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Asset-Liability Management of PACS in Kerala A Diagnostic Study

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Introduction

The Primary Agricultural Credit Societies (PACS) in Kerala are unique in more ways than one. They have a large membership and very sound resource base unlike their counterparts else where in the country. The performance of PACS in Kerala vis-a-vis the PACS in the country as a whole is presented in Table 1.

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TABLE 1

Primary Agricultural Credit Society : Important Items of Data as on 31.3.95

(Amount Rs. in Lakhs)

Sl. No.	Item	Kerala		All India	
1.	No. of Societies	1583		90406	
2.	Membership (lakhs)	110.98	(7011)	880.86	(974)
3.	Owned Funds	23448	(14.81)	262199	(2.9)
4.	Deposits	153860	(97.08)	251986	(2.79)
5.	Borrowings	51603	(32.60)	959576	(10.61)
6.	Working Capital	268132	(169.38)	1630368	(18.03)
7.	Loans Outstanding (ST + MT)	146191	(92.35)	1140442	(12.61)

*Figures in bracket indicate average per society.

Source : Co-operative Movement in India-A Statistical Profile 1996. Department of Agriculture and Co-operation, Ministry of Agriculture, pp. 16-18.

The average deposits mobilised and loans disbursed by PACS in Kerala were many times more than the All India average. The average membership per society was 7011 against the All India average of 974. Despite these strengths, PACS in Kerala exhibited certain anatomical and physiological disabilities of a financial character.

Out of the 1583 PACS in Kerala 1030 were running at a loss and the total loss incurred by them amounted to Rs. 45.53 crores in 1994-95. The loss of PACS was mainly on account of poor funds management by incompetent personnel. The Parameswaran Pillai Committee appointed by the Govt. of Kerala to study the working of PACS in Kerala also made the same observation.

The liabilities are created at a cost and the assets are made for a return by the banks. Naturally the profitability of banking business depends largely upon the judicious matching of the assets and liabilities. The banks, must, therefore, match the maturities of liabilities with the maturities of the assets so as to minimise the risks related to credit, liquidity and interest rate fluctuation.

The PACS in Kerala were lending small amounts to a large number of customers by mobilising high cost deposits (the share of fixed deposits in the total deposits around 8.5 percent). As a result the PACS in Kerala fall in the range of 'high risk' related to credit and liquidity. It was in this context that an attempt was made to go for an in depth study of the asset-liability structure of PACS in two blocks of Thrissur district in Kerala.

Objectives of the Study

The objectives of the study are :

i) to examine the asset-liability structure of PACS; and

ii) to analyse the impact of the asset-liability structure on the financial performance of PACS.

Methodology

There were 157 PACS, spread over five Blocks, in Thrissur District. All the 20 PACS except one in the Vadakkancherry and Pazhayannoor Blocks were running at a loss since long. Hence all the PACS in these two blocks were selected for the study. However, due to inadequacies and deficiencies in the data, two PACS were dropped from the final analysis. The study was based on financial data collected for four years 1993-94 to 1996-97 from the selected societies using a structured format. The data were analysed by working out relevant financial ratios based on the balance sheet and income statement.

Results and Discussion

The asset pool of PACS contains high yielding and low yielding assets; performing as well as non-performing assets. Similarly the liabilities basket of PACS include high cost and low cost funds. The financial performance of a PACS is thus a function of the asset-liability mix and match. The structure of the assets and liabilities was analysed by means of certain financial structural ratios [Table 2]. The impact of asset-liability structure on the financial performance was examined by means of certain profitability ratios.

TABLE 2

Asset-Liability Management Ratios

	Particulars	1993-94	1994-95	1995-96	1996-97
I.	**Liability Structure Ratios**				
	(a) Owned Funds To Working Capital	4.83	4.32	4.60	4.31
	(b) Other Funds To Working Capital	8.49	7.58	7.05	6.69
	(c) Deposits To Working Capital	72.50	67.83	76.94	81.39
	(d) Deposit Mix				
	i) Fixed Deposits	85.15	83.96	85.80	86.18
	ii) Savings Deposits	14.55	15.72	13.90	13.62
	iii) Current Deposits	0.30	0.32	0.30	0.26
	(e) Borrowings to Working Capital	36.19	38.90	30.10	26.37

