

CHAPTER I

RESEARCH DESIGN



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CHAPTER- I

Research Design

1.1 INTRODUCTION

During the year 1990, Government of India faced critical situation of balance of payment. To honor the commitment of its debts, it pledged gold in international bank. After this government of India appointed Narsimham Committee to recommend international financial standards to banking industry. Recommendations of Narsimham Committee were accepted by Govt. of India & RBI. Initially, commercial banks & then after primary Urban Co-op banks are given direction to implement NPA instructions. The basic idea of implementing these norms were to classify the assets into income generating & non-income generating assets. This committee also pointed that bank or FI's should present their annual balance sheet in clean & transparent way.

The RBI introduced adequate capital norms but commercial & national banks showed no efforts of recovering their dues. The borrower renewed their loan accounts by getting additional limit of loan & afterwards they showed unwillingness to pay the debt amount. This resulted in to growth in NPA's. In the year 2002 the growth of NPA's of scheduled commercial banks were more than 70904 cores & NPA's in percentage were 21.9 % in 2002.¹

The present legal machinery is very lengthy & time consuming to get decrees & orders from either Civil Courts & Co-op courts. The Govt. of India passed DRT act 1993 & set up Debt Recovery Tribunals (DRT) at various places all over country for speedy recovery of bank or FI's. In Maharashtra three DRTs have been established, one each at Mumbai, Pune & Aurangabad. The Debt Recovery Appellate Tribunal (DRAT) is

established at Mumbai. The act enjoys on the DRT to dispose off the case within 180 days of its filing.

As per the speech of Shri. G. P. Muniappan, Deputy Governor, RBI

*“Cases pending with different DRT’s numbered 33,043 involving Rs. 42,989 crores in 2002. Thus, the task seems to be too difficult for the DRT’s to handle effectively. Setting up of DRTs & DRATs was bold step taken by Central Govt. But this also not gave much result to solve the problem of recovery in public money locked in NPA’s accounts. To impart justice to banks as well as borrowers. The SARFAESI Act was enacted in 2002.”*²

The act gives teeth to the banks to summarily proceed against willful defaulters & to enforce its security interest without the intervention of the court. This act also empowers the RBI to frame policy guidelines & issue directions in public interest & to regulate financial system of the country. Bank & FI's got wide powers to enforce its security interest. Bank & FI's can demand due amount u/s 13(2) by sending 60 days notice. If borrower failed to repay the loan amount within 60 days, banks can directly seize the secured property of the defaulter by simply sending possession notice of 30 days.

SARFAESI Act provides for the setting up of Reconstruction Companies & Central Registry for the purpose of enforcement of security interest. This one Act covers three facets, so it can be called as three in one Act .The SARFAESI Act has three main facets .

- 1) Enforcement of security interest by secured creditors.
- 2) Transfer of NPA to Asset Reconstruction Company (ARC) .
- 3) Securitisation of assets which basically means acquisition of Financial Asset from the defaulters.

1.2 Statement of the problem

Numbers of research projects have been presented to the Indian Universities & Central Research Institute, which focused light on co-op banking, co-op marketing, co-op processing and co-op agriculture. But according to the best of my knowledge none of the project deals with problem of recovery machinery for banks & financial institutions, increasing trend of NPA & implementation of SARFAESI ACT 2002.

With the increasing accumulations of un-recovered & irrecoverable debts in the books of the bank, the problem of NPA's assumed serious proportions, which affects on profitability of bank. The efforts of banks to recover their dues have been mostly futile leading to the heap of NPA's. The flows of NPA's are increasing year after year. The gross NPA's of scheduled commercial banks increased from Rs. 50,722 crores at the end March 1999 to Rs. 70,904 crores at the end of March 2002.³

To meet this inadequacy of measures the union budget for 2002-2003 announced setting up of an Asset Reconstruction Company.

For speedy recovery of loan, parliament enacts the SARFAESI ACT 2002. But whether all banks & FI's implement this act to recover its debt amount? Whether they follow the procedure of implementation of its rights according to Security Interest (Enforcement) rules 2002. Already CPC 1908, Maharashtra Co-op Societies Act 1960 & Debt Recovery Tribunals are there which provides for the recovery of loan amount. Then what was the need to enact this new law for recovery of due amount? It is also important to know that how Urban Co-op Banks have taken asylum of SARFAESI Act. We should also know whether the purpose for enacting this act to reduce NPA's is served in practice?

