record of recovery. Bank is not required to classify an advance as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non renewal of the limits on the due date etc. In the matter of classification of accounts with such deficiencies banks/financial institution may follow the following guidelines.

A). Banks is required to ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Drawing power is required to be arrived at based on the stock statement which is current. However considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months would be deemed as irregular.

Working capital borrower account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working on the borrowers financial position is satisfactory.

B). Regular and adhoc credit limits needs to be reviewed/regularized not later than three months from the due date or date of adhoc sanction. In case of constraints such as non-availability of financial statements & other data from the borrowers, the branch is required to furnish evidence to show that renewal/review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where regular/adhoc limit have not been reviewed/renewed within 180 days from the due date / date of adhoc sanction will be treated as NPA.[20]

4. Net worth of Borrower/Guarantor or availability of security:-

Since income recognition is based on recoveries from an advance account net worth of borrower/guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise likewise, the availability of security is not relevant for determining whether an account is NPA or not (this is ,however subject to certain exceptions).[21]

5. Asset Classification to be borrower wise and not facility wise:-

i). It is difficult to visualize a situation when only one facility to a Borrower/one investment in any of the securities issued by the borrower becomes a problem credit/investment and not others. Therefore, all the facilities granted by a bank to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA/NPI and not the particular facility/investment or part thereof which has become irregular.

ii). If the debits arising out of devolvement of letters of credit or invoked guarantees are parked in a separate account, the balance outstanding in that

[20] http://www.paras.org.in/pdfs/mast_circ_irac_%20norms

[21] Study material of IPCC (2011), Paper 5, "Advance Accounting", ICAI, pp. 6.67

account also should be treated as a part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

iii). The bills discounted under LC favoring a borrower may not be classified as a Non-performing advance (NPA), when any other facility granted to the borrower is classified as NPA. However, in case documents under LC are not accepted on presentation or the payment under the LC is not made on the due date by the LC issuing bank for any reason and the borrower does not immediately make good the amount disbursed as a result of discounting of concerned bills, the outstanding bills discounted will immediately be classified as NPA with effect from the date when the other facilities had been classified as NPA.

iv). The overdue receivables representing positive mark-to-market value of a derivative contract will be treated as a non-performing asset, if these remain unpaid for 90 days or more. In case the over dues arising from forward contracts and plain vanilla swaps and options become NPAs, all other funded facilities granted to the client shall also be classified as non-performing asset following the principle of borrower-wise classification as per the existing asset classification norms. Accordingly, any amount, representing positive mark-to market value of the foreign exchange derivative contracts (other than forward contract and plain vanilla swaps and options) that were entered into during the period April 2007 to June 2008, which has already crystallized or might crystallize in future and is / becomes receivable from the client, should be parked in a separate account maintained in the name of the client / counterparty. This amount, even if overdue for a period of 90 days or more, will not make other funded facilities provided to the client, NPA on account of the principle of borrower-wise asset classification, though such receivable overdue for 90 days or more shall itself be classified as NPA, as per the extant IRAC norms. The classification of all other assets of such clients will, however, continue to be governed by the extant IRAC norms.

v). If the client concerned is also a borrower of the bank enjoying a Cash Credit or Overdraft facility from the bank, the receivables mentioned at item.

vi). Above may be debited to that account on due date and the impact of its non-payment would be reflected in the cash credit / overdraft facility account. The principle of borrower-wise asset classification would be applicable here also, as per extant norms.

vii). In cases where the contract provides for settlement of the current mark-to-market value of a derivative contract before its maturity, only the current credit exposure (not the potential future exposure) will be classified as a non-performing asset after an overdue period of 90 days.

viii). As the overdue receivables mentioned above would represent unrealized income already booked by the bank on accrual basis, after 90 days of overdue period, the amount already taken to 'Profit and Loss a/c should be reversed.[22]

6. Accounts regularized near about the balance sheet date:-

The asset classification of borrower accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the statutory Auditors and Inspecting officers about the manner of regularization of the account to eliminate doubts on their performing status.

[22] http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6519

7. Advances under consortium Arrangements:-

Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank & or where the bank receiving remittances is not parting with the share of other member banks, the accounts will be treated as not serviced in the books of other member banks and therefore, be treated as NPA. The banks participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead bank or get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respecting books.

8. Up gradation of loan accounts classified as NPAs:-

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer treated as non-performing & may be classified as standard accounts. With regard to up gradation of a restructured or reshedulement account which is classified as NPA some RBI norms will be applicable.

9. Accounts where there is erosion in the value of security/ frauds committed by borrower:-

In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non availability of security and existence of other factors such as frauds committed by borrowers it will not be prudent that such accounts should go through various stages of asset classification. In cases of such serious credit impairment the asset should be straightaway classified as doubtful or loss asset as appropriate:

i). Erosion in the value of security can be reckoned as significant when the realizable value of the security is less than 50 percent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets.

ii). If the realizable value of the security, as assessed by the bank/ approved values/ RBI is less than 10 percent of the outstanding in the borrower accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided for by the bank.

10. Appropriation of recovery in NPAs:-

Interest realized on NPAs can be taken to income. However, it should be ensured that the credits towards interest in the relevant account are not out of fresh/additional credit facilities sanctioned to the borrowers concerned.[23]

11. Agricultural Advances:-

a). In respect of advances granted for agricultural purpose become NPA if interest and /or installment of principal remains overdue for two crop seasons in case of short duration crops and a loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crops season.

Crops having crop season of more than one year i.e. up to the period of harvesting the crops raised will be termed as long duration crops and other crops will be treated as 'short duration' crops.[24]

b). Where natural calamities impair the repaying capacity of agricultural borrower, banks may decide their own relief measures conversion of the short term loan into a term loan or reschedulement of the repayment period and the sanctioning of fresh loan issued by RBI time to time.

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[23] http://www.paras.org.in/pdfs/mast_circ_irac_%20norms

[24] Study material of IPCC(2011), Paper 5, "Advance Accounting", ICAI, pp. 6.65

c). In such cases of conversion or reschedulement the term loan as well as fresh short term loan may be treated as current dues and need not to be classified as NPA. The asset classification of these loans would there after be governed by the revised terms & condition and would be treated as NPA.

d). While fixing the repayment schedule in case of rural housing advances granted to agriculturist under India AwasYojana and Golden Jubilee Rural Housing Finance Scheme bank should ensure that the interest/installment payable on such advance are linked to crop cycle.

12. Government guaranteed advances:-

The credit facilities backed by guarantee of the central government though overdue may be treated as NPA only when the government repudiates its guarantee when invoked. This exemption from classification of government guaranteed advances as NPA is not for the purpose of recognition of income. The requirement of invocation of guarantee has been delinked for deciding the asset classification and provisioning requirement in respect of state government guaranteed exposures. With effect from the year ending 31 March 2006 state government guaranteed advances &investments in state government guaranteed securities would attract asset classification and provisioning norms if interest and/or principal or any other amount due to the bank remains overdue for more than 90 days.

13. Advance to PACS /FSS ceded to commercial banks:-

In respect of agricultural advances as well as advances for other purposes granted by banks of PACS/FSS under the on-lending system, only that particular credit facility granted to PACS/FSS which is in default for a period of two crop seasons in case of short duration crops and one crop season in case of long duration crops, as the case may be, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS/FSS. The other direct loans & advances, if any, granted by bank to the member borrower of PACS/FSS outside the on-lending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.

14. Advances against term deposits, NSCs, KVP/IVP etc:-

In respect of advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs, provided adequate margin is available in the accounts. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

15. Loans with moratorium for payment of interest:-

In the case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest becomes 'due' only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence do not become NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected.

In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on the respective due dates.

16. Take out finance:-

Take out finance is the product emerging in the context of the funding of long-term infrastructure projects. Under this arrangement, the institution bank financing infrastructure project will have an arrangement with any financial institution for transferring to the latter the outstanding in respect of such financing in their books on a predetermined basis. In view of the time lag involved in taking over, the possibility of a default in the meantime cannot be ruled out. The norms of asset classification will have to be followed by the concerned bank/financial institution in whose books the account stands as balance sheet item as on the relevant date. If the lending institution observes that the asset has turned NPA on the basis of the record of recovery, it should be classified accordingly.

The lending institution should not recognize income on accrual basis and account for the same only when it is paid by the borrower/taking over institution (if the arrangement so provides). The lending institution should also make provision against any asset turning into NPA pending its takeover by taking over institution. As & when the asset is taken over by the taking over institution, the corresponding provisions could be reversed. However, the taking over institution on taking over such assets, should make provisions treating the account as NPA from the actual date of it becoming NPA even though the account was not in its books as on that date.

17. Advances under rehabilitation approved by BIFR/TLI:-

Banks are not permitted to upgrade the classification of any advance in respect of which the terms have been renegotiated unless the package of renegotiated terms has worked satisfactorily for a period of one year. While the existing credit facilities sanctioned to a unit under rehabilitation packages approved by BIFR/term lending institutions will continue to be classified as sub-standard or doubtful as the case may be, in respect of additional facilities sanctioned under the rehabilitation packages, the income recognition. Asset classification norms will become applicable after a period of one year from the date of disbursement.

3. Provisioning norms for NPA:-

General :-

The main responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors. The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines.

Standard assets:-

Banks should make general provision for standard assets at the following rates for the funded outstanding on global loan portfolio basis. The provisioning requirement for all types of standard assets stands as follows:

(a). Direct advances to agricultural and Small and Micro Enterprises (SMEs) sectors at 0.25%.

(b). Advances to Commercial Real Estate (CRE) Sector at 1.00 per cent;

(c). All other loans and advances not included in (a) and (b) above at 0.40 per cent.

In conformity with the prudential norms, provision should be made on the basis of classification of assets into prescribed categories on non performing assets. Taking into account the time lag between an account becoming doubtful of recovery its recognition as such; the realization of the security and the erosion over time in the value of security charged to the Bank, the bank should make provision against sub standard assets, doubtful assets and loss assets as below.

i). The provision on standard assets should not be reckoned for arriving at net NPAs.

ii). The provision towards standard assets need not to be netted from gross advances but shown separately as contingent provision against standard assets under other liability & provisional others in schedule 5 of the balance sheet.

iii). It is clarified that the medium enterprise will attract 0.40% standard assets provisioning.

Substandard assets:-

(i). In the case of all loan account categorized as sub standard ,a general provision of 15 percent on total outstanding should be made without making any allowance for ECGC guarantee cover and securities available.

(ii). The 'unsecured exposures' which are identified as 'substandard' would attract additional provision of 10 per cent, i.e., a total of 25 per cent on the outstanding balance. However, in view of certain safeguards such as escrow accounts available in respect of infrastructure lending, infrastructure loan accounts which are classified as sub-standard will attract a provisioning of 20 per cent instead of the aforesaid prescription of 25 percent.

Doubtful assets:-

A provision of 100 percent is to be made to the extent to which the advance is not covered by the realizable value of the security to which the bank has a valid recourse and the realizable value is estimated on a realistic basis.

In regard to the secured portion, provision is to be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful:

Table No. 3.1

Provision in Doubtful assets

Period for which the advance has remained in 'doubtful' category	Provision requirement (%)
Up to one year	25
One to three years	40
More than three years	100
Note: Valuation of Security for provisioning purposes	

Source: www.rbi.org

Loss assets:-

The entire loss assets should be written off. If loss assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

Rates of Provisioning:-

RBI has directed that bank should make provision against all assets as follows:

Table No. 3.2

Rate of provisioning on assets

S.N.	Category of Advance	Rate of provisioning **
1	Standard Advance	
a.	Direct advance to agriculture & SME	0.25
b.	Advance to commercial real estate (CRE) sector	1.00
c.	All the other loans & advance not included in a & above	0.40
2	Sub-standard advances	
a.	Secured Exposures	15
b.	Unsecured Exposures	25
c.	Unsecured Exposures in respect of infrastructure Loan A/c where certain safeguards such as escrow A/c are available	20
3.	Doubtful Advance -Unsecured portion	100
	Doubtful Advances- Secured portion	
a.	For doubtful up to 1 yrs.	25
b.	For doubtful > 1 yrs. & up to 3 yrs.	40
c.	For doubtful > 3 yrs.	100
4.	Loss advances	100

** *RBI DBOD Circular No. DP.BC 94/21.04.048/2011-12 dated 18.05.2011*

Floating Provision:-

The bank's Board of Director should lay down approved policy regarding the level to which the floating provision can be created. The bank should hold floating provision for advances & investment separately. But the prescribed guidelines will be applicable to floating provision held for both advances and investment portfolio. It cannot be reversed by credit to the profit and loss account. They can only be utilized for making specific provisions in extraordinary circumstances. Until such utilization, these provisions can be netted off from gross NPAs to arrive at disclosure of net NPAs. Alternatively, they can be treated as part of Tier II capital within the overall ceiling of 1.25 % of total risk weighted assets.

Disclosures:-

Bank should make comprehensive disclosure on floating provision in the "Notes on Accounts" to the balance sheet on

a). Opening balance in the floating provision in the account,

b). The quantum of floating provision made in the accounting year,

c). Purpose and amount of draw down made during the accounting year &

d). Closing balance in the floating provision account.

Additional Provisions for NPAs at higher than prescribed rates:-

The regulatory norms for provisioning represent the minimum requirement. A bank may voluntarily make specific provisions under existing regulations for advances at that rates which are higher than the prescribed rates, to provide for estimated actual loss in collectible amount, provided such higher rates are approved by the Board of Directors and consistently adopted from year to year. Such additional provisions are not to be considered as floating provisions. The additional provisions for NPAs, like the minimum regulatory provision on NPAs, may be netted off from gross NPAs to arrive at the net NPAs.

Guidelines for Provisions under Special Circumstances:-

1. Advances granted under rehabilitation packages approved by BIFR/term lending institutions

(i). In respect of advances granted under rehabilitation package approved by BIFR/term lending institutions, the provision should continue to be made in respect of dues to the bank on the existing credit facilities as per their classification as substandard or doubtful asset.

(ii). As regards to the additional facilities sanctioned as per package finalized by BIFR and/or term lending institutions, from the date of disbursement provision on additional facilities sanctioned need not be made for a period of one year.

(iii). No provision need to be made for a period of one year, in respect of additional credit facilities granted to SSI units which are identified as sick [as defined in Section IV (Para 2.8) of RPCD circular RPCD.PLNFS.BC. No 83 /06.02.31/20042005 dated 1 March 2005] and where rehabilitation packages/nursing programmes have been drawn by the banks themselves or under consortium arrangements.

2. Advances granted against term deposits, NSCs eligible for surrender, IVPs, KVPs, gold ornaments, government & other securities and life insurance policies would attract provisioning requirements as applicable to their asset classification status.

3. Advances covered by ECGC guarantee:-

Provision should be made only for the balance in excess of the amount guaranteed by the Corporation in the case of advances classified as doubtful and guaranteed by ECGC. Further, while arriving at the provision required to be made for doubtful assets, realizable value of the securities should first be deducted from the outstanding balance in respect of the amount guaranteed by the Corporation and then provision is to be made

4. Advance covered by CGTSI guarantee:-

In case of the advance becomes non performing which is covered by CGTSI guarantee, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.

5. Takeout finance:-

The lending institution should make provisions against a 'takeout finance' turning into NPA pending its takeover by the taking-over institution. As and when the asset is taken-over by the taking-over institution, the corresponding provisions could be reversed.

6. Excess Provisions on sale of Standard Asset / NPAs:-

(a). If the sale is in respect of Standard Asset and the sale consideration is higher than the book value, the excess provisions may be credited to Profit and Loss Account.

(b). Excess provisions which arise on sale of NPAs can be admitted as Tier II capital subject to the overall ceiling of 1.25% of total Risk Weighted Assets.

7. Provisions for Diminution of Fair Value:-

Provisions for diminution of fair value of restructured advances, both in respect of Standard Assets as well as NPAs, made on account of reduction in rate of interest and / or reschedulement of principal amount are permitted to be netted from the relative asset.

8. Provisioning norms for Liquidity facility provided for Securitizations transactions:-

In respect of securitization transactions undertaken in terms of our guidelines on securitization dated February 1, 2006, should be fully provided for the amount of liquidity facility drawn and outstanding for more than 90 days.

9. Provisioning requirements for derivative exposures:-

Credit exposures computed as per the current marked to market value of the contract, arising on account of the interest rate & foreign exchange derivative transactions, and gold, shall also attract provisioning requirement as applicable to the loan assets in the 'standard' category, of the concerned counterparties. All conditions applicable for treatment of the provisions for standard assets would also apply to the aforesaid provisions for derivative and gold exposures.

10. Restructured Advances:-

i). Restructured accounts classified as standard advances will attract a provision of 2 per cent in the first two years from the date of restructuring. In cases of moratorium on payment of interest/principal after restructuring, such advances will attract a provision of 2 per cent for the period covering moratorium and two years; and

ii). Restructured accounts classified as non-performing advances, when upgraded to standard category will attract a provision of 2 per cent in the first year from the date of up gradation.

11. Treatment of interest suspense account:-

Amounts held in Interest Suspense Account should not be reckoned as part of provisions. Amounts lying in the Interest Suspense Account should be deducted from the relative advances and thereafter, provisioning as per the norms, should be made on the balances.[25]

3.8 Writing off of NPAs:-

In terms of Section 43(D) of the Income Tax Act 1961, income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the RBI in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the bank's profit and loss account or received, whichever is earlier.

This stipulation is not applicable to provisioning required to be made as indicated above. In other words, amounts set aside for making provision for NPAs as above are not eligible for tax deductions.

Therefore, the banks should either make full provision as per the guidelines or write off such advances and claim such tax benefits as are applicable, by evolving appropriate methodology in consultation with their auditors/tax consultants. Recoveries made in such accounts should be offered for tax purposes as per the rules.

3.9 Write-off at Head Office Level:-

Banks may write-off advances at Head Office level, even though the relative advances are still outstanding in the branch books. However, it is necessary that provision is made as per the classification accorded to the respective accounts. In other words, if an advance is a loss asset, 100 percent provision will have to be made therefore.

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[25] http://www.paras.org.in/pdfs/mast_circ_irac_%20norms

3.10 Disclosure in the Published Annual Report :-

In order to bring about uniformity in the disclosure practices adopted by the FIs & with a view to improving the degree of transparency in their affairs, FIs were advised to disclose certain important financial year2000-2001. Disclosure were to be made as part of the 'Notes on Account' to enable the auditors to authenticate the information, notwithstanding the fact that the same information might be published annual reports. These disclosure pertain to capital to Risk- weighted assets ratio (CRAR), Non Performing Assets and credit concentration, maturity pattern of rupee & foreign currency assets & liabilities, details of operating results, provisioning, movement in NPAs, exposure to sensitive sectors. Besides, separate details on loan assets and sub standard assets which have been subjected to restructuring etc, would also need to be disclosed. Furthermore, accounts restructured under corporate debt resrtructuring system also should be disclosed by FIS in their annual report as part of 'notes on account'.[26]

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[26]Shekhar, K.C., Shekharlekshamy, "Banking Theory and Practice" pp.258

CHAPTER – 4

LOAN GIVEN BY MPFC AND POSITION OF NON PERFORMING ASSETS

Chapter – 4

Loan given by MPFC and position of Non Performing Assets

4.0 Introduction:-

For the banks or financial institution, loans and advances as assets is a significant part in Gross earnings and Net profits and it constitute a major proportion in the assets portfolio of a financial institution. The share of advances in the total assets of the banks or financial institution forms more than 60 percent and as such it is the backbone of financial institution.[1]

Loans and advances provided by financial institution are helpful to fulfill the short-term and long term financial needs of the business enterprises such as individuals, firms, companies and industrial concerns. The growth and diversification of business activities are effected to a large extent through bank or institutional financing.[2]

The strength and soundness of the financial institution mainly depends upon the health of the advances. In other words, improvement in assets quality is very essential to strengthen the working of financial institution and it also improves the financial viability of financial institutions.[3] Therefore effective and efficient management of these assets is highly importance. If the quality of loans and advances does not maintained in the proper manner then it resulted the increasing of over dues, bad debts

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[1] Prof. Arunkumar, Rekha & Kotreshwar, G., " Risk Management in commercial Banks (A case study of public & private sector Banks)". Indian Institute of capital market 9th Capital market conference paper, India.

[2] http://download.nos.org/srsec319/319-35.pdf

[3] Prof. Arunkumar, Rekha & Kotreshwar, G., " Risk Management in commercial Banks (A case study of public & private sector Banks)". Indian Institute of capital market 9th Capital market conference paper, India.

and write off. All this had an adverse impact on profitability of the financial institution.[4]

4.1 Meaning of Loans and Advances:-

The amount borrowed by one person from another is termed as 'loan'. In the nature of loan, the amount refers to the sum paid to the borrower for specified time period. Therefore, it is 'borrowing' from the point of view of borrower and 'lending' from the point of view of bank. It may be regarded as 'credit' which is given for a definite purpose and for a specified time period and where the money is disbursed and its recovery is made on a later date. It is a debt for the borrower on which interest is charged at agreed rate and intervals of payment. On the other hand, 'Advance' is a credit facility provided by the bank to the borrower. Advances are mainly granted by banks to cater the short term needs of the borrower such as purchase of goods traded in and meeting other short-term trading liabilities. There is a sense of debt in loan, whereas an advance is a facility being availed of by the borrower. However, like loans, advances are also to be repaid. Hence, a credit facility repayable in installments over a period is termed as loan while a credit facility repayable within one year may be known as advances. However, these two terms are used interchangeably.[5]

4.2 Loan given by MPFC:-

There was a great need aroused to establish Regional Development Banks which fulfill the needs of medium & small scale industries. For this purpose from 1949 onwards, State Financial Corporation (SFCs) has been set up in nearly all the state. Each SFC provides financial assistance to the industrial concerns located within the political boundaries of the state to

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[4] Singh Kanhaiya and Dutta Vinay, "Commercial Bank management". pp.290

[5] http://download.nos.org/srsec319/319-35.pdf

which it belongs. Thus in the year 1955, Madhya Pradesh Financial Corporation was established in the state of Madhya Pradesh. It has been established to help entrepreneurs to set up new industries and undertake programmes of modernization, renovation, expansion & diversification. This corporation provides financial assistance mostly in the form of Term loan. MPFC was established with the basic objective of promoting industrial development in the state of Madhya Pradesh which has a high potential for industrial growth & which is endowed with abundant natural resources. It provides financial assistance to tiny sectors, SSIs, ancillary industries and medium scale industries in the state of Madhya Pradesh.

Terms and conditions required for financial assistance to industries:-

MPFC provides financial assistance to all industries of M.P. which manufacture goods but before providing assistance to the industries, MPFC seeks that how far the project seeking assistance will contribute towards the economic development of the state. For the promotion and development of industries in the state, the government has been granting loans and subsidy through the department of industries. Madhya Pradesh Financial Corporation plays an important role in providing loans to industries for development projects. The financial assistance provided by MPFC for purchase of fixed assets or long term assets, for expansion of existing units, for modernization or renovation, improving existing methods of production, increasing installed capacity & for implementation of entirely new scheme & projects. The applications of the industries are concerned against background of technical & financial feasibility, their future prospects and profitability & than their eligibility are being found out.

As MPFC provides financial assistance to many industries but it provides assistance under some terms and condition that is it has own policies of industrial finance or some rules and regulation under which it works, so some terms and condition are :

Concerns eligible for assistance:-

MPFC provides financial assistance to that industrial concern which defines in clause © of section 2 of SFC Act 1951 and which are located in the state of M.P. However, fee based services can be extended to units located in any part of the country.

MPFC can grant financial assistance to only those concerns that's paid up capital & free reserves taken together do not exceed Rs. 20.00 crore as per the provision of the SFC Act 1951. This limit is not applicable to non fund based activities. MPFC's total exposure to a single concern under all the schemes taken together shall not exceed Rs. 200. lacs in case of partnership and proprietary concern & Rs. 500 lacs in corporate entities subject to the limits prescribed under the various schemes of MPFC.[6]

Under the SFC act 1951; those industrial concerns are eligible for financial accommodation which is engaged in the following activities.

a). Manufacture of goods

b). Preservation of goods

c). Processing of goods

d). Mining

e). Generation of distribution of electricity or any other form of power

f). Hotel Industry

g). Transport of passenger of goods by road or by water or by air

h). Maintenance, repair, testing or servicing of machinery of any description of vehicles or verses of motor boats of, trawlers or tractors.

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[6] www.mpfc.org

i). Assembling, repairing or packing any article with the aid of machinery or power.

j). The development of any contiguous area of land as an industrial estate.

k). Fishing or providing shore facilities of fishing or maintenance thereof

l). Providing special or technical knowledge or other services for the promotion of industrial growth.[7]

Security:-

The first condition of MPFC was eligibility & the second condition is security. MPFC grants loans against security only. The primary security for the loan is usually a first charge on land, building, plant & machinery etc. acquired/ proposed to be acquired, in case of loan under consortium arrangement, pari passu charge is accepted along with other participating institutions. Generally, MPFC takes collateral security of land and /or building of the borrower or any third party in addition to primary security. MPFC also has a floating charge on all the remaining assets of the borrower subject to the charge in favor of the bankers for working capital.

Margin:-

The difference between the value of assets offered as prime security and the amount of loan is known as Margin.

The margins prescribed for loans under various categories are shown in Table No. 4.1 :

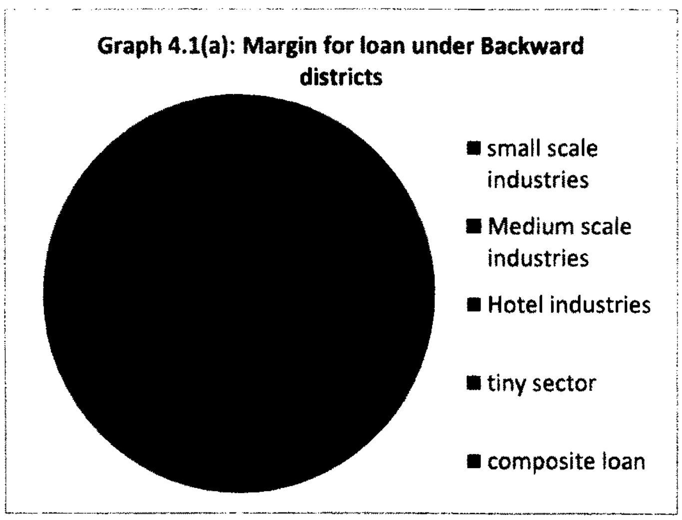
[7] Desai. Vasant. "The Dynamics of Enterpreneurial. Development & Management". Himalaya Publishing House. pp. 510-511

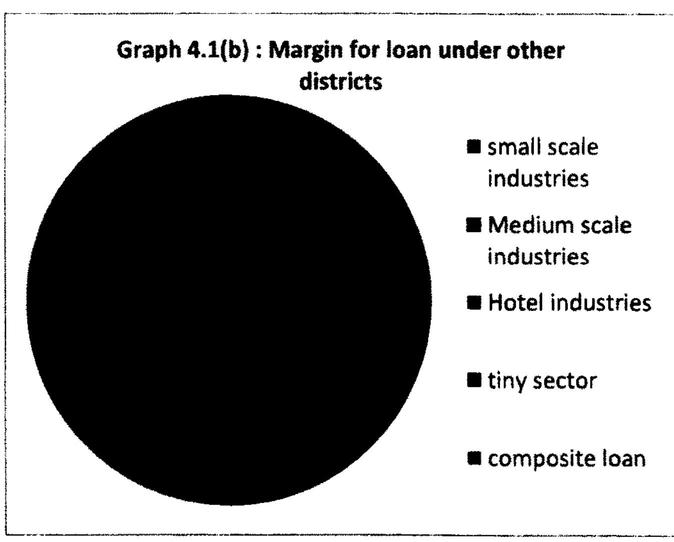
Table No. 4.1

Margin prescribed for loans under various categories in MPFC

Category	Backward Districts	Other Districts
Small Scale Industries	20%	25%
Medium Scale Industries	25%	40%
Hotel Industry	50%	50%
Tiny Sector	10%	15%
Composite Loan	Nil	Nil

Source: ***www.mpfc.org***





Promoter's Contribution:-

The minimum promoter's contribution expected in the project is worked out on the basis of Debt- Equity norm and the security margin norm applicable at the time of sanction of the loan. The debt equity ratio is the ratio of debt i.e. loan component and the equity contribution in the total project cost. The maximum amount of assistance shall be lower of the two amounts worked out on the basis of Debt-Equity norm and the security margin norm. The normal lending norm for debt-equity is 1.5:1; however in some specific schemes this norm may be flexible. The entire promoter's contribution expected in the project is desired to be raised by way of capital before first disbursement of the loan installment. However, in case the promoters are short of own capital, some amount may be raised as unsecured loan in the form of quasi-capital. The quantum is ascertained during the appraisal of loan proposal.

Repayment Period:-

The repayment period of loan is generally ranges between 5 to 8 years, which is decided on the merits of each case. The principal amount of loan is normally payable in six monthly installments with an initial moratorium period of 6 months to 2 years, which is depend upon the size of the project & stage of the implementation. Normally, the Interest is also charged on half yearly basis and the months of payment of interest & principal are kept different to even out the liability of the borrowers.

Insurance:-

MPFC offered assets as a security of the loan. Those assets should be kept insured for their full value during the currency of the loan. Under the insurance, the risk normally cover is those which are related to fire, riots etc. and the specific risks attributable to a specific project which the corporation may specify. The insurance policy should be taken in the joint names of the corporation and the borrower- with the usual mortgage clause. The first insurance policy and the subsequent renewals of the insurance policy should be sent to MPFC as soon as they are affected. In case the same is not spent in time. MPFC has a right to get the same insured on the cost & risk of the borrower unit.

Other Conditions:-

- Application of borrowers for getting financial assistance should be duly filled –up and signed. It should be submitted to concerned field office of MPFC in the prescribed form along with all necessary details and enclosures as specified in the said application form. Application is to be made by the borrower in duplicate/triplicate as may be required by the concerned field office.
- In case of proprietor or partners, they should not draw any remuneration, interest on capital, or any other payment and in case of corporate bodies no dividend should be declared till the project commences operation or any installment or interest is in default towards the corporation.
- During the currency of the loan, the capital and unsecured loans fixed& raised as per the terms and conditions of sanction should not be withdrawn.
- An undertaking should be given by the promoters that in case of any short fall in the resources then, they met the same from their own sources.
- The promoters of the concern should give a declaration that no inquiry has been instituted against them/him and/or is pending against them/him/ or any of them for economic offenses by the central of state govt. and they/ be shall under take no to do anything which may constitute such an economic offense.

- The sanction loan will automatically cancel, in case; the documentation is not done within one year from the date of sanction letter.
- In case, if full sanctioned amount is not availed within a period of 18 months from the date of sanction then the balance loan is automatically canceled.
- MPFC has a right to appoint director/directors on the company's Board of Directors who shall not be required to hold qualification shares and shall also not be liable to retire by rotation.
- MPFC has a right to inspect the factories, offices, godowns, other business places. It also has a right to inspect all the books of account, voucher and related records etc. and can get the same audited, investigated etc.