Particulars	1993-94	1994-95	1995-96	1996-97
II. Asset Structure Ratios				
(a) Fluid Resources to Deposits	23.72	22.98	19.16	18.45
(b) Fluid Resources to Working Capital	17.20	15.59	14.74	15.02
(c) Credit - Deposit	100.65	100.30	99.99	94.33
(d) Credit to Working Capital	72.98	68.04	76.94	76.78
(e) Loan Mix				
i) Short Term Loans	81.93	81.02	81.12	81.04
ii) Medium Term Loans	7.98	10.24	11.36	12.22
iii) Long Term Loans	10.08	8.74	7.52	6.75
(f) Fixed Assets to Working Capital	2.33	2.15	2.12	2.13
(g) Accumulated Loss to Owned Funds	3.74	3.51	3.34	3.56
(h) Accumulated Loss to Working Capital	18.08	15.19	15.37	15.38
III. Profitability Ratios				
(a) Return on Assets	9.99	9.65	11.68	11.21
(b) Cost of Funds	9.44	8.24	8.29	8.43
(c) Interest Margin to Working Capital	0.55	1.40	3.39	2.77
(d) Cost of Management to Working Capital	2.80	2.37	3.50	3.36
(e) Provisions to Working Capital	1.89	2.06	2.46	1.85
(f) Net 'Loss' to Working Capital	-4.14	-3.03	-2.57	-2.44

Liabilities Structure Ratios

A. *Owned Funds to Working Capital*

The owned funds do not have any specific explicit cost. A higher share of owned funds minimises the cost of funds and strengthens the buffer for lenders. The ratio during the four year period declined from 4.83 percent to 4.31 percent. The ratio had infact declined because of the negative operating results of the PACS.

B. *Other Funds to Working Capital*

The other funds comprise of various non-statutory reserves which are either appropriation of or charge on profits. The other funds ratio declined from 8.5 percent in 1993-94 to 6.7 percent in 1996-97. The decline in the ratio was mainly due to the reduced provisions and appropriations.

C. Deposits to Working Capital

Deposits are high cost funds. A higher share of deposits in the working capital increases the cost of funds. The ratio increased from 72.5 percent in 1993-94 to 81.4 percent in 1996-97. The higher rate of interest offered by PACS vis-a-vis. commercial banks was the main attraction for depositors to favour the PACS.

D. Deposit Mix

Not only the quantum of deposits but the quality of deposits also influence the operational flexibility and efficiency of PACS. The fixed deposits constituted around 85 percent of the deposit mix, the balance being savings deposits mainly. The total deposits and the fixed deposits registered a growth of 70 percent and 72 percent respectively. The higher share of fixed deposits in the deposit mix undoubtedly granted greater operational flexibility to PACS but at the cost of operational efficiency. The share of savings and current deposits declined but marginally over the years. The deposit pattern of the PACS was almost range bound.

E. Borrowings to Working Capital

PACS borrowed mainly from the Central (District) Co-operative Bank for agricultural and non-agricultural purposes. While borrowings for agricultural purpose offered a clear four percent margin, borrowings for non-agricultural purposes often resulted in a negative margin. The ratio after showing a marginal rise in 94-95 steadily declined in the following years and touched 26.4 percent. The sharp drop in the ratio was due to the stagnation in aggregate borrowings against a 51.1 percent growth in working capital. The PACS in this area showed a reluctance to make full use of the refinance facility because of the complicated loaning procedures and non-availability of timely credit. As a result, the PACS was forced to lend their own funds which were raised at a high cost for high risk, low return purposes.

Asset Structure Ratios

A. Fluid Resources to Deposits

Fluid resources consist of cash in hand, cash at bank and marketable securities. The ratio steadily declined and touched 28.5 percent in 1996-97 from 23.7 percent 1993-94. This trend was encouraging from the angle of profitability but alarming from the liquidity angle. Though PACS were legally bound to keep 25 percent of the Demand and Time Liabilities (DTL) as fluid resources, the PACS of this area, in practice, declined to toe in line with this norm.

B. Fluid Resources to Working Capital

The ratio also showed a declining trend similar to the ratio of fluid resources to deposits. The ratio dropped from 17.2 percent to 15 percent during the study period. The low return on fluid resources and the inadequency of loanable funds would have forced the PACS to sacrifice the liquidity to maintain the loaning operations unaffected.

C. *Credit - Deposit Ratio*

The ratio was 100.1 percent in 1993-94. It gradually declined and touched 94.3 percent in 1996-97. The CD ratio of PACS could go well above 100 percent as borrowings from the District Co-operative Banks are free from fluid resources requirements. The low CD ratio is not justified as the borrowings of PACS in this area was around 33 percent of the working capital and they were keeping fluid resources below the required mark.

D. *Credit to Working Capital*

Credit-Working capital ratio is a better mirror of the credit creation capacity of PACS. The ratio though increased from 73 to 77 percent during the study period, it was showing a stagnant trend. Unlike the CD ratio, the credit -working capital ratio showed an increase, though marginal as the working capital eroded to the extent of accumulated losses. The credit-working capital ratio of PACS in this area was only within the range of 70 when sound financial management demanded a ratio above 100 percent.

