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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	A CROSS-SECTIONAL STUDY OF ACCEPTANCE OF MENTORING FOR PROFESSIONAL DEVELOPMENT IN EDUCATIONAL INSTITUTIONS IN GULF COUNTRIES *DR. IMRAN HAMEED & DR. NAZIA RASOOL QAZI*	1
2.	ROLE OF USER FEES IN ETHIOPIA: A CASE STUDY OF JIMMA UNIVERSITY SPECIALIZED HOSPITAL, SOUTH WEST ETHIOPIA *DR. DEVI NAIR & KORA TUSHUNE*	6
3.	EXPORT GROWTH OF NON – OIL SECTOR IN OMAN: THE ERA OF LIBERALIZATION *DR. THRESIAMMA VARGHESE*	13
4.	CORPORATE SOCIAL RESPONSIBILITY: ORGANIZATIONAL COMMITMENT IN THEORY & PRACTISE *DR. QADAR BAKHSH BALOCH, IMRAN ULLANH KHAN & SHAHED JAN*	17
5.	CORPORATE GOVERNANCE AND PERFORMANCE OF PAKISTANI LISTED COMPANIES - A CASE STUDY OF SUGAR SECTOR *QAISER RAFIQUE YASSER*	23
6.	STATE OF FLEXIBLE CAREERS FOR THE WOMAN PROFESSIONAL IN INDIA *SAUNDARYA RAJESH*	31
7.	WHAT DRIVES THE PERFORMANCE OF COMMERCIAL BANKS IN ETHIOPIA? *DR. DEEPAK KAPUR & ABEBAW KASSIE GUALU*	38
8.	NEEDS ASSESSMENT OF EMOTIONAL INTELLIGENCE IN BUSINESS EDUCATION *KRISHNA PRIYA & DR. K. S. CHANDRASEKAR*	43
9.	CREDIT MANAGEMENT OF INDIAN COMMERCIAL VEHICLE INDUSTRY *N. VELMATHI & DR. R. GANESAN*	48
10.	EVALUATION OF PASSENGER SATISFACTION AND SERVICE QUALITY IN INDIAN RAILWAYS - A CASE STUDY OF SOUTH CENTRAL RAILWAY USING RAILQUAL *M. DEVI PRASAD & DR. B. RAJA SHEKHAR*	53
11.	A STUDY OF TERTIARY EDUCATION AND SHIFTS IN GLOBALLY MOBILE STUDENTS *DR. Y. V. REDDY & D. M. DESHPANDE*	58
12.	DIMENSION OF FINANCIAL PERFORMANCE OF CEMENT UNITS IN SOUTH INDIA - AN EMPHIRICAL STUDY (Z SCORE ANALYSIS) *DR. R. SRINIVASAN & C. U. TIRIPURA SUNDARI*	64
13.	AN EMPIRICAL ANALYSIS OF FINANCIAL LEVERAGE, EARNINGS AND DIVIDEND: A CASE STUDY OF MARUTI SUZUKI INDIA LTD. *DR. SANJAY J. BHAYANI & DR. BUTALAL AJMERA*	69
14.	SERVICES MARKETING DYNAMICS – AN EXAMINATION OF SPORTS SPONSORSHIP STRATEGIES OF U. K. MARKET *DR. S. P. RATH, DR. BISWAJIT DAS & CHEF. ANANT BHAMKAR*	73
15.	NPA'S SIDE EFFECT AND IT'S CURATIVE MANTRA *DR. B. CHANDRA MOHAN PATNAIK, DR. IPSEETA SATPATHY & AROOP KUMAR MOHAPATRA*	77
16.	THE ROLE OF EMOTIONAL INTELLIGENCE IN SELF DEVELOPMENT OF DOCTORS AN EMPIRICAL STUDY *M. N. R. MANOHAR & A. V. SATYANARAYANA RAO*	81
17.	RISK MINIMIZATION IN SPOT AND DERIVATIVE MARKET *DR. SUBRATA MUKHERJEE & DR. SAMIR GHOSH*	87
18.	IMPORTANCE-PERFORMANCE ANALYSIS (IPA) TO EXPLORE ORGANIZATIONAL CLIMATE – EMPIRICAL EVIDENCE *SUBASHINI R & SAMUEL S*	93
19.	GOA TOURISM: MYTHS AND REALITIES *DR. HIRANMOY ROY*	98
20.	SPIRITUALITY AND MANAGEMENT *V. NITHYANANTHAN & DR. B. KALPANA*	103
21.	ORGANIZATIONAL HEALTH: EXAMINING WORKPLACE PRACTICES AND WELL-BEING *DR. R. PRABHAKARA RAYA & P. SIVAPRAGASAM*	107
22.	EMPLOYEESSIXTH PAY COMMISSION: ESTIMATION OF JOB SATISFACTION AMONG CENTRAL GOVERNMENT *DR. RAJESH KUMAR SHASTRI & MALAVIKA SINHA*	111
23.	PRODUCTIVITY CHANGE IN THE INDIAN HEALTH INSURANCE BUSINESS: A MALMQUIST TOTAL FACTOR PRODUCTIVITY ANALYSIS *DR. SUMNINDER KAUR BAWA & RUCHITA*	115
24.	THE IMPACT OF CAPITAL ADEQUACY REQUIREMENTS ON PROFITABILITY OF PRIVATE BANKS IN INDIA - A CASE STUDY OF J&K, ICICI, HDFC AND YES BANK *DR. KHALID ASHRAF CHISHTY*	122
25.	AN EMPIRICAL STUDY ON EFFECT OF WELFARE MEASURES ON EMPLOYEES' SATISFACTION IN INDIAN RAILWAYS *DR. ASIYA CHAUDHAY & ROOHI IQBAL*	130
	REQUEST FOR FEEDBACK	138