Without the prior approval, the concern / company shall not do the following acts:

- Undertaking expansion or implementing other scheme involving capital expenditure other than the one for which loan is sanctioned.
- Change in constitution and / or management.
- Giving on lease, hire, license the land, building, machineries or any part thereof, or creating any change on the properties mortgaged/ hypothecated.
- Transfer of disposal of the share holdings by the promoter/directors.
- Change in the scheme approved like in building specification / supplies of machineries etc.[8]

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[8] www.mpfc.org

4.3 Key operation area of MPFC:-

The key operation area of MPFC is Sanction, Disbursement and Recovery of loans. The position of sanction, disbursement and recovery portfolio of MPFC are as follows:

Sanction :-

MPFC primarily provides financial assistance to small and medium scale industries. After receiving the loan application of the borrower, the concern authority appraises loan proposals and scrutinizes the whole documents of the borrower. Then, the concerning authority sanction the loan cases as per power delegated to them.[9] The study of Sanction portfolio of MPFC has shown in Table No. 4.2

Table No. - 4.2

The study of Sanction Portfolio of MPFC

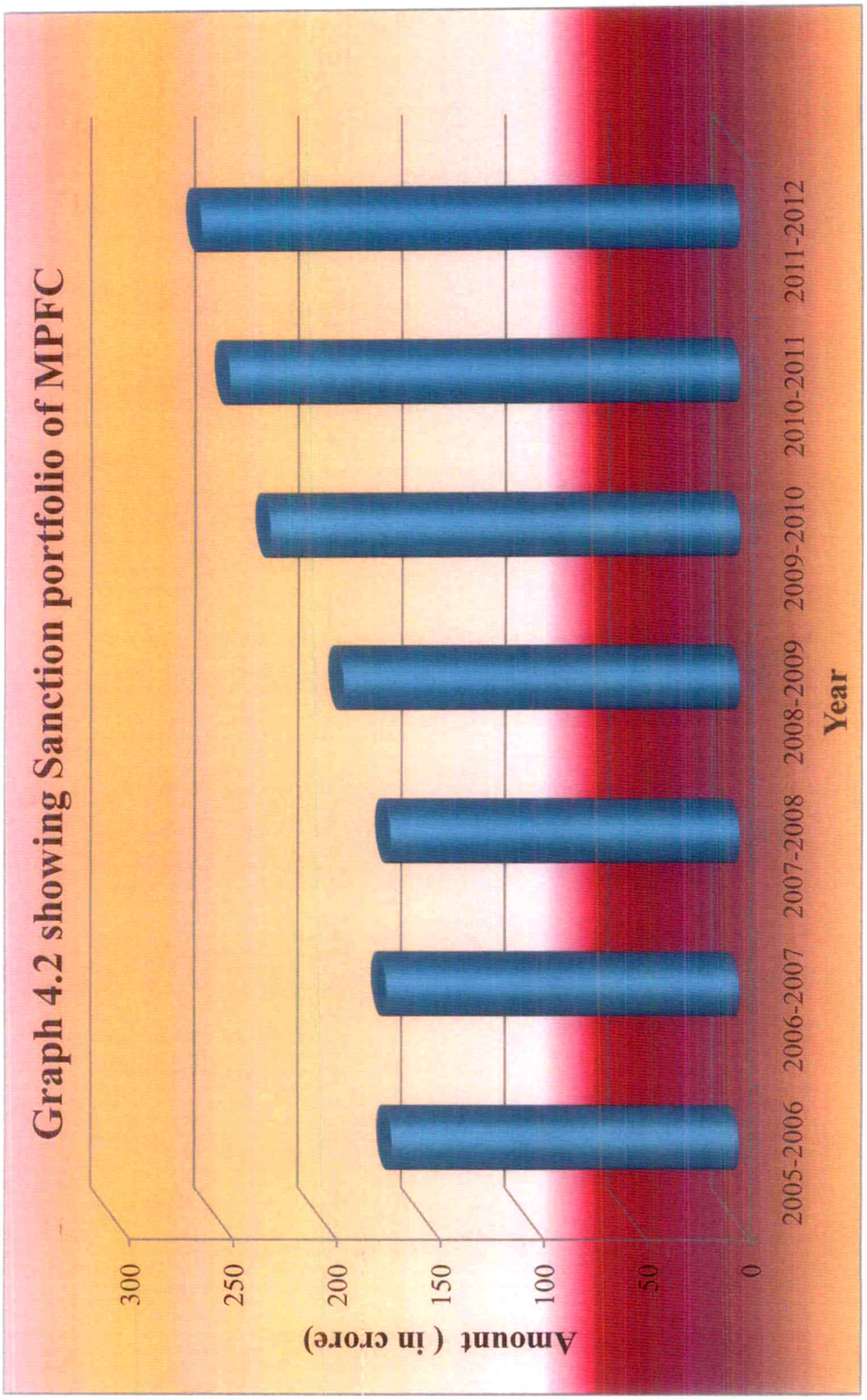
(Rs in crore)

Year	Sanction Amount	Index (Base Year is 2005-06)
2005-06	167.72	100
2006-07	170.30	102
2007-08	168.45	100
2008-09	191.32	114
2009-10	226.73	135
2010-11	246.35	147
2011-12	260.03	155

(Excluding liquid fund scheme)

Source: Annual Report of MPFC from 2005-06 to 2011-12

[9] Dr. Jagtap Uttam, Deo Rahul and Malu Sandeep (2012) conducted a study on "An analytical study Of Sanction, Disbursement & Recoveries Of MPFC after liberalization [1991-2003]". International Journal of Research in Commerce, Economics & Management, Vol. 3, no.-1, Jan-April-2012, pp. 34



Graph 4.2 showing Sanction portfolio of MPFC

The study of sanction portfolio of MPFC has shown in Table No. 4.2 which shows that in the year 2005-06, MPFC sanctioned loan Rs. 167.72 crore and became 170.30 crore in the year 2006-07 in absolute term, thus it increased to 2%. But in the year 2007-08, it slightly increased as compared to 2005-06, then in the year 2008-09; it increased to 14%, 35% in 2009-10, 47% in 2010-11 and 55% in 2011-12 as compared to 2005-06. It has been found that loan sanctioned by MPFC shows increasing trend.

Disbursement:-

For the success of the project, only sanction of loan after proper appraisal is not sufficient. Disbursement of loan according to the requirement of the project & close supervision and follow up are also equally important. After receiving of sanction letter, the entrepreneur is required to give the acceptance of term & condition in writing to the corporation within 15 days. After receiving the acceptance from the borrower, the corporation prepare a loan agreement and comply all the required legal formalities, then corporation disburse loan impart as a project work is on progress. Obviously, disburses amount of loan might be less than sanctioned amount or it may have equal with sanction amount.[10]Table No. 4.3 showing the study of Disbursement portfolio of MPFC.

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[10] Dr Jagtap Uttam, Deo Rahul and Malu Sandeep (2012) conducted a study on "An analytical study Of Sanction, Disbursement & Recoveries Of MPFC after liberalization [1991-2003]". International Journal of Research in Commerce, Economics & Management, Vol. 3, no.-1, Jan-April-2012.. pp. 36

Table No. – 4.3
Disbursement portfolio of MPFC

(Rs in crore)

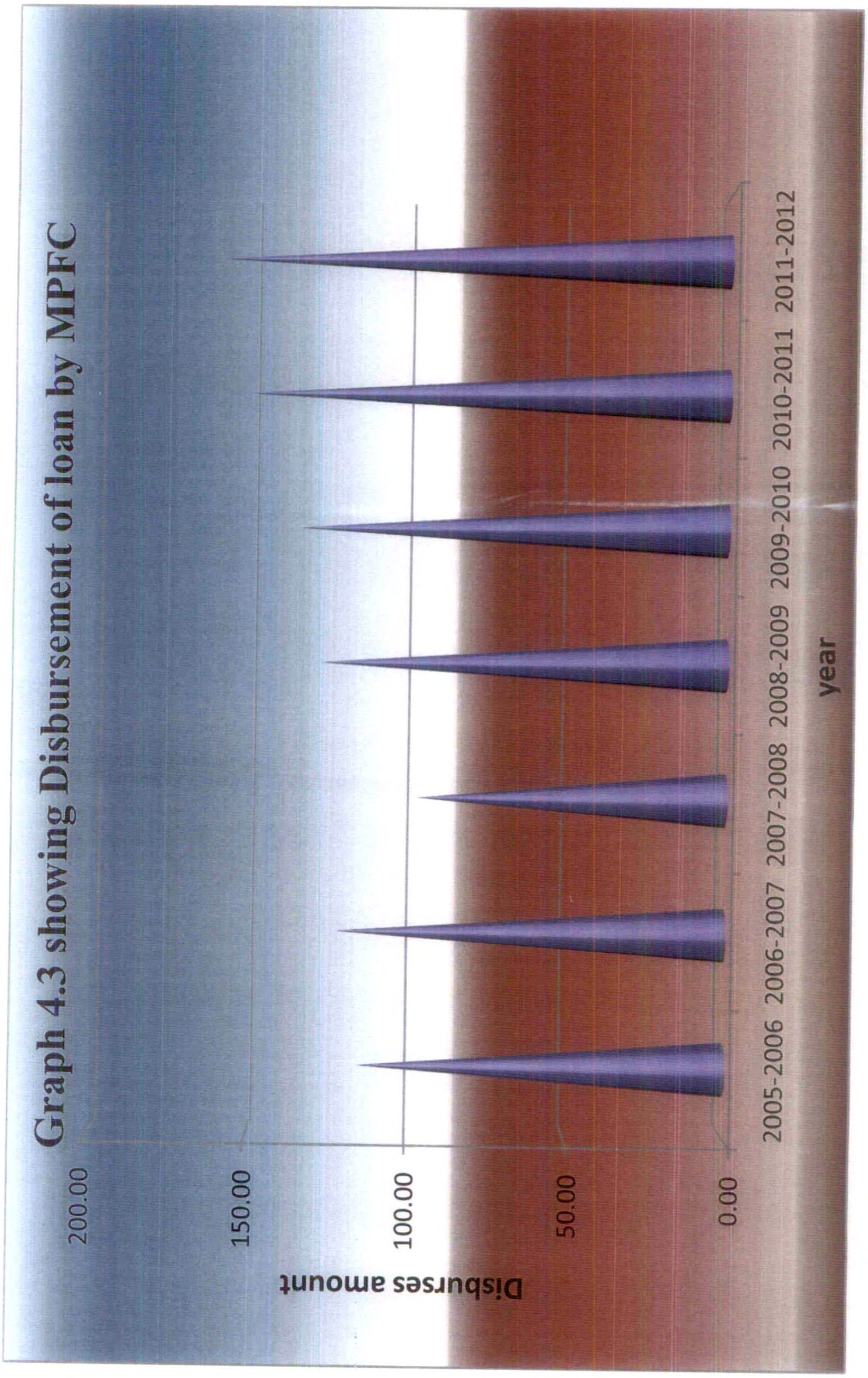
Year	Disbursed Amount	Index (Base Year is 2005-06)
2005-06	115.54	100
2006-07	122.60	106
2007-08	97.27	84
2008-09	127.93	111
2009-10	135.41	117
2010-11	151.25	131
2011-12	163.03	141

(Excluding liquid fund scheme)

Source: Annual Report of MPFC from 2005-06 to 2011-12

The study of the disbursement portfolio of MPFC has showing in Table no. 4.3 which shows that in the year 2005-06; MPFC disbursed Rs. 115.54 crore loans to the borrowers and became 122.60 crore in the year 2006-07, thus it registered a growth of 6%. Then in the year 2007-08, it decreased to 16% as compared to 2005-06. During this year, the loan disbursed by MPFC reduces as an effect of revised RBI instruction for providing refinance to SFCs. So that the corporation had to face difficulties in availing refinance from SIDBI which resulted into reduction in disbursement in the first half of the year.[11] Then from 2008-09, it again increased to 11%, 17% in 2009-10, 31% in 2010-11 and 41% in 2011-12 as compared to 2005-06. This indicates that loan disbursed by MPFC shows increasing trend.

[11] Annual report 2007-08 pp.4



Graph 4.3 showing Disbursement of loan by MPFC

Recovery:-

Recovery means collection of amount due. It is that instrument which measures the progress of any institution. In other words, progress is not measured through the borrowed amount given by any institution, but it is measured through the recovery quantity of that institute. It is one of the very important sources of funds for the corporation. If any institute could not recover a loan amount and interest in any particular time, then the corporation's economic condition sets down. Financial institutes or corporation does recoveries in three levels firstly; they recovered principal amount secondly; interest amount and thirdly; is penalty on delayed payment. If the recoveries of any institution are well in all these three levels; then, the concerned institute will remains in the profit; while it has been available liquidity for future business.[12] MPFC has also made its effort for recovery in every financial year.

The study of recovery portfolio of MPFC is shown in Table No. 4.4.

[12]Jagtap Dr. Uttam, Deo Rahul and Malu Sandeep (2012) conducted a study on "An analytical study Of Sanction, Disbursement & Recoveries Of MPFC after liberalization [1991-2003]". International Journal of Research in Commerce, Economics & Management, Vol. 3, no.-1, Jan-April-2012. EISSN 2277-4955. pp. 38

Table No. 4.4

Recovery Portfolio of MPFC

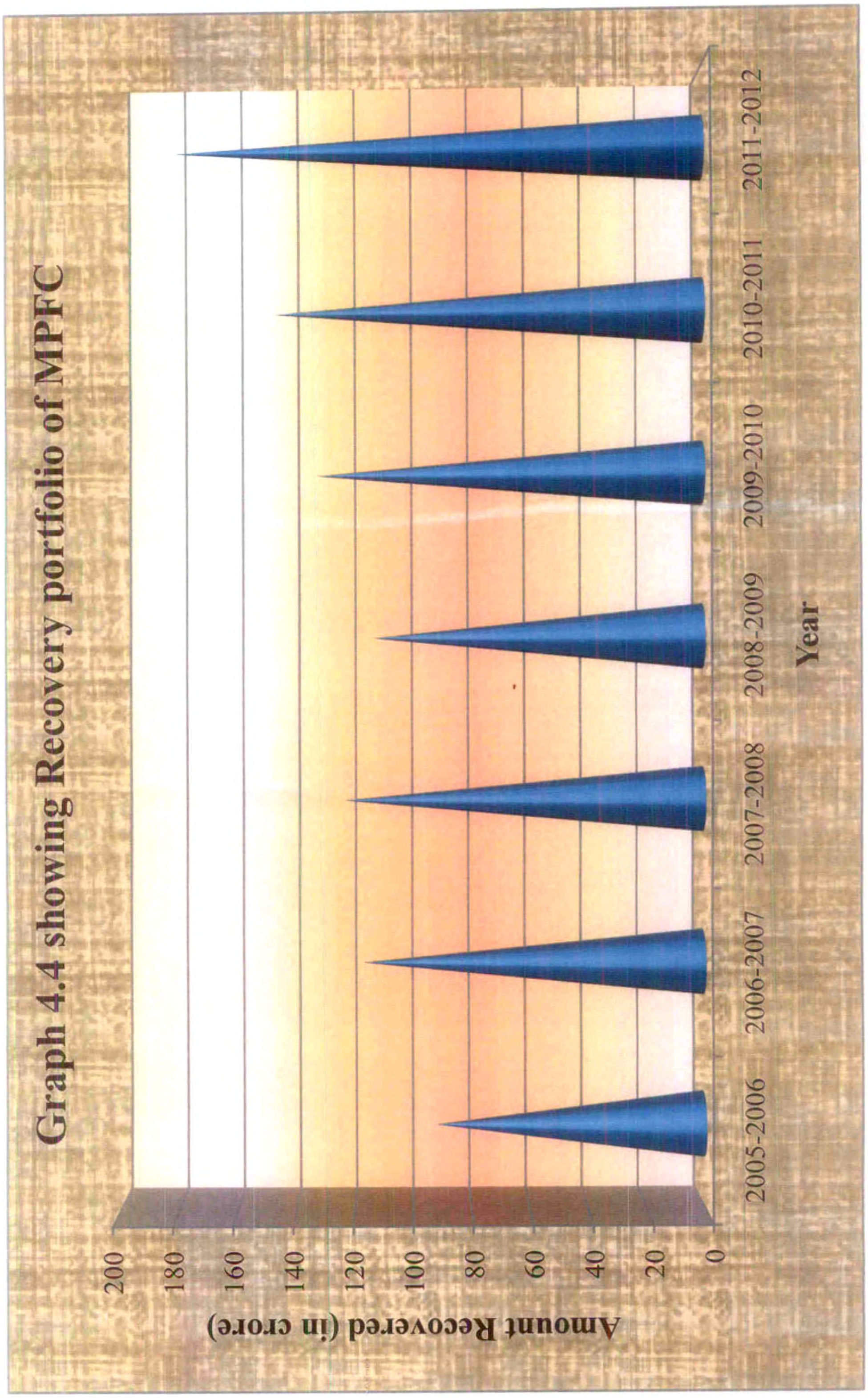
(Rs. in crore)

Year	Amount Recovered	Index (Base Year is 2005-06)
2005-06	91.80	100
2006-07	116.72	127
2007-08	122.83	134
2008-09	113.11	123
2009-10	132.70	145
2010-11	147.06	160
2011-12	181.15	197

(Excluding GOMP recovery)

Source: Annual Report of MPFC from 2005-06 to 2011-12

The study of recovery portfolio of MPFC has shown in Table no. 4.4. It shows that in the year 2005-06, MPFC recovered 91.80 crore from its portfolio and became 116.72 in the year 2006-07, it increased to 27%. Then in the year 2007-08, it again mounted by 34% as compared to 2005-06. But in the year 2008-09, it became 113.11 crore as compared to previous year i.e. 122.83 crore in absolute term, thus it declined about 8%. This was despite slowdown in economy due to global downturn having affected Indian scenario. In the subsequent year, the recovery portfolio of corporation mounted from 132.70 crore in the year 2009-10 to 181.15 crore in the year 2011-12 in absolute term; despite the impact of economic


Graph 4.4 showing Recovery portfolio of MPFC
Amount Recovered (in crore)
200
180
160
140
120
100
80
60
40
20
0
2005-2006
2006-2007
2007-2008
2008-2009
2009-2010
2010-2011
2011-2012
Year

slowdown. This inferred that MPFC showed increasing trend in recovery of loans and advances despite of economic slowdown in Indian economy.

Accumulated study of Sanction, Disbursement & Recovery of loan in MPFC:-

The Accumulated study of Sanction, Disbursement & Recovery portfolio of MPFC has shown in Table No. 4.5

Table No. 4.5

Accumulated study of Sanction, Disbursement & Recovery of loan in MPFC

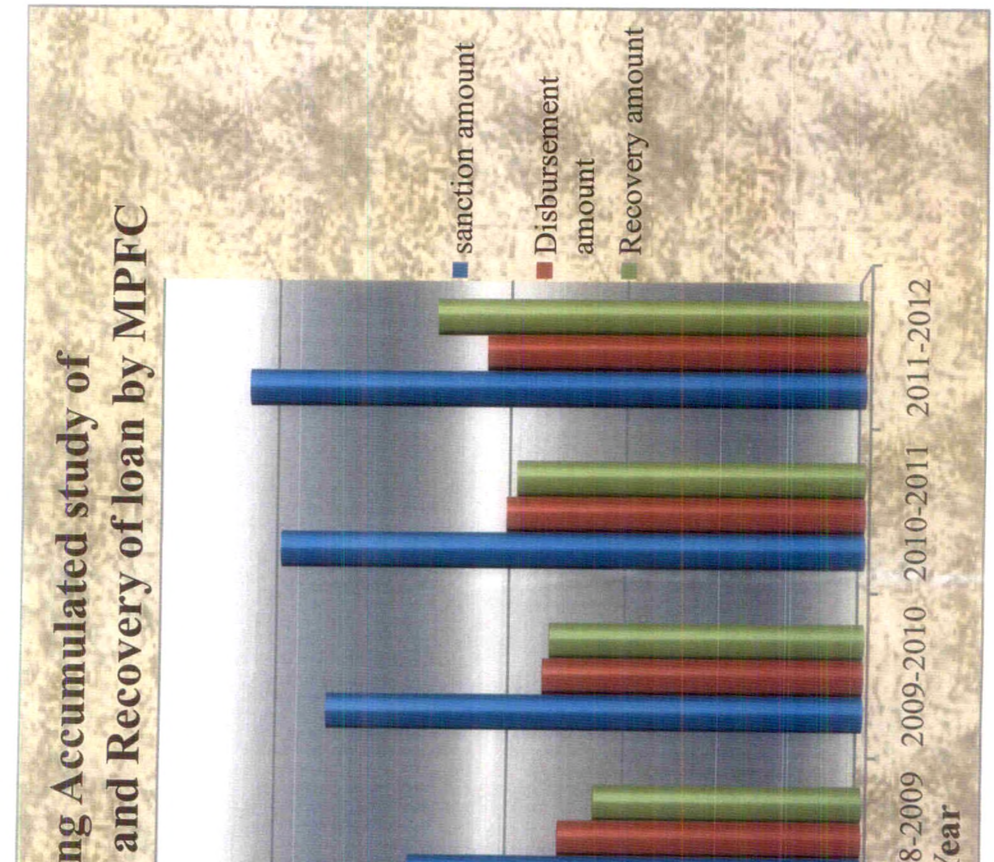
(Rs. in crore)

Year	Sanction Amount (A)	Disbursement Amount (B)	Recovery Amount (C)	% of Disbursement to Sanction	% of Recovery to Disbursement
2005-06	167.72	115.54	91.80	69	79
2006-07	170.30	122.60	116.72	72	95
2007-08	168.45	97.27	122.83	58	126
2008-09	191.32	127.93	113.11	67	88
2009-10	226.73	135.41	132.70	60	98
2010-11	246.35	151.25	147.06	61	97
2011-12	260.03	163.03	181.15	63	111
Total	1430.9	913.03	905.37	64%	99%

Source : Annual Report of MPFC from 2005-06 to 2011-12

Sanction & Disbursement:-

Table no. 4.5 shows percentage of disbursement against sanction. The total sanction & disbursement figure of corporation aggregated Rs. 1430.9 crore & Rs. 913.03 crore respectively. The total disbursement as a


Graph 4.5 showing Accumulated study of Sanction, Disbursement and Recovery of loan by MPFC
Amount (in crore)
300
250
200
150
100
50
0
2005-2006
2006-2007
2007-2008
2008-2009
2009-2010
2010-2011
2011-2012
Year
sanction amount
Disbursement amount
Recovery amount

percentage of sanction during the period of study is 64%. This indicates that 64% of sanctioned loans are converted into disbursement. This shows that the disbursement procedure of the MPFC is not very complicated.

Disbursement & Recovery:-

Table no. 4.5 shows the percentage of recovery against disbursement of loan it does not indicate NPA. The percentage of Recovery to disbursement increased from 79% in the year 2005-06 to 111% in the year 2011-12. This percentage touched all time high in the year 2007-08. This may be attributed to the loan disbursed by MPFC reduces; as an effect of revised RBI instructions for providing refinance to SFCs. During this year, the corporation had to face difficulties in refinance from SIDBI which resulted into reduction in disbursement in the first half of the year. The total disbursement & recovery figure of corporation aggregated Rs. 913.03 crore & 905.37 crore respectively. The average recovery as a percentage of disbursement during the period of study is 99%, which is very healthy.

4.4. Classification of loans and Advances given by MPFC:-

MPFC has played a very important role in the development of industry in the state of Madhya Pradesh. The main objective of MPFC is to provide financial assistance to small and medium scale industries in state of M.P. It provides financial assistance to industries by way of term loan, working capital loans etc. It operates a number of schemes of refinance and equity type assistance on behalf of IDBI/ SIDBI in addition to the various schemes for special target groups.[13] The table given below, shows overall scenario of loans and advances given by MPFC to various category of term loan and working capital medium term loan since its inception. This overall

[13] Garg Rakesh and Gupta Priya, "State Financial Corporations and industrial development: A case study of PFC & HFC. Journal on Banking Financial Services & Insurance Research, Vol. 1, Issue 6 (Sep. 2011), pp. 69-70

portfolio comprises of principle outstanding, interest due, penal interest, and other dues till date.

Term Loan:-

Term loan is normally sanctioned to the borrowers for purchasing long term assets such as land, factory, building, plant and machinery, electrical installation etc. and for modernization, diversification, expansion etc. to existing units.[14] The term loan is that kind of loan, which is repayable in installments irrespective of a period or the security over. It is not a demand loan.[15]

MPFC provides term loan to new industrial units for purchasing of fixed assets, such as land, factory, building, plant & machinery, electrical installation etc. and for modernization, diversification, expansion and replacement of equipment etc. to existing units. It is also provided to Hotels, service Industries, R&D activities and setting up of various facilities for industries. Term loan provided by MPFC for the period of 5 to 8 years, which depends upon merits of the case. The maximum limit of assistance to non corporate sector is Rs. 200 lacs and for corporate sector is Rs. 500 lacs.[16] Position of Term loan provided by MPFC has shown in Table No. 4.6

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[14]Muraleedhran.D., "Modern Banking: Theory & practice", pp.61

[15]Iyenger Vijayaragavan., "Introduction to Banking", pp. 383

[16]www.mpfc.org

Table No. – 4.6

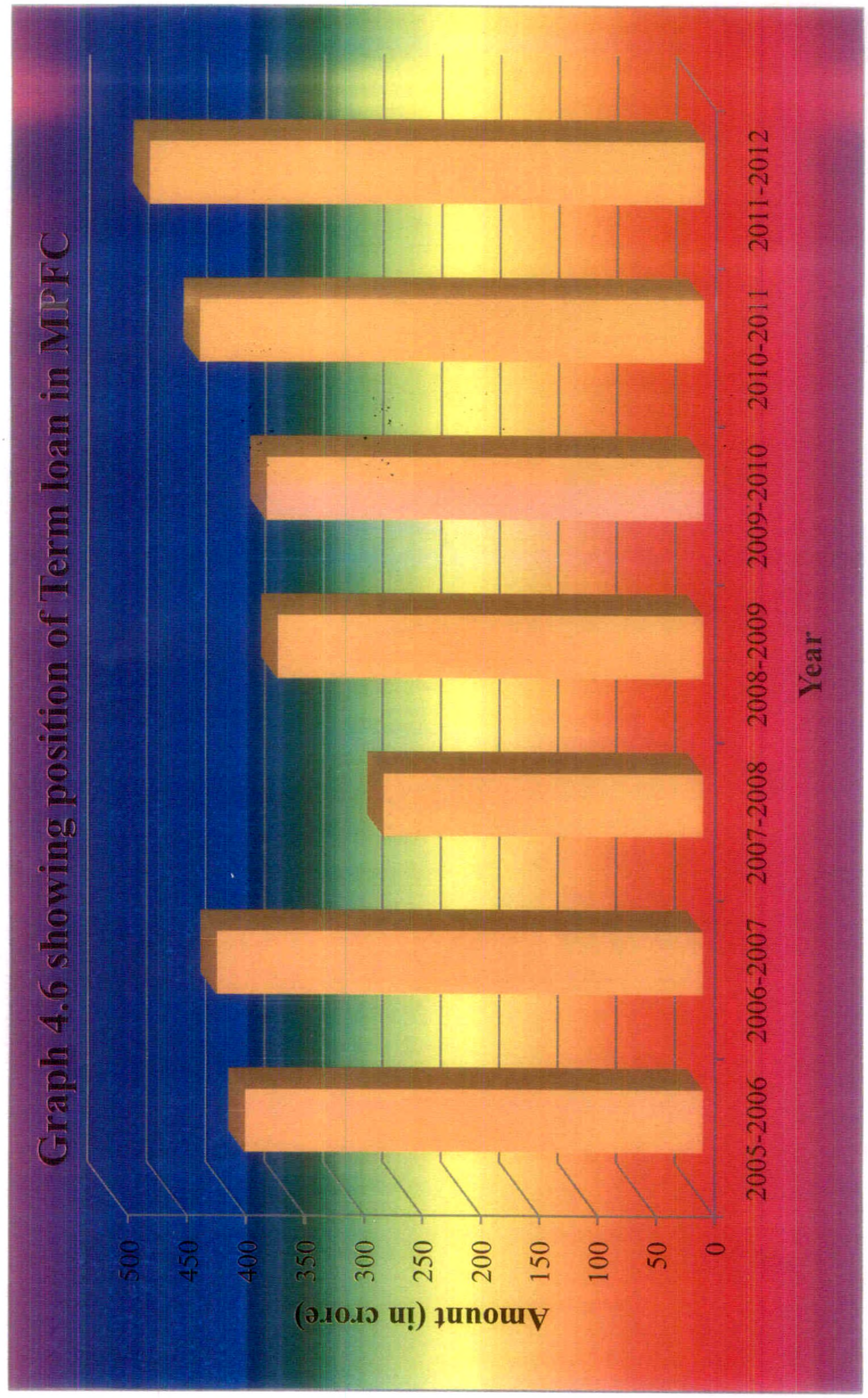
Position of Term loan provided by MPFC

(Rs. in crore)

Year	Total	Index (Base Year is 2005-06)
2005-2006	391.12	100
2006-2007	414.92	106
2007-2008	272.99	70
2008-2009	363.55	93
2009-2010	373.21	95
2010-2011	430.37	110
2011-2012	473.63	121

Source : Computed from Annual Reports & Accounts of MPFC

The study of position of Term loan is shown in Table No. 4.6 which shows that in the year 2005-06, MPFC provides 391.12 crore of Term loan to entrepreneur and it increased up to year 2011-12 about 21% as compared to 2005-06. But in the year 2007-08, it became 272.99 crore, thus it registered a decline of 30% as compared to 2005-06; this was because of the effect of revised RBI instruction for providing refinance to SFCs. The corporation during the year 2007-08 had to face difficulties in availing refinance from SIDBI. This resulted into reduction in disbursement in the first half of the year. Thereafter from 2008-09 to 2011-2012 term loans position improved and increased as compared to 2007-08 in absolute term. Thus, this shows that Term loan position of MPFC is in increasing trend which indicates that MPFC provides better financial assistance to the industrial units.


Graph 4.6 showing position of Term loan in MPFC
Amount (in crore)
0
50
100
150
200
250
300
350
400
450
500
2005-2006
2006-2007
2007-2008
2008-2009
2009-2010
2010-2011
2011-2012
Year

Working Capital Medium terms Loans:–

Terms loan is provided under this scheme by MPFC to part finance long term/medium term working capital requirement of the industrial units. It is provided to those industries that's having last 3 years profitable operations and having good track record with institution/banks. MPFC borrowers whose fixed assets are mortgaged with MPFC and those who are not MPFC borrowers but intend to offer all their existing fixed assets by way of mortgage as primary security can avail assistance. If the unit has availed working capital assistance from bank, MPFC normally shall not have any charge on the current assets of the units. The assistance is repayable in 3 to 5 years. Minimum 2.50 lacs and maximum 500 lacs of loan provided under this scheme.[17] Position of working capital medium term loan has shown in Table No. 4.7

Table No. 4.7

Position of Working Capital Medium Term loan provided by MPFC

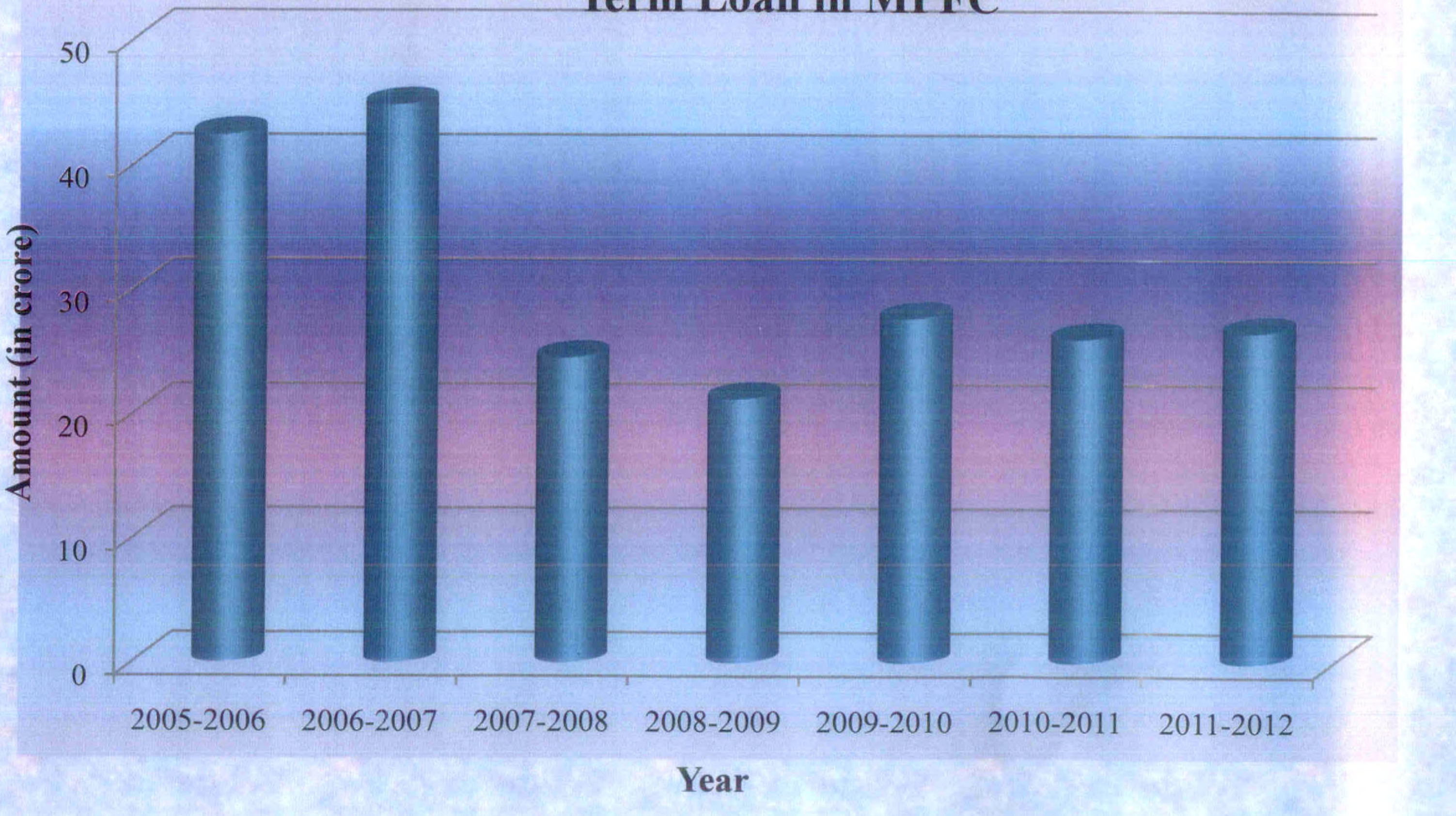
(Rs. in crore)

Year	Total	Index (Base Year is 2005-06)
2005-2006	42.41	100
2006-2007	44.82	105.68
2007-2008	24.53	57.8
2008-2009	21.21	50
2009-2010	27.70	65.3
2010-2011	26.078	61.5
2011-2012	26.60	62.7

Source: Computed from Annual Report & Accounts of MPFC

[17] www.mpfc.org

Graph 4.7 showing position of Working Capital Medium Term Loan in MPFC



The study of position of working capital medium term loan is shown in Table No. 4.7, which shows that in the year 2005-06, Working capital medium term loan provided by MPFC was 42.41 crore and became 26.60 crore in the year 2011-12. Thus, it decreased about 37.3% as compared to 2005-06. In the year 2006-07, it has increased about 5.68% as compared to previous year. In the subsequent years; it went on decreasing up to 2008-09, which was about 53% as compared to 2006-07. Then, in the year 2009-10, it registered a growth of Rs. 6.49 crore in absolute term as compared to 2008-09. Further, it decreased in 2010-11 and then in the year 2011-12, it slightly increased in absolute term as compared to their previous year. This shows the fluctuating trend of working capital medium term loan.