E. *Loan Mix*

The PACS are the principal source of Short-Term credit (ST) in Kerala. The ST loans on an average accounted for 82 percent of the total loans; the balance being Medium-Term (MT) and Long-Term (LT) loans. During the study period the share of LT loans decreased from 10 to seven percent and MT loans increased from 8 to 12 percent. The total loans advanced had grown by 59 percent during the reference period. But for a marginal shift from LT to MT, the loan portfolio of PACS in this area remained the same over the period.

F. *Fixed Assets to Working Capital*

Usually the fixed capital of banking institutions would be very small. In the case of PACS in this area, the fixed assets constituted around 2.18 percent of the working capital and it showed a marginal decline over the years.

G. *Accumulated Loss to Owned Funds*

The owned funds of the PACS studied had been eroded completely. The accumulated loss amounted to 3.5 times of the owned funds. The ratio had severely crippled the credit creation capacity of the PACS. The losses resulted mainly due to provisioning for overdues, thin interest margin and mounting cost of management.

H. *Accumulated Loss to Working Capital*

The extent of erosion of funds is better represented by the accumulated loss-working capital ratio. The erosion was to the extent of 18 percent in 1993-94 but it declined to 15.38 in 1996-97.

Profitability Ratios

A. *Return on Assets*

Return on assets is a measure of efficiency of deploying the funds. The average rate of return on assets showed a fluctuating trend during the period. It ranged between 9.6 percent and 11.7 percent. The wide fluctuations in the ratio may be attributed to the changing composition of the asset portfolio and occasional revision of interest rates.

B. *Cost of Funds*

The average cost of funds measures the efficiency of funds mobilisation. The ratio decreased from 9.4 percent in 1993-94 to 8.4 percent during the study period. However, the decline was not steady.

C. *Interest Margin*

Interest margin indicates the overall efficiency of banking business. It exhibited an upward trend from 0.55 percent in 1993-94 to 2.78 percent in 1996-97. Still the ratio was short of the minimum four percent margin suggested for PACS. The improvement in the ratio might be attributed to the improvement in the return on assets ratio.

D. *Cost of Management to Working Capital*

The interest margin must be good enough to cover the cost of management and provisions and leave a surplus. However, the average cost of management of PACS in the area was above the interest margin. The cost of management increased from 2.8 percent in 1993-94 to 3.36 percent in 1996-97 with fluctuations in the intervening years.

E. *Net Loss to Working Capital*

The profitability of PACS was analysed in relation to the working capital. The profitability which was - 4.14 percent in 1993-94 improved to - 2.44 percent in the terminal year of the study. The profitability, though it was negative in all the years, was improving steadily throughout the period. The improvement in profitability was chiefly on account of the improvement in interest margin as the cost of management increased and the provisions ratio declined only marginally during the period.

Conclusion

The study has been able to highlight same weaknesses of the asset-liability management of PACS. The fact that all the PACS except one in the two blocks were incurring loss is a matter of great challenge for policy making. The accumulated losses of some individual societies had completely eroded their 'Own Funds' and were on the verge of liquidation.

The PACS in their own enthusiasm for deposit mobilisation, collected high cost deposits through innovative fixed deposit schemes without even looking into their viability. However, the societies forgot or failed to create assets matching with the risk-return complexion of the liabilities they floated either due to the negligence or ignorance of personnel. (The secretaries of almost all the societies only S.S.L.S. and J.D.C. qualification). It was astonishing to hear that some societies were depositing their fluid resources in savings account when fixed deposits of different maturities were available for investment. The secretaries of these societies were not even aware of the adverse impact of their bad investment decisions. The societies were either reluctant or illequipped to make full use of the refinance facility and were using their own funds for lending for agricultural purposes. The complicated loaning procedures and non-availability of timely credit were deterring the societies from availing refinance facilities. The financing banks should review and revise the loaning policies and procedures to make them customer friendly.

Non-banking businesses of the societies were often a drain on the profitability of several societies. Due to the lack of separate accounting system for each activity the societies were not able to evaluate the cost and benefit of each activity. Activity based costing system must be introduced in societies which carry on non-banking businesses.

Save the conventional annual budget, the PACS were neither planning nor controlling their performance in a systematic manner. The introduction of performance in PACS will lend more predictability to the operations of PACS. Planning and control of performance presupposes the presence of an information system. A computerised accounting system and management information system suitable to the organisational functions and management decision needs of the PACS must be developed.

Development of appropriate systems and absorption of modern technology must be supplemented and complimented by the development of the human resources. The requirement policies in PACS should be thoroughly reviewed and revised so as to attract professionals with the right knowledge, skills and attitude to man the PACS in Kerala. The cutting edge of modern banking is technology and appropriate human skills.