

CHAPTER I

INTRODUCTION

1.1 Background of the Study:

The present economic scenario of Nepal has not been so encouraging. Amidst it, Nepalese commercial Banking sector seems to be the only one sector which has been able to sustain well. In spite of the negligible growth in GDP Nepal during recent years, the credit and deposits of bank has lead to simultaneous growth in level of the banks. Today level of bank is the biggest problem for any commercial banks of Nepal.

Overall national development of any country depends upon the economic development of that country and economic development largely depends upon the financial infrastructure of that country. Therefore, the primary goal of any nation including Nepal is rapid economic development to promote the welfare of the people and the nation as well. Nepal being one of the least developed countries has been trying to embark upon the path of economic development by economic growth rate and developing all sectors of economy.

The proper mobilization and utilization of domestic resources is one of the key factors in the economic development of a country. Similarly, integrated and speedy development is only possible when competitive and reliable banking services are reached and operated to every corner of the country. It has been well established that the economic activities of any country can hardly be carried without the assistance and support of financial institutions. Financial institutions have catalytic role in the process of economic development. The investment policy of financial institutions, especially banks has long term impact not only on their growth and sustainability but also on the economic development of the country. Successful formulation and effective implementation of investment policy is the prime requisite for the successful performance of banks and others financial institutions. Good investment policy has a positive impact on economic development of the country and vice-versa.

Sound banking system is the crucial means to accelerate the development of a country by strengthening the economic condition in this globalize economy of the twenty-first century. This requires the well-developed corporate culture, proper management of risk and return and healthy competitive environment that facilitate mobilization of small saving in the commercial and industrial sectors that will enhance the economic and social welfare of a country.

Concisely, Bank is a financial institution, which deals with money by accepting various types of deposits, disbursing loan and rendering various types of financial services. It is the intermediary between the deficit and surplus of the financial resources. Banking when properly organized, aids and facilitates growth on trade and considered not as dealers in money but as the leader of development. Bank are not just the storehouse of the country's wealth but are the reservoirs of resources necessary for economic development. (*Radhaswami and Vasudevan, 1991: 23*).

In Nepal, banking sector started in 1937 A.D with the establishment of Nepal Bank Ltd. Nepal Rastra Bank, the central bank of Nepal, established in 1957 A.D followed by Rastriya Banijya Bank in 1966 A.D. As Nepalese government took liberal economic policy, joint venture banks started to operate since 1984 A.D with the establishment of Nepal Arab Bank Ltd. Since then, twenty six commercial banks with their 752 branches have been operating in the country.

With the growth rate of banking industry from the 1984 A.D., the risk on banking has also made a mark simultaneously. Most of the Nepalese banks have suffered from the credit risk, which is associated with the non-payment of loan by the borrowers. Nepal Bank Limited, Rastriya Banijya Bank are the greatest victim of such risk, leading these banks to have negative net worth.

Present challenges to the banking sector are: to manage the excess liquidity outstanding, to invest the money in productive as well as new sector, to manage the accumulated non-performing loan. The non-performing loan for entire banking industry is Rs 15,747

million in fiscal year 2004/05, which is 3.87% of total loan and advances. Commercial banks collect deposits from individuals and invest them as loan and advance to the borrowers and receive interest as the output of the business. Commercial banks profit and operating cost are borne by these interest collected from the borrowers. When these interests as well as the principal are not collected in due time, the existence of the bank and the deposits of individuals will be in threat. So, necessary action must be taken by the banks and government to overcome this situation. Assets and liabilities are the two major parts of balance sheet of commercial bank. Cash reserves, deposits to other banks, investment in securities, loan and advances and other assets comprise the total assets. Liabilities comprise public deposits, borrowings, other current liabilities and share capital. As this study is focused with the Non-performing Asset (NPA), it is mainly concerned with the assets of bank. Generally, the loan advances occupy more than two third parts of assets of bank in balance-sheet and it is found that they produce more than half of bank revenues. Therefore, in practice loan quality is mostly studied as assets quality. In banking literature, loan is often found synonymously used to assets. According to onsite inspection manual, for Commercial Banks Finance Companies, Volume – two, published by Nepal Rastra Bank, the study of asset quality is mainly concerned with loans quality. So, it should be clear that assets are used to indicate the meaning of loan.