Researcher was encouraged because of the enactment of SARFAESI Act on the recommendation of Narsimham Committee appointed by the Govt. of India. This act deals with speedy recovery of

the debt amount by the banks & financial institutions. Researcher thought to do study in the field of urban co-op banking, their recovery machinery under various laws. Researcher stimulated her interest to study whether Urban Co-op Banks are following the rules for implementations of SARFAESI Act & whether NPA's are reduced due to implementation of this act?

As regards the urban co-op banks in Sangli, they are making rapid growth in recent years. There are total 30 urban co-op banks in Sangli District, out of them seven urban co-o banks are established in Sangli city. And they have many branches in Sangli District.

The fact is that when the researcher visited UCB's in Sangli & made discussion with some of the bank managers, recovery officers, researcher found that most of the banks are not implementing SARFAESI Act. Till they are depending on old recovery measures and on own treaty for the recovery of dues. The researcher realised that there was no guidance or training is given to implement SARFAESI Act to the officers of some Urban Co-op Bank's in Sangli. So researcher felt the necessity to assess the present available legal machinery for recovery of debts adopted by the urban co-op banks particularly in Sangli. Therefore researcher has selected the topic of SARFAESI Act 2002, for recovery of urban co-op banks.

Hence the title of the study is,

“A Critical Study of the Securitisation and Reconstruction of Financial Assets with Special Reference to Urban Co-Operative Banks In Sangli”

1.3. Scope and Significance of the study

The present study is significant in many ways. In the first place this study could help to know overall legal machinery available for recovery of loan. This would help the Urban Co-op Banks & also to

borrowers to know their rights & responsibilities vis-à-vis in relation to granting the loans & repayment of loans, their recoveries under various laws. Researcher has given more stress on SARFAESI Act , passed by the parliament under which banks have got wide powers to recover the due amount.

Securitisation in the context of NPA's reduction is with respect to an asset. A measure to reduce the bad loan (NPA's) of bank is the subject of this study. Securitisation means conversion of bank loan into a security. It refers to the transfer of loans (assets) from lending institutions to the Securitisation Company packaging them in the form of securities. This means that, the Securitisation Company holds the loans & issues securities to the bank. Banks can make new loans to their new customers. Banks benefit from securitisation & their bad debts which are far from being recoverable are recovered. Thus, the money for further expanding the banking business becomes available.

In this way securitisation act create security of a lien. After enactment of securitisation act banks get wide powers to enforce the security interest without the intervention of court or tribunal. The creditor i.e. bank may ask the borrower to discharge the full liabilities by issuing a notice u/s 13(2) under the said act. If debtor fails to discharge his liabilities within 60 days from the date of notice, creditor i.e. bank is empowered to take possession of the secured asset of the borrower. It can take over the management of the assets of the borrower. It can recover the amount of expenditure made for initiating action against borrower, who has failed to discharge his liability. Thus bank has got an effective tool by which it can liquidate the amount locked in NPA's through securitisation act 2002.

The present research study intended to provide basic information & procedures which will enable to understand the evolutionary changes in the Indian Banking, its structure, position of Urban Co-op

Banks in Indian Banking, the concept of NPA's, various measures available for recovery of dues from borrowers.

The present study will enlighten the impact of the securitisation act. It will prove whether the new act is a really a boon to the banks in reducing their NPA's? It will also study whether it was necessary to enact SARFAESI Act in the view of the Recovery of Debts Due to Banks & Financial Institutions Act & Co-operative Societies Act 1960 for co-op banks already being in place.

Numerous tables, figures, examples, graphs & charts are used throughout this research study. Researcher has tried to give up-to date data available on the relevant topics.

1.4. Objectives of study

The present study has been designed & executed with following objectives: -

1. To study the concept of NPA's & enforcement of security interest.
2. To study the major causes of increasing NPA's.
3. To examine appropriate legal machinery for recovery of bank loans.
4. To study the need, objectives & importance of enacting securitisation act 2002.
5. To assess and analyse SARFAESI Act 2002.
6. To study regulation of securitization & reconstruction of financial assets of the Urban Co-Op Banks in Sangli.
7. To study the need of SARFAESI Act 2002 vis-à-vis Mah. Co-op Societies Act 1960.
8. To make suitable suggestions for debt recovery on the basis of comparative study of selected urban co-op banks in Sangli.

1.5. Hypothesis

Problem of recovery & increased rate of NPA's of Urban Co-op Banks is complex one & there is no easy solution available to reduce NPA's. Recovery of due amount must be prompt to reduce the NPA's of Urban Co-op Banks.