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NPA'S SIDE EFFECT AND IT'S CURATIVE MANTRA

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ABSTRACT
Non-performing assets (NPAs) or bad loans, as they are commonly called, have been menace for the banking sector. Non-performing assets have been detrimental to the performance of the Indian Banks. Their continued amelioration in absolute terms proved the survival of Indian Banks very difficult. The Non-Performing Assets are the bad debts or non-recovered loans of the banks which now stands at Rs.56,668 crores as against the total advances Rs,25,07,885 crores which is 2.26% percent of total advance as on 31st March 2008 (Complied data of Money and Banking ,CMIE, November 2009). In the present study an attempt is made to analyze the various side effects of NPA and its curative mantra. It is observed that the recovery of NPAs improving since 2001-2002 in all the scheduled commercial banks. However, it is suggested that the banks should take care to ensure that they give loans to creditworthy customers as prevention is always is better than cure.

KEYWORDS
NPA, Doubtful assets, Substandard Assets, loss assets and standard assets.

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

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

TABLE 1: OVERVIEW OF NPA CLASSIFICATION IN INDIA

Sub- standard Asset	NPA for a period less than or equal to 12 months.
Doubtful Asset	NPA for a period exceeding 12 months.
Loss Asset	An asset where loss has been identified by the bank or internal or external auditors or by the RBI inspection.
Standard Asset	It does not create any problem while paying interest/ installments of the principal. It usually carries more than normal risk attached to the business.

OBJECTIVE OF THE STUDY
The question of NPAs in banks is a cause of worry to all concerned, may it may be the management of banks, the government, industry federations or the public at large. The study aims at assessing the magnitude of non-performing assets of various Banks. Moreover, NPAs are a serious strain on the profitability as, on the one hand, banks cannot book income on such accounts and, on the other hand, they are required to charge the funding cost and provision requirements to their profits..

The following would be the main objectives of the present research pertaining to Non-Performing Assets in particular.
- To study the factors responsible for growth of NPAs from lenders and borrowers perspective.
- Studying in problem in relation to NPAs.
- To examine the impact of NPAs on profitability and other strategic banking variables
- To give suggestions to overcome the problem of NPAs.

LIMITATION OF THE STUDY
- The period of study is limited to January2011 and February 2011.

- The sample size is limited it may not represent the perception of all the beneficiaries and employees.
- Two different set of attributes considered for the beneficiaries and bank staff considering the response and mind set of the participants.
- As the paper is not specific on any particular segment of NPA so the attributes limited for the purpose of collecting data after initial study for this purpose.

SAMPLING PLAN

In support of the objective of the research there is a primary research questionaire admistration method in the field through stratified random sampling method covering the four districts of Odisha through regional, geographical, economic, cultural, lingual and settlement wise. Total 300 questionaires served and 190 response received from the beneficiaries similarly 120 questionaires served to the bank employees and out of that 65 persons responded. The benficiaries includes the Gramya banks, Co-operative banks and Commercial banks. Same is the case for employees.