Since this study is mainly concerned with loan, some facts are highlighted regarding loan. The deposits of public create loanable fund. Banks make their profit by issuing loans. But loans also have higher probability of default than other assets. The loans, which are actively working gives well, return to the banks. The default loans cause the loss in return to the bank. For the strength and stability of banking system, the assets/loan should yield positive returns. The assets/loans, which do not yield positive returns, become Non-performing Assets (NPA). In a narrow sense, Non-performing Assets, NPA refer to loan and advances, which do not yield any positive, return or contribute to the profit of banks. In a broader sense, NPA includes the unutilized cash balances, physical assets and the workforce. In this study major concern is with the narrow sense of NPA, which means the loan/assets that do not yield positive return in cash.

It is well known that the loans, which do not yield positive return in cash, are NPA since the loans do not yield positive returns in cash, it has direct effect to lender bank. In this situation bank can not pay the interest to the depositors and dividend to the share holders. If the interest income which has to maintain the operational expenses including depositor's interest and share holders' expectations could not be regularized, it may have great financial effect to the bank. On one hand the outstanding interest is not allowed to show as income and on the other hand loan and advances become non-performing, which creates the situation of additional expenses to profit and loss account of bank. As a result there may be significant effect in the financial position of the bank" (Adhikary, 2062:167)

Nepal is an undeveloped country having very low per capita income and corporate growth rate. The traditional concept of business and commerce is deep rooted in the people and most of them are unaware of modern form of commerce. Majority of population live below the poverty line. The agro-dominated economy is further worsened by the complex geographical situation. Various factors like land locked ness, poor resource mobilization, lack of entrepreneurship, lack of institutional commitment, erratic government policies, political instability, Maoists problem etc. are responsible for the slow pace of development in Nepal.

But after the restoration of democracy in 1990 and universal echo of economic liberalization, Nepal has implemented liberal economic policy. As a result, many more companies are established in different sectors such as industrial, tourism, transportation, trade and mostly in the financial sector whose contribution in economy has great significance.

In Nepal, the industrial revolution took after the establishment of Biratnagar Jute Mill in 1993 B.S. (1936 A.D.) and in 1994 B.S. (1937 A.D.) Nepal Bank Limited was established (Shakespeare vaidya 1999:67). Nepal Rastra Bank was established in 2013 B.S. (1956 A.D.), which has helped to make banking system more systematic and dynamic during that time. In 2022 B.S.(1965 A.D.) Rastriya Banijya Bank was

established which is fully government owned bank. His Majesty's Government with the view of accelerate the pace of economic development under the structural adjustment program undertook a significant step towards financial liberalization in the year 2043/44 B.S. (1986/87 A.D.) The liberalization policy of the government of Nepal has encouraged the private sector to invest in various fields, which support the domestic overall economic growth. The government of Nepal introduced financial sector reforms in 1980s, which encouraged the healthy competition in the financial sector as well as allowed the entry of foreign banks in the Nepalese market in the forms of joint ventures banks.

1.1.1 Introduction of Sample Banks

Nepal SBI Bank Limited

Nepal SBI Bank Ltd. (NSBL) is the first Nepal- Indo joint venture bank in the country. It is sponsored by three institutional promoters. They are State Bank of India, Karmachari Sanchaya Kosh (Employees Provident Fund) and Agricultural Development bank of Nepal (ADB/N). Nepal SBI Bank Limited became operational on the 8th July 1993.

The bank was registered on 2050/ 01/16 (28.04.1993) in the Department of Industry, Nepal Government (NG) under the Company Act 2021 and Commercial Bank Act 2031. The formal inauguration of Nepal SBI Bank Limited took place on 7th July 1993. It commenced its operations