. Hence following are the hypothesis

1. Urban Co-op Banks are facing the recovery problems. The NPAs of Urban Co-op Banks are increasing.
2. Urban Co-op Banks are enforcing their security interest through section 91 and 101 of MSC Act 1960.
3. Urban Co-op Banks are enjoying the SARFAESI Act 2002 by getting wide powers under it.
4. Cases filed at the trial court took much time for examination of facts, documents, pleading, arguments and interpretation of law etc. before sanctioning any order or decree for recovery.

1.6. Research Methodology.

1.6.1 Methodology

The investigation is the sample study based on primary and secondary data and personal discussions with the official involved with working of Urban Co-op Banks by using schedule. The scheduled case study method was used by providing Questionnaire to selected UCB's for appropriate data collection.

Discussions with the Bank Managers, Special Recovery Officers, and Advocates practicing in recovery cases were made by researcher personally during working hours of the selected urban co-op banks in their premises and offices of advocates.

1.6.2 Sampling

First of all list of the UCB's in Sangli was prepared. Personal visits were paid to the branches of banks in different parts of Sangli City. Annual Reports of the visited Urban Co-op Banks were collected. These banks were grouped under two categories: -

1. Urban Co-op Banks established in Sangli & functioning in Sangli District & else where. There are 7 such banks in Sangli city.
2. Urban Co-op Banks established out side of the Sangli City but functioning in Sangli. There are 23 such banks in Sangli District.

Then researcher has made efforts to select only two Urban Co-op Banks out of seven banks, who are originally established in Sangli city and functioning in Sangli and elsewhere. The samples selected are representative in character. Following two banks are selected as sample banks for research study.

- 1) Sangli Urban Co-op Bank Ltd. Sangli
- 2) Vasantdada Shetkari Sah. Bank Ltd. Sangli.

According to the annual report of UCB's association 2005 – 2006 the membership of these two banks is 61,694 and their capital is Rs 1434 lakhs. These above two banks accepted deposits near about 38,549 lakhs and advanced Rs.65, 666 lakhs. These two banks provided 72% of total advances of 90,270 lakhs provided by other Urban Co-op Banks in Sangli. These are the major two banks in Sangli District, which advances huge amount of loans to the needy peoples. So researcher has selected these two banks for the case study assuming that these are the representatives of all other Urban Co-op Banks in Sangli District.

1.6.3 Reference period and data collection

The study is limited only for the period of three years. This period is selected as best period for evaluating implementation of SARFAESI Act

by Urban Co-op Banks. The Act is enacted in 2002, so researcher has selected the period from 2003-2004 to 2005-2006.

Both direct & indirect methods are used for the collection of information from selected samples. Annual reports for three years (from 2003-04 to 2005-06) were collected & informal discussions with the managers of the selected Urban Co-op Banks were made. Some information was collected from the annual record of Urban Co-op Banks Association Sangli. Visits to selected Urban Co-op Banks in Sangli were arranged during the working hours to get the information needed for research study. Researcher has also made discussion with Advocates to get legal information about recovery of the bank loans.

Another source of the information, which was used in carrying out the research was the published material viz. Books, journals, seminar reports, program reports, published work shops papers , CAB calling (periodicals) published by agricultural college, Pune, relating to Urban Co-op Banks & NPA's. For the purpose of the data collection, the libraries of the following institutions were consulted.

- G. A. College of Commerce, Sangli.
- M. G. K. Mahavidyalaya, Sangli.
- Smt. C.B. Shah Mahila Mahavidyalaya, Sangli.
- Bharati Vidyapith's law college, Sangli.
- N. S. Law college of Sangli.
- Law library of Sangli Bar Association, Sangli.

1.6.4 Tools and techniques of analysis

The standard tools and techniques were used for analysis of collected information and was classified, analyzed & projected into tabular form. Tables so prepared are designed in such a fashion so that they have been self-explanatory. Simple statistical techniques such as percentages & ratios have been used to draw necessary conclusion.

Along with this charts and graphs are also drawn to make the information easy to interpret & easy to understand.