Particulars	Questionaire served to benficiaries	Response received	Questionaire served to bank employees	Response received
Cuttack District	75	51	30	18
Puri District	75	43	30	14
Khurda District	75	64	30	20
Balasore District	75	32	30	13
Total	300	190	120	65

REVIEW OF LITERATURE

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

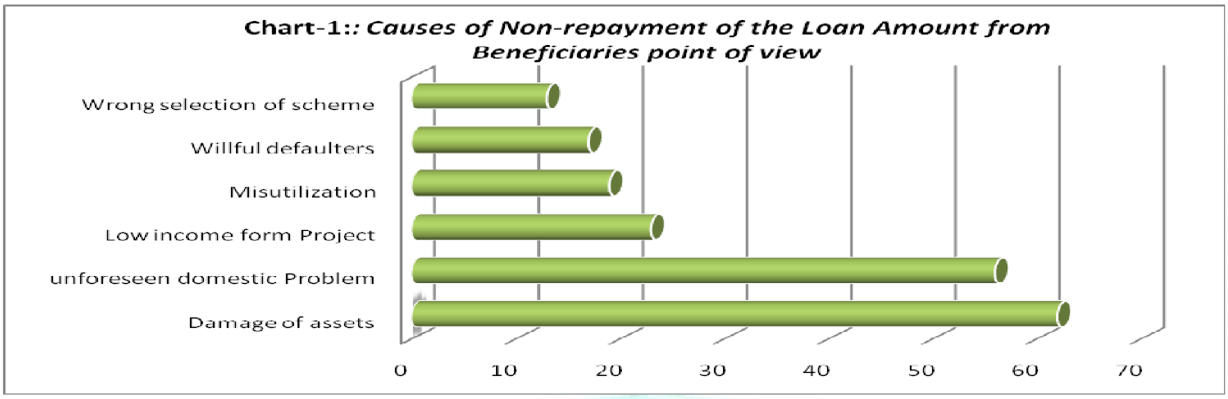
CAUSES OF NON-REPAYMENT FROM THE VIEW POINT OF BENEFICIARIES

To study the problem 256 beneficiaries approached and however only 190 beneficiaries responded and they were interviewed during the field survey over last six months, with a view to ascertaining their perception about reason for defaults. The causes of default are highlighted in Table-2

TABLE 2: CAUSES OF NON-REPAYMENT OF THE LOAN AMOUNT FROM BENEFICIARIES POINT OF VIEW

Sl. No	*Causes*	*No. of Beneficiaries (Respondents)*
1	Damage of assets like disease or death or live stock , crop failure, industrial sickness, effect of natural calamities	62
2	Unforeseen domestic problems like marriage, death, birth ,illness	56
3	Low income generation from the project	23
4	Misutilization	19
5	Willful defaulters	17
6	Wrong selection of scheme	13
	Total	190