4.5. Position of Gross Loan and Advances in MPFC:-

Gross loans & advances is the sum of total loans & advances. This portfolio has assumed greater importance as it constitutes the largest proportion in the assets portfolio of the financial institution. The study of position of Gross Loans & Advances in MPFC has shown in Table No. 4.8.

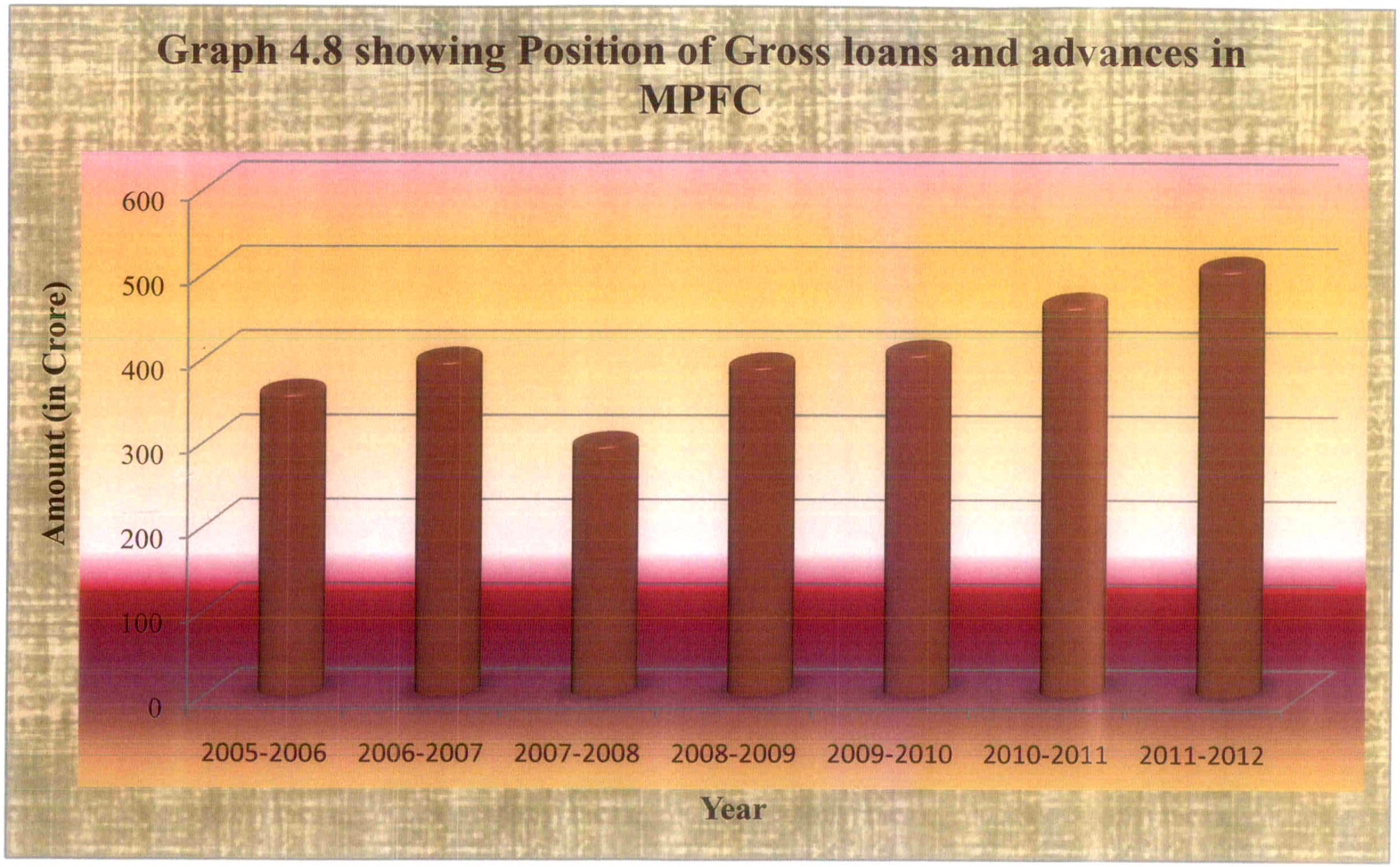
Table No. 4.8

Position of Gross Loans & Advances in MPFC

(Rs. In crore)

Year	Gross Loans & Advances Amount	Index (Base year 2005-06)
2005-2006	358.91	100
2006-2007	397.46	111
2007-2008	297.52	83
2008-2009	391.24	109
2009-2010	406.73	113
2010-2011	463.46	129
2011-2012	506.63	141

Source: Computed from Annual Reports & Accounts of MPFC


Graph 4.8 showing Position of Gross loans and advances in MPFC
Amount (in Crore)
600
500
400
300
200
100
0
2005-2006
2006-2007
2007-2008
2008-2009
2009-2010
2010-2011
2011-2012
Year

The study of position of Gross loans & advances has shown in Table no. 4.8, which shows that in the year 2005-06, MPFC provided 358.91 crore loans & advances to the borrowers and in the year 2011-12, it has increased to 506.63 crore about 41% as compared to the year 2005-06. But in the year 2007-08, it has decreased about 17% as compared to 2005-06. Because, during this year corporation had to face difficulties in availing the refinance from SIDBI due to this loans & advances were decreased and thereafter; from the year 2007-08 to 2011-12, it registered a growth about 70% as compared to 2007-08. This study revealed that loans & advances provided by MPFC shows increasing trend.

4.6. Position of Net Loans & Advances in MPFC:-

Provision for NPA is deducted from gross loans and advances then the outcome will be Net loans and advances. The study of position of Net Loans & Advances in MPFC is shown in Table No. 4.9

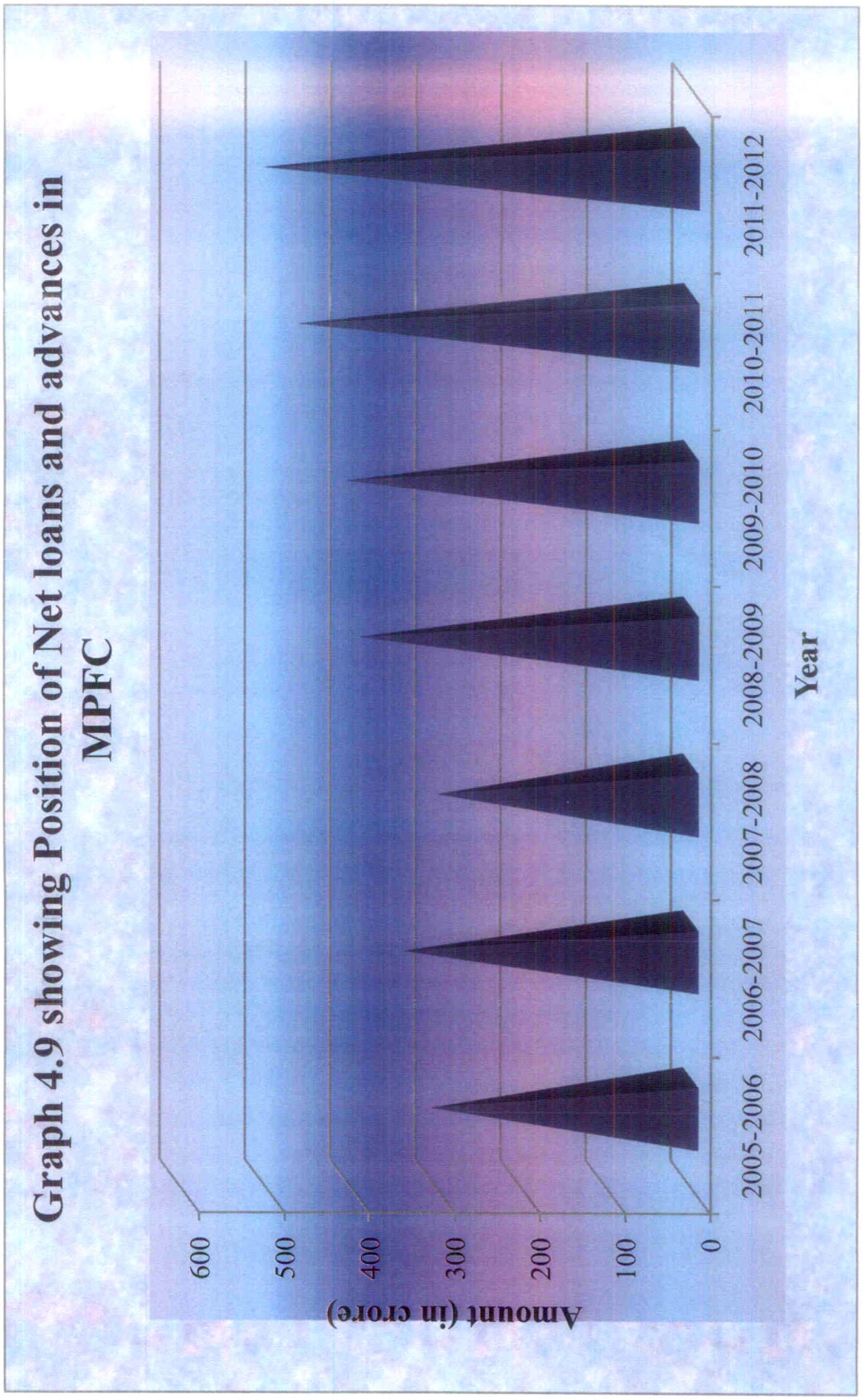
Table No. 4.9

Position of Net Loans & Advances in MPFC

(Rs. in crore)

Year	**Net Loans & Advances Amount**	**Index (Base year 2005-06)**
2005-2006	305.03	100
2006-2007	337.51	111
2007-2008	297.52	97.5
2008-2009	390.42	128
2009-2010	405.75	133
2010-2011	461.99	151
2011-2012	502.16	165

Source: Computed from Annual reports & Accounts of MPFC



Graph 4.9 showing Position of Net loans and advances in MPFC
Amount (in crore)
600
500
400
300
200
100
0
2005-2006
2006-2007
2007-2008
2008-2009
2009-2010
2010-2011
2011-2012
Year

The study of position of Net loans & advances in MPFC has shown in Table No. 4.9, which shows that in the year 2005-06, Net loans and advances in MPFC was registered to Rs. 305.03 crore and became Rs. 337.51 crore in 2006-07 thus it increased to 11% as compared to 2005-06. But in the year 2007-08, it decreased by 2.5% as compared to 2005-06. During this year corporation had to face difficulties in availing refinance from SIDBI and there was no provisioning of NPA was made in this year. But in the subsequent year it raised to 28% in 2008-09, 33% in 2009-10, 51% in 2010-11 and 65% in 2011-12 as compared to 2005-06. This showed an increasing trend of Net loans and advances in MPFC.

Position of Non Performing Assets in MPFC:-

4.7 Introduction:-

RBI has introduced prudential norms for income recognition, assets classification & provisioning norms in a phased manner, as per the recommendation of the Narsimham Committee on the financial system, so as to move towards greater consistency and transparency in the published account.[18] Since 1991, SFCs had to work in a competitive environment with the opening up of economy and the initiation of financial sector reform. The strict provisioning norms and capital adequacy norms have already affected the bottom line of SFCs. The high level of NPA in the financial institution has been a matter of big worry.[19] Thus it becomes imperative to study the position of NPA in MPFC. There is some guideline or policies of MPFC which are as follows:

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[18]Sreenivas T., Banking Sector and Human Resources changing scenario. pp.68

[19] http://www.cosidici.com/news/4.htm

Significant Accounting Policies of MPFC:-

1. **Basis of Accounting:-**

   In MPFC, financial statement has been prepared under historical cost convention on accrual basis in accordance with the Generally Accepted Accounting Principles (GAAP) in India.

   Up to financial year 2006-07, the corporation has following cash systems of accounting. As advised by SIDBI, the corporation has change the system of accounting from cash to mercantile system & accordingly, the financial statement for the year 2007-08 have been prepared on mercantile basis.[20]

2. **Revenue/Expenses Recognition:-**

   A. Loan Portfolio - Performing assets on accrual basis.
   - Non performing assets on realization basis

   B. All other items - on accrual basis

3. **Assets Classification & Provisioning:-**

   The loans and advances of MPFC have been classified as per the prudential norms set by RBI/SIDBI, provision on account of Non – Performing assets have been classified as under:

[20] MPFC Annual Report 2007-08 pp.41

Table No. 4.10 (a)
Assets classification norms in MPFC

S.No.	Assets	Guideline
1.	Standard Assets	If interest and/or installment of principal remained overdue upto 3 months.
2.	Substandard Assets	If interest and/or installment of principal remained overdue for more than 3 months (90 days) and upto 15 months
3.	Doubtful A	If interest and/or installment of principal remained overdue for more than 15 months and upto 27 months.
	Doubtful B	If interest and/or installment of principal remained overdue for more than 27 months and upto 51 months.
	Doubtful C	If interest and/or installment of principal remained overdue for more than 51 months.
4.	Loss	As identified by internal or external auditor or management.

Source: Information provided by the employees of the corporation

Provisioning norms: - Provisioning account of Non performing assets have been made as under:-

Table No. 4.10(b)

Provisioning norms for NPA in MPFC

Standard Assets	0.25% of the outstanding (1.00% for outstanding under infrastructure sector)
Substandard Assets	15% of the out standing
Doubtful Assets	100% of non secured portion plus 25% / 40% / 100% of the secured portion depending upon the period for which the outstanding remained doubtful.
Loss Assets	100% of the outstanding (No outstanding amount I under this category)

Source: MPFC Annual Report 2011-12, pp.40

Financial Restructuring by state government during 2007-08:-

Due to accretion of high NPA, MPFC was facing scarcity of funds to cater its repayment obligation, increasing business volume, requirement of funds for retiring high interest bearing bonds & non availabilities of funds. The MPFC submitted a proposal to state government for financial restructuring.[21] The government of M.P. emphasizing the significance of this corporation in the industrial growth of the state and endorsing its commitment for financial restructuring provided substandard support. The proposal was approved in March 2008.[22]

1. Government of M.P. converted loan of Rs. 60.00 crore into share capital.

2. The corporation has transferred its Non performing assets to the tune of Rs. 113.50 crore to the state Govt. of M.P. Rs. 85.12 crore (i.e.at 25% discounted value) and received the payment. The loss on sale of NPA amounting to Rs. 28.38 crores has been adjusted out of provision for NPA available in the books of the corporation.

3. The corporation has sold all its NPA to state government of M.P. as on 31.03.08 and as such there is no provision of NPA in the books of corporation as on 31.03.08. in view of this the corporation after retaining required provision against standard assets of Rs.2,04,70,000/- transferred balance of Rs. 30,22,75,000/- lying in provision for NPA account to restructuring reserve.

4. It has also provided cash capital support of Rs. 5.00 crore during the year.[23]

[21] AGMP Report 2010-11. pp. 37-38.

[22] MPFC Annual Report 2007-08. pp.8

[23] MPFC Annual Report 2007-08 pp.42-43

4.8 Assets Classification of Performing & Non Performing Assets in MPFC:-

Any financial institution can be accessed by their assets classification pattern. The Quality of assets held by financial institution is a critical indicator of the health of financial system. A high quality of assets reflects the level of financial institution, credit risk, & efficiency in allocation of resources to productive sector.[24]

Loan assets of MPFC are classified into four category i.e. standard, substandard, doubtful assets & Loss assets. Standard assets being the good quality of loan assets, on the other hand substandard assets, doubtful assets, & loss assets put together constitutes Non performing assets.[25] A large part of standard assets in the portfolio can be defined as progressive & healthy performance of the institute. The monitoring skill of the management of that concerning financial institution may also be described by year after year tendency of standard assets. It is therefore necessary to through light on the assets classification pattern of MPFC. The study of assets classification of Performing and Non performing assets in MPFC during the tenure of 2005-06 to 2011-12. has shown in the Table No. 4.11.

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[24] Pathak V. Bharati " The Indian Financial System: Markets, Institution & Services", Second Edition, pp. 576

[25] Dr. Hosmani.A.P and Hudagi Jagadish, "Unearthing The Epidemic Of Non-Performing Assets -A Study With Reference To Public Sector Banks In India" Zenith International Journal of Multidisciplinary Research, Vol.1 Issue 8, December 2011. pp.453.

Table No. 4.11

The study of assets classification of performing and non performing assets in MPFC during the tenure of 2005-06 to 2011-12

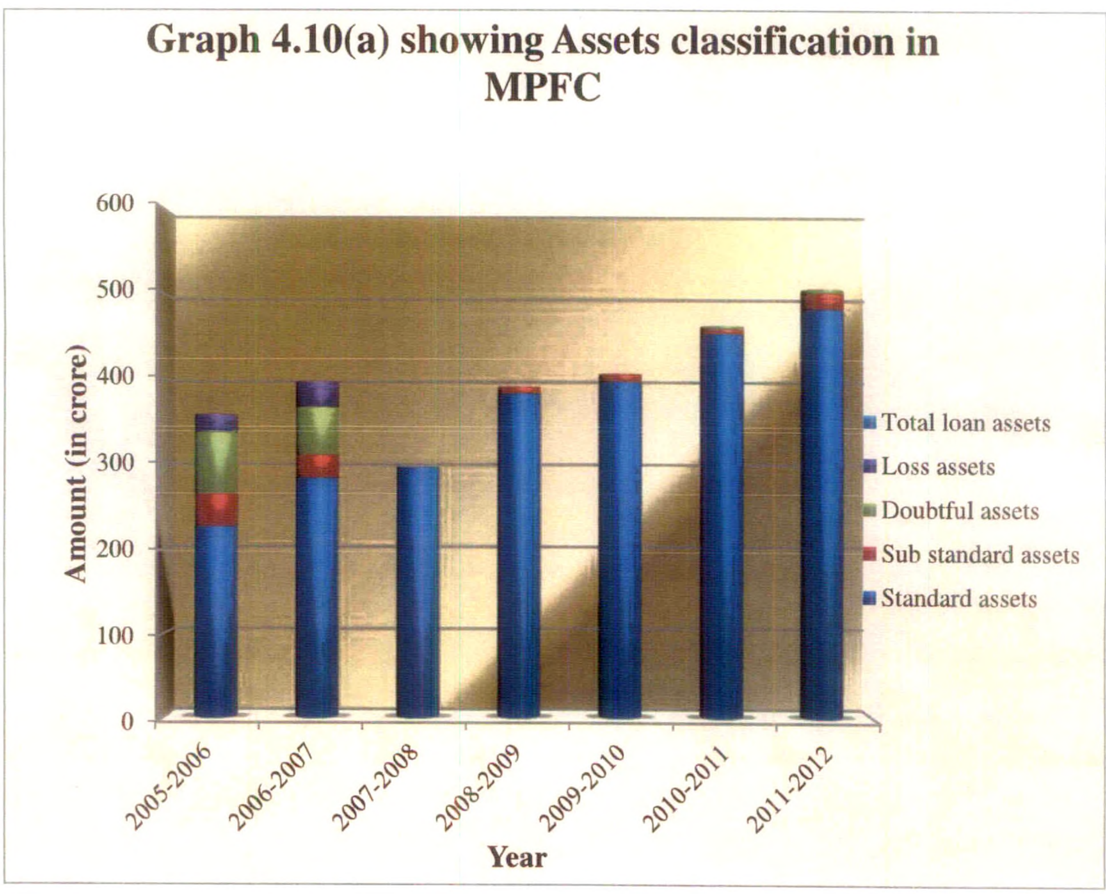
(Rs. in crore)

Year	Performing Assets		Non Performing Assets						Total Loan Assets	
	Standard Assets		Sub Standard Assets		Doubtful Assets		Loss Assets			
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
2005-2006	227.48	63.4%	37.83	10.5%	72.65	20.2%	20.95	5.84%	358.91	100%
2006-2007	284.45	71.6%	26.77	6.7%	55.93	14.1%	30.31	7.6%	397.46	100%
2007-2008	297.52	100%	--	--	--	--	--	--	297.52	100%
2008-2009	383.09	97.9%	8.15	2.1%	--	--	--	--	391.24	100%
2009-2010	397.27	97.7%	9.20	2.26%	0.26	0.06%	--	--	406.73	100%
2010-2011	453.26	98%	6.03	1.30%	4.17	0.90%	--	--	463.46	100%
2011-2012	482.96	95.3%	18.77	3.70%	4.90	0.97%	--	--	506.63	100%
Mean	360.86	89.1%	15.25	3.8%	19.7	5.2%	7.32	1.92%	403.14	100%

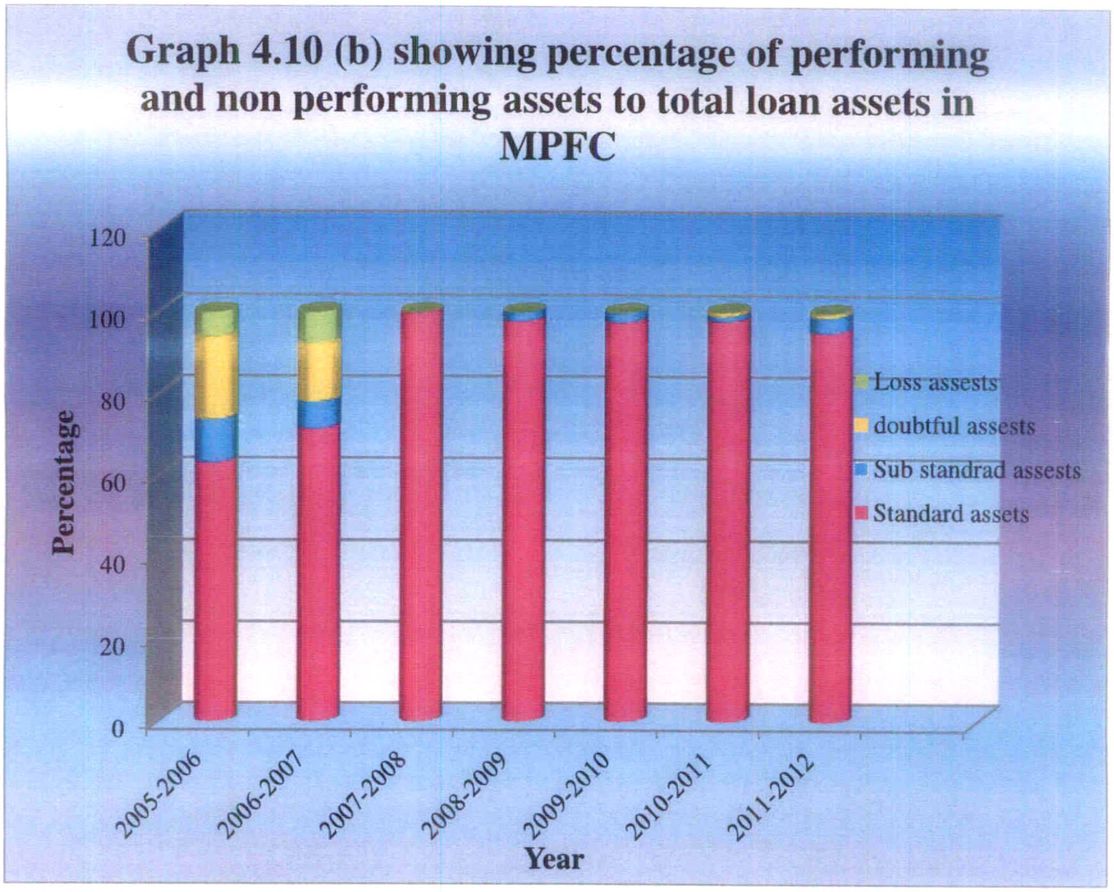
Source: Computed from Annual Reports & Accounts of MPFC

The study of MPFC's performance towards maintenance of its total loan assets during the time period of 7 years has shown in Table no. 4.11 which shows that MPFC has 403.14 crore of total loan assets as an average, out of which 360.86 crore of assets were belonging to standard category i.e. 89.1 % of total loan asset as an average of 7 years. It implies that about 89% of loans are disbursed that they have been generating the regular income in terms of interest. This fact reveals that the better outcome of their performance in total. Year wise portfolio of standard assets gradually increased year after year. The grand total of the average of sub standard, doubtful and loss assets was 42.27 crore i.e. (15.25+19.7+7.32) in absolute term. The average percentage of Gross NPA to total loan and advances is 10.92% (i.e. 3.8+5.2+1.92) which shows that only around 11% of MPFC total loan assets have come under the shadow of Nonperforming assets. This shows a good NPA management of MPFC.

This reflects that MPFC did a good and very satisfactory job and playing a significant role with their performance. It can also conclude that MPFC has successfully been preventing their assets from slippage into NPA.



Analysis of Graph of percentage



Analysis of category to category classification of percentage of assets as shown in the Graph no. 4.10 (b) shows that in the year 2005-06, standard assets was 63.4%, and in their corresponding the sub standard assets was 10.5%, doubtful assets 20.2% while loss assets was 5.84% of total loan assets. Then in the year 2006-07, standard assets was 71.6% while sub standard assets was 6.7%, doubtful assets 14.1% & loss assets was 7.6% of total loan assets. On proceeds to the next year, in the year 2007-08, standard assets was 100% of total loan assets and the sub standard assets, doubtful assets, & loss assets became nil because in this year government of M.P. has taken over the entire NPA portfolio of MPFC.

But after financial restructuring by state govt., in the year 2008-09; standard assets became 97.9% of total loan assets and the sub standard category assets was 2.1% and next two categories doubtful & loss has a nil percentage of assets. Similarly, in the next coming year of 2009-10, 2010-11 & 2011-12 standard assets remained around 97.7%, 98%, 95.3% and sub standard category involved 2.26%, 1.3%, 3.7% and the doubtful category involved below 1% of total loan assets in these three years. Thus, MPFC has always retained very high percentage of standard assets as compared to sub standard, doubtful category & loss category under the period of study.

Thus, it may conclude that MPFC properly managed its NPA and played a significant role with its own performance.

4.9 Position of Gross NPA in MPFC:-

There are two concepts relating to NPA i.e. Gross NPA and Net NPA of all loan assets that are classified as NPA as per RBI guidelines as on balance sheet date. Gross NPA reflects the quality of loans made by financial institutions. It comprises of all the non standard assets like as sub-standard, doubtful and loss assets.[26] The study of position of gross NPA in MPFC has shown in Table no. 4.12

[26] Balasubramaniam. C.S.,"Non performing assets and profitability of commercial banks in india: Assessment & emerging issues". Abhinav Journal of Research in Commerce and Management. ISSN 2277-1166,vol.no.1.issue no.7, pp.43

Table No. 4.12

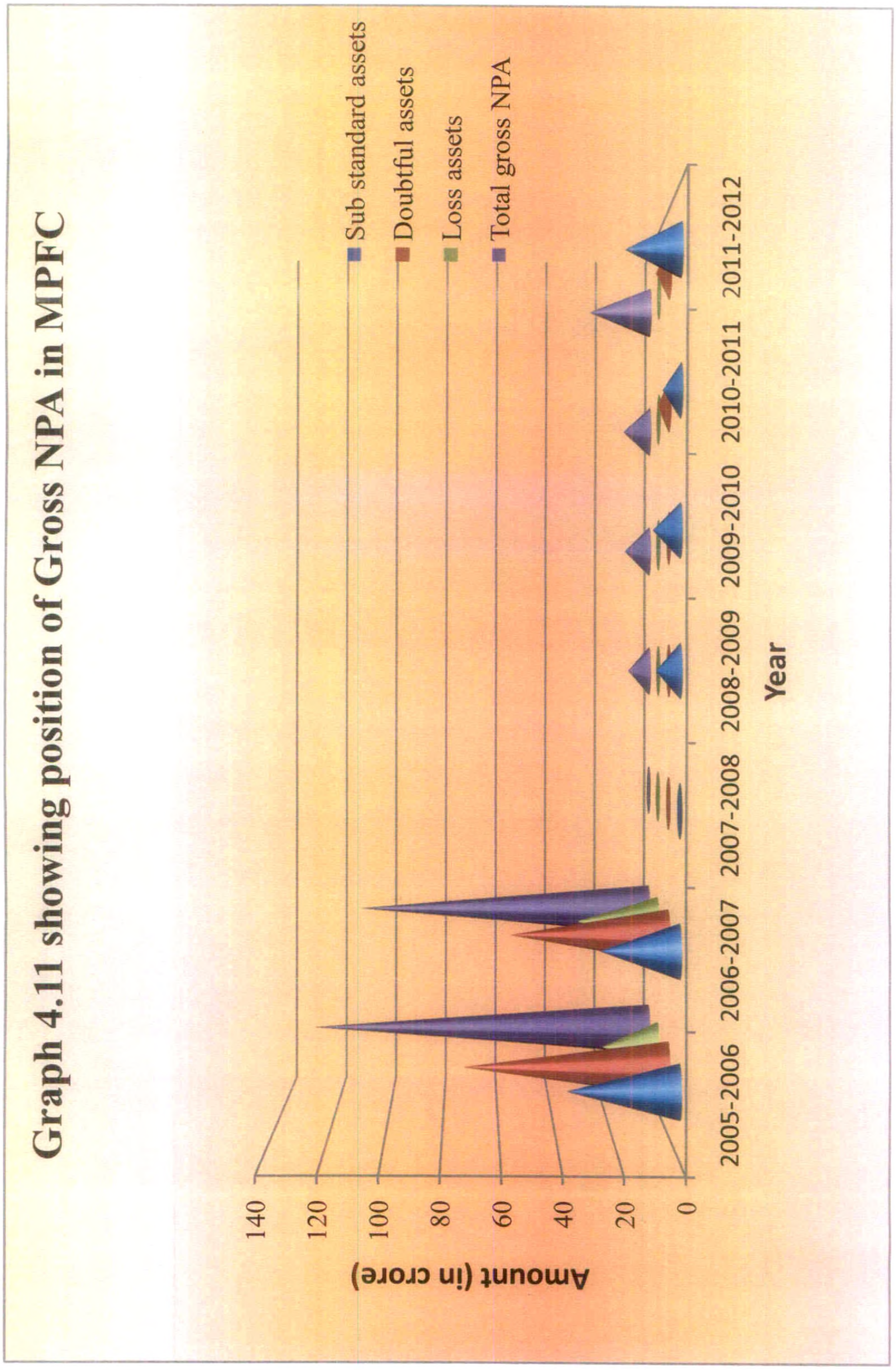
Position of Gross NPA in MPFC

Year	Sub Standard Assets (in crore)	Sub standard assets Ratio (%)	Doubtful Assets (in crore)	Doubtful assets Ratio (%)	Loss Assets (in crore)	Loss assets Ratio (%)	Total Gross NPA (in crore)
2005-2006	37.83	29	72.65	55	20.95	16	131.43
2006-2007	26.77	24	55.93	49	30.31	27	113.02
2007-2008	-	-	-	-	-	-	Nil
2008-2009	8.15	100	0	-	-	-	8.15
2009-2010	9.20	97	0.26	3	-	-	9.46
2010-2011	6.03	59	4.17	41	-	-	10.20
2011-2012	18.77	79	4.90	21	-	-	23.67

Source: Computed from Annual Reports & Accounts of MPFC

The study of Gross NPA in the MPFC during the tenure of 2005-06 to 2011-12 has shown in Table no. 4.12 and gross NPA comprises of substandard, doubtful & loss category of various year.

NPA in Sub standard category shows that in the year 2005-06, sub standard assets was 37.83 crore in absolute term but in the next year it reduced to 26.77 crore about 29% as compared to previous year. In the year 2007-08, the entire NPA portfolio was taken over by government of M.P. therefore this shows nil value in every column of the table. After financial restructuring by government of M.P. MPFC has started new account of gross NPA to 8.15 crore in the year 2008-09. The sub standard asset raised and became 9.20 crore in the year 2009-10 which rose by 13% than previous year. In the year 2010-11, substandard assets went down to 6.03 crore as compared to previous year. Further, in the year 2011-12, it



Graph 4.11 showing position of Gross NPA in MPFC

increased to 18.77 crore which was more than 3 times than previous year. This shows that after help provided by Government of M.P. the asset of sub standard category were increasing.

NPA in Doubtful category shows that in the year 2005-06, doubtful assets was 72.65 crore in absolute term whereas substandard assets was 37.83 crore which was 92% higher (approx). In the year 2006-07, doubtful assets leading to substandard category more than 2 times approx. But in the year 2007-08 and 2008-09, doubtful assets became nil, in the next year of analysis that in 2009-10 doubtful assets was registered to 0.26 crore in absolute term. Further in the year 2011-12, it increased to 4.90 crore which was more than 19 times approx as compared to 2009 - 10.

Assets in the loss category shows that in the year 2005-06, loss assets was 20.95 crore & in the next year it became 30.31 crore which has increased by 45% approx. But after taking over of NPA by Government of M.P. it showed no loss assets in MPFC portfolio which is a good sign.

Total gross NPA in MPFC was 131.43 crore in the year 2005-06 and became 113.02 crore in 2006-07, thus registered a decline of 18.41 crore in absolute term. In the year 2007-08, it became nil. Further from 2008-09 to 2011-12, it registered a growth of Rs. 15.52 crore in absolute term which is a matter of great concern and the corporation management must control it seriously (Increase must have because of economic slowdown). This shows that after financial restructuring by state government fresh loans of MPFC are slippage into NPA.

But one more factor resembled that after taken over of NPA by Government of M.P. sub standard assets has contributed major share out of total gross NPA than doubtful and loss assets which shows that quantum of NPA was never to a level of higher risk. More in other words, gross NPA in various categories was not too alarming but it was moderate. It is suggested that management of MPFC should put more efforts for preventing their assets from slippage into NPA.

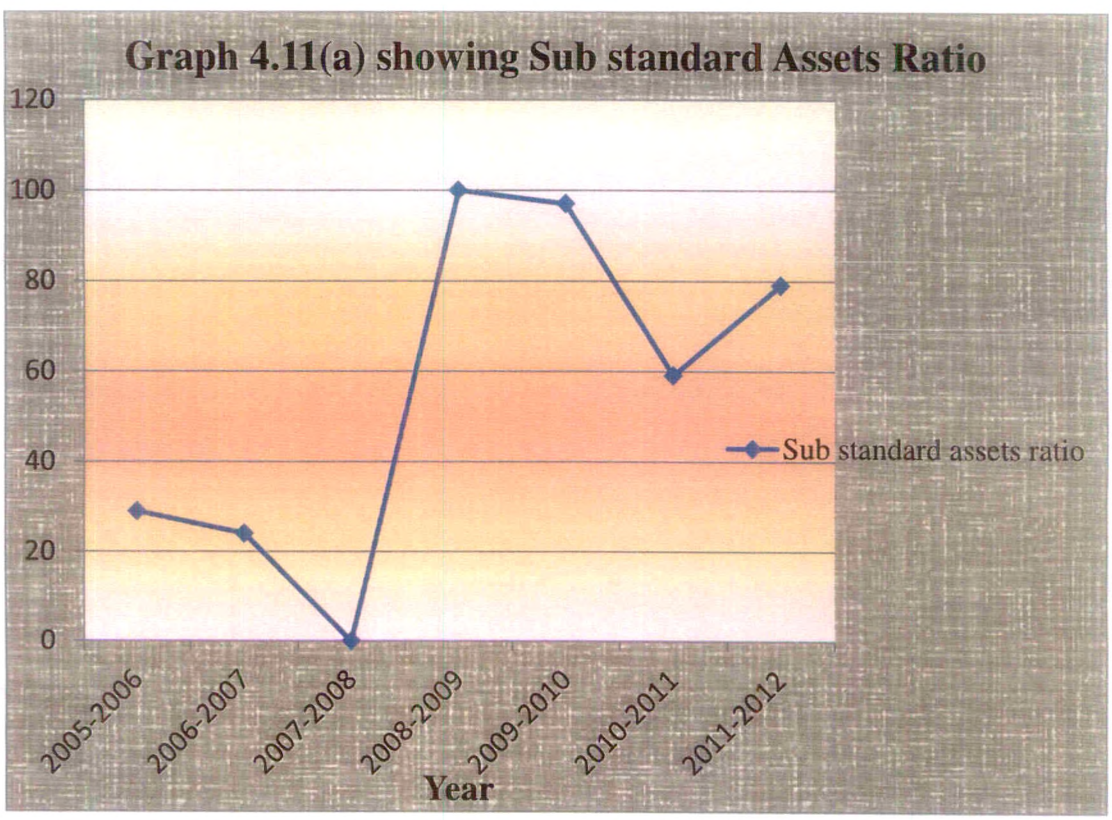
Analysis of Ratio:-

An attempt has also made to judge the position of NPA in MPFC through following ratio:

Sub standard assets Ratio:-

It is the ratio of total substandard assets to gross NPA. This ratio indicates the scope for up gradation and improvement in NPA. The higher the ratio the better is position of recovering the advances. The formula of sub standard assets ratio is.[27]

$$\text{Sub standard assets ratio} = \frac{\text{Total sub standard asset X 100}}{\text{Gross NPA}}$$



[27] http://shodhganga.inflibnet.ac.in/bitstream/10603/2543/13/13_chapter%206.pdf

Table No. 4.12 and Graph no. 4.11(a) revealed the sub standard assets ratio in percentage wise. It shows that in the year 2005-06, the sub standard ratio was 29%; progressively, it was decreases by 5% in 2006-07. In the year 2007-08, the sub standard assets ratio became nil, due to NPA portfolio taken by government of M.P. In the subsequent year, it became 100% because in this year the entire NPA was registered in substandard category. From 2008-09 to 2010-11, it reduced to 59%, further it again increased in 2011-12, and became 79%. The variations in substandard ratio are caused by variation in doubtful ratio. So this ratio shows that after 2007-08, large percentage of NPA was registered in substandard assets than doubtful assets, it means there is a scope for up gradation or improvement of NPA in MPFC.

Doubtful Assets Ratio: -

It is the ratio of total doubtful assets to gross NPAs of the financial institution. This ratio indicates, if the ratio is higher, then there is more scope for financial institution can recover more of the advances through compromise & reducing the NPAs.[28]

$$\text{Doubtful Assets Ratio} = \frac{\text{Total Doubtful Assets X 100}}{\text{Gross NPA}}$$

[28] http://shodhganga.inflibnet.ac.in/bitstream/10603/2543/13/13_chapter%206.pdf

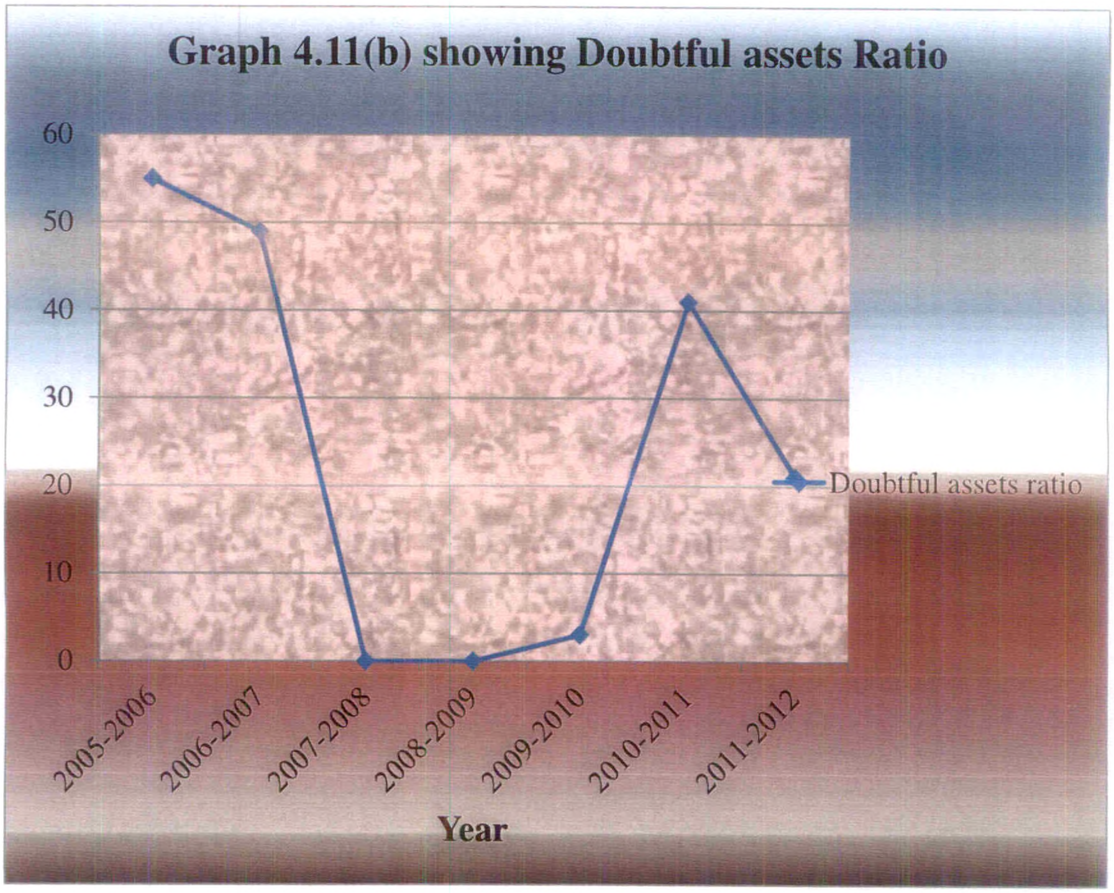


Table No. 4.12 and Graph no. 4.11(b) shows that in the year 2005-06, the Doubtful assets ratio was 55% & decreased in 2006-07 and became 49%. In the year 2007-08 & 2008-09, the doubtful assets ratio became nil. In the subsequent year it was registered to 3% in 2009-10 and increased in 2010-11 to 41%, and further, it again decreased & became 21% in the year 2011-12. Thus, this shows that MPFC must try to recover as much as doubtful advances as possible so that gross NPA can be reduced.

Loss assets Ratio:-

It is the ratio of total loss assets to gross NPA of the financial institution. This ratio shows the proportion of loss that the financial institutions are likely to suffer as compared to Gross NPA. The ratio must be low, as this ratio indicates that the assets to be lost would be lower as compared to Gross NPA. The loss assets are not likely to be recovered at all and so higher ratio would suggest higher losses.[29]

$$\text{Loss Assets Ratio} = \frac{\text{Total Loss Assets X 100}}{\text{Gross NPA}}$$

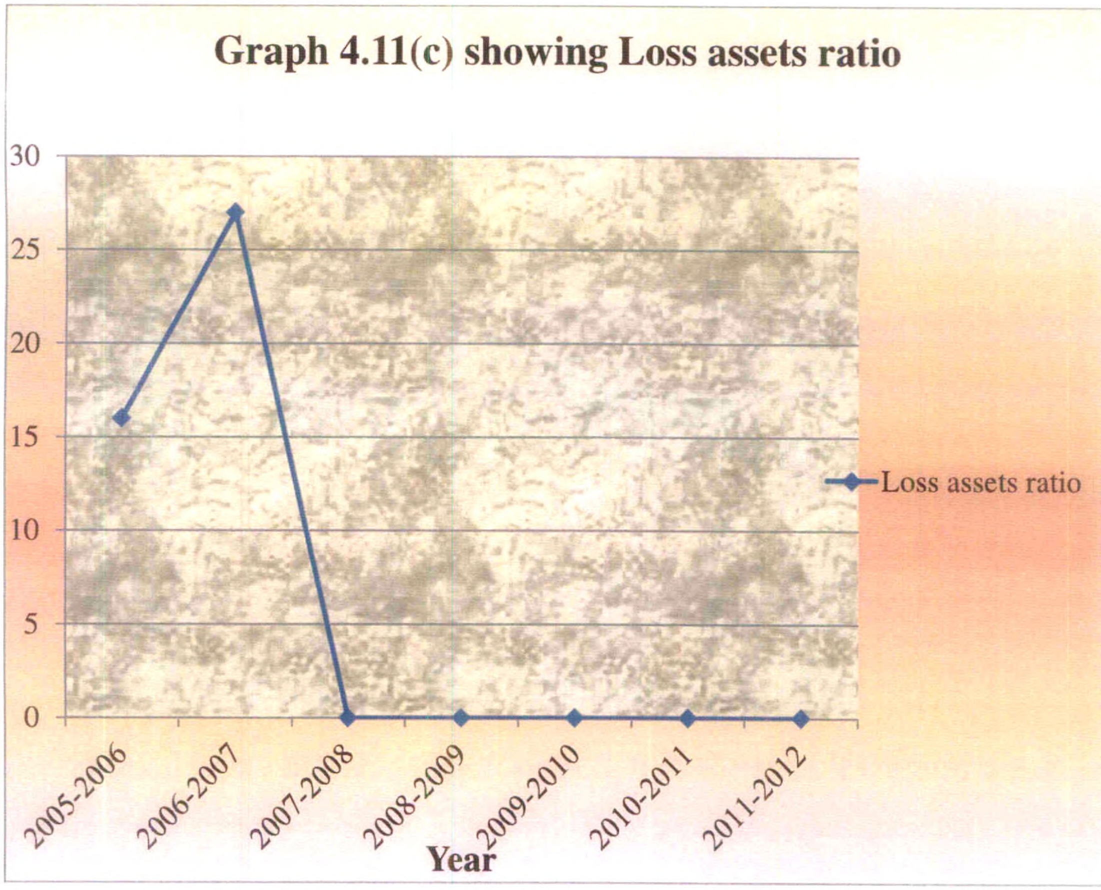


Table no. 4.12 and Graph no. 4.11(c) shows that the loss assets ratio in 2005-06 was 16% and increased in 2006-07 about 27% then in the subsequent year it became nil. Thus, this shows that after NPA portfolio taken over by government of M.P., MPFC properly manage its loss assets. This is a good sign for the health of MPFC.

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[29] http://shodhganga.inflibnet.ac.in/bitstream/10603/2543/13/13_chapter%206.pdf

4.10 Position of Net NPA in MPFC:-

Net NPA are those type of NPA's in which the bank has deducted the provision regarding NPA's as per RBI guideline. It shows the actual burden of banks. Since in India, bank balance sheets contain a huge amount of NPAs and the process of recovery and write off loans is very time consuming. The banks have to make provision against NPAs according to the RBI guideline which is quite significant.[30] Table no. 4.13 showing the position of Net NPA comprises of sub standard, doubtful & loss categories in MPFC for the period of study.

Table No. – 4.13

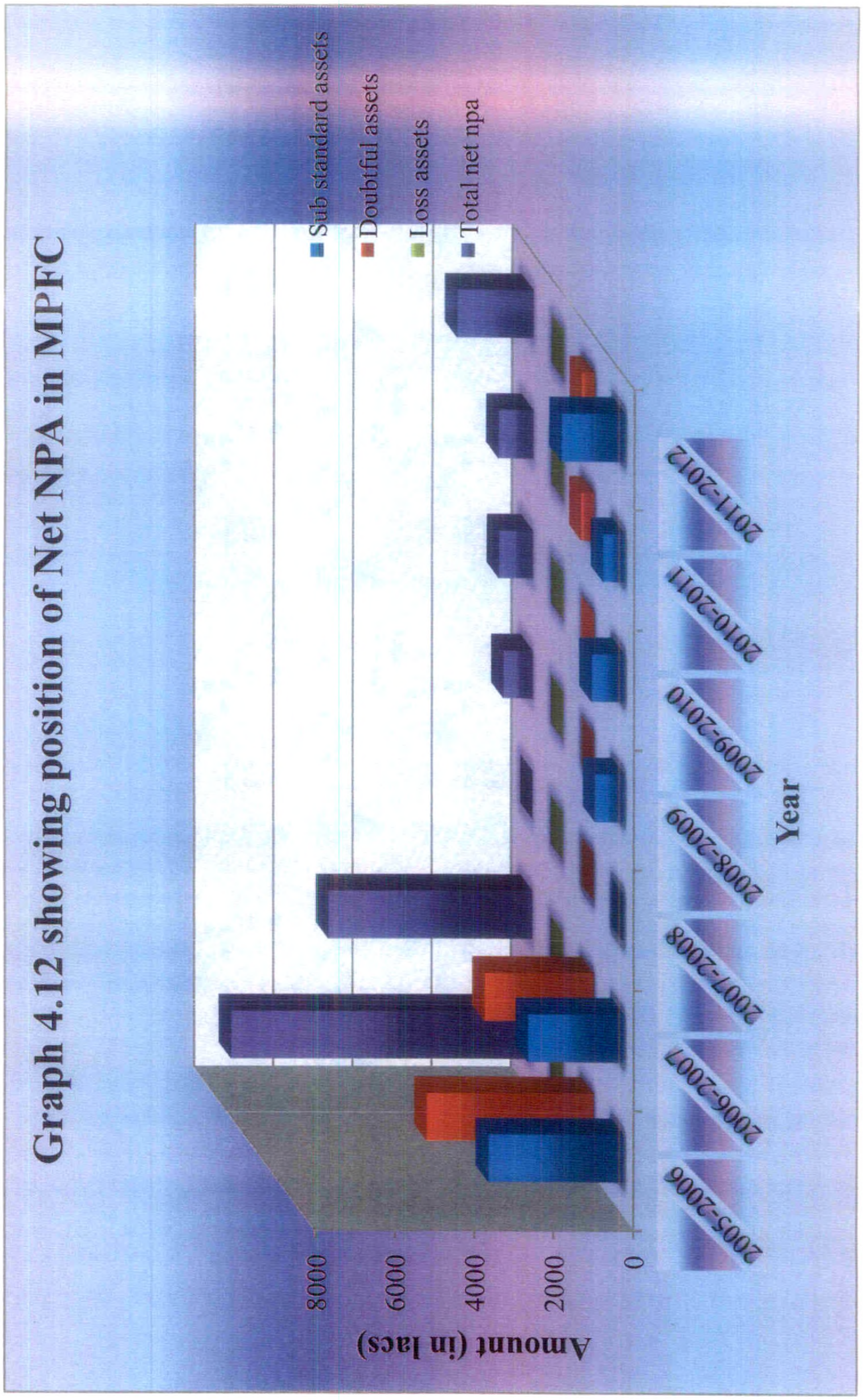
Position of Net NPA in MPFC

(Rs. in lacs)

Year (1)	Sub Standard Assets (2)	Doubtful Assets (3)	Loss Assets (4)	Total Net NPA (5)
2005-2006	3407	4192	--	7599
2006-2007	2410	2738	--	5148
2007-2008	--	--	--	--
2008-2009	733.50	--	--	733.50
2009-2010	827.74	21.02	--	848.76
2010-2011	542.34	330.71	--	873.05
2011-2012	1595.85	324.2	--	1920.05

Source: Computed from Annual Reports & Accounts of MPFC

[30] Balasubramaniam. C.S.,"Non performing assets and profitability of commercial banks in india: Assessment & emerging issues",Abhinav Journal of Research in Commerce and Management. ISSN 2277-1166,vol.no.1,issue no.7, pp.43



Graph 4.12 showing position of Net NPA in MPFC

The study of position of Net NPA in MPFC has shown in Table no. 4.13 which shows that after deducting provision from Gross NPA, the substandard assets of MPFC was registered to 3407 lacs of Net NPA in the year 2005-06 and decreased to 2410 lacs in 2006-07 which was nearly about 29%. In the year 2007-08, total NPA portfolio was taken over by Government of M.P. This year shows nil values in every column of the table. Then, after restructuring by Government of M.P. Net sub standard assets of MPFC was registered to 733.50 Lacs in 2008-09 and increased to 827.74 lacs in the year 2009-10. Thus, it registered the growth of 12.8% than previous year. In the subsequent year i.e. 2010-11, NPA in Sub standard category went down to 542.34 lacs as compared to 827.74 lacs of previous year. Further in the year 2011-12, sub standard assets reached to Rs.1595.85 lacs which have increased two times as compared to 2008-09. This shows that after help provided by Government of M.P. MPFC, Net sub standard assets were increasing except 2010-11.

Column 3 of the above table shows that in the year 2005-06, the Net NPA in the doubtful category was registered to Rs.4192 lacs than Rs.3407 lacs in sub standard category which was 23% higher approx. In the year 2006-07, doubtful assets were leading to sub standard category by 13.6% approx. Then, in the year 2007-08 & 2008-09, Net NPA in the doubtful assets was nil due to restructuring by state Govt. and in the next year of analysis i.e. in 2009-10 it became Rs.21.02 lacs but in the next coming year it increased to Rs. 330.71 lacs in 2010-11 & Rs. 324.2 lacs in 2011-12.

Column no. 4 in the above table shows the loss category of net NPA which has no data because 100% provision was made in this category.

It has been observed from the Table no. 4.14 that the quantum of Net NPA in MPFC has decreased from 7599 lacs in the year 2005-06 to 5148 lacs in 2006-07. Then, in 2007-08, it became nil due to entire NPA taken over by state government. But in the year 2008-09, the Net NPA increased from 733.50 lacs to 1920.05 lacs in the year 2011-12 which is a matter of great concern and the corporation management must control it seriously (Increase must have because of economic slowdown). This shows that in spite of financial restructuring by state government; MPFCs Net NPA portfolio was increasing. But one remarkable factor resembled that after taken over of NPA by Government of M.P. sub standard assets has contributed major share out of total Net NPA than doubtful and loss assets which shows that quantum of NPA was never to a level of higher risk. It is suggested that MPFC must take more appropriate steps to recover the loans & advances and prevent their assets from slippage into NPA.

4.11. Movement of Net NPA in MPFC:-

As define previously that Net NPA concept means assets left after provisioning out of total NPA portfolio or gross NPA. The movement of NPA during tenure of analysis can show tendency of generation of NPA. Acceleration of NPA is nothing but a seismograph which indicates magnitude of fore coming dangers which can affect the health of banks/ financial institution. If movement is much fluctuating it shows unstable tendency in the books of account. Table no. 4.14 showing the study of movement of Net NPA during the period of seven years.

Table No. 4.14

Movement of Net NPA in MPFC

(Rs. in Lacs)

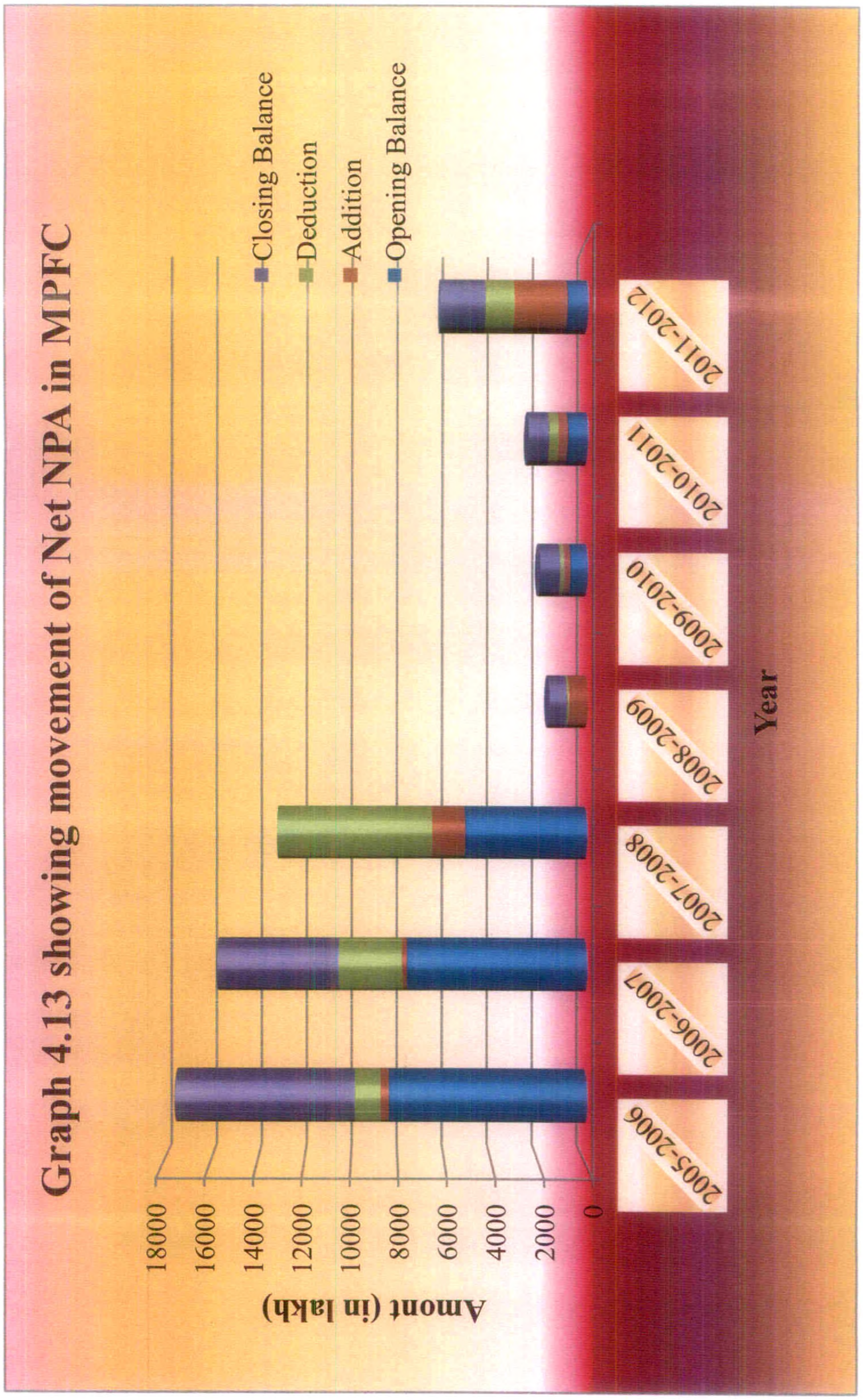
Year	Opening Balance	Addition	Deduction	Closing Balance
2005-2006	8361	346	1108	7599
2006-2007	7599	220	2671	5148
2007-2008	5148	1399.76	6547.76	Nil
2008-2009	Nil	815	81.5	733.50
2009-2010	733.50	283.97	168.71	848.76
2010-2011	848.76	416.76	392.47	873.05
2011-2012	873.05	2253.33	1206.33	1920.05
Mean	3366.2	819.26	1739.38	2446.05

Source: Computed from the Accounts of MPFC

The study of movement of Net NPA during the period of seven years in MPFC has shown in Table no. 4.14 which shows that in the year of 2005-06, opening balance of NPA was Rs. 8361 Lacs and generation of new NPA during the year were Rs. 346 lacs and deduction in NPA was 1108 lacs & at the end of the year it remained 7599 lacs it means NPA reduced about 9% as compared to opening balance.

Similarly in the year 2006-07, opening balance was Rs. 7599 lacs & Rs. 220 lacs addition in Net NPA & deduction of NPA of this year were Rs. 2671 lacs. During this year Rs. 2671 lacs recovered / write off as a resolution of NPA and provisioning was also made. Thus, at the end of the year it became Rs.5148 lacs which was reduces about 32.25% as compare to opening balance of that year.

Then, in the year 2007-08, opening balance of Net NPA was Rs. 5148 lacs and new addition of Net NPA worth Rs. 1399.76 lacs during the year &


Graph 4.13 showing movement of Net NPA in MPFC
Amont (in lakh)
18000
16000
14000
12000
10000
8000
6000
4000
2000
0
Closing Balance
Deduction
Addition
Opening Balance
2005-2006
2006-2007
2007-2008
2008-2009
2009-2010
2010-2011
2011-2012
Year

deduction of Net NPA were Rs. 6547.76 lacs which was completely wiped out during the year of analysis it was because of NPA portfolio was taken over by state government.

Further, in the year 2008-09, started with nil opening balance as total NPA portfolio was taken over by state government during this year new NPA was generated to the tune of Rs. 815 lacs out of which 81.50 lacs disposed off / recovered and the closing balance were Rs. 733.50 lacs.

In the year 2009-10, opening balance was Rs. 733.50 lacs & addition of Net NPA was Rs. 283.97 lacs; thus accumulated Net NPA was 1017.47 lacs & Rs. 168.71 lacs were settled / recovered / write off during this year and Rs. 848.76 lacs net NPA left with MPFC in that particular year and this shows that it increased about 15.71% as compared to opening balance.

In the year 2010-11, opening balance of Net NPA was Rs. 848.76 lacs and new addition of NPA were Rs. 416.76 lacs and accumulated net NPA was Rs. 1265.52 lacs out of which only Rs. 392.47 lacs wiped out & at the end it remained 873.05 lacs. This shows that it increased about 2.86% as compared to opening balance.

Again in the year 2011-12, the opening balance was Rs. 873.05 lacs and addition of new NPA was Rs. 2253.33 lacs thus total Net NPA was Rs. 3126.38 lacs out of which 1206.33 lacs wiped out during the year and it remained 1920.05 lacs which was about two times of opening balance.

It has been found that beginning of the three year shows down fall of the opening balance & also down fall in closing balance. This can be defined as favorable NPA movement but in fore coming years from 2008-09 to 2011-12 showed upwards movement of opening and closing balance year after year because of economic slowdown. And average addition of Net NPA during the period of 7 years was 819.26 lacs. On other hand, deduction of NPA was 1739.38 lacs.

4.12 Magnitude of Gross NPA Ratio and Net NPA Ratio:-

The NPA ratio is one of the most important ratios in the financial institution; it helps to identify the quality of assets that a bank/ financial institution possess.

- **Gross NPA Ratio: –**

The accumulation of huge Nonperforming assets in financial institution has assumed greater attention & importance. It measures the quality of the loan made by the financial institution. It comprises substandard, doubtful & loss assets. This ratio is always shown in terms of percentage which indicates that the proportion of NPA in the advances in gross. The lower ratio indicates the better quality of advances.[31]

$$\textbf{GNPA Ratio} = \frac{\textbf{GNPA x 100}}{\textbf{Gross loans \& advances}}$$

- **Net NPA Ratio: –**

The Net NPA to loans & advances ratio is used as a measure of the overall quality of the bank's loan book. An NPA are those assets for which interest is overdue for more than 90 days (or 3 months). Net NPA are calculated by reducing cumulative balance of provision outstanding at the period end from gross NPA. Higher ratio reflects rising bad quality of loans. It is the indicator of high risk for the financial institution.

$$\textbf{NNPA Ratio} = \frac{\textbf{NNPA x 100}}{\textbf{Net loans \& advances}}$$

[31] Chisti, Khalid Ashraf, "The impact of Asets quality on profitability of Private Banks in India: A case study of JK, ICICI, HDFC & Yes Bank". Journal of African Macroeconomic Review. Vol.2, no.1 (2012), pp.132

Table No. 4.15

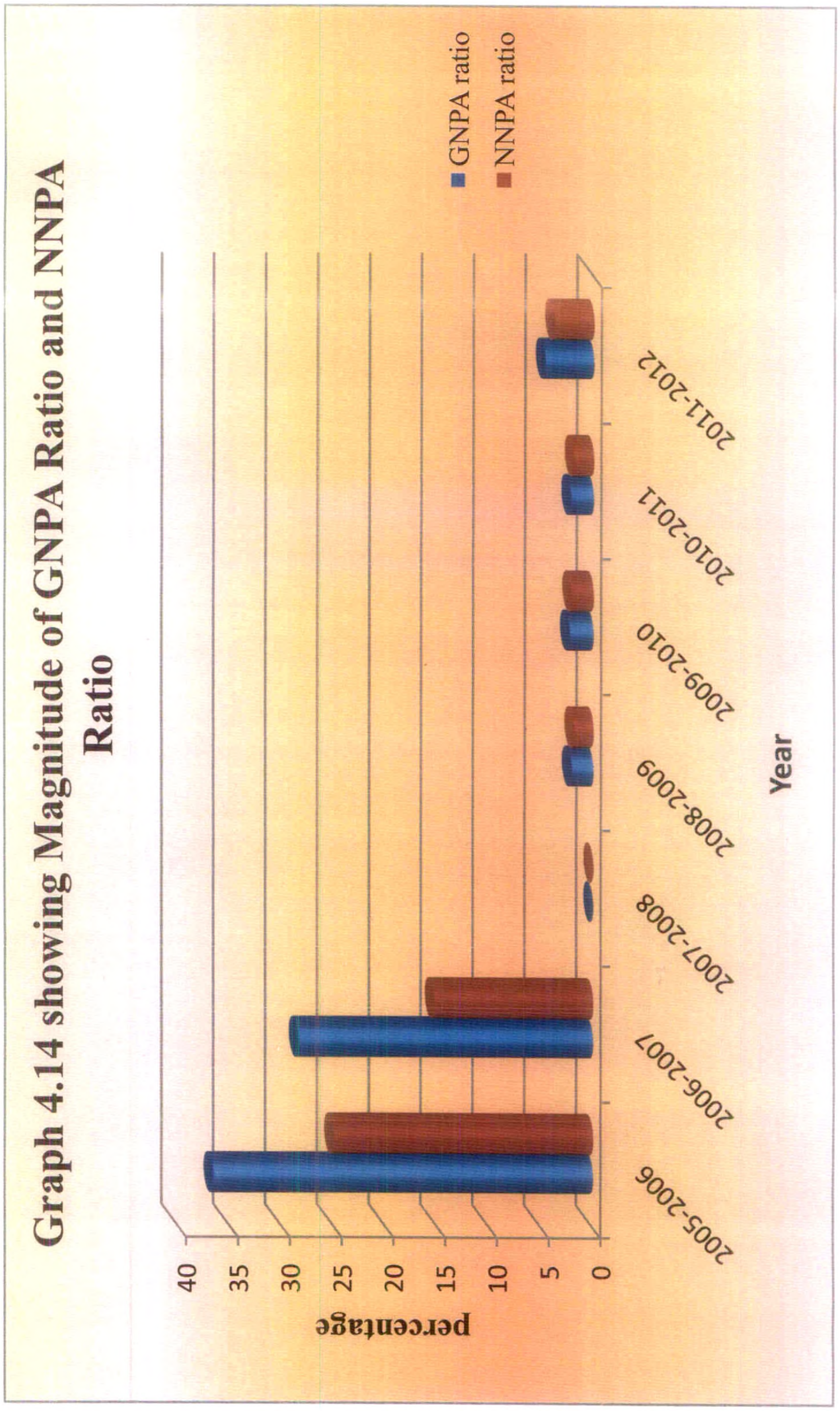
Magnitude of Gross NPA Ratio and Net NPA Ratio in MPFC

Year	Gross loans and advances (Rs. in Crore)	Gross NPA (Rs. in Crore)	Gross NPA Ratio %	Net loans and advances (Rs. in Crore)	Net NPA (Rs. in Crore)	Net NPA Ratio %
2005-06	358.91	131.43	36.6	305.03	75.99	25
2006-07	397.46	113.02	28.4	337.51	51.48	15.3
2007-08	297.52	Nil	-	297.52	--	-
2008-09	391.24	8.15	2.1	390.42	7.33	1.88
2009-10	406.73	9.46	2.3	405.75	8.49	2.09
2010-11	463.46	10.20	2.2	461.99	8.73	1.89
2011-12	506.63	23.67	4.7	502.16	19.20	3.82
Mean	403.14	42.27	10.9%	385.77	24.46	7.14%

Source: Computed from Annual Reports & Accounts of MPFC

It is found from the Table No. 4.15 that Gross loans & advances have been increasing from the year 2005-06 to 2011-12 about 41%, except 2007-08. Whereas, Gross NPA registered a decline from 2005-06 to 2006-07 to 18.41 crore, but in the year 2007-08 due to NPA portfolio taken over by government of M.P., it has nil value. After NPA taken over by state government, it has increased from the year 2008-09 to 2011-12 about 3 times (app.) and stood at Rs. 23.67 crore in the year 2011-12.

The ratio of Gross NPA to Gross loans & advances has been brought down from 2005-06 to 2006-07 by 8.2%. But in the year 2007-08, it has nil value and after that the ratio was ranged between 2.1% to 2.3% from the year 2008-09 to 2010-11 and became 4.7% in 2011-12 which has increased about 2 times than previous year.



Graph 4.14 showing Magnitude of GNPA Ratio and NNPA Ratio

On the other hand, Net loans and advances have been increasing from the year 2005-06 to 2011-12 about 65% except 2007-08 whereas Net NPA decreased from 2005-06 to 2006-07 to 24.51 crore in absolute term. Further it became nil in the year 2007-08. After that, Net NPA was registered to 7.33 crore in the year 2008-09 and increased to 19.20 crore in the year 2011-12 which was nearly 2.5 times more than 2008-09.

The ratio of Net NPA to Net loans and advances was 25% registered in 2005-06. But it has been brought down by 10 % app. in 2006-07. Then in the year 2007-08, it became nil and after that 1.88% in 2008-09, then slightly increased in the year 2009-10 and again decreased in the year 2010-11. But in 2011-12, it was 3.82%. The Net NPA ratio from 2007-08 to 2011-12 was below 4% which shows that the quantum of NPA was never to the level of higher risk.

The average of Gross NPA to Gross loans and advances ratio is 10.9% which shows that nearly 11% of Gross loans & advances convert into NPA. On other hand the average of Net NPA to Net loans and advances ratio is 7.14% which shows that only 7 % of Net loans & advances convert into NPA during the period of 7 years. Thus, this study shows that very less percentage of loans and advances goes into NPA.

CHAPTER- 5

PROBLEMS DUE TO NON PERFORMING ASSETS

Chapter 5

Problems due to Non Performing Assets

5.0 Introduction

In the overall development of a country, financial sector plays an important role. The financial institution is the main component of this sector. It is the major source of long term finance for the economy and to fulfill the needs of the commercial sector, they also provide a variety of financial products and services. These institutions provide financial assistance to small and medium scale industries, new enterprises as well as the industries established in the backward areas. The Madhya Pradesh Financial Corporation, since its inception plays an important role in the development of the economy.[1]

Since 1991, SFCs had to work in a competitive environment with the opening up of economy and the initiation of financial sector reform. As a resolve, they have to cope up now with a new set of challenges. In recent time, the most adverse problem being faced by SFC's & financial institutions is that the most of the assets are turning into Nonperforming assets and the overdue increases time by time.[2] It affected the viability and solvency of the financial corporation. NPA makes two pronged attack on the bottom lines of the financial corporation or institutions;

One, interest applied on such assets is not taken into consideration because such interest is to be taken into account only on its realization. It means when interest will actually be received than it will be taken into consideration. Two, it also hurts the profitability of the financial institution

[1] Pradhan Pradip Kumar," The impact of Non Performing Assets in the performance of Financial Institution: A case study of OSFC". Sai Om Journal of Commerce & Management. Vol.1, issue 9 (Sep.2014). pp. 11

[2] http://www.cosidici.com/news/4.htm

because they have to make provisions for NPA from the income earned by them on Non performing Assets. It means with the high level of NPAs, financial institution have to hold more own funds by way of capital & create reserve and provisions & to provide cushion for the loan losses.[3] It seriously constrain in obtaining finance, operation & management of the financial institution by the mounting of NPA.[4]

5.1 Causes/ General Reason for Assets become NPA:-

The origin of growing NPA lies in the quality of managing credit risk by the financial institution. The financial institution has been facing the serious problem of burgeoning NPAs.[5] Nonperforming assets are those burdens which cannot be avoid by the financial institution in India. The reason of rising NPA and nowadays these are one of the major concerns for the financial institution in India.

An account does not become an NPA over night. It becomes NPA when the borrower fails to repay the interest and/ or principal on agreed term. It gives sufficient signals in advance, so that immediate steps can be taken to prevent the slippage of the account into NPA category. Various studies have been conducted to analyze the reasons for NPAs. An account becomes an NPA due to causes attributable into three as follows:

1. Borrowers
2. Financial Institutions
3. Reason beyond the control of both.

[3] Rani Chanchal, "Evaluation of various techniques used by the Public Sector Banks for the management of Non Performing Assets". International Journal of Research in Economics and Social Sciences, Vol.III, Issue-1 (January 2013) .pp.46

[4] Pradhan Pradip Kumar," The impact of Non Performing Assets in the performance of Financial Institution: A case study of OSFC". Sai Om Journal of Commerce & Management. Vol.1, issue 9 (Sep.2014). pp. 11

[5] Bansal Anshu, "A study on recent trends in Risk management of Non Performing Assets (NPAs) by Public Sector Banks in India". Journal of Information and Operation Management, Vol. 3, issue 1, 2012. pp. 51

Borrowers:-

There are some causes which are attributable to borrowers like:-

1. **Intentional defaulters:-**

Some firms and individuals are professional defaulters. They maintain an equation with the bank officials and are able to get loans by any means, by hook and crook. These firms and individuals from time to time, prepare false documents and apply for loans & advances for fictitious purpose. They also succeed in getting the loan in the name of a fictitious or non existing firm. With one excuse or the other, they also try to make delay in the payment of interest. In other words, they are intentional or professional defaulters. Any legal action against such persons/ firm also takes long procedures where as the total recoverable amount remains same, rather it increases with the passage of the time. Such persons/ firm are highly responsible for converting the assets into non performing assets of the financial institution.[6]

2. **Misutilization / Diversion of Funds:-**

This is also one of important factor for nonpayment of loan by the borrower, if the borrower misuses the amount given as loan by the financial institution. They do not utilize the fund for the purpose for which they have applied rather; they use it for some other purpose. For example, borrower utilizes the fund to repay their old debts or for other purpose due to which NPA occurs.[7]

3. **Deficient analysis of project viability:-**

Success of any project depend upon the viability of the project and the viability in turn, depends upon the easy availability of raw material, transportation, skilled labor, communication facility, market etc. If any of

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[6] Jain T.R., Trehan Mukesh, Trehan Ranju, "Indian Business Environment" pp. 234

[7] Jain T.R., Trehan Mukesh, Trehan Ranju, "Indian Business Environment" pp. 234

the above is not easily available to the borrower/ entrepreneur, then it results in cost overrun and time overrun. Due to this unavoidably default in repayment of loan by the borrower. So, this is also one of the causes of rise in NPA.

4. Lack of Demand:-

If the entrepreneur takes loan from the financial institution for production of any product without forecasting the demand of that product and he starts the production then it ultimately piles up their product. Thus, they become unable to pay their dues. Hence, these irrecoverable amounts become NPAs for the financial institution.[8]

5. Fund blocked in credit sale:-

If borrower sells their product on credit to the customer and if their payment is not received on time, then they would have to face fund problem. Due to this, he will not be able to pay their dues on time which leads to rise in NPA.

6. Delay in Implementation of Project:-

If the entrepreneur do not implement their project on time, it increases the cost of project like transportation cost, wages cost, production cost etc. which ultimately affect their profit. Due to this, entrepreneur is unable to pay their debts thus resulting into NPA.

7. Lack of knowledge:-

Sometimes a person takes the loan without proper planning or the person who have a little knowledge of the field, enters into that field just because other people have got success in that field. Thus, he is unable to manage the resources & ultimately could not repay the loans.

[8] Gupta Bratati, "A Comparative study of NPA of SBI & Associate & Other Public Sector Banks." SIT Journal of Management, Vol-2 December 2012, ISSN 2278-9111. pp. 178

8. Highly ambitious projects:-

The borrower takes the loan from financial institution for establishing the projects. They overestimate the return on investment on such projects. And because of that they prepare the tight repayment schedule for the loan taken by them. In actuality, the loan taken by the entrepreneur for the project does not produce that much return and the borrower is unable to repay the loan. This creates NPA in the financial institution.

Financial institutions:-

There are some causes which are attributable to financial institutions or banks like:-

1. Improper Selection of Borrower:-

Selection of right borrower is one of the major factors in the profitability of financial institution. Selection of borrower should be done very cautiously. Before sanctioning of loan to the borrower, credit worthiness as well as the project should check very careful. Strict measures should be taken before sanctioning of the loan.[9]

2. Non availability of proper security against funds:-

Sometimes financial institution gives loans to the borrower without getting adequate security. The non availability of proper security against these loans makes them insecure to recover. It is important to presume by the financial institution that if the borrower does not repays their dues, then the security given by the borrower will be helpful to recover their dues. If it does not happen, then NPA occurs.

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9 Dharwal Mridul, Agarwal Ankur and Gola, K. R., " A Study on Reduction of Non-Performing Assets in Commercial Banks (A Case Study of Alwar District, Rajasthan, India)" available at *www.scribd.com/doc/218880898/65-206-1-PB*

3. No Proper Follow up Actions:-

To keep the borrowing unit under constant view, the financial institution should take proper follow up measures regularly & systematically. But the authorities of the financial institutions do not adopt any proper follow up actions for the advance they have given. While granting loan, the authorities do the paper work formalities. The institution gets the certificate from the borrower which gives the assurance that amount will be rightly used in the project for which they have taken the loan. But the authorities never bother to verify the validity of the certificate. The reality comes to the limelight only when the recovery process is started. Thus, due to no proper follow up actions by the officials of the financial institution it becomes rather very difficult to recover the amount and thus it leads to rise in nonperforming assets.[10]

4. Poor Credit Appraisal System:-

Another reason for mounting NPA is poor credit appraisal system. Before giving advances to a borrower, financial institutions should undergo credit rating procedure to evaluate where you stand. Otherwise due to poor credit appraisal system, the institution gives advances to those who are not able to repay it back. There are various measures to ascertain credit rating. For reducing or managing NPA, financial institution should use good credit appraisal system. If it is neglecting, this results into NPA.[11]

5. Absence of Regular Industrial Visit:-

Absence of regular industrial visit by financial institution is also responsible for rise in NPA. Irregularities in spot visit by the official to the customers or borrowers point decreases the collection of interest and principal of the loan. The NPAs due to willful defaulters can be collected by

[10] Jain T.R., Trehan Mukesh, Trehan Ranju, "Indian Business Environment" pp. 234

[11] Gupta Bratati. "A comparative study of NPA of SBI & associate & other public sector banks." SIT journal of management, Vol-2 December 2012, pp. 180

regular industrial visit. Thus, it will be helpful in decreasing the NPA of the financial institutions.[12]

6. Reloaning Process:-

Non remittance of recoveries to higher financing agencies and re - loaning of the same have already affected the smooth operation of credit cycle. Due to re-loaning, the defaulter is increasing day by day which ultimately leads to rise in NPA.[13]

7. Inadequacy of Capital and tools relating to assets quality monitoring:-

Financial Institutions suffer from lack of capital funds to prosecute any meaningful investments in quality control, loan monitoring etc. Due to inadequacy of capital or shortage of funds, absence of independent management, it leads to low focus on assets quality tracking and taking corrective actions by the financial institutions.[14]

8. Inappropriate Technology:-

Inappropriate and obsolescence technology is also responsible for rise in NPA. Due to inappropriate technology and management information system, market driven decisions on real time basis cannot be taken. In the absence of proper management information system (MIS) and financial accounting systems, it leads to poor credit collection, thus it resulted into rise in NPA.[15]

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[12] Gupta Bratati, "A comparative study of NPA of SBI & associate & other public sector banks." SIT journal of management, Vol-2 December 2012, pp. 180

[13] http://www.slideshare.net/shami1988/a-study-of-non-performing-assets-with-special-reference-to-icici-bank

[14] http://www.slideshare.net/shami1988/a-study-of-non-performing-assets-with-special-reference-to-icici-bank

[15] http://www.mbatab.blogspot.in/2012/02/non-performing-assets-npa.html

9. Delay in loan Disbursement:-

If the financial institution delays in disburses loan to the borrower as per prescribed scheduled, it can throw a project off track of the borrower and it has a cascading effect on its viability and capacity to repay off the loan. Thus, this will also be responsible for emergence of NPA in financial institution.[16]

10. Pressure of seniors on the operating Managers:-

Sometimes excessive pressure of the seniors on their operating staff or managers, forces them to advance credit. These managers know it fully that it will be very difficult to recover the amount of loans. But the forced circumstances induce them to obey the orders and give loan to them. This is also a cause of emergence of NPA in financial institution.[17]

11. Unscientific repayment schedule:-

Sometimes financial institution makes mistake in preparing the repayment schedule of the borrowers. They prepare unscientific repayment schedule without considering the borrowers capacity to bear the financial burden of repayment of loan. Thus it accelerates the pace of NPA's.

12. Poor human resource management:-

The age profile of the staff is the cause of poor human resource. At the same time frequency of training sessions are also low. So, due to lack of staff in financial institution they are unable to keep eye on each borrower and thus NPA occurs.

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[16] Infosys finacle thought paper, "Non-performing assets: an Indian perspective" (http://www.infosys.com/finacle/solutions/thought-papers/Documents/non-performing-assets-indian-perspective.pdf)

[17] Jain T.R., Trehan Mukesh, Trehan Ranju, "Indian Business Environment" pp. 235

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[14] http://www.slideshare.net/shami1988/a-study-of-non-performing-assets-with-special-reference-to-icici-bank

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[16] Infosys finacle thought paper, "Non-performing assets: an Indian perspective" (http://www.infosys.com/finacle/solutions/thought-papers/Documents/non-performing-assets-indian-perspective.pdf)

[17] Jain T.R., Trehan Mukesh, Trehan Ranju, "Indian Business Environment" pp. 235

Reasons beyond the control of both:-

There are some other causes also which are responsible for rise in NPA as follows:-

1. Natural Causes and Calamities:-

Sometimes natural causes and calamities are also responsible for the occurrence of NPA. On account of natural calamities; the borrowers obtain loans for the purpose of developing their activities like poultry, dairy, land development and cultivation of crops in rural and semi urban areas. When natural calamities such as floods, poor inflow of rains etc occurs, the farmers are unable to earn income from the agricultural products and they find it difficult to paying back the principal and interest amount in respect of the loans availed from the banks. Thus, it indirectly increases the level of nonperforming assets in the financial institution.

For example – In the year 2002, in Rajasthan, it happened that a farmer borrowed the money for the purchase of seeds or fertilizers, but due to drought there had been no crop throughout the year or there had been excessive rains thus it destroyed the whole crop. Due to this reason they were not able to repay their dues. [18]

2. Political Pressure:-

Sometimes the official of the financial institution provides loans to those borrowers under political pressure whose repaying capacity is not good. Moreover, they have to grant loan to priority sector under government guidelines, so as to meet social objective. Often these loans are sanctioned on lesser security. Later on these loans become bad debts.[19]

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18 Jain T.R., Trehan Mukesh, Trehan Ranju, "Indian Business Environment" pp. 234-235

19 Jain T.R., Trehan Mukesh, Trehan Ranju, "Indian Business Environment" pp. 235

3. Lack of Transport facility:-

Sometimes due to poor transport facility, the product does not reach in the market on time for sale. Thus, an unsold stock of product piles up and there is a delay in paying back the loan by the borrower. Thus, this cause is also responsible for emergence of NPA.

4. Competition in Marketing of the Product:-

If a businessman or producer takes loan for the production of a product, but after sometimes any other producer also starts producing the similar products. If it happens to be superior to the former, then this product fails in the market due to the competition. It becomes difficult for the former business man or the producer paying the amount of loan back to the financial institution. So due to this reason NPA occurs.[20]

5. Change in Government Policies:-

Banks or Financial Institutions get new policies for its operations with every new government. Thus, the financial institution has to deal with the changing principles and policies for the regulation of mounting Non Performing Assets. The fallout of handloom sector is continuing as most of the weavers cooperative societies have become non operational, largely due to withdrawal of state patronage. The rehabilitation plan worked out by the central government to revive the handloom sector has not yet been implemented. So, the over dues to the handloom sectors are becoming NPA.[21]

6. Internal Management Problems:-

Sometimes entrepreneur faces internal management problem like strike of workers, strike of transporters, shut down for seasonal maintenance

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20 Jain T.R., Trehan Mukesh, Trehan Ranju, "Indian Business Environment" pp. 235

21 http://www.sbioak.org

by electric supplier agencies, non availability of working capital etc. Due to this, production is not executed and demonstrated on time which leads to default on payment by borrower leading to rise in NPA.

7. Announcement of Debt Relief Schemes by the Government:-

Debt relief scheme are also responsible for giving negative impact on recovery. For example, in agriculture sector, which is having a huge portion of NPA because of government scheme, with the mere announcement of such schemes, the farmers stop repaying their installment on presumption of their dues were being waived. However, such schemes increase the burden of NPA at institutional part.[22]

8. Ineffective recovery tribunal:-

For the recovery of loans and advances, the government has setup a number of recovery tribunals in India. But they are not fully equipped to handle very large number of cases. In some of the DRTs, the number of pending cases is quite large. In fact DRTs have failed to achieve the declared objective of cases in speedy recovery of advances. Due to their negligence and ineffectiveness in their work, the banks or financial corporation's suffer the consequences of non recovery of dues, thereby it reducing the profitability and liquidity.[23]

9. Poor infrastructure:-

In terms of providing basic infrastructure like power, roads housing etc; the poor infrastructural facilities like power add to the huge portion of bad assets; As the production get hampered with long hours of power cut,

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[22] www.ijrcm.org.in

[23] Gupta Bratati,," A comparative study of Non performing assets of SBI and associate & other public sector banks."SIT journal of management, Vol.2. Dec.2012, pp.179

corporate or entrepreneur are not able to repay their dues on time. So these are also responsible for rise in NPAs.[24]

10. Problem of Recessions:-

Generally industrial recession, especially in industries like textiles, steel, sugar, cement, electronics, leather etc. is also responsible for increasing NPA.[25] Due to recession, globally stock markets have tumbled. The Indian economy has been much affected due to sticky legal system, poor infrastructural facilities, high fiscal deficit, cutting of exposures to emerging markets etc. Further, international rating agencies like, standard and poor have lowered India's credit rating to sub- investment grade. Under such a situation, it goes without saying that banks are no exception and are bound to face the heat of global downturn.[26]

11. Over optimistic promoters:-

This is also important factor for rise in NPA. Sometimes promoters were optimistic in setting up large projects. They often set up projects with the expectation that part of the funding would be arranged from the capital markets, which were booming at the time of the project appraisal. When the capital markets consequently crashed, the requisite funds could never be raised, promoters often lost interest and lenders were left trapped with incomplete or unviable projects.[27]

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[24] www.ijrcm.org.in

[25] http://gaurishankar.blogspot.in/2011/06/reasons-for-gowth-of-non-perorming.html

[26] Gupta Bratati.," A comparative study of Non performing Assets of SBI and associate & other public sector banks."SIT journal of management, Vol.2. Dec.2012. pp.178-179

[27] http://www.scribd.com/doc/88177767/A-REPORT-ON-NPA-IN-BANKING

12. Global economic slowdown affecting export sector:-

On account of certain global economic slowdown, exporters may find it difficult to market their products. Then, they are unable to pays their due loan.[28]

13. Frequent changes in regulatory norms:-

Frequent changes in regulation can turn assets into non performing assets. Accounting reason like reduction in income recognition norms from 180 days to 90 days could be the reason for rise in NPA.[29]

Thus, these are the general reasons which are responsible for increasing NPA in any financial institutions. There are some other factors also which are responsible for rise in NPA in the context of MPFC has explained further.

5.2 Reasons for emergence of NPA in the context of MPFC:-

All the general reasons which has described earlier are also applicable to MPFC, being a lead financer of the state. More or less MPFC is also affected by way of government policies, tax structure, and new budget provisions, attitude of monsoon, institutional peace & stability in the state.

According to G.P. Gupta committee Report:- "Report of the committee on restructuring of SFCs" low recovery and high NPA in SFC's can be attributed to following factors;

1. Weak credit appraisal, monitoring and lack of accountability.
2. Reduction in tariff barriers and liberalization of imports leading to adverse pressure on domestic industry.

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[28] http://gaurisankar.blogspot.in/2011/06/reasons-for-growth-of-non-performing.html

[29] Poongavanam.S, "Non performing assets: Issues, Causes & Remedial solution." Asian Journal of Management Research. Vol-2, Issue-I, 2011, ISSN-2229-3795, pp. 127.

3. High incidence of sickness in industries located in backward and developing areas and also those promoted by first generation entrepreneur.

4. Willful defaults and legal hurdles in expeditious recovery/ settlement of dues.

5. Decline in disbursement due to lack of bankable projects and resource constraints.[30]

Thus, these factors are responsible for NPA according to Gupta committee report. Some other reasons also have been found by the researcher through discussions with the employees or official or some borrowers of MPFC. They are as follows:-

1. Failure to take coercive action:-

Under the provision of SFCs Act, sometime financial corporation fails to take coercive action like delay in taking physical possession, sale of prime assets of assisted units and non issuance of recovery certificate. So due to this NPA occurs.

2. Delay in sanctioning of loan:-

Due to delay in sanctioning of loan to the borrower, the cost of project increases. Ultimately project does not implemented on time. Thus, it can throw a project off track of the borrower and it's have a cascading effect on its viability and capacity to repay and then, he is unable to repay their dues on time.

3. Obtaining Inadequate Securities:-

Every loan is secured by fixed assets & it must be kept in mind by every financial institute that loan amount should be covered by a higher range of security, by which at the time of default, the loan can be covered by

[30] G.P. Gupta committee report, "Report of the committee on restructuring of SFCs" pp. 79-83

sale of valued property of the borrower. Sometimes it is seen that not only in MPFC but also in banks, that they release their loan on second charge property of the borrower. Even MPFC also do such practice. Sometimes MPFC does not recover the loan amount with good security or disputed assets which resulted into rise of NPA portfolio.

4. Sanction of Loans without ensuring working capital requirement of borrower:-

Working capital is assumed to be blood of every business. It is very necessary for any entrepreneur that proper assessment of working capital shall be done before commencing of any business. Mainly banks are responsible for providing working capital to any industry and MPFC deal with building, plant and machinery etc. but at the time of appraising project, it is very necessary to check the working capital requirement of that project. Sometimes appraising authority fails to concentrate over this important aspect which results in bad debts (NPA).

5. Poor pursuance for recovery of loans:-

On going through the annual report of MPFC, it shows a good trend of recovery under a period of analysis but in depth, as on look towards the amount of total outstanding, the recovery efforts are not to its maximum. Every institute needs an optimum level of recovery efforts and in the absence of which NPA grows and stands as a big problem for the institution.

6. Sanction of loan to non feasible/ non viable projects:-

There are various tools available for financial corporation's through which the feasibility and viability of the project can be measured like DER, DSCR, Break even analysis, Security cover analysis, Return on own capital etc. Sometimes financial corporation fails to do this complete assessment leads to rise in NPA.

7. Deficiencies in appraisal of loan:-

Though before financing to any entrepreneur, MPFC go through every standard of norms but sometimes related officer/ authority is incompetent to evaluate the performance of that particular business to which he is going to finance. It has been found that M.P.F.C. provides loans to those borrowers whose goodwill is not good in the market or gives additional loan to those borrowers who are not able to repay it back. Thus NPA occurs.

8. Disbursement of loan on unapproved terms:-

The financial corporation sanctions loan to the borrower on the basis of some prescribed terms and condition such as interest rates, schedule of repayment, rebates etc. The rebates would be allowable only in case of prompt payment by the borrower. But sometimes the corporation did not follow their practice uniformly in all the cases. The corporation discretionally extended rebate to the borrowers who did not make timely payment (within first five days) of principal & interest dues. Sometimes the corporation extends benefit to the borrower by not charging the rate of interest as per the term of sanction or given some reliefs also and as a result there is a loss of income.[31]

9. Ineffective legal System:-

One of the most important factors for rise of NPA in financial institutions is ineffective legal system and there is no separate legal system for financial corporation. Extremely slow judicial system has contributed significantly to high level of NPAs.

[31] Report of AGMP 2010-11, pp.25-26.

10. Negligence in supervision:-

Negligence in supervision at proper interval too, may become an important cause for turning an advance as Non performing. A continuous and constant supervision is helpful to know the position of the borrower. It helps to keep in touch with the borrower. In the absence of this rise in NPA occurs.

11. Lack of Staff:-

It has been observed that in MPFC, from 1990 new recruitment are restricted. On the contrary business quantum increased gradually, in the past year. To handle the business in all over M.P., only 180 employees are left to serve. After division of Chhattisgarh, MPFC had allotted 310 employees at various levels to handle the responsibility of MPFC. Due to continuous retirement and blockage in fresh recruitment, only180 strength is left now. Good brains & skilled worker are confined which results in weak credit appraisal & monitoring of the loan cases & loan portfolio.

12. Delay on taking recovery action against defaulter:-

"Timely action taken then you will be winner". Corporation has set up recovery committee, which works for recovery of loans & advances. Sometimes due to their negligence and delay in their work, the corporation suffers the consequence of non recovery of their loan, thereby reducing their profitability and liquidity.

13. Insufficient training to staff:-

Insufficient training to staff is also responsible for further deterioting the situation. Mishandling of loan cases is an example of this problem.

The above mentioned facts shows that, several reasons related to occurrence of NPA in MPFC, but it is not only due to corporation in fact it is also from the side of borrower and from other prospects which are responsible for rise in NPA like natural calamities, poor infrastructure facilities, lack of marketing facilities, intentional defaulters, fund blocked in credit sale, cost overrun, time overrun, death of the borrower etc. are also responsible for emergence of NPA in MPFC.

5.3 Impact of Non Performing Assets:-

The problem of Non Performing Assets in the financial institution is one of the fore most and formidable problem that had impacted the entire financial sector.[32] It is the smoking gun which threatens the stability of Indian banks / financial institution. It's a burden which cannot be avoided by banking industry or financial institutions in India. In the globalization era, Banks & financial institution of India are facing serious problems due to NPA's. It wrecks the profitability of Banks or a financial institution through a loss of interest income & write off's of the principal loan amount itself. The NPA's level acts as an indicator, viewing the banker's credit risk & competence of allocation of resources. So, NPA's do not just reflect badly in a financial institution account books, but it adversely affects the national economy. A few notable areas are as follows-

1. Profitability:-

The impact of NPA on profitability of financial institution in the following way –

- **i).** The interest income of the financial institution is reduced, because it is accounted only on receipt basis.
- **ii).** Due to NPAs institutions profit also affected it is because of creation of reserves and provisions that comes from profits which act as cushion for loan losses.

[32] Dr. kumar Mohan & Singh Govind, "Mounting of NPAs in Indian commercial banks". International Journal of Transformations in Business Management.Vol.1, Issue-6, April-June(2012).

iii). Due to NPAs, assets and liability mismatch will increase. The economic value addition (EVA) by banks gets upset, it is because EVA is equal to the net operating profit minus cost of capital and thus, it reduces recycling of the funds.

iv). Low ROI is another impact of reduction in profitability, which adversely affects the current earning of the financial institution.[33]

2. Liquidity:–

Mounting NPAs not only critically affect the liquidity of financial institution but also force the financial institution to maintain more liquid assets, thereby increasing the cost.[34] Neither principal amount nor interest amount is being received to the financial institution against the assets. The mobilization of funds is stopped. It affects the liquidity of funds.[35]

3. Solvency:–

Decrease in profitability and liquidity ultimately affects the solvency position of financial corporation. Recovery of credit on time is very important. The solvency of the financial institution, as exhibited by capital adequacy ratio which is directly related to quality of its loan portfolio/ assets, since the loan portfolio is a major part of net assets of any financial institution, loan defaults are prime source of potential losses. Thus, new equity is required whenever such loan losses occurs. A substantial portion of nonperforming assets in loan portfolio thus jeopardize solvency of the financial institution as accretion to owned fund is reduced due to higher provision and consequently less profit.[36]

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33 Prasad Bhavani G.V. & Veena D.(2011), " NPAs reduction strategies for commercial banks in india", International Journal of Management and Business Studies. Vol.1, issue 3, September(2011),. pp. 48-49

34 http://www.nabard.org/pdf/oc21.pdf

35 Manishkant Arya, "Non performing assets & the survivability of banks." BAUDDHIK EISSN-2277-4955, Vol.4 (September- December 2013). pp. 10

36 http://www.nabard.org/pdf/oc21.pdf

4. Involvement of Management:-

Time & efforts of management is another indirect cost which financial institution has to bear due to NPAs. The time & efforts of management in handling and managing NPA would have to be diverted to some productive activities, which would have given good returns. Nowadays, financial institutions have special employees to deal & handle NPAs which is the additional cost to the financial institutions.[37]

5.4 Problems due to NPA in MPFC:-

Today, the word non performing asset strike terror in banking sector and financial institution. According to the guideline of the NPA, when interest or over due to a financial institution or bank remains unpaid for more than 90 days then the entire loan automatically converts into an NPA. The recovery of loans & advances has always been a problem for banks & financial institutions in India.[38] The problem of NPA in financial institution is somewhat similar to disease in some part of the body. The ripple effect of NPA, as in the case of cancer, is gradually felt in all parts of the economy viz savings, investment, production, employment and services etc. which adversely affects the capital formation, economic growth, fiscal deficit and inflation. The worth of the financial institution act as an efficient intermediary, which is dependent on its soundness, based on its quality of assets, particularly advances.[39]

In the globalization era, banks & financial institution get high priority. The high level of NPAs in state financial corporation has been matter of great concern. The earning capacity and profitability are highly

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37 Manishkant Arya, "Non performing assets & the survivability of banks." BAUDDHIK, EISSN-2277-4955, Vol.4 (September- December 2013) pp. 10

38 Manishkant Arya, "Non performing assets & the survivability of banks." BAUDDHIK, EISSN-2277-4955, Vol.4 (September- December 2013) pp. 9

39 Gopal Krishnan. T.V., (2006). "Management of non performing advances – A study with reference to public sector banks". New Delhi, India: Northern Book Center. pp.15-18

affected due to NPA. While the primary function of the financial corporation is to provide loan to various sectors such as industries, trade, housing loan, etc. In recent times, the financial corporation has become very cautious in increasing loans due to increase in Nonperforming assets. Non performing assets are that thought which never be desired by anyone neither by a borrowing institute nor by a borrower. The levels of NPA act as an indicator viewing the credit risk and competence of allocation of resources in financial corporation. So the impact of nonperforming assets in financial institutions or corporation is in several ways.

MPFC has also faced various problems due to NPA. Following are the some of the repercussion of NPA's in MPFC which has been found by the researcher through discussion with the employees or official of MPFC are:

1. Due to NPA Profitability also affected:-

After the introduction of prudential norms, profitability is the yardstick for any business enterprise including the financial institution. It adversely affects the profitability of banks or financial institutions as the NPA do not generate interest income but at the same time banks or financial institution are required to provide provision for NPA from their current profit.

The efficiency and performance of any financial institution is not always judged by the size of its balance sheet but also the level of Return on Assets. The profit level of the financial institution is that parameter which measures the efficiency of financial institution. Actual return on assets & Net profit are considered as superior parameter to measure the efficiency of financial institution than the size of balance sheet level of any financial institutions.[40]

[40] http://www.scribd.com/doc/125845658/EJEFAS-51-04

In MPFC too, if performing assets are turning into NPAs, it is because lot of things happens to change the quality of assets in this backdrop. Hence, it becomes very important to understand the relationship of NPA and profitability, whether decrease in NPA leads to increase in profitability or not. For measuring the efficiency of MPFC, Net profit and actual return of assets are considered as profitability measure. So due to NPA profitability of MPFC are affected has shown in following tables.

i). Study the impact of Net NPA on Net profit of MPFC:-

The study of impact of Net NPA on Net profit of MPFC has shown in Table no. 5.1(a)

Table No. 5.1(a)

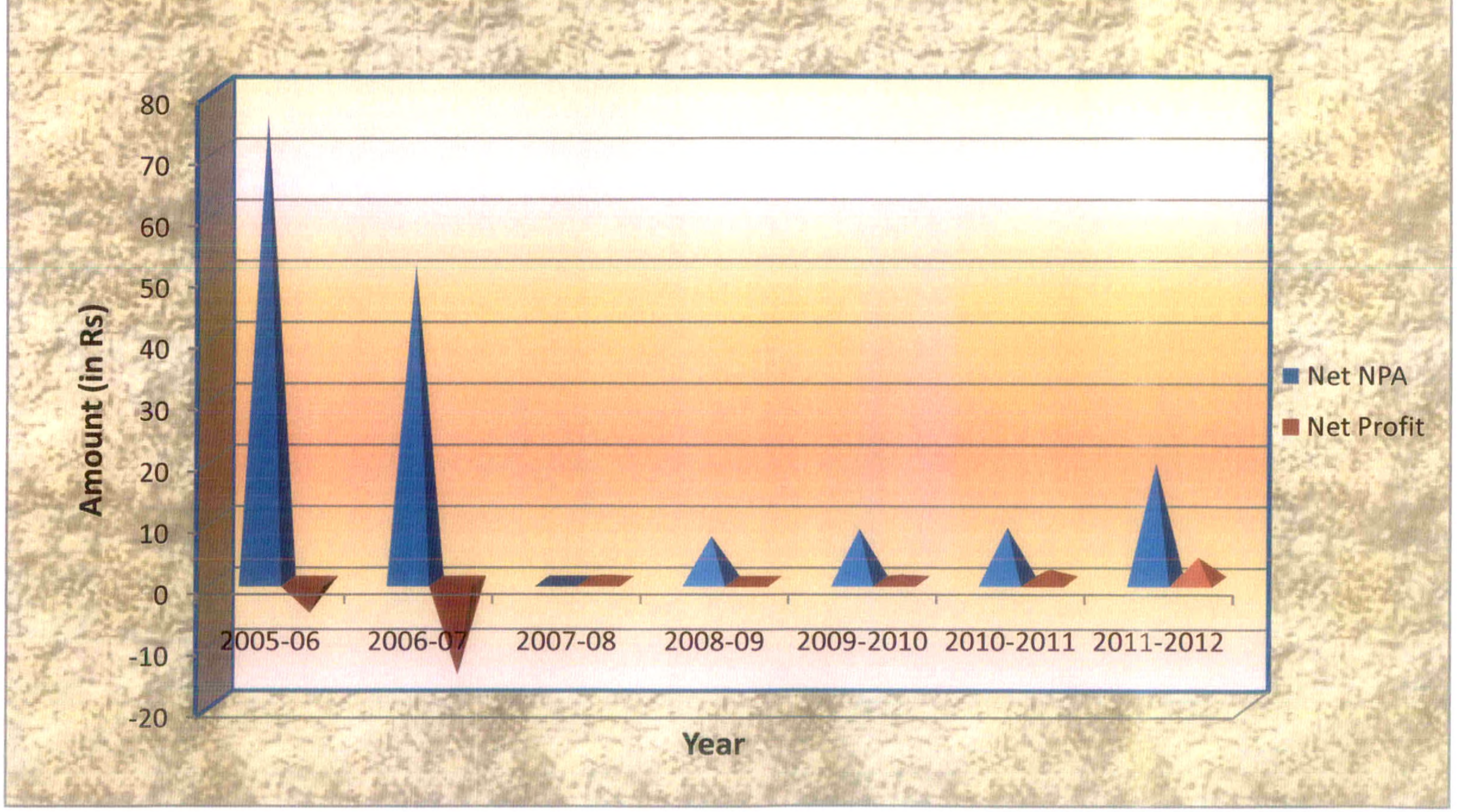
Study of the impact of Net NPA on Net profit in MPFC

(Rs.in crore)

Year	Net NPA	Net profit
2005-06	75.99	-5.14
2006-07	51.48	-15.22
2007-08	--	1.01
2008-09	7.34	0.51
2009-10	8.49	1.10
2010-11	8.73	2.00
2011-12	19.20	4.00

Source: Computed from Annual Reports & Accounts of MPFC

Graph 5.1 (a) showing study of Net Profit and Net NPA



The study of the impact of Net profit on Net NPA in MPFC has shown in Table No. 5.1(a) which shows that in the year 2005-06, the Net NPA was 75.99 crore and decreased to 51.48 crore about 24.51 crore in the year 2006-07. On other hand, Net loss -5.14 crore was registered in 2005-06 and increased to -15.22 crore in 2006-07, thus Net loss registered an increment about 10 crore. But in the year 2007-08, Net NPA became nil due to financial restructuring by state govt. and in this year there was no provision for NPA was made and in this year profit was registered about 1.01 crore in MPFC. Further in 2008-09, Net NPA was 7.34 crore and increased to 19.20 crore in 2011-12 about 2.6 times whereas, Net profit was registered to 51 lacs in 2008-09 and increased to 4 crore in 2011-12 about 3.51 crore. Overall position shows that Net NPA reduced from 75.99 crore to 19.20 crore on other hand, Net profit increased from -5.14 crore to 4 crore during the period of study.

The correlation between Net NPA and Net profit is -0.70 which shows negative correlation between them and there is an inverse relationship between them. It implies that, if NPA are controlled then, ultimately profitability will increase.

ii). Study of Gross NPA Ratio and ROA Ratio in MPFC:-

The Return on assets shows how profitable institution assets are in generating revenue. The objective of computing this ratio is to find out how efficiently the total assets have been used by the firm. The return on assets indicated the overall efficiency of the management in generating profits at a given level of assets at its disposal. The formula of ROA is-

$$ROA = \frac{\text{Net Profit x 100}}{\text{Average total Assets}}$$

The study of GNPA Ratio and ROA Ratio has shown in Table no. 5.1(b)

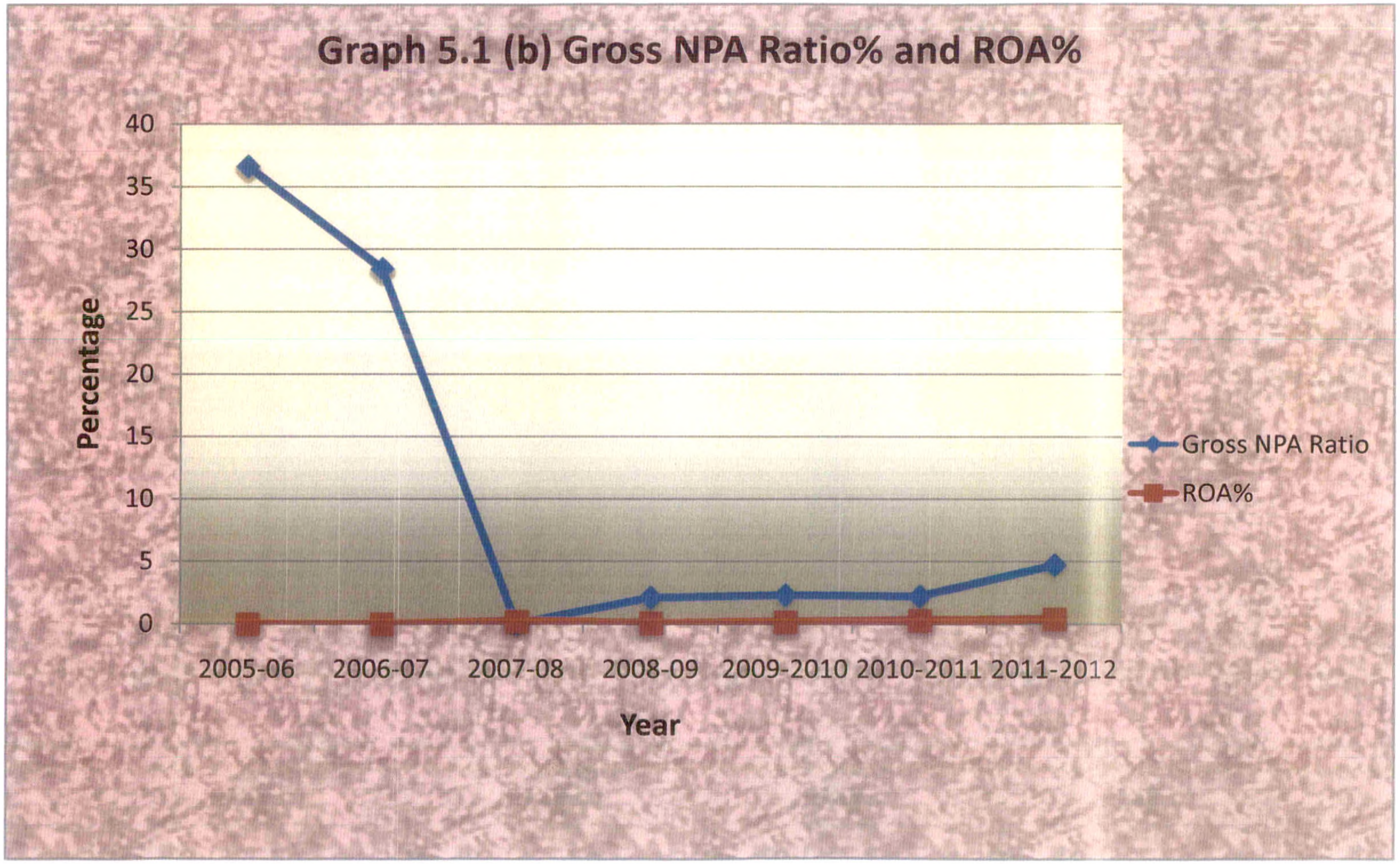
Table No. 5.1(b)

The study of Gross NPA Ratio and ROA Ratio in MPFC

Year	Gross NPA Ratio %	ROA %
2005-06	36.6	-
2006-07	28.4	-
2007-08	-	0.20
2008-09	2.1	0.08
2009-10	2.3	0.17
2010-11	2.2	0.30
2011-12	4.7	0.42
Mean	10.9	0.167

Source: Computed from Annual Reports & Accounts of MPFC

The study of Table No. 5.1(b) shows that in the year 2005-06 to 2006-07, the gross NPA ratio has been decreasing from 36.6% to 28.4%. On the other hand, ROA ratio has nil value because in these two years, MPFC suffered a loss or it might be say that corporation failed to utilize the assets to maximize the return. But in the year 2007-08, Gross NPA Ratio has nil value on their contrary; ROA ratio became 0.20% because in this year profit was registered in MPFC. Then from 2008-09 to 2011-12, gross NPA ratio increased by 2.6%. On other hand, in 2008-09, ROA ratio decreased by 0.12% as compare to their previous year and from the year 2009-10 to 2011-12, it went on increasing by 0.25%.


Graph 5.1 (b) Gross NPA Ratio% and ROA%
Percentage
40
35
30
25
20
15
10
5
0
2005-06
2006-07
2007-08
2008-09
2009-2010
2010-2011
2011-2012
Year
Gross NPA Ratio
ROA%

The mean value of GNPA ratio of 7 year is 10.9% & ROA ratio is 0.167% which is much less than GNPA Ratio. This indicates that due to increase in GNPA ratio, ROA is also affected.

iii). Study of Net NPA Ratio & ROA Ratio:

The study of Net NPA Ratio & ROA Ratio has shown in Table no. 5.1(c)

Table No. 5.1 (c)

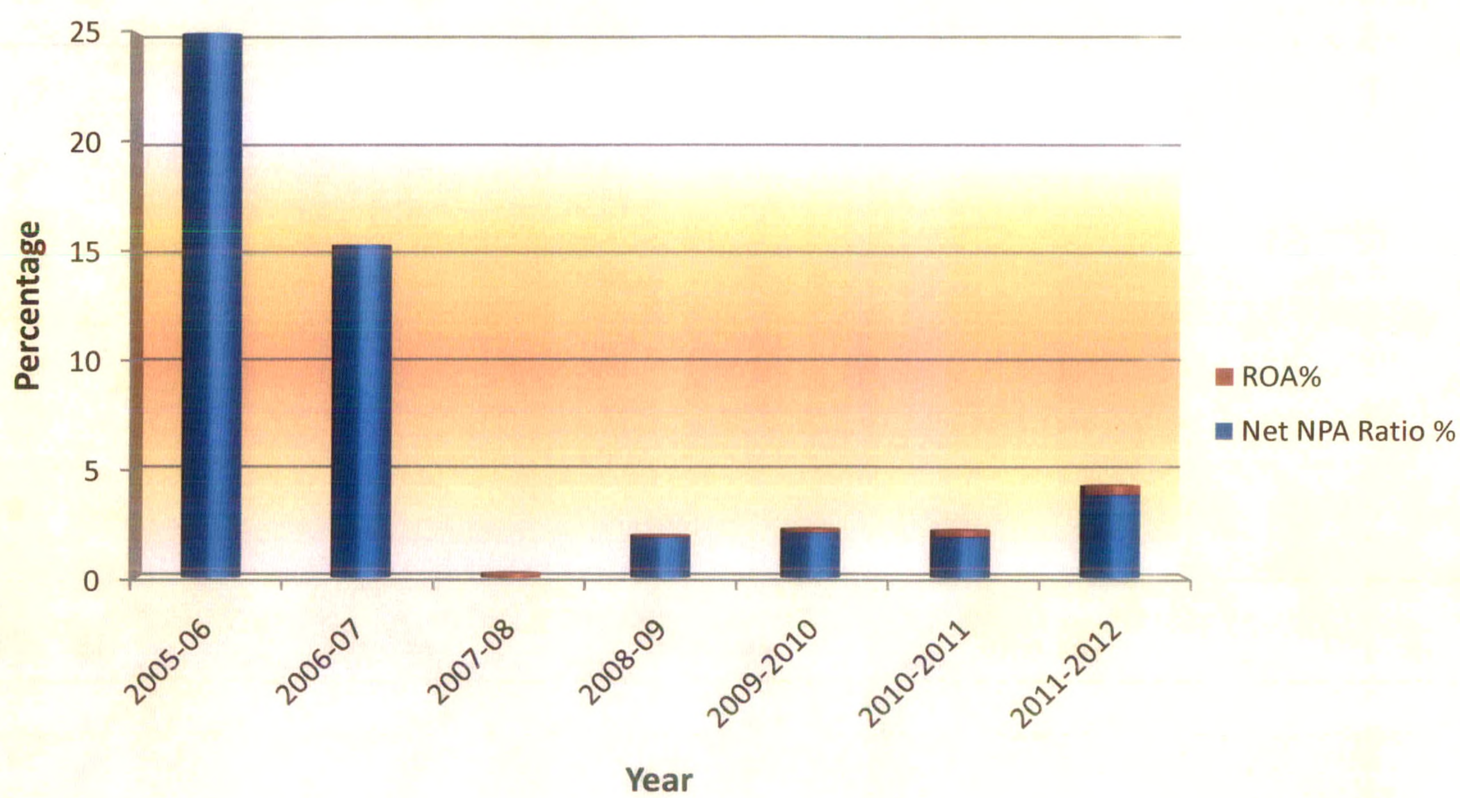
Study of Net NPA Ratio & ROA Ratio

Year	Net NPA Ratio %	ROA %
2005-06	25	-
2006-07	15.3	-
2007-08	-	0.20
2008-09	1.88	0.08
2009-10	2.09	0.17
2010-11	1.89	0.30
2011-12	3.82	0.42
Mean	7.14	0.167

Source: Computed from annual reports & accounts of MPFC

The study of Table No. 5.1(c) shows that in the year 2005-06 to 2006-07, the Net NPA ratio decreased from 25% to 15.3% approx. On other hand, ROA ratio became nil because in these two years, MPFC suffered a loss. But in the year 2007-08, Net NPA ratio has nil value on their contrary; ROA ratio became 0.20% because in this year profit was registered in MPFC. And thereafter, Net NPA ratio was registered to 1.88% in 2008-09, it slightly increased in the year 2009-10 and then in the year 2010-11, it witnessed a decrement about 0.2% as compared to their previous year.

Graph 5.1(C) Net NPA Ratio% and ROA%



Further, in the year 2011-12, it again increased about 1.93% as compared to their previous year. This shows that after 2007-08, Net NPA Ratio seems to be fluctuating. On other hand, ROA ratio became 0.08% in the year 2008-09 & thereafter from 2009-10 to 2011-12, it increased about 0.25%.

The average of Net NPA Ratio of 7 years was 7.14% & ROA is 0.167%, which is much less than Net NPA ratio. It indicates that due to increase in Net NPA ratio, ROA also affected.

2. Due to NPA capital adequacy ratio is also affected:-

NPA and CAR are an indication of the financial strength. The capital adequacy ratio (CAR) measures the amount of a bank's or financial institution capital in relation to its risk weighted credit exposures. It indicates the cushion the banking system has against potential losses. The capital adequacy ratio for all SCBs in India over the year has been well above the Basel mandate of 10% & RBIs requirement of 9 %.[41]

As per Basel norms, financial institution are required to maintain adequate capital on risk weighted assets on ongoing basis. Every increase in NPA level adds to risk weighted assets which warrant the financial institution to shore up their capital base further.[42] Position of capital adequacy ratio in MPFC has shown in Table no. 5.2

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[41] http://www.dnb.co.in/BFSI Sector In India/Banks C5.asp

[42] Article on Non Performing Assets impact on bank balance sheet by NSN Reddy, AGM, Andhra Bank) available at: http://www.allbankingsolutions.com/Articles/NPA-impact-on-Balance-Sheet.htm

Table No. 5.2

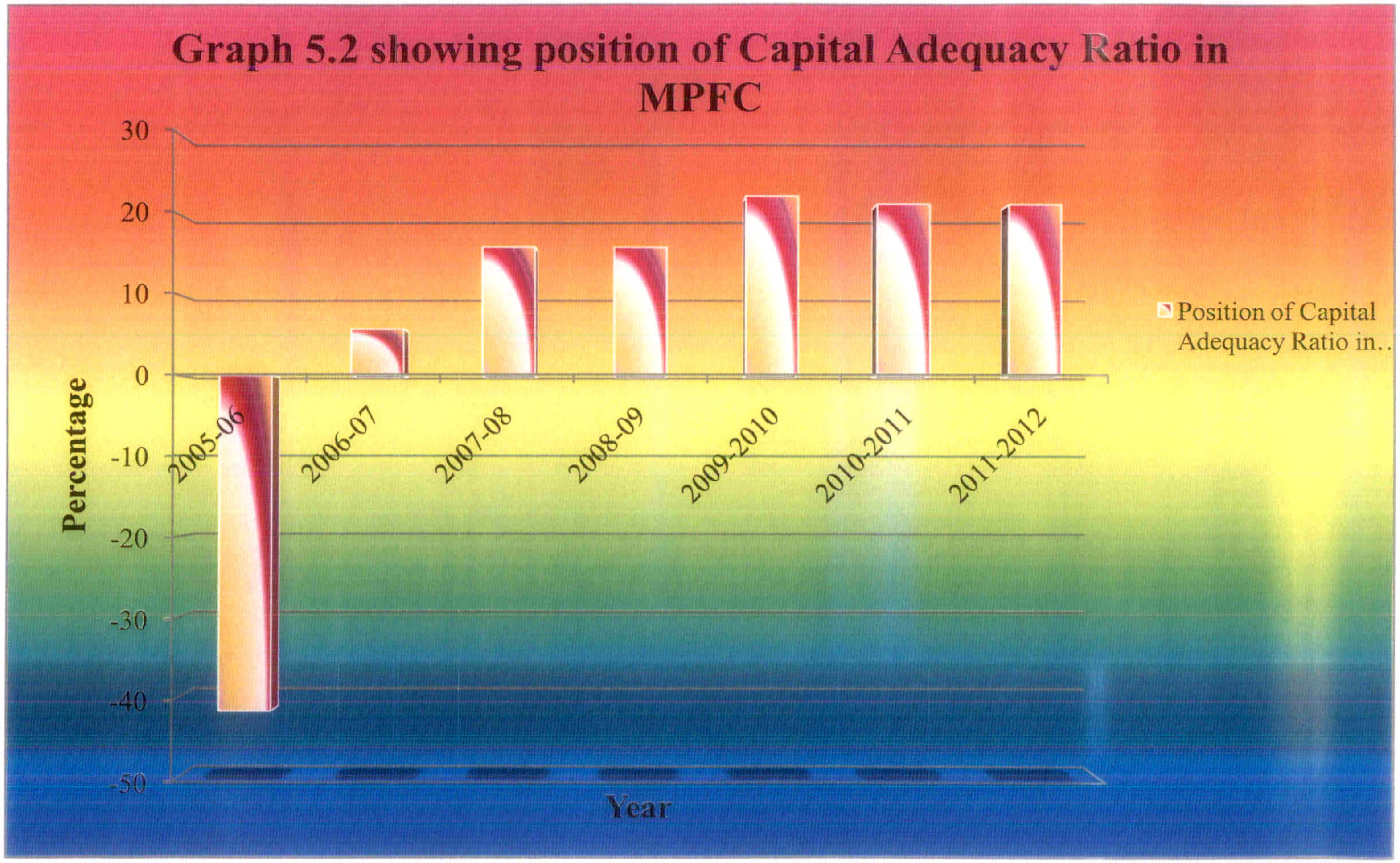
Position of Capital adequacy ratio in MPFC

Year	CAR%
2005-06	-41.70
2006-07	5.75
2007-08	15.90
2008-09	15.88
2009-10	22.21
2010-11	21.24
2011-12	21.18

Source: Annual Report of MPFC from 2005-06 to 2011-12

The study of position of CAR has shown in Table No. 5.2 which shows that in the year 2005-06, the capital adequacy ratio shows negative value which is -41.70%, which indicates that MPFC was not adequately capitalize to expand to its operation due to NPA. In 2006-07, it becomes 5.75% because government of M.P. has contributed Rs. 189 crore during this year.[43] Although it is below the RBI minimum requirement of 9% and from 2007-08 to 2011-12, it increased from 15.9% to 21.18% i.e. about 5.28%, which was above the minimum requirement of the RBI. In the year 2007-08, state government had taken over the entire NPA portfolio of MPFC, so that there was no provision for NPA were made in this year, subsequently it affects the profit then ultimately the capital adequacy ratio also affected.

[43] MPFC Annual report 2006-07, pp.8


Graph 5.2 showing position of Capital Adequacy Ratio in MPFC
30
20
10
0
-10
-20
-30
-40
-50
Percentage
2005-06
2006-07
2007-08
2008-09
2009-2010
2010-2011
2011-2012
Year
Position of Capital Adequacy Ratio in..

3. Difficulties in subscription of Bonds:-

One of the important sources of funds is to raise money from subscription of bonds. MPFC prepare its Business Planning & Resource Forecast (BPRF) at the beginning of financial year and with the approval of RBI, a series of bonds with a period of 5 years is subscribed by the MPFC. Amount of bonds and duration of subscription is fixed by the R.B.I. & subscription of bonds is only for financial institutes like Banks, Scheduled Banks, L.I.C. and Apex Banks. Subscription is not open for general public. Rate of interest of such series of bonds is kept higher, for which other investing financial institutes are interested to avail Bonds.

It is quite obvious that if balance sheet of any financial institute shows a larger amount of NPA, all kinds of adverse repurcation comes to every angle of future business. MPFC has raised big amount of funds through subscription of bonds through out every financial year. When annual report shows losses due to increase in NPA, the investor in the bonds do not show their desire to avail bonds even on higher rate of interest, as they are suspected to be benefitted and the danger is always hovering over a financial institute to become closed at any time.[44]

4. Difficulty in availing refinance from SIDBI:-

The loan portfolio with NPA reduces the liquidity position of financial corporation. NPA affects the interest of both the borrowers and the lending agencies. When the resources deployed by the financial corporation are locked up as NPA's and overdue respectively, the financial corporation is impaired from obtaining refinance from SIDBI/IDBI. MPFC, during the year 2007-08 had to face difficulty in availing refinance from SIDBI which resulted into curtailment of disbursements in the first half of the year.[45]

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[44] Information provided by the employee of MPFC.

[45] Annual Report 2007-08 of MPFC. pp.4

5. Difficulty in receiving financial assistance from state government:-

Quantum of NPA always reflects the financial health of present and future of the financial institution. Parental and supporting institution, before providing financial assistance to the financial institution, always takes NPA% into consideration. If the NPA percentage of financial institution increases year by year then the state govt. will stretch their hand to issue share capital. So due to NPA, finance from state government is also affected. The Table No. 5.3 shows the position of share holding of state government and financial assistance received from the state government.

Table No.5.3

The position of share holding of state government and financial assistance received from the state govt. in MPFC

Years	Share holding of state Govt. in %	Financial assistance received from State Govt. (Rs. in crore)
2005-06	72.68	4.00
2006-07	91.73	189.00
2007-08	93.32	65.00
2008-09	93.42	5.00
2009-10	93.51	5.00
2010-11	93.61	5.00
2011-12	93.70	5.00
Mean	90.3	39.7

Source: Annual Reports of MPFC

Table No. 5.3 shows the study of share holding of state government and financial assistance received from the state govt. This shows that a big share holding is held by state government in MPFC. It is about 90.3% as an average of 7 year under the period of study and the average financial assistance received from the state government is about 40 crore . Thus, MPFC must be cautious about their NPA %.

6. NPA erodes the capital of the corporation:-

Capital plays a significant role in the economic system of the corporation. Finance is that resource which can smoothly direct the activities of the financial institutions. The biggest problem of the corporation is that, they had given loans to such entrepreneur or industries who does not pays their dues on time thus, it becomes NPA. And NPA are that asset which ceases to generate income from interest and principal both which ultimately blocked the cash inflows from the investment. So, financial corporation feels difficult to mobilize their resources effectively. Due to scarcity of funds in hand the new investment of the financial corporation interrupted and the capital of the corporation eroded.

7. Productivity hampers:-

It is found that the high level of non-performing assets not only increases the working cost of financial institution but also affects the productivity and efficiency of the employees. The understandings behind that institution staffs are primarily engaged in preparing papers for filing suits to recover loan and over dues on the borrowers instead of devoting time for planning for mobilization of funds. Due to this, productivity and efficiency of financial corporation is also affected.[46]

[46] Yadav, Mahipal Singh, " Impact of Non Performing Assets on Profitability and Productivity of Public sector Banks in India", AFBE JOURNAL, Volume 4, No. 1, June, 2011, ISSN 2071-7873

8. Credit loss:-

It is found that NPA hampers the value of financial corporation or institution in terms of market credit. The main reason of the NPA is lack of efficiency in management. Another reason of reduction in the value of goodwill is lack of profit due to non receipt of interest & principal from NPAs. It loses its goodwill and brand image and the credit rating of the financial corporation is also affected due to high NPA.

9. High operative cost:-

Due to increase in the NPA, the operational cost of the corporation is increased. The monitoring cost of NPA is very high. On one hand, the NPA does not generate any income from interest and on the other hand it creates loss through effective management. Both the preventive & curative measures for decreasing the NPA attract high expenses.[47]

10. Rise in NPA affects the lending capacity of financial corporation:-

Due to NPA, the capacity to undertake fresh lending is impaired; adding sadness to the existing resources constraints. NPA adversely affects the lending capacity of the financial corporation, due to their inability to recycle or to raise more resources from RBI/SIDBI.[48]

11. Interest Rate:-

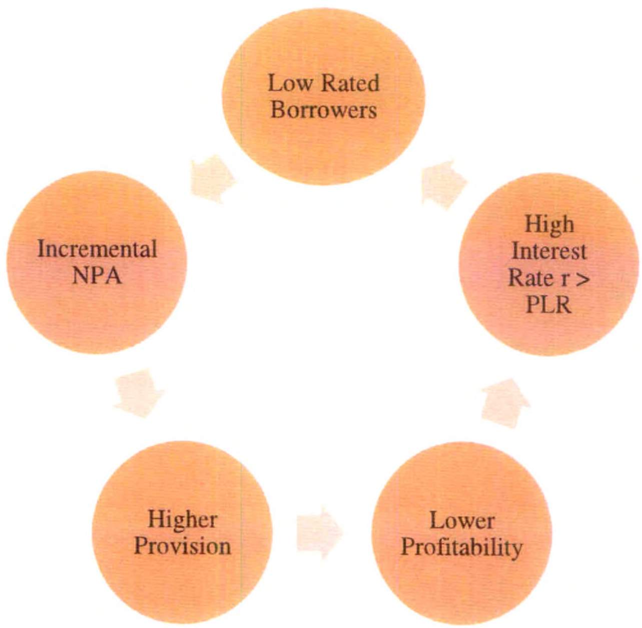
Due to high NPAs, fallout of lower profitability and shrinkage of performing loan portfolio of the financial institution and financial corporation are not able to reduce the lending rate in relation to bank rate, which adversely affects their competitiveness and leads to poor credit

[47] Pradhan Pradeep Kumar, " The impact of Non Performing Assets in the performance of financial institutions: A case study of OSFC". Sai Om journal of commerce & management, Vol-1, issue 9 (sep 2014). pp. 11-17

[48] Veerakumar K., "Non performing assets in priority sector: A threat to Indian SCBs", International Research Journal of Finance & Economics, issue 93(2012).

expansion. Moreover, as a result of higher provisioning due to increase in NPAs & the cost of servicing the resources, the financial institution have to perforce charge higher interest rate on the performing borrower.

As the interest rate become higher than the market rate, the financial institution are left only with option of adverse selection i.e. availability of only low rates borrower for their credit expansion, which again increases the risk of creating new NPAs.[49] Thus start a vicious cycle as given below –



The Problem caused by low recoveries and high incidence of NPAs in SFCs are also due to competition faced by commercial banks. These banks offer finer rate to good clients and thus, they weaning them away from SFCs. The major predicament faced by SFCs lies in carrying the cost of bringing up and nurturing SSI units at the initial stage, when the credit from commercial banks is not easily available & later good clients go away to commercial banks during the stage of their growth.[50] The above mention point shows that NPA is a big worry for any financial institution. If the financial institution could reduce the NPA then the profit, return on equity, return on assets etc. will ultimately increase.

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[49] http://www.nabard.org/pdf/oc21.pdf

[50] G.P. Gupta committee report, "Report of the committee on restructuring of SFCs" pp. 80-81

CHAPTER- 6

MANAGEMENT OF NON PERFORMING ASSETS

Chapter- 6

Management of Non Performing Assets

6.0 Introduction:-

SFC plays an important role for the industrial development of the country. The corporation is engaged in providing financial assistance to various MSME as well as Commercial Real Estate (CRE) projects. The lending business involves various risks such as credit risk, liquidity risk, interest risk, market risk, operational risk & management risk. Apart from these risks the most important risk is loan recovery. The sound position of a financial institution depends upon the recovery of loan or its level of NPAs. Non performing asset are the major concern for the financial institution or corporation in India. It is not just a problem for financial institution but they are bad for the economy too. It also reflects the performance of the financial institution. Mounting of NPA shakes the confidence of investors, depositors, lenders etc. Non recovery of loans not only affects the further availability of credit but also financial soundness of the credit of the institution or corporation.[1] This is a matter of big worry, therefore management of NPAs assumes significant for credit management of financial corporation. Before going through the management of NPA in MPFC it is very essential to see the recovery mechanism in MPFC.

[1]Dr. kumar Mohan and Singh Govind, "Mounting of NPAs in Indian commercial banks". International Journal of Transformations in Business Management.Vol.1, Issue-6, April-June(2012). ISSN-2231-6868.

6.1 Recovery Mechanism:-

RBI[2] had conducted study in the year 1999 on 5 State Financial Corporation & 15 banks for measuring the usefulness effectiveness of the available recovery measures in these institutions.

The special recovery measure empowering SFCs to take possession of assets sale there of etc. under the SFC Act 1951 for recovering of dues are as under:

Sec. 29: Rights of Financial Corporations in case of Default:-

"Where any industrial concern, which is under liability to the financial corporation." Under an agreement , makes any default in repayment of any loan or advance or any installment thereof, the financial corporation shall have the right to take over the management of possession of both of the industrial concern......... and realize the property pledged, mortgaged, hypothecated or assigned."

This section deals with the execution of powers entrusted to corporations for the recovery of their dues, the power to take over possession of the mortgaged properties of the defaulting borrower, particularly those who are willful defaulters. The corporation then disposes off the property so acquired and recovers their dues and penalties from the sale proceeds of the mortgaged property.

Sec. 31: Special Provision for enforcement of claims by Financial Corporations:-

"Where an industrial concern............ fails to make such repayment, then without prejudice to the provision of Sec. 29, and of Sec. 69 of the Transfer of Property Act, 1882, any officer of the Financial Corporation............ May apply to the District Judge.......... for an order for sale of the property...............for enforcing the liability of any surety,

2 www.rbi.org

for transferring the management............for ad interim injunction restraining the industrial concern from transferring or removing its machinery.........."

Sec. 32: Procedure to be followed by the District Judge in respect of applications under Sec. 31:-

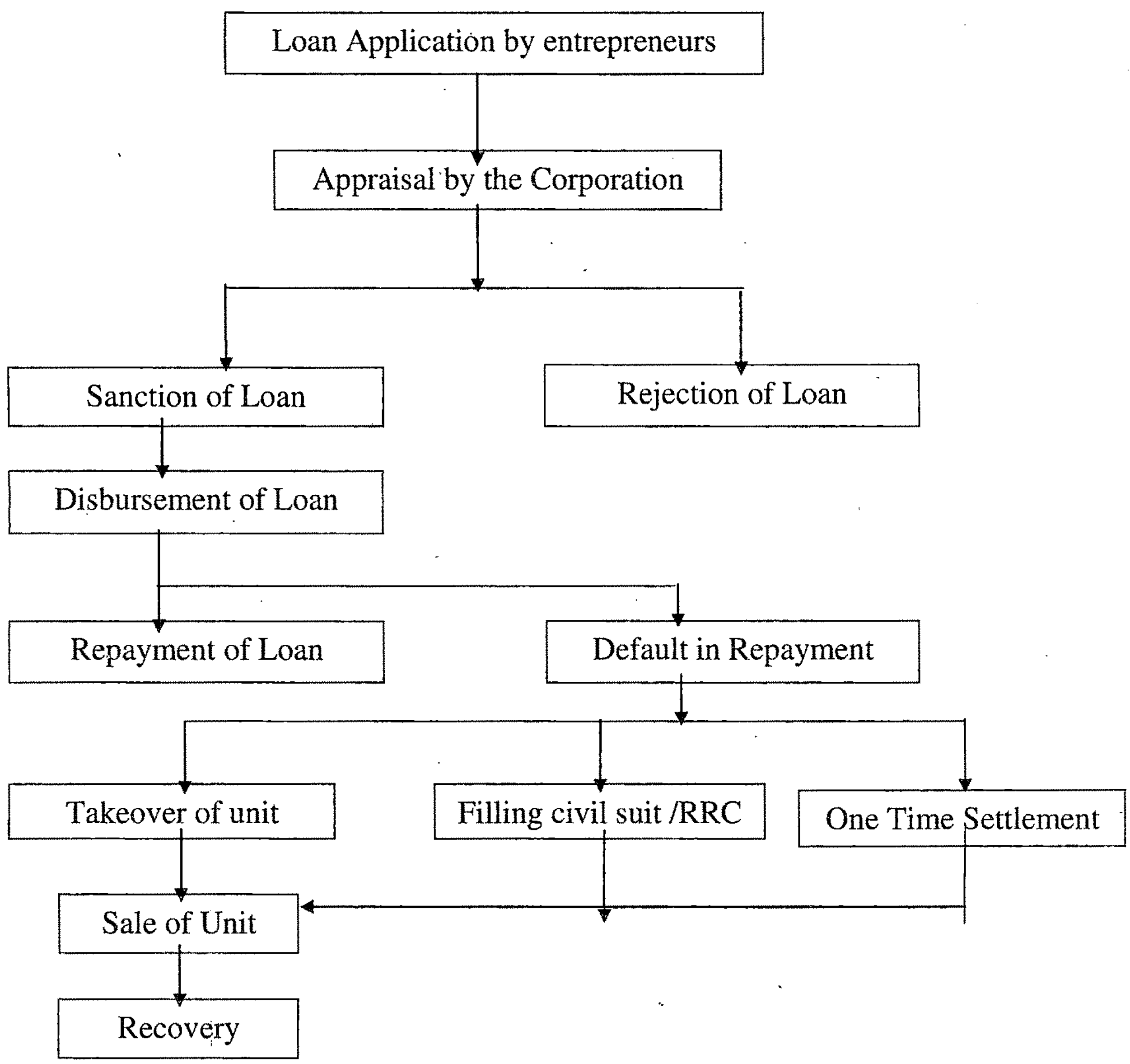
When the application is for the reliefs, the District Judge shall pass an ad interim order attaching the security with or without an ad interim injunction restraining the industrial concern from transferring or removing its machinery, plant or equipment. District Judge shall issue a notice calling upon the surety – to show cause on a date to be specified in the notice why his liability should not be enforced: to show cause why industrial concern should not be transferred to show cause on a date to be specified in the notice why the ad interim order of attachment should not be made absolute or the injunction confirmed. If no cause is shown on or before the date specified, the District Judge shall forthwith order the enforcement of the liability of the surely.

Other Supplementary Enactments/Powers:-

Under the SFCs Act, 1951, the above are the uniform powers given to the Financial Corporation. In certain States, the State Governments have extended the powers/measures under the Revenue Recovery, Recovery of Public Money provisions to the dues of the Corporation also and taken other supplementary measures. For instance, in one State, the State Government declared that the corporation's dues are recoverable as arrears of land revenue under the State's Public Monies Recovery Act as well as under Section 32G of the SFCs Act. The officers of the Financial Corporation not below the rank of Assistant Branch Manager are conferred with the powers of Tahsildar under Section 146 & 147 of the State's Land Revenue Code.

The study shows that on the basis of data collected from SFCs and banks it was however observed that SFCs could affect better recoveries as compared to banks in those cases where the assets of the borrower now seized under the special power vested with the corporations. However, despite use of such powers SFCs on the whole have not been able to show better results & their NPAs are uniformly much higher than the banks.[3]

Recovery Mechanism of MPFC:-



Source : AGMP Report 2010-11 pp.110

[3]www.rbi.org

6.2 Management of NPA:-

Financial institutions are the backbone of any economy. The financial assistance provided by the financial institution has been responsible for the development and growth of many small and medium sized businesses otherwise, that would have emaciated and died. Today, the NPA is a serious threat to the financial sector. The level of NPAs affects the financial health of the institution. The high level of NPA is the greatest hindrance to the economic growth of the country and any blockage in the smooth flow of credit is bound to create consequence in the economy.[4] The M.P. Financial Corporation needs to keep its non performing asset as low as possible through regularly recovery of its loan and they should keep its portfolio as per the guideline set by RBI/SIDBI. Hence, the management of NPAs emerged as one of the major challenges for the financial institution. There are some strategies for reducing or managing NPA in MPFC are as follows:

1. Follow up:-

After disbursing loan to the borrower, MPFC starts supervising the loan. For this, the follow up cell of MPFC keeps eye on the performance of assisted units. This involves regular visit of the units, watch on the position of loan account, solving interment issues like working capital, electricity, second charge in favor of other banks etc.

2. Reschedulement:-

Rescheduled loan is the loan made to the borrower where the lender has extended the repayment period. Reshedulement of loans implies that the financial institution reschedule the repayment of the borrower and also provides other relief and concessions so as to facilitate the units to overcome the problem. Because defaults would hurt the borrower and the

[4]Nivethitha. J and G. Brindha (2014, "Management of Non Performing assets in Virudhnagar district Central Cooperative Bank – An overview", Middle East Journal Of Scientific Research (July 2014) pp. 851

lender; the lender often works with the borrower through options such as rescheduling the repayment. [5]

Reschedulement is first drug to cure NPA. The cases which are under Reschedulement are not always NPA. They are primary defaulter and may turn into NPA portfolio. At the earlier stage of default, Reshedulement mostly works as deferment of burden. It is time being life saving drugs. MPFC under the review has rescheduled many cases. It is worth to mention that number of cases rescheduled and amount of reschedulement does not accept any statistical tools to apply over them. It may possible that in one particular year, number of rescheduled cases may be less but the amount of reschedulement may be higher than that of year in which no. of rescheduled cases is higher but amount of reshedulement is less. It is just because of size of industry in the context of their loan amount may be differ case to case. It is also worthy to mention that reshedulement does not bear any interest loss only principal amount is deferred for payment. Table no. 6.1 showing position of Reschedulement of loan in MPFC during the period of 2005-06 to 2011-12.

[5]http://financial-dictionary.thefreedictionary.com/Rescheduled+Loans

Table No. 6.1.

Position of Reschedulement of loan in MPFC

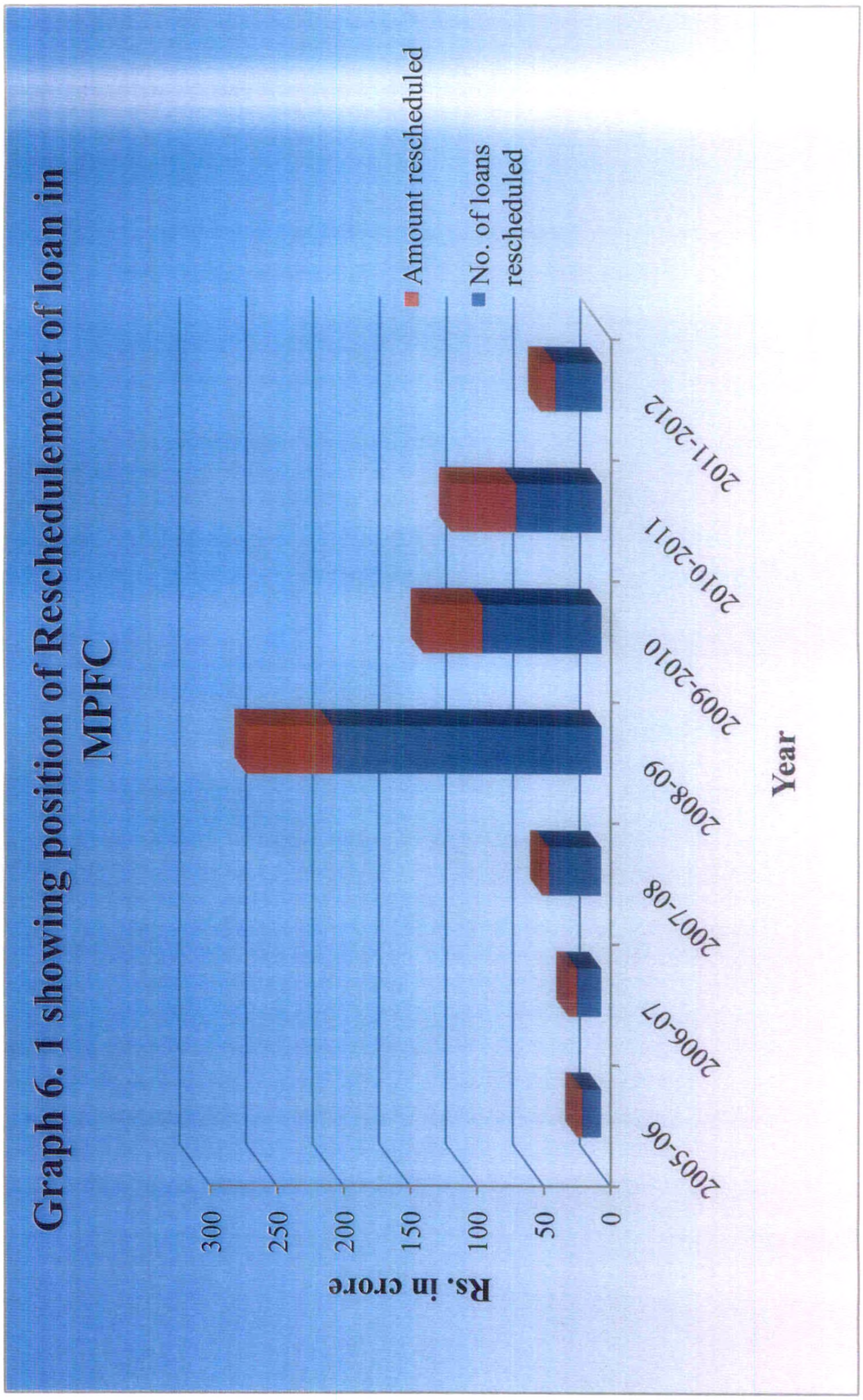
(Rs. in Crore).

Year	No. of Loan Rescheduled	Amount Rescheduled
2005-2006	14	3.79
2006-2007	18	6.45
2007-2008	39	4.94
2008-2009	201	64.61
2009-2010	89	44.51
2010-2011	64	48.50
2011-2012	35	11.19
Total	460	183.99

Source: Annual Report of MPFC from 2005-06 to 2011-12

The study of Table no. 6.1 shows that in the year 2005-06, the number of loan rescheduled was 14 and the amount rescheduled was 3.79 crore. And in the year 2006-07, the no. of loan rescheduled was 18 and the amount rescheduled was 6.45 crore,; it increased about 70%. In the year 2007-08, the no. of loan rescheduled was 39 and their amount rescheduled was 4.94 crore, it witnessed a decrement about 23% as compared to 2006-07. In this year restructuring by state Govt. has done. Then in 2008-09, no. of rescheduled cases becomes 201; these cases were rescheduled without sacrificing interest & keeping the pace of recovery in line with previous years recovery[6] and the amount rescheduled were 64.61 crore. The number

[6] MPFC Annual Report 2008-09. pp.7


Graph 6. 1 showing position of Reschedulement of loan in MPFC
Rs. in crore
300
250
200
150
100
50
0
2005-06
2006-07
2007-08
2008-09
2009-2010
2010-2011
2011-2012
Year
Amount rescheduled
No. of loans rescheduled

of loan cases was high it is just because after restructuring by state government, corporation maintain a healthy practice to prevent NPA account. It is quite obvious that reshedulement is one of the easiest ways to maintain healthy account. Then in 2009-10, the no. of loan rescheduled was 89 and their amount became 44.51 crore so it decreased about 31% as compared to 2008-09. Then in the year 2010-11, the no. of loan rescheduled was 64 and their amount increased about 9% as compared to 2009-10. In the year 2011-12, the no. of loan rescheduled was 35 and their amount registered to 11.19 crore.

Total no. of loan rescheduled by MPFC during the period of study was 460 and the amount rescheduled was 183.99 crore which indicates that MPFC takes preventive measures through reschedulement for reducing fresh slippage into NPA.

3. Rehabilitation of potentially viable units:-

If the borrowing units gets entrapped into financial sickness temporarily, so that the chances of its revival are much there, if immediate measures are taken at proper time, the rehabilitation strategy works out to be the most successful medicine in such cases. Thus, rehabilitation of potentially viable units underlies the principle of nursing the units on the basis of a revived programme.

If any assisted units by a financial institution, turn out to be sick & the institution feels that the units potentially viable & their management is reliable, or the promoters are very keen& ready to revive the units then the rehabilitation of potential viable units must be encouraged. If the rehabilitation programme runs smoothly, it may not be necessary to make provision even after one year for provided additional facility.

In MPFC, the corporation reviews the cases both at the zonal & head office level, depending upon the amount of the effective sanction. Such a review is made through Default review committee which working at both the levels.

Under revival strategy, the measure which may be taken for the benefit of the sick unit generally includes Reschedulements of loan account, funding of overdue interest, sanction of fresh loan, allowing rebate, approving change in the management and recommending to other financial institution etc.

4. Acquisition of sick units by healthy units:-

When a sick units is in a that position where it cannot survive and stand by itself even after being nursed &feeded by the financial institution under rehabilitation strategy, the institution may advise & encourage other financially healthy units in the same line to purchase such weaker units on moderate term which will be benefited to all the three portion – the sick units, the institution, and finally the purchasing unit. However in such cases, sick unit may be able to safeguard its interest and property in the hands of an experienced & healthy unit by way of an agreement. In other words, if healthy unit acquires a sick unit; the outstanding loan amount of sick unit may be transferred to the healthy unit the entire NPA may be even wiped off. Therefore for reducing NPA, financial institution should encourage this practice. The financial institution would also save from the lengthy & tiresome process of acquisition and sale of sick units. MPFC also encourage this practice.

5. Rights of financial corporation in case of default (Sec.-29):-

The special recovery measure empowering SFCs to take possession of assets and sale thereof etc. under the SFC Act 1951.

MPFC has a right to take over the unit'sus/s 29 for recovery of loans under State Financial Corporation Act, 1951. That borrower who does not pay their due then, in those circumstances SFC or MPFC has the special power to taken over the unit. It is the principal legal action adopted by the corporation for increasing recoveries as also to create payment culture amongst defaulting borrowers. In case payment are not made, then Corporation first start issuing legal notice to the defaulters as well as guarantors for their outstanding loan and informing about initiation of legal action. For this purpose, systematic procedures are chalked out at head office and circulated to all field offices time to time with detailed guideline. These guidelines include entire formalities to be completed at different stages of proceedings with formats of all activities. This has resulted with uniform, systematic, informative and timely completion of all activities throughout the state by all branches of the corporation. Section 29 of the SFC act 1951, permits the corporation for takeover of only mortgaged property and for the sale of the properties so acquired.

MPFC sell the assets through notice or advertisement after selling of assets, MPFC could not recover the entire dues amount, then MPFC can claims in court for remaining amount. MPFC has not used this right till 1991. But all other financial corporation has used the right of taken over of unit from their starting period.

Position of Units taken over and sold in MPFC:-

In the year 2005-06, opening balance of unit in MPFC was 151 &units taken over in the year was 25, & total unit available for sale became 151+25=176 units out of these 69 units were sold and 30 units were given back, so the balance available at the end of the year was 77 units.

In the year 2006-07, opening balance of unit was 77 and units taken over were 50, so units available for sale were 50+77=127 unit. So, out of 127 units 25 units were sold and 42 units given back to the borrower and 60 units remain unsold at the end of the year.

In the year 2007-08 total units available for sale was 102 units under this 42 units taken over was included, so out of the total units 18 units was sold & 24 units given back to the borrower and 60 units remain unsold at the end of the year.

In the year 2008-09, 20 units were taken over by MPFC therefore 80 total units available for sale.Out of these 10 units were sold, and 13 units were given back, so unsold units remain at the end of the year was 57 units.

In the year 2009-10, MPFC has taken over 10 units, so total units available for sale in MPFC was 67 units and out of these 6 units were sold. But in the year 2010-2011, 22 units were taken over by MPFC & in this year MPFC has sold 12 units.

In the year 2011-12, MPFC has taken over 11 units and out of these 4 units has sold.

This shows that MPFC is strictly following sec 29 for recover its dues.

6. Legal notices u/s 30:-

It is another legal measure to increasing recoveries from the defaulters. In case of persistent defaults, the corporation feels that the dues are willfully not being paid or the management is unable to run the unit. As an alternate to action u/s 29, under the SFCs Act 1951, corporation may serve legal notice for taking over the management of the defaulting unit into own hands. But the corporation rarely exercises this measure during the period under review.

7. Application u/s 31:-

It is another legal measure which is used by the corporation in earlier years for recovering their dues from the sale of mortgage property.

According to this section, the mortgaged property can realized though court only. The corporation however can file civil suit against borrowers and guarantors in court for the balance recovery from their personal assets. But this process is very time consuming and cumbersome therefore, MPFC has not exercise this measure widely.

8. Revenue Recovery Certificate (RRC) u/s 32 G:-

MPFC was acquiring the property of the debtors in case of their inability in repaying the dues. But this created a huge problem to the corporation as it was very difficult to maintain those properties as well in selling them out. As a result, in addition to acquiring the properties, MPFC also started to take action against the guarantors of the borrowers. According to under section 32G of the State Financial Corporation Act 1951, financial corporation have been empowered for issuing Revenue Recovery certificate (RRC) that authorizes District Revenue officials for recovery of dues of Financial Corporation. These RRC are issued by the corporation against the property of the defaulting borrowers and their guarantors directly to the Collectorate for recovery of the dues of financial institutions. In this process, MPFC obtained "Revenue Recovery Certificate" and on the basis of this certificate, it started to take over the assets of the guarantors and selling them for recovers their dues amount. This statutory step is a yield of liberalization age as MPFC took this step in October, 1996. The state governments may also confer powers of Tehsildars on the Dy. General Managers of the State Financial Corporation for the purpose of recovery of dues as arrears of land revenue.

RRC is an important tool for recovery of the dues because RRC is such step of recovery which extracts borrowers & that much of guarantors. This recovery is final filtration of NPAs with regards to their poor possible outstanding. When a borrower is seized by the all kind of recovery efforts then guarantor involved in that particular loan case is focused to recover the remaining amount. RRC can be defined as final weapon to expel out residual amount from NPAs. Table No. 6.2 shows the study of recovery through RRC in MPFC.

Table No. 6.2

The study of recovery through RRC in MPFC

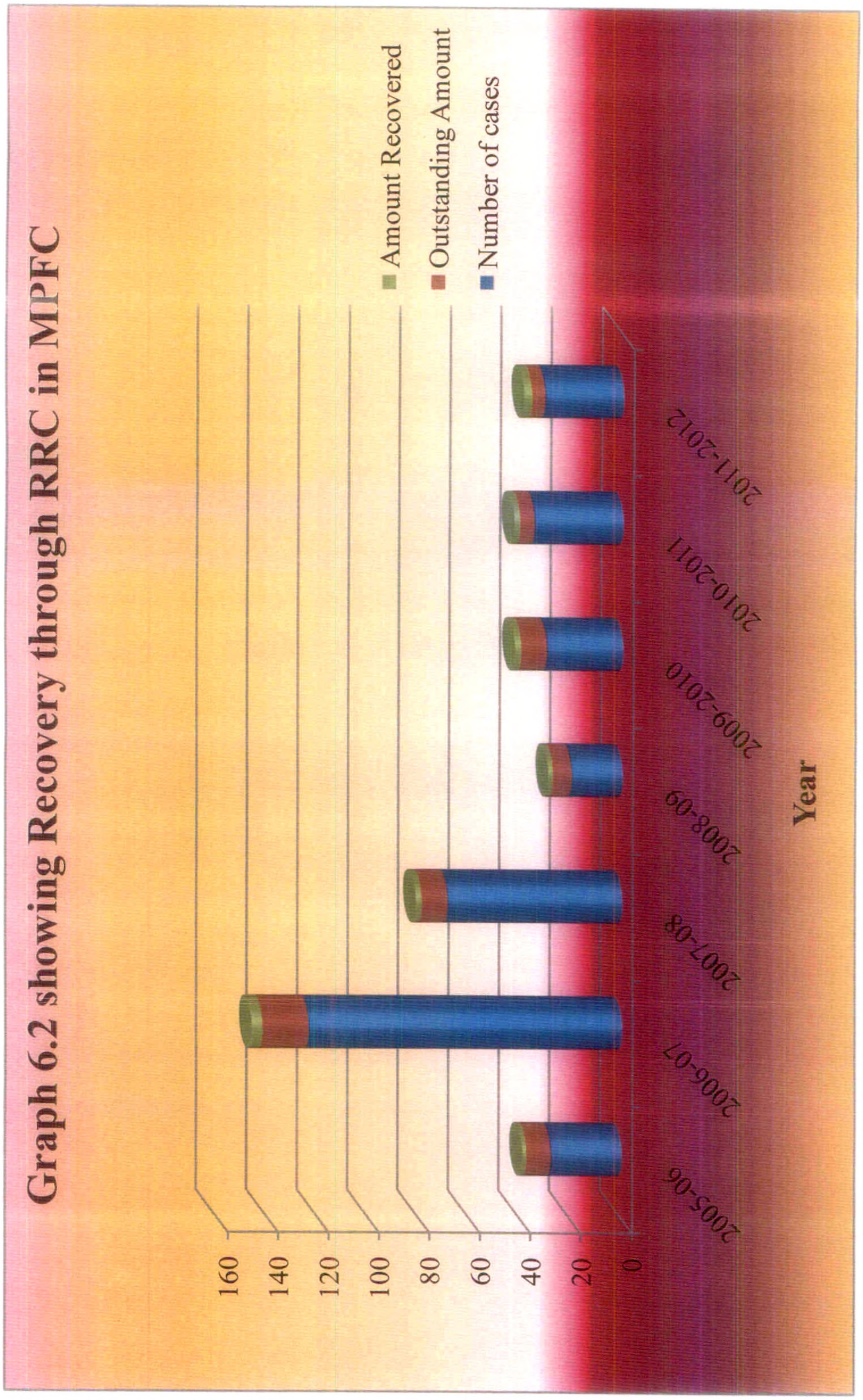
(in Crore)

Year	No. of Cases	Out Standing Amount (Rs. in crore)	Amount Recovered (Rs. in crore)
2005-2006	28	9.72	1.72
2006-2007	124	18.30	4.38
2007-2008	69	10.37	2.39
2008-2009	20	7.66	1.80
2009-2010	30	10.40	2.49
2010-2011	35	5.93	2.35
2011-2012	31	5.52	3.09
Total	337	67.90	18.22

Source : Data provided by the employee of the corporation

The study of Table no. 6.2 shows that MPFC had issued RRC to total 337 industrial defaulter including government of M.P. portfolio in the tenure of 7 year & recovered accumulated about 18.22 crore out of total outstanding of Rs. 67.90 crore which was 26.83%. It means MPFC could not reach to 50% of the total outstanding.

On analyzing year wise status, it shows that in the year 2005-06, RRC



Graph 6.2 showing Recovery through RRC in MPFC
160
140
120
100
80
60
40
20
0
2005-06
2006-07
2007-08
2008-09
2009-2010
2010-2011
2011-2012
Year
Amount Recovered
Outstanding Amount
Number of cases

issued in 28 cases with outstanding amount of 9.72 crore and 1.72 crore has recovered i.e. about 18% of their outstanding amount. Then in the year 2006-07, RRC issued to 124 cases with an outstanding amount of 18.30 crore out of which 4.38 crore or 24% amount has recovered. This was higher than previous year. In the year 2007-08, 69 cases with an outstanding amount of 10.37 crore was standing out of these MPFC recovered 2.39 crore or 23% of outstanding amount. Further in the year 2008-09, 20 cases with an outstanding amount of Rs 7.66 crore was standing in the portfolio out of these 1.80 crore or 23.5% has recovered . Then in the year 2009-10, RRC issued in 30 cases for outstanding of Rs. 10.40 crore out of these 2.49 crore or 24% amount has recovered. Further in the year 2010-11, RRC issued in 35 cases, their outstanding amount was Rs. 5.93 crore out of which 2.35 crore or 40% approx amount has recovered. In the year 2011-12, 31 RRC cases with an outstanding of Rs. 5.52 crore was in the portfolio out of which 3.09 crore or 56% approx has recovered. This shows that this tool is also very important for recovering the NPA in MPFC.

9. One time settlement scheme:-

For recovery of over dues the corporation has two options:

a). Action taken by the corporation u/s 29 of SFC Act 1951,under which the industrial assets of the defaulting borrowers are taken over & sold through open tenders by the corporation.

b.) Action taken by the corporation u/s 31 of SFC Act 1951 under which the mortgaged assets of the defaulting borrowers are taken over & sold through the court by the corporation.

It has been observed that both the options are time taking & highly expedite procedure as the disposal of taken over units takes long time because of various factors such as decay in assets over a period of time, closure of units for a long time, non feasible& non viability of product, due to product obsolescence or obsolete technology, heavy arrears of other liabilities etc. In 1992, with the objective of realizing sticky overdues and to reduce the NPA introduced one time settlement scheme (OTS) policy by the corporation. The main objectives of OTS scheme are:

1. To settle the sticky loan account and collect maximum possible amount as early as possible so that these funds can be recycled to earn interest income;
2. To improve the overall quality of assets portfolio of the corporation;
3. To improve the recovery rate against demand, and
4. To reduce the non performing assets.[7]

The study of OTS scheme in MPFC has shown in Table no. 6.3.

Table No. 6.3

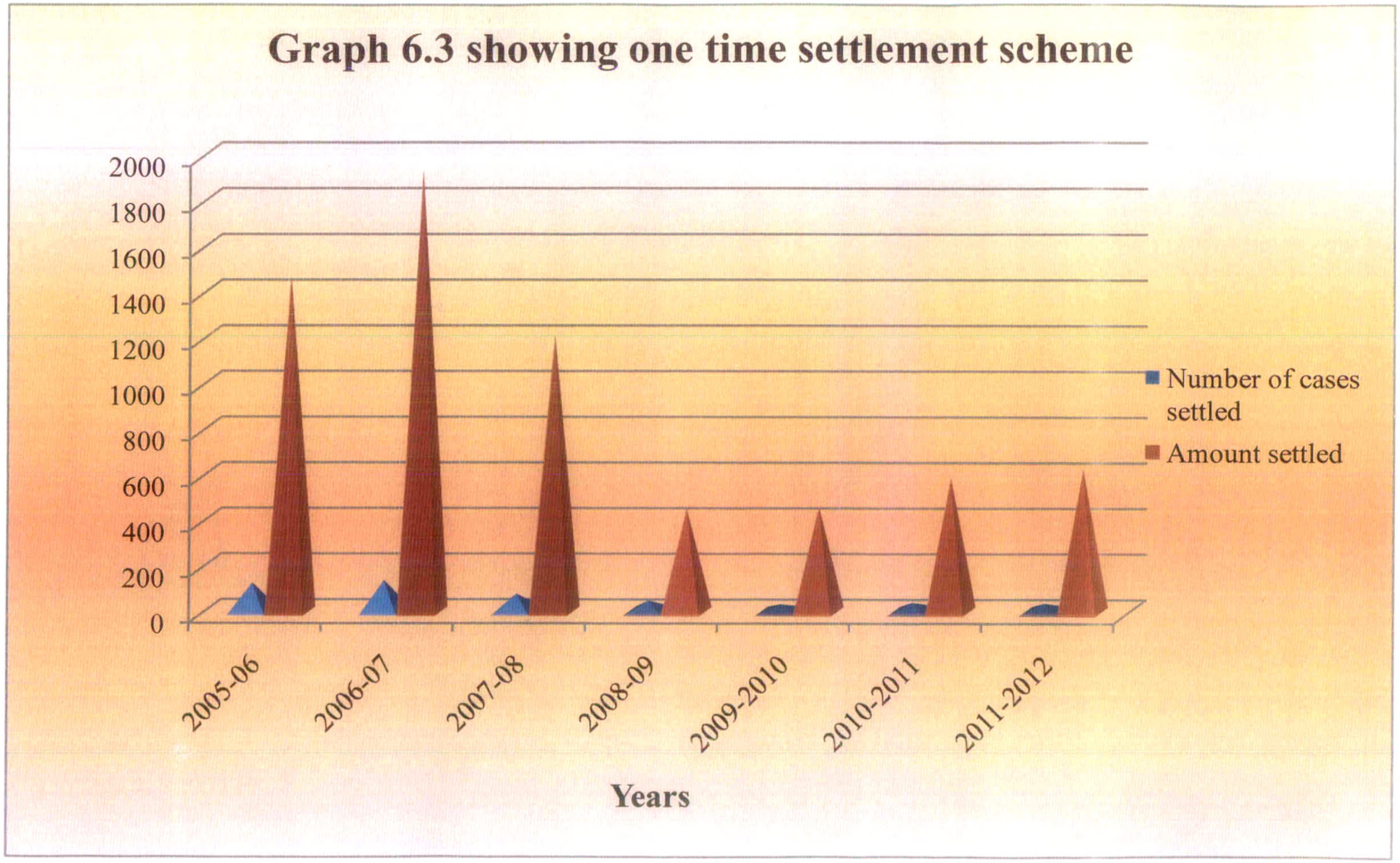
Study of one time settlement scheme in MPFC

(Rs. in Lakh)

Year	No. of Cases settled	Amount Settled
2005-2006	123	1466.31
2006-2007	135	1929.28
2007-2008	76	1208.26
2008-2009	47	451.64
2009-2010	31	460.16
2010-2011	39	586.86
2011-2012	35	625.71
Total	486	6728.22

Source: Data provided by the employee of the corporation

[7]http://www.saiindia.gov.in/english/home/Our_Products/Audit_Report/Government_Wise/state_audit/recent_reports/Andhra_Pradesh/rep_2003/com_chapter_3.pdf


Graph 6.3 showing one time settlement scheme
2000
1800
1600
1400
1200
1000
800
600
400
200
0
2005-06
2006-07
2007-08
2008-09
2009-2010
2010-2011
2011-2012
Years
Number of cases settled
Amount settled

The study of OTS scheme in MPFC has shown in Table no. 6.3.which shows that in the year 2005-06, no. of cases settled were 123 and their amount was 1466.31 lakhs. Then in the year 2006-07, no. of cases settled were 135 and the amount settled was 1929.28 lakhs which increased about 32% than previous year. From the year 2007-08 to 2009-10, no. of cases decreased from 76 to 31 and the amount settled was also decreased from 1208.26 lakhs to 460.16 lakhs. But in the year 2010-11, no. of cases settled was 39 and their amount was increased and became 586.86 lakhs. Then in their subsequent year, no.of settled cases were 35 and their amount stood at 625.71 lakh. Thus it increased about 7% as compared to previous year.

From 2005-06 to 2011-12, the total no. of cases settled by MPFC including Government of M.P. portfolio was 486 cases and amount recovered was 6728.22 lakhs. This shows that MPFC has succeeded in settlement of large number of accounts recovering huge amount from these borrowers through persuasion and/or coercion was not possible.

10. Litigation :-

Different types of litigation which the MPFC has to face can be divided into two categories:

i). Litigation initiated by MPFC against borrower/ guarantors etc for the recovery of dues u/s 31 of SFC Act 1951, civil suits, criminal complaints, cases u/s 138 of Negotiable Instrument Act etc.

ii). Litigation initiated by MPFC to defend itself from cases brought against MPFC by borrowers or guarantors etc.

i). Litigation initiated by MPFC:-

After disposing the mortgaged assets, the corporation proceeds or recovery by way of attachment and sale of personal assets of borrowers or guarantors taking benefit of amendment effected in SFCs Act. Besides, the corporation resorts to the powers granted under section 31 for sale of the debt instrument including the guarantees and also the assignment of court decrees obtained in action u/s 31 of the SFCs Act, 1951.

ii). Litigation against MPFC:-

Against the stiff legal action u/s 29 of the SFC act, 1951 i.e. taken over and sale of the unit, many borrowers move towards the different courts of law by way of writ petition, civil suits, special leave petitions, appeals etc. seeking thereby remedies of different kinds. Some of the borrowers also file contempt of the court before the High court of M.P. These litigation works involves prompt, cautious and careful attention as the matters are directly related to recovery and the corporation has started incurring heavy expenditure on account of securities, insurance etc. Moreover, it is necessary to establish corporation's rights and remedies against the defaulters' at large scale so that direct and indirect impact may be made to compel them clear their dues.

Management of NPA is need of the hour. To be effective, NPA management has to be exercise pervading the entire corporation from the Board down the last level. Time is the prime essence of NPA management.[8] Above are the measures which are taken into consideration by the corporation for reducing NPAs. Along with these measures the following steps will go a long way in reducing the non performing assets of the financial corporations:

- The problems of NPAs should studied branch wise, amount wise and age wise.
- Loan recovery policy may be prepared and strategies should be adopted for reducing NPAs.
- Special recovery cells should be identified for recovery.

[8] http://www.cab.org.in/Lists/Knowledge%20Bank/Attachments/26/NPA%20MANAGEMENT.pdf

- Critical branches should be identified for recovery.
- The targets of recovery should be fixed and time bound action plan should be drawn.
- Corrective steps should be taken wherever found necessary while implementing the action plan and make changes in the original plan if necessary.
- Enlist the cooperation of Government officials, co bankers for recovery camps/ recovery drives.[9]

[9] Jain T.R., Trehan Mukesh, Trehan Ranju, "Indian Business Environment" pp. 238

CHAPTER-7

FINDINGS, CONCLUSION AND SUGGESTIONS

Chapter 7

Findings, Conclusion and Suggestions

7.0 Findings and conclusion of the study:-

Nonperforming assets have been a big worry for financial institution in India. It is not just a problem but it is bad for economy[1]. It has grown like a cancer and has infected every limb of the financial system. Complete elimination of nonperforming assets is not possible but it reduced through proper organization of recovery camps, direct contact with the borrowers, Rephasement of loan, Reshedulement, one time settlement scheme, proper monitoring of loans cases etc. As we studied on Analysis and Management of Non performing assets in MPFC following findings has drawn from our study as:

1. It is found from the study that sanction, disbursement and recovery portfolio of MPFC shows increasing trend.
2. It is found from the accumulated study of sanction, disbursement and recovery of MPFC that their average percentage of disbursement to sanction is 64% which is very healthy & indicates that 64% of sanctioned loan is converted into disbursement whereas average percentage of recovery to disbursement during the period of study is 99% which is also very healthy.
3. It is found from the study that term loan provided by MPFC was 391.12 crore to entrepreneur in the year 2005-06 and increased to 21% in the year 2011-12 as compared to 2005-06. This shows

[1] Rani Chanchal, "Evalution of various techniques used by the Public sector bank for the management of Non performing assets." International Journal of Research in Economics and Social Science, Vol-3,Issue 1(Jan. 2013). pp. 45 - 52

increasing trend and indicates that MPFC provides better financial assistance to the industrial units.

4. The study of working capital medium term loan provided by MPFC shows fluctuating trend.

5. It is found that the MPFC provided 358.91 crore Gross loans and advances to the borrowers and it increased to 506.63 crore about 41% in 2011-12 as compared to the year 2005-06. This study revealed that loans & advances provided by MPFC shows increasing trend except year 2007-08 because during this year corporation had to face difficulties in availing the refinance from SIDBI due to this loans & advances were decreases.

6. It is found from the study that Net loans and advances provided by MPFC was registered to Rs. 305.03 crore in the year 2005-06 and increased to 502.16 crore about 65% in 2011-12. Thus, this shows increasing trend except year 2007-08.

7. The study of Assets Classification of Performing & Non Performing Assets in MPFC shows that the average percentage of Gross NPA to total loan and advances is 10.92% which shows that around 11% of MPFC total loan assets have come under the shadow of nonperforming assets. This shows a good NPA management of MPFC. This reflects that MPFC did a good and very satisfactory job and playing a significant role with their performance. It can also conclude that MPFC has successfully been preventing their assets from slippage into NPA.

8. It is found that after entire NPA taken over by state government the Gross NPA in MPFC were increasing but it was not too alarming because sub standard assets has contributed major share out of total gross NPA than doubtful and loss assets which shows that quantum of NPA was never to a level of higher risk.

9. The study of substandard assets ratio shows that after 2007-08; large percentage of NPA was registered in substandard assets (except year 2010-11), it means there is a scope for improvement in NPA in MPFC.

10. The study of doubtful assets ratio shows that after financial restructuring by government of M.P. in 2007-08, the doubtful assets ratio is less than substandard ratio which is a positive sign.

11. The study of loss assets ratio shows that after NPA portfolio taken over by government of M.P., there was no loss assets in the portfolio under the period of study; this indicates that MPFC properly manage its loss assets. It is a good sign for the health of MPFC.

12. It is found from the study of Net NPA in MPFC that after financial restructuring by state government, Net NPA increased from 733.50 lacs to 1920.05 lacs .This shows that MPFC net NPA were increasing but never to a level of higher risk.

13. It is found from the study of movement of Net NPA that the average addition of NPA during the period of 7 years was 819.26 lacs and deduction of NPA was 1739.38 lacs.

14. The Magnitude of Gross NPA and Net NPA ratio shows that the mean value of Gross NPA ratio is 10.9% which shows that nearly 11% of gross loans & advances go into NPA. On other hand, the mean value of Net NPA ratio is 7.14% which shows that only 7 % of net loans & advances go into NPA during the period of 7 years. Thus, this study shows that very less percentage of loans and advances goes into NPA.

15. It is observed that general reasons that contributed to increase in non performing assets are attributed into three i.e. reasons related to borrowers, financial institution and others.

16. It is observed that the causes that contributed to increase in NPA in MPFC are delay in sanctioning of loans by MPFC, failure to take coercive action, obtaining inadequate securities, sanction of loans without ensuring working capital requirement of borrower, poor pursuance for recovery of loans, sanction of loan to non feasible/ non viable projects, deficiencies in appraisal of loan, disbursement of loan on unapproved terms, ineffective legal System etc.

17. It is found from the study of the impact of Net NPA on Net profit in MPFC shows that Net NPA reduced from 75.99 crore to 19.20 crore, whereas net profit increased from (-5.14) crore to 4 crore during the period of study. And the correlation between net NPA and net profit is -0.70 which shows negative correlation between them and there is an inverse relationship between them. It implies that, if NPA are controlled then profitability will increase.

18. It is found from the study of Gross NPA ratio and Return on assets ratio that the average of GNPA ratio of 7 year is 10.9% & ROA ratio is 0.167% which is much less than GNPA ratio. This indicates that due to increase in GNPA ratio, ROA also affected.

19. It is found from the study of Net NPA ratio and Return on assets ratio that the average of Net NPA Ratio of 7 years was 7.14% & ROA is 0.167%, which is much less than Net NPA ratio. This indicates that due to increase in Net NPA ratio, ROA also affected.

20. It is found from the study of capital adequacy ratio in MPFC that after financial restructuring by state government, CAR increased from 15.9% to 21.18% i.e. about 5.28% and in the year 2007-08, state government had taken over the entire NPA portfolio of MPFC, so that there was no provision for NPA were made in this year, subsequently it affects the profit then ultimately the capital adequacy ratio also affected.

21. It is also found from the study that MPFC faces difficulty in refinance from state government. MPFC has a big share holding is hold by state government. It is about 90.3% as an average of 7 year under the period of study. So, MPFC must be cautious about their NPA %.

22. It is observed that MPFC faces difficulty in subscription of bonds, availing refinance from SIDBI, difficulty on receiving financial assistance from state govt. etc. due to NPA. It erodes the capital of the corporation, affected productivity; credit loss, high operating cost etc are the problems due to NPA.

23. It is found that total no. of loan Rescheduled by MPFC during the period of study were 460 and the amount rescheduled was 183.99 crore which indicates that MPFC takes preventive measures through Reschedulement for reducing fresh slippage into NPA.

24. The study of units taken over and sold by MPFC shows that MPFC is strictly following sec 29 to recover its dues.

25. The study of recovery through RRC in MPFC shows that MPFC has issued RRC to total 337 industrial defaulter in the tenure of 7 year & recovered accumulated about 18.22 crore out of total outstanding of Rs. 67.90 crore which is 26.83%. This shows that this tool is also very important for recovering the NPA in MPFC.

26. It is found that from the study of one time settlement scheme in MPFC during the period of study that in the year 2005-06 to 2011-12, the total no. of cases settled by MPFC including Government of M.P. portfolio was 486 cases and amount recovered was 6728.22 lakhs. This shows that MPFC has succeeded in settlement of large number of accounts recovering huge amount from these borrowers through persuasion and/or coercion was not possible.

Conclusion:-

MPFC plays an important role for the industrial development of the state. The corporation is engaged in providing financial assistance to various MSME as well as Commercial Real Estate (CRE) projects. The lending business involves various types of risk such as credit risk, liquidity risk, interest risk, market risk, operational risk and management risk. Apart from these risks the very important risk is recovery of loan and dues. The sound financial position of a financial institution depends upon the recovery of loans or its level of Non-performing assets (NPAs). Nonperforming assets have been a matter of great concern for the financial institution in India. It does not produce any income and wrecks the profitability of the financial institution and also affects the performance or growth of the organization adversely. It is not just a problem but bad for economy too. On the basis of above finding it is found that NPA is an important parameter for accessing the performance of financial institution. The findings revealed that NPA has a negative impact on profitability. Due to NPA, MPFC faces difficulties in subscription of bonds, scarcity of funds, difficulty on receiving financial assistance from state government and it also affected the credibility of the corporation. The study further revealed that after financial restructuring by state government that the level of NPA was not too alarming as the sub standard assets has contributed major share out of total NPA than doubtful and loss assets. Thus, MPFC should take appropriate steps to reduce present NPA as well as for avoid future NPA.

7.1 Testing of Hypothesis:-

Before starting research few hypotheses are kept in mind which was as under:

1. MPFC provides loans and advances. Minimum amount of some loans goes into NPA.
2. MPFC properly manages its NPA.
3. Decrease in the amount of NPA has resulted in increase the growth of MPFC.

These were the hypothesis which is tested at various stages of research.

1. MPFC provides loans and advances. Minimum amount of some loans goes into NPA:-

MPFC is the premier institution of the state engaged in providing financial assistance and related services to small and medium sized industries. The main objective of MPFC is to provide loans and advances to Micro, Small and Medium Enterprises (MSMEs). According to the study of chapter 4 and Table no. 4.15 shows that average gross NPA ratio is 10.9% which shows that nearly 11% of gross loans & advances go into NPA. On other hand average Net NPA ratio is 7.14% which shows that only approx 7 % of net loans & advances go into NPA during the period of 7 years. So this study shows that during the period of study very less percentage of loans and advances goes into NPA. This proves our first hypothesis is that MPFC provides loans and advances. Minimum amount of some loans goes into NPA. Hence our hypothesis has proved.

2. MPFC properly manages its NPA:-

The analysis of MPFC's performance towards maintenance of its total loan assets during the period of 7 years has shown in Table no. 4.11 which shows that the average percentage of Gross NPA to total loan and advances is 10.92% which shows that around 11% of MPFC total loan assets have come under the shadow of nonperforming assets. This shows a good NPA management of MPFC. This reflects that MPFC did a good and very satisfactory job and playing a significant role with their performance. It can also conclude that MPFC has successfully been preventing their assets from slippage into NPA. This proves our second hypothesis that MPFC properly manages its NPA. Hence our hypothesis has proved.

3. Decrease in the amount of NPA has resulted in increase the growth of MPFC:-

The study of Table No. 5.1 (a) shows that the Net NPA reduced from 75.99 crore to 19.20 crore whereas Net profit increased from -5.14 crore to 4 crore during the period of study. And the correlation between Net NPA and Net profit is -0.70 which shows an inverse relationship between them. Since because of negative correlation; the profitability of MPFC increases then NPA gets reduces. As the profitability increases there will increase the growth of MPFC. Thus, NPA hampers the growth of MPFC. Hence our third hypothesis has proved.

7.2 Suggestions:-

The problem of NPA in financial institution is somewhat similar to disease in some part of the body. The ripple effect of NPA as in the case of cancer is gradually felt in all parts of the economy viz savings, investment, production, employment and services etc. which adversely affected the capital formation, economic growth, fiscal deficit and inflation. MPFC has also faced various problems due to NPA. Here are some suggestions for reducing Non performing assets. If these suggestions are implemented effectively, they would be helpful for reducing NPA with immediate steps.

1. It is suggested that corporation should take enough care in selection of the borrower. For this the corporation should perform an in depth investigation about the credit worthiness of the borrower.

2. Regular follow up of borrower is very essential for reducing NPA. To reduce this danger, the corporation must take regular follow up at regular interval which keeps the borrower alert and chances of default will be reduced.

3. At the time of providing loan to the small scale and tiny industries or entrepreneurs, corporation must pay attention on the following points:

i). what is future of their industries or business?

ii). Possibility of paying back their dues.

iii). Security given by the entrepreneur.

Only after confirming the above points, corporation must grant the loan.

4. MPFC is a financial institution and due to insufficiency of capital it adversely affects the operations of the corporation. Therefore, corporation should made efforts to increase its working capital. For this corporation must try to obtain more financial support from the state government so that they can avail working capital for providing financial assistance.

5. Corporation must ensure, before providing loan to the entrepreneur, that there must be proper facilities of water, electricity, road and other basic infrastructural facilities provided by the state government.

6. Corporation must reduce their operating cost, they must appoint the trained employees and recruitment of new expertise in the main working stream periodically, so that they will not have to expedite extra amount on their training & development. If the corporation wants to give training to their old employees then they must adopt those techniques which give maximum result at minimum cost.

7. Incentives and award should be given to encourage recovery of NPA amount, any branch which reduces the NPAs should be awarded as the best NPAs turn around branch, thus which motivates other branches or officers to work hard for recognition which indirectly improve assets of the quality of the corporation.

8. MPFC should focus on small projects which may be related to manufacturing sector or service sector. It is observed during the research that to avoid hectic appraisal procedure; official of the MPFC are interested in big projects so that they can achieve their target by just financing 2 or 3 big projects. Because of these, if one big project comes in defaulters list, a big part of money lending by MPFC can disturb the profitability as well balance sheet of the year. Therefore, it is suggested that MPFC should give short term loan (repayment 1-5 year) & MPFC should also focus on service sector which is still deprived to finance.

9. Unless proper monitoring of restructured loan accounts is carried out, there is every possibility of loan slippage into NPA thus it is suggested that there should be an independent monitoring agency which monitored the restructured accounts with credit exposures above a certain amount.

10. It suggested that a credit risk management policy as a part of the integrated risk management should be put in place in MPFC.

11. It is observed in the financial statement of MPFC that the amount of Gross NPA recovered/ Write off/ Reduced is given together. This does not exhibit the true financial condition of MPFC because it cannot be analyzed that how much NPA was recovered, how much was write off and how much NPA was reduced? Thus, it is suggested that MPFC should represent separate amount for all three categories.

12. It is suggested that MPFC should disbursed loan timely to the borrowers so that the project will be implement on time. Hence, project will be able to earn profit all the time.

13. For the recovery of loan, the corporation must give sufficient rights to recovery committee & try to recover all the dues as per their prescribed schedule.

14. It has been observed that under the SFC Act, there is no provision of separate tribunal to resolve loan cases which are purely related to SFCs so that timely action against defaulter can't be performed. Due to this many pending case of default are awaited to be solved but no decision is being taken by the court. This is happening because a lot of money is spent on judicial procedure. It is suggested that there should be a separate tribunal to resolve loan cases which are purely related to SFCs.

15. It has been observed that during the disbursement many entrepreneurs changes their machine supplier, product versatility & also they change their banks which should be strictly prohibited. Provision of contingencies should be made in case; if disbursement gets delayed, the cost overrun can be met out from contingencies.

16. SFCs have the right to sale taken over units of the borrower to recover the amount of default. But due to the fear of the defaulters, there are no buyers to purchase such property or due to other factors the corporation cannot realize the full amount of default. Then in such case the corporation should assign such case to a special agencies or companies that will find out an buyer so that the full amount of default can be realized by selling the securitized property held with the corporation.

17. There should be grievance cell in the corporation which can note down & forward the problem related to sanction or disbursement to the Managing Director. Due to formation of grievance cell there will be ethic over the officer of the corporation who are very rigid or who are not doing work with some mollified intension. And there should also be a joint effort & a tendency to disburse sanction loan not in piece meal but as per the requirement of the project.

18. MPFC provides loans for acquisition of building, plant & machinery and for working capital entrepreneur have to depend upon the banks. Hence it is very necessary for both the financial institutions, MPFC as well bank, to make a tie up with each other so that project can stand and be implemented within the stipulated time period. If it is not done the borrowing account may turn into default before it commence. Thus it is suggested that before sanctioning loans to the borrowers; MPFC should avail working capital sanction by the banks.

19. The branch managers do not have adequate powers to take on strict recovery of loans. If they are assigned with adequate powers then they will perform strict recovery of loans. They will take over or realize securities charged to them for the recovery of loans without going to courts so that chances of NPAs would reduce.

20. MPFC should critically examine and analyze the reason behind time overrun and cost overrun.

21. It is necessary that all kinds of relief should be given at a time, so that the first default can be reduced.

22. MPFC needs to upgrade the credit appraisal skill which is highly inadequate.

23. Corporation should ensure that the assets are fully insured.

24. Separate NPAs recovery department should be constituted at the Head office and branch office to recover the loans in time.

25. It has been observed that there is no personal accountability of staff members who sanctioned the loans. For reducing NPAs, the staff of sanction department should be made accountable for all the loans sanctioned.

7.3 Scope for future studies:-

The research work presented here answers the questions related to NPA in the Madhya Pradesh Financial Corporation. The study conducted was successful to know the position of NPA in MPFC. But there are several questions remains unanswered and it creates the scope for future research. The researcher recommends that the comparative study can be made with one or more state financial corporation and with other banks with respect to NPA management. The study can be further extended to know sector wise classification of NPA in MPFC.

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Study of Non Performing Assets in Indian Private Sector Banks

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Abstract

In India, the financial sector comprises of banking and non-banking financial institutions. Banking institutions simply accept the long term deposits from the public and then lend to the borrowing community. Banking institutions are creators and purveyors of credit. While the liabilities of banks are part of the money supply, this may not be true of non-banking financial institutions. There is no hard and fast rule to distinguish between banking and non-banking institutions.

The banking system is the heart of the financial system. The Indian financial system comprises of a large number of commercial and cooperative banks and specialized developmental banks for industry, agriculture, external trade and housing, social security institutions, collective investment institutions, etc..

Introduction

A developing country faces many problems like poverty, scarcity of capital, lack of entrepreneurship, etc. There is a high dependence on agriculture and at the same time agriculture is not modernized and the means of transport is underdeveloped1. There are inter-regional and inter-sector disparities. There is also unequal distribution of wealth.

Banks play a very useful and dynamic role in the economic life of every modern state. They are important constituents of the money market and their demand deposits serve as money in the modern community. Banks can work as catalytic agents of growth by following the right kind of policies in their working, depending upon the socio-economic conditions prevailing in a country. It is realized that since banks have the required investment potentiality, they can make a significant contribution in eradicating poverty, unemployment and they can bring about progressive reduction in inter-regional, inter-state and inter sector disparities through rapid expansion of banking services.

Banking system is also referred to as a system provided by the bank which offers cash management services for customers, reporting the transactions of their accounts and portfolios throughout the day. The banking system in India should not only be hassle free but also be able to meet the new challenges posed by the technology and any other external and internal factors. For the past three decades, India's banking system has had several outstanding achievements to its credit. The Banks are the main participants of the financial system in India. Although deregulation and liberalization in the banking sector have resulted in enhanced efficiency and systematic resilience, they have also raised legitimate concerns with regard to the quality of customer services provided by banks 2. The Banking sector offers several facilities and opportunities to their customers. All the banks safeguard the money and valuables and provide loans, credit and payment services, such as checking accounts, money orders and cashier's cheques. The banks also offer investment and insurance products. As a variety of models for cooperation and integration among finance industries have emerged, some of the traditional distinctions between banks, insurance companies and securities firms have diminished. In spite of these changes, banks continue to maintain and perform their primary role - accepting deposits and lending funds from these deposits.

Commercial banks have come to play a significant role in the development of countries. The two basic functions of commercial banks are: mobilization of the savings of the people and disbursement of credit according to direction. The world over, banking system is the focal point in the financial setup of any developing country. In India too economic development has evolved around the banking system 3.

Functions of the Bank

The following functions of the bank explain the need of the bank and its importance:

1 To provide the security to the savings of customers.

2 To control the supply of money and credit.

3 To encourage public confidence in the working of the financial system, increase savings speedily and efficiently.

4 To avoid focus of financial powers in the hands of a few individuals and institutions.

5 To set equal norms and conditions (i.e. rate of interest, period of lending etc) to all types of customers.

Banking System In India

Indian banking industry has been divided into two parts, organized and unorganized sectors. The organized sector consists of Reserve Bank of India, Commercial Banks and Co-operative Banks and Specialized Financial Institutions (IDBI, ICICI, IFC etc). The unorganized sector, which is not homogeneous, is largely made up of money lenders and indigenous bankers. An outline of the Indian Banking structure may be presented as below:

1. Reserve banks of India.
2. Indian Scheduled Commercial Banks.

a) State Bank of India and its associate banks.

b) Twenty nationalized banks.

c) Regional rural banks.

d) Other scheduled commercial banks.

3. Foreign Banks.
4. Non-scheduled banks.
5. Co-operative banks.

Role of Banks in Indian Economy

Banking is an important segment of the tertiary sector and acts as a backbone of economic progress. Banks play a very useful and dynamic role in the economic life of every modern state. They are important constituents of the money market and their demand deposits serve as money in the modern community4. The banks render vital services to the masses belonging to the various sectors of the economy like Agriculture, industry whether small scale large scale5.

The Indian financial sector has considerably widened and depends there by on lending strong support to capital accumulation and overall economic growth. And the commercial banks in India constitute the single most important component of the Indian Financial System in bringing about the financial intermediation process in India. Within the banking institutions, the role of commercial banks has occupied a new meaning and significance, in view of the changing structure and requirements of a developing economy. The increasing horizon of commercial banks identifies itself with the problems and responsibilities for making banking an instrument for bringing about social and economic transformation of a developing country, Social responsibilities have undergone far-reaching changes. Banks have become the prime movers and pace setters for the achievement of socio-economic objectives of the country. The operations of commercial banks record the economic pulse of economy of almost all countries big or small, rich or poor, socialist or capitalist and they are faced with the problem of regional disparities in economic development.

In modern economy, bankers are to be considered not merely as "dealers in money" but move realistically as the "lenders in development". Similarly, banks are not just the storehouses of the country's wealth but are the reservoirs of resources necessary for economic development. Banks are the purveyors of money and credit to the factors of production in every country and thus help in the acceleration of growth6. Banks are the pivot of modern commerce; industrial innovations and business expansions become possible through finance provided by banks. Economic Development needs an appropriate monetary policy. But a well-defined banking is a necessary pre-condition for the effective implementation of the monetary policy7.

Banking is a basic industry, which not only caters to the development of a trade, commerce and industry, but also helps in removing many obstacles in the way of economic development.

Non Performing Assets (NPAs)

Authentic history of banking tells that it deals with lending and collection of money. However, it followed the basic law of demand and supply where persons having excess money lent to persons who needed it for more productive purposes and were willing to pay a price for this. The operations were limited to the money lender knowing every person he lent money to.

Proper regulation and organization of these activities was necessitated, over a period of time, as the operations began to grow because of increase in the number of clients. Gradually, simple banking transformed itself into commercial banking and the commercial banking itself has undergone numerous changes all over the world, during the last five decades. In the regard, India is not an exception and in fact, the changes that have taken place in India have been far more significant and much more radical in some regards, than elsewhere in the world.

The concept of Non-Performing Assets (NPAs) was introduced for the first time in the Narasimham Committee on "Financial System Reforms" that was tabled in Parliament on December 17th, 1991. The Committee studied the prevailing financial system, identified its short comings and weaknesses and made with ranging suggestions and recommendations in line with internationally accepted norms. Based on the recommendations of the Committee on "Financial System Reforms", the RBI evolved prudential norms on Income recognition, Asset classification and Provisioning and issued revised instructions to banks in April 1992. While conveying non-performing category and their anxiety to present rosy picture of their affairs the above instructions to banks also advised them that as per practice followed internationally, income on NPAs is not to be recognized on accrual basis but is to be looked only when it is actually realized because an asset becomes non-performing when it ceases to generate income. The above instructions of RBI have since been implemented by banks from the financial year ended March 1998.

The problem of NPAs is linked to the function of lending money. The lending of money collected from the public, for interest, instead of one's own money, was the beginning of banking. Though the present day banking does not restrict itself to traditional deposit collection and money lending, encompassing a wide sphere of financial activity, lending still remains the prime activity connected with banking. Most credit needs of the society, for carrying, commercial activities are fulfilled by the banks. The conventional credit from the banking system to the Commercial sector comprises bank loans and advances in the form of term loans, demand loans, cash credit, overdrafts, inland and foreign bills purchased and discounted as well as investments in instruments issued by non-government sector.

Non-performing assets (NPAs) constitute integral part of banks' operations. A bank gives out money upfront and earns income over a time on the promise of a borrower to repay. When loans are not repaid, the bank loses both its income stream, as well as its capital. Lending is always accompanied by the credit risk arising out of the borrower's default in repaying the money8. The level of nonperforming loans is recognized as a critical indicator for assessing banks' credit risk, asset quality and efficiency in allocation of resources to productive sectors.

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The most calamitous problem facing commercial banks all over the world in recent times is spiraling NPA's which are affecting their viability and solvency and thus posing challenge to their ultimate survival. So the problem of NPAs should be nipped in the bud. It is possible only if the check is placed on NPAs from the very beginning.

The major cause for the NPA can be attributed to:

1 Improper selection of borrower's activities
2 Weak credit appraisal system
3 Industrial problem
4 Inefficiency in management of borrower
5 Slackness in credit management & monitoring
6 Lack of proper follow up by bank
7 Recession in the market
8 Due to natural calamities and other uncertainties

Banks are ultimately made to finance the losses incurred by constituent industries and businesses. The lack of preparedness and structural weakness of our banking system led to the emerging scenario and trying to switch over to globalization were only aggravating the crisis. The major reason for this situation was that the threat of NPAs was being surveyed and summarized by Reserve Bank of India (RBI) and Government of India with a bird's eye-view of the banking industry, independent from the rest of the economy.

Objective of the Study

The present study has been taken with the following objectives:

1 To understand the performance of Private Sector banks in terms of Percentage of NPA to Gross Advances and Net Advances.
2 To compare magnitude and dimension of NPA's of new private sector banks and old private sector banks.
3 To examine the measures and strategies followed for reduction of the burden of NPA's
4 To suggest for the Private banks to effectively handle the challenge posed by NPA's

Methodology

The study is primarily based on secondary data which is collected from RBI bulletins and statistical tables. IBA bulletins were also referred for collection of secondary data. The data so collected was tabulated and compared with the help of generally acceptable statistical tools which are used for analysis of large data.

Data, Interpretation and, Findings

Advances (Rs. In Billions)

Year (End-March)	Old Private Sector banks	New Private Sector banks
2000-01	379.73	300.86
2001-02	422.86	741.87
2002-03	494.36	895.15
2003-04	556.48	1151.06
2004-05	677.42	1236.55
2005-06	829.57	2300.05
2006-07	928.87	3218.65
2007-08	1116.70	4067.33
2008-09	1285.04	4468.24
2009-10	1541.36	4783.58
2010-11	1846.47	6128.86
2011-12	2301.00	7363.00
Source: www.rbi.org.in		

It can be observed that the new private sector banks grown at more than double the growth rate of old private sector banks. Where in the last 12 years, old private sector banks could grow 6 times, the new private sector banks grown 24 times. We can say that old private sector banks lagging behind in acceptance of deposits. However, one can argue that the old private sector banks

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utilize their deposits in a more conservative way.

NPA (Rs. In Billions)

Year (End-March)	Old Private Sector banks	New Private Sector banks
2000-01	43.46	16.17
2001-02	48.51	68.11
2002-03	45.50	72.32
2003-04	43.98	59.83
2004-05	42.00	45.82
2005-06	37.59	40.52
2006-07	29.69	62.87
2007-08	25.57	104.40
2008-09	30.72	138.54
2009-10	36.22	140.17
2010-11	36.00	145.00
2011-12	42.00	145.00
Source: www.rbi.org.in		

Net NPA as percentage of Net Advances

Year (End-March)	Old Private Sector banks	New Private Sector banks
2000-01	7.3	3.1
2001-02	7.1	4.9
2002-03	5.2	1.5
2003-04	3.8	1.7
2004-05	2.7	1.9
2005-06	1.7	0.8
2006-07	1.0	1.0
2007-08	0.7	1.2
2008-09	0.9	1.4
2009-10	0.8	1.1
2010-11	0.5	0.6
2011-12	0.6	0.5
Source: www.rbi.org.in		

It is evident from the above table that old private sector banks have somehow been able to maintain their Non Performing assets. On the other hand when we see the NPA of new private sector banks we observe that they have grown substantially. NPA of new private sector banks have grown 9 times while the old private banks remained as it is. It can once again be connected to the details of advances and can be interpreted that old private sector banks selected their advances with caution. This is the reason of their low advances vis-à-vis NPA's. NPA of private sector banks have reduced till 2007-08 and then there was a trend of increment till 2012.

Gross NPA as percentage of Gross Advances

Year (End-March)	Old Private Sector banks	New Private Sector banks
2000-01	10.9	5.1
2001-02	11.0	8.9
2002-03	8.9	7.6
2003-04	7.6	5.0
2004-05	6.0	3.6
2005-06	4.4	1.7
2006-07	3.1	1.9
2007-08	2.3	2.5
2008-09	2.4	3.1
2009-10	2.3	2.9
2010-11	1.9	2.7
2011-12	1.8	2.2
Source: www.rbi.org.in		

The Gross NPA as percentage of Gross Advances has revealed that in old private sector banks initially NPA was almost 10-11 percent of advances while the same was only 5 percent in new private sector banks. The latest information about gross NPA as percentage to Gross Advances is that the old private sector banks have been able to control gross NPA as in a better way compared to new private sector banks. In the year 2012 the Gross NPA as percentage to Gross Advances was 20 percent less than the percentage of new private sector banks.

If we observe the Net NPA as percentage of Net Advances we will find that at the end of March 2012 both Old Private Banks and New Private Banks are almost on the same position. The Net NPA to Net Advances for

Old Private Sector Banks is 0.6 percent while same is 0.5 percent for New Private Sector Banks.

Conclusion

With respect to the study of non Performing Assets of Indian Private Sector Banks we can conclude that both New Private sector and Old Private sector Banks are doing extremely well in not only the recovery of Non Performing assets but in selection of advances as well. Although we can observe that the magnitude of NPA's is large it is headed towards a downturn. In both New and Old Private Sector Banks, NPA are now reducing. Banka are further suggested that an integrated information system for advances should be constructed so that it becomes easy for the bankers to exchange the detailed information of defaulters. This will definitely be reducing the credit risk and hence occurrence of more NPAs.

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