1.6.5 Limitation of the study

The present study has been undertaken to assess how the Urban Co-op Banks have taken asylum of SARFAESI ACT 2002. And what are the problems facing by these co-op banks in implementing this act to recover the loan amount. The study is confined to only two selected Urban Co-op Banks in Sangli purposely. Following are the limitation of research study

➤ **Limitations of the study**

- 1) In view of limitations of the cost, researcher has selected only two Urban Co-op Banks in Sangli.
- 2) SARFAESI Act is recently enacted. All Urban Co-op Banks are not totally implemented this act for the recovery, because till they prefer old methods for the recovery of debts.
- 3) SARFAESI Act includes total 42 sections. But however researcher concentrated on section 13 to 19 only which are related to enforcement of security interest by banks and FI's.

1.7 Chapter scheme

Chapter 1: - Research Design

In this chapter the problem of study is stated, the objectives taken up for the study are listed. The methodology adopted for this research & various sources used for primary data & secondary data collections have been explained. The significance of the study is also described in this chapter. Limitations for the research study are also mentioned in this chapter. Finally, detailed sample design & review of literature regarding the financial system, structure of banks, their functions, over

dues & NPA's, recovery of Urban Co-op Banks under various laws have been outlined.

Chapter 2: - Financial system of India

This chapter deals with the Indian financial system, Indian banking in economic development, the concept & functions of bank, structure of financial institutions in India, co-op banks & their functions. This chapter also contents the historical background of co-op movement in Maharashtra & Sangli, co-op banking structure, historical background & progress of Urban Co-op Banks in India, Maharashtra & Sangli. The profiles of selected Urban Co-op Banks are given in this chapter.

Chapter 3: - Issues in Indian financial system

This chapter is highlighted on problems of banking sector, Non-Performing Assets, their causes & effects, provisioning for NPA's. This chapter also contents various tables showing increase in NPA's of co-op banks in India, Maharashtra & Sangli District.

Chapter 4: - Recovery machinery for banks

This chapter is divided into three parts. First part is related to Civil Procedure Code (CPC) 1908 & its procedure. Second part is related to Co-op Society's Act 1960 & its procedure. Third part is dealt with DRT & DRATs for speedy recovery.

Chapter 5: - The Nature and Need of SARFAESI ACT 2002.

This chapter is the core subject of this research study .This chapter contents historical background, the recommendations of Narsimham Committee & importance of SARFAESI Act. This chapter also highlighted on the provisions & procedures under SARFAESI Act

for recovery of loan amounts. In present study the section 13 to 19 related to enforcement of security interest by banks & financial institutions are elaborated.

Chapter 6: - Data Analysis and Interpretation

In this chapter, case study of selected banks in Sangli City is taken into account. This chapter contents profile of the selected Urban Co-op Banks in Sangli, their consolidated statistical data. This chapter also describes financial position of selected Urban Co-op Banks in Sangli, their deposits & advances, over dues & NPA's, their recoveries under various laws.

Chapter 7: - Conclusions and suggestions

Conclusions & suggestions on the basis of analysis and interpretation of collected data have been presented in this chapter. Every effort is made to present the concrete suggestions.

1.8. Review of literature

The Urban Co-op Banks in India have completed 100 years. They came into existence to satisfy the credit needs & providing banking facilities to the middle class peoples, salary earners & small traders from urban areas. At the end of 2006 there were 2250 Urban Co-op Banks in India; out of them 1545 Urban Co-op Banks are in Maharashtra, Gujarat, and Karnataka & A.P. They accepted deposits of Rs 37,242 crores & made advances of Rs. 29,960 crores. ⁴ It shows that Maharashtra is leading state in the development of UCB's in India. According to annual report of District Urban Co-op Banks Association 2005-2006 , there are 30 Urban Co-op Banks in Sangli Districts having 310 branches situated in Sangli Districts & elsewhere. These Urban Co-op Banks in Sangli accepted the deposits of Rs. 2700 crores &

advances 2000 crores. This shows that Urban Co-op Banks in Sangli Districts advanced huge amount in Sangli District. It would be further observed that Urban Co-op Banks are efficiently operating where as, some of them are not doing well. Hence the Urban Co-op Banks have to face several problems in recovery of debt amount & in reducing its NPA's below 10 %.

While talking about the problems & prospects of Urban Co-op Banks, Jagadish Capoor - Deputy Governor RBI tried to throw light on some of the issues that he believed.

“Urban Co-op Banks were set up with the important objectives of promoting sustainable banking practices amongst relatively specific clients viz. the middle income strata of the urban population. They brought under the regulatory ambit of RBI by extending certain provisions of the banking regulation act 1949 effective from March 1966.