Source: Compiled from field survey



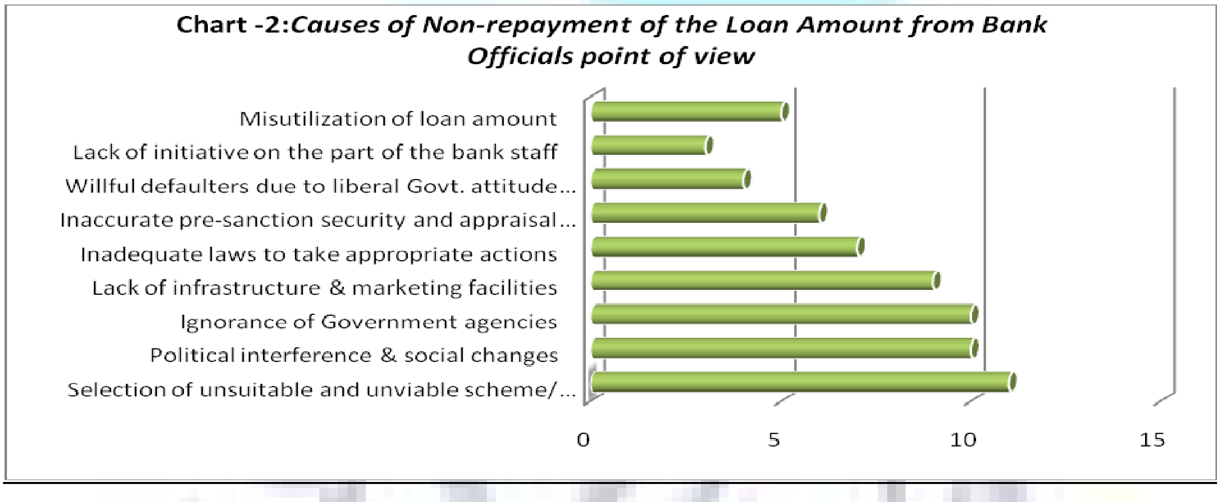
CAUSES OF NON-REPAYMENT FROM THE POINT OF VIEW OF BANK OFFICIALS

To assess the problems the 65 different branch officials were interviewed orally as well as through well designed questionnaires. The main reasons for poor recovery performance expressed by the bankers are presented in Table-3

TABLE 3: CAUSES OF NON-REPAYMENT OF THE LOAN AMOUNT FROM BANK OFFICIALS POINT OF VIEW

Sl. No	*Causes for non-repayment of the loan amount*	*Number of bank officials*
1	Selection of unsuitable and unviable scheme/ project	11
2	Political interference & social changes	10
3	Ignorance of Government agencies	10
4	Lack of infrastructure & marketing facilities	9
5	Inadequate laws to take appropriate actions	7
6	Inaccurate pre-sanction security and appraisal of the loan proposal	6
7	Willful defaulters due to liberal Govt. attitude and expectation of debt relief	4
8	Lack of initiative on the part of the bank staff	3
9	Misutilization of loan amount	5
	Total	65

Source: Compiled from the field survey



NPA'S SIDE EFFECT

Assets that do not earn any income to the bank adversely affect in numerous ways:

- The resources locked up in NPAs are borrowed at a cost and have to earn at least a minimum return to service this cost.
- NPAs, on the one hand, do not earn any income and, on the other hand, drain the profits earned by performing assets through the claim of provisioning requirements and hence return on assets and equity capital is adversely affected.
- Since they do not earn interest, they bring down the yield on advances and the net interest margin or the spread.
- The risk weight on these assets is a hundred percent and capital has to be blocked. These assets do not produce income to sustain the capital blocked by them, which again drains the profits earned on the other performing assets.
- As the income earned on performing assets subsidizes NPAs, the ability of the banks to offer finer spreads to good customers comes down. This in return, makes the best customers choose other cheaper financing options and banks assets portfolio quality deteriorates. This results in future NPAs.
- It also affects the ability of the bank to start other business venture. For example, RBI stipulated minimum NPA percentage for the issue of licenses for insurance business.

CURATIVE MANTRAS

The following curative mantras are made to control the Non Performing Assets in banks.

- General compromise settlement policy for all loan accounts.
- While making pre-lending appraisal, the repaying capability of the borrower must be ascertained by the bank employee carefully.
- In the same way, post-lending supervision and approaching the borrower at the right time for repayment may prove effective in the controlling of NPA.

- In case willful defaulters, the bank must flash their photos and warn them through the local news paper and if there is no response, stern action will have to be taken with the help of the legal authority.
- The legal system must be effective: the Government of India and /or the RBI have initiated many legal measures to recover overdue. However, as there are some flaws in each legal measure, they need improvement made in order to bring down the level of NPA.
- Dynamic people are to be recruited to collect doubtful debts and for better asset liability management.
- Political pressures are to be resisted in the operation of banks.
- Banks must operate in a democratic environment.
- Banks have to adopt professionalism and accountability in their functioning.
- New technologies should be introduced to reduce administrative costs and increase the profit margin.
- Banks must transparent in their functioning and accountable to share holders and public to maintain international standards of corporate governance.
- Sanctioning authority should not succumb to external pressure.

CONCLUDING NOTE

NPAs have always been a big worry for the banks in India. It is just not a problem for the banks; they are bad for the economy too. This paper has analyzed the causes of NPA from borrower's point of view and bank official's point of view and its implications. In this direction concerted efforts are required at Ministry of Finance, RBI and at bank's level to control the maintenance of NPAs. Government should also not use banks as a vehicle to achieve its political objectives by lending to unviable projects, announcing loan melas and loan waiver scheme etc. The banks should not be loaded with twin objectives of profitability and social welfare which are mutually incongruent. This calls for a strong political will only then can banks be able to find satisfactory solution of the problem.

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