

Risk of Credit and Non-Performing Assets in Banks – A Case Study of Karnataka Vikas Grameena Bank

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Abstract

Credit risk of banks arises due to the inability or unwillingness of a borrower or counter party to meet its obligations in accordance with the agreed terms. Credit risk is inherent to a financial intermediary. Its management is more important than managing other risks like interest risk and liquidity risk. Credit risk management comprises of – (i) identification, (ii) measurement, (iii) monitoring and (iv) control of the credit risk exposure.

Credit risk is ultimately reflected in the emergence of non-performing assets of a bank. NPAs are the primary indicators of credit risk. High level of NPAs indicate high probability of credit defaults that affect the profitability and net worth of banks and also erode the value of assets.

Karnataka Vikas Grameena Bank is a major Regional Rural Bank in Karnataka covering 9 districts. Despite its operational expansion and its expanding financial resources, the bank has been experiencing a trend of growing NPAs during the period from 2010-11 to 2014-15. The analysis of the growing NPAs of the bank has been made in terms of NPAs as percentage of total and net advances of the bank, proportion of NPAs to priority sector and other sector advances and provision made by the bank towards the NPAs. The overall position has indicated a trend of high NPAs level of the bank during the study period. This calls for streamlining the financial risk management by the bank.

Key words

Credit Risk, Identification, Financial Resources, Measurements

Introduction

Credit risk comprehends the inability or unwillingness of a borrower or counterparty to meet its obligations in accordance with the agreed terms. In a bank's portfolio losses stem from outright default due to inability or unwillingness of a customer or counterparty to lending, trading settlement and other financial transactions. Credit risk is inherent to a financial intermediary and its management is perhaps more important than managing other risks like interest rate risk and liquidity risk.

Credit Risk Management

Credit risk management involves evaluating and managing the growth and diversification of loans/investments and establishing the tolerance limits for credit and investment. Credit risk management is segregated into micro and macro level risk management. Credit risk at the micro level focuses independently on each credit transaction of the bank while the macro level credit risk management targets the total credit exposure of the bank. Credit risk management encompasses (i) identification, (ii) measurement, (iii) monitoring and (iv) control of the credit risk exposure.

Credit Risk and Non-Performing Assets of Banks

Credit risk is ultimately reflected in the emergence of non-performing assets of a bank. Non-Performing Assets (NPAs) reflect on the performance of banks. They are primary indicators of credit risk. A high level of NPAs suggests high probability of larger number of credit defaults that affect the profitability and net worth of banks and also erode the value of assets. The NPA growth involves the necessity of provisioning which reduces the overall profits and shareholders value. At present the core financial problem of banks is NPAs. Spiralling NPAs, piling debt restructuring cases and lower recovery have affected bank's balance sheets. State Bank of India for instance saw its net profit going down by 35 percent in July-September 2013 on account of

high NPAs. The State Bank of India itself has written off loans worth over Rs. 7000 crore relating to 63 wilful defaulters (The Hindu, 17-11-2016, p. 10). If earlier the public sector banks had seen deterioration in their assets, some of the private sector banks too have run into similar issues. Gross NPAs of all scheduled banks was 5.1 percent of total advances in September 2015. Banks aggregate Gross Non-Performing Assets (GNPAs) have shot up to humongous level of Rs. 6.68 lakh crore both public and private sector lenders included.

Non-Performing Assets of Karnatak Vikas Grameena Bank – An Analysis

Karnatak Vikas Grameena Bank is a major Regional Rural Bank in Karnataka covering 9 districts with a vast network of branches. Despite its growth in the direction of its operations by way of expanding its financial resources and the magnitude of its credit deployment and deposit mobilisation the bank has been experiencing a trend of growing NPAs. The bank's growth NPAs during the study period from 2010-11 to 2014-15 has been analysed in terms of the following variables viz.

1. Percentage of Gross NPAs to Total Advances
2. Percentage of Net NPAs to Net Advances
3. Percentage of Gross NPAs to Gross Priority Sector Advances
4. Percentage of Gross NPAs to Gross Advances to Other Sectors
5. Provision for NPAs to the Bank

Objectives of the Study

The study is conducted with the following major objectives.

1. To study the credit risk of the study unit covering the Karnataka Vikas Grameena Bank.
2. To identify the credit risk in relation to the NPAs of the bank during the study period and
3. To analyse the growth of NPAs of the bank in relation to the

bank's financial operations.

Research Methodology

The analysis in this study is based on secondary data obtained from the annual reports of Karnataka Vikas Grameena Bank. The study covers a period of 5 years from 2010-11 to 2014-15. The growth of NPAs of the bank is compared with the variables like total advances of the bank during the study period, provisions made towards NPAs, percentage of NPAs to net advances and advances made by the bank top priority sector and other sectors. Based on these comparative analysis inferences are derived about the dimensions of the NPAs of the bank and its credit risk. The study is exploratory and analytical.

Non-Performing Assets of Karnataka Vikas Grameena Bank – Analysis and Results

The analysis of the growth of NPAs of Karnataka Vikas Grameena Bank during the study period has indicated some significant trends. The data obtained from the Annual Reports of the bank have been analysed for a period of 5 years from 2010-11 to 2014-15.

Percentage of Gross NPAs to Total Advance

The analysis of the gross NPAs to total advances of the bank during the study period indicates a slowdown of NPA growth from Rs. 92.58 crore in 2010-11 to Rs. 88.93 crore in 2012-13 and a sharp increase during the last two years to reach a high of Rs. 213.85 crore in 2014-15. The percentage of gross NPAs declined from 2.54% in 2010-11 to 1.58% in 2012-13 and rose to 2.96% in 2014-15. The overall trend indicates a rise in gross NPAs from 75.98% in 2011-12 to 116.54% in 2014-15. The following table provides the details.

Table-1 : Percentage of Gross NPAs to Total Advances of Karnataka Vikas Grameena Bank during 2010-11 to 2014-15 (Rs. in crores)

Year	Gross NPA	Total Advances	% of gross NPA to Total Advances	Trend in % of Gross NPA to Total Advance
2010-11	92.58	3640.81	2.54%	100%
2011-12	89.17	4616.89	1.93%	75.98%
2012-13	88.93	5622.14	1.58%	62.21%
2013-14	126.65	6445.01	1.97%	77.56%
2014-15	213.85	7229.52	2.96%	116.54%

Source: Annual Reports of KVG Bank

Percentage of Net NPAs to Net Advances

The data indicated that net advances of Karnataka Vikas Grameena Bank during the study period have gone up considerably from Rs. 3548.24 crore in 2010-11 to Rs. 7139.72 crore in 2014-15. However, net NPAs were found zero percent during 2010-11 to 2012-13 but have increased steeply to 0.68% in 2013-14 and further to 1.74% in 2014-15. The trend of growth of Net NPAs was 168% in 2013-14 and 348% in 2014-15. The following table provides the details.

Table-2 : Percentage of Net NPAs to Net Advances (Rs. in crores)

Year	Net NPA	Net Advances	% of Net NPA to Net Advances	Trend (%)
2010-11	000	3548.24	0%	100%
2011-12	000	4427.72	0%	100%
2012-13	000	5533.21	0%	100%
2013-14	043.57	6361.93	0.68%	168%
2014-15	124.04	7139.72	1.74%	348%

Source: Annual Reports of KVG Bank

Percentage of Gross NPAs to Gross Priority Sector Advances of Karnataka Vikas Grameena Bank

The data obtained from the Bank Reports indicate a continuous increase in the Gross NPAs of the bank from Rs. 92.58 crore in 2010-11 to Rs. 213.85 crore in 2014-15. There is simultaneously increase in priority sector advances of the bank from Rs. 3338.38 crore in 2010-11 to Rs. 6141.89 crore in 2014-15. There has been an increase in the Gross NPAs relating to priority sector advances from 2.77% in 2010-11 to 3.48% in 2014-15 with a trend of fluctuation during the intervening period. The trend growth of NPAs has indicated a rise from 83.75% in 2011-12 to 125.63%. The details are provided in the following table.

Table-3 : Percentage of Gross NPAs to Gross Priority Sector Advances of Karnataka Vikas Grameena Bank (Rs. in crores)

Year	Gross NPA	Gross Priority Sector Advance	% of Gross NPA to Gross PSA	Trend (%)
2010-11	92.58	3338.38	2.77%	100%
2011-12	89.17	3842.25	2.32%	83.75%
2012-13	88.93	4779.15	1.86%	67.15%
2013-14	126.65	5598.34	2.26%	81.59%
2014-15	213.85	6141.89	3.48%	125.63%

Source: Annual Reports of KVG Bank

Percentage of Gross NPAs to Gross Advances to Other Sectors

Gross NPAs as percentage of Gross Advances to Other Sectors have declined from 30.61% in 2010-11 to 19.66% in 2014-15. This trend is indicated in the wake of an increase in the amount of Gross Advances of the Bank to other sectors and increase in the Gross NPAs during the same period. However, trend growth of Gross NPAs in relation to Gross Advances to other sectors have gone up from 43.19% in 2011-12 to 64.23% in 2014-15. The following table provides the details.

Table-4: Percentage of Gross NPAs to Gross Advances of Karnataka Vikas Grameena Bank to Other Sectors (Rs. in crores)

Year	Gross NPA	Gross Advances to other sectors	% of Gross NPA to GAOS (%)	Trend (%)
2010-11	92.58	302.44	30.61%	100%
2011-12	89.17	674.64	13.22%	43.19%
2012-13	88.93	842.99	10.55%	34.47%
2013-14	126.65	846.66	14.96%	48.87%
2014-15	213.85	1087.63	19.66%	64.23%

Source: Annual Reports of KVG Bank

Provision for NPAs of Karnataka Vikas Grameena Bank during 2010-11 to 2014-15

Provisions for NPAs by the Karnataka Vikas Grameena Bank during the study period have been lower during the first four years. They declined from Rs. 92.58 crore in 2010-11 to Rs. 83.08 crore in 2013-14. However, there is an increase in the amount of provision for NPAs to Rs. 89.81 crore in 2014-15. The details are provided in the following table.

Table-5 : Provisions for NPAs of Karnataka Vikas Grameena Bank during 2010-11 to 2014-15 (Rs. in crores)

Year	Gross NPA	Provision for NPA's	Net NPA
2010-11	92.58	92.58	-
2011-12	89.17	89.17	-
2012-13	88.93	88.93	-
2013-14	126.65	83.08	43.57
2014-15	213.85	89.81	124.04

Source: Annual Reports of KVG Bank

Findings

- The growth of NPAs of the KVG Bank during the study period has indicated a fluctuating trend. Percentage of Gross NPAs to Total Advances declined from 2.54% in 2010-11 to 1.58% in 2012-13, but rose to 1.97% in 2013-14 and further to a high of 2.96% in 2014-15. Percentage of Net NPAs to Net Advances remained zero during the period from 2010-11 to 2012-13, but have increased steeply to 0.68% in 2013-14 and further to 1.74% in 2014-15.
- The Bank experienced a similar trend of fluctuations in relation to gross percentage of Gross NPAs to Gross Priority Sector Advances. Percentage of Gross NPAs to Gross Priority Sector Advances declined from 2.77% in 2010-11 to 1.86% in 2012-13, but rose to 2.26% in 2013-14 and further to 3.48% in 2014-15.
- A trend of fluctuations in relation to Gross NPAs as a percentage of Gross Advances to Other Sectors is observed during the study period from 2010-11 to 2014-15. Percentage Gross NPAs to Gross Advances to Other Sectors declined from 30.61% in 2010-11 to 10.55% in 2012-13 but rose to 14.96% in 2013-14 and further to 19.66% in 2014-15.
- There has been a continuous decline in the provision for

NPAs of KVG Bank from 2010-11 to 2013-14. However, the provision for NPAs by the KVG Bank has risen in 2014-15. The decline in provision for NPAs was from Rs. 92.58 crore in 2010-11 to Rs. 83.08 crore in 2013-14 and an increase in provision for NPAs stood at Rs. 89.81 crore in 2014-15.

Conclusion and Suggestions

Non-Performing Assets are primary indicators of credit risk of a bank. The NPA growth involves the necessity of provisioning which reduces the overall profits and shareholders value. Karnataka Vikas Grameena Bank despite its growth in the direction of its operations by way of expanding financial resources and the magnitude of its credit deployment and deposit mobilisation the bank has been experiencing a trend of growing NPAs. There is need for streamlining its financial risk management and keep down the NPAs within safer limits.

The problem of Non-Performing Assets (NPAs) needs to be addressed by the banks in general and the KVG Bank in particular. There is need for improvement of quality of appraisal, supervision and follow up of the loan assets advanced to the borrowing parties. A rigorous and appropriate credit appraisal mechanism is needed at the bank level. The mindsets of borrowers have to be changed. Banks should see that the borrowers use the funds only for the purpose for which the loan is advanced and should see that there is no diversion of funds for unwanted purposes. Banks should not focus on single target group of customers. A system of "Central Information Pool" is useful through which a bank can obtain complete financial dealings of a customer with banks. This will reduce over lending to a customer and reduces the possible NPA.

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