The performance of the co-op-banking sector as a whole has attracted considerable attention in the recent years especially in the context of the ongoing phase of financial sector reforms. However, there is significant heterogeneity in the performance of UCB's that is more than 2250 at present. While a large number of these banks have shown creditable performance but on the other hand some banks have shown signs of weaknesses. Incidence of sicknesses of Urban Co-op Banks has become source of serious concern to regulators. It has been felt that inadequate entry point capital, lack of professionalism; absence of compliance with prudential norm & the absence of timely definition sickness have been the major contributive factor behind persistence weaknesses of Urban Co-op Banks. The overdue & NPA's of Urban Co-op Banks are increasing. One issue of serious concern regarding Urban Co-op Banks is the delay, non-submission of returns within the stipulated time frame. There is often a serious delay in the submission of these returns by individual banks. Non-availability of

adequate & timely data would no doubt have serious effect on timely policy action. So Urban Co-op Banks have to improve their statistical reporting system & bridge the wide gap in data availability as compared to that of commercial banks”⁵

K. J. Taori - Assistance general manager of SBI, NPA dept. Mumbai expressed his views on management of NPA’s as under

“The quality of loan asset is the most important factor for the basic viability of the banking system. The overdue advances of banks in India are mounting in consequence impinging on the bank viability. This not only eats in to the banks profitability but also hampers their ability to recycle the funds for productive purposes. Performing assets allow banks to improve their profits. Better ratio of performing assets gives credence to efficiency of the management but higher NPA ratio shakes the confidence of investor, depositors & lenders. It makes the supervisory authority strict & rigid in its attitudes. If bank’s profitability ratios are comparable to international banks, they get benefits on account of :---

1) Higher rating. 2) Better rate for equity & debt which they offer. 3) Finer margins in respect of international borrowing. 4) Better alliance.

To control NPA menace a pronged approach viz. preventive & curative measures would be necessary. Banks should basically focus on budget for reductions in NPA’s, strengthening credit management, follow up cases with DRT’s & courts. Bank should emphasis on compromise, One Time Settlement & write off. Documentation of credit policy, credit audit immediately after sanction & human resources development through trading interventions are some of measures necessary to upgrade a quality of credit appraised in banks. The bank should design curative measures to maximize recoveries so that funds locked up in NPA’s are realised for recycling.

The public sector banks should use their wide network of branches & infrastructure to deepen lending for wholesale, retail trade, housing, agriculture etc. with a view to reducing to NPA ratio.”⁶

While talking about the NPA's P. N. Joshi Ex-Chairman, United Western Bank Ltd., Satara observed many points on NPA's, its consequences ,legal procedure for recovery etc which are referred below ;-

“The magnitude of NPA's viz. Rs. 70,904 crores at the end of March 2002 is gigantic & it assumes serious proportions when we realise that a few large corporate owe the banks huge amounts”.⁷

“ Bank should be advised to disclose the total provisions held against the NPA's & not only provision made from the current year's profit & loss account. This will give confidence to the shareholders about the magnitude of provisions held against problem accounts. It is also necessary for the banks to give disaggregated data of NPA's such as 'sub-standard', 'doubtful' & 'loss assets' which will throw more light on the quality of the assets.”⁸

While throwing light on the present legal procedure and delays in recovery by banks and financial institutions he stated that ,

“Once the borrower evades payment of interest & repayment of installments, banker was left with no alternative except going to courts. As in every stage of litigation bank cases also took years or decades. If by any chance, in some cases lower court gave the decision, appeals to higher courts are common. During this period, the borrower used to sale a part of valuable security, divert useful machinery to other units etc. thousands of suits of individual major banks are pending in different courts of the country. The law requires that the officer, who was in the bank at the time of sanction of loans, should verify the signature of the borrowers. After 5 or 6 years of filing the legal suits, the case would come up for hearing when that manager or officer

would have been transferred to some remote branch. After getting the summons to remain present in the court on the day of hearing the officer/ manager has to travel to the place. It was found on an average, every day nearly 200 to 300 bank officers are traveling to attend court cases. To cover long distances, they would travel by aeroplane merely to verify only the signature!”⁹

This observation of P.N. Joshi throws light on the NPA's & huge amount locked in it, delay in legal procedure in recovery & burden of expenditure of recovery on banks & financial institutions. He has also given the amounts of NPA's of some major companies, which are really, mind-boggling. He has given best example that nearly about 200 to 300 bank officers travels daily in India, only for attending the court to verify the signature. This shows wastage of personnel energy, money, time etc. for recovery of due amount. Thus we can imagine that recovery of NPA's is the major problem and burden of expenditure on lending institutions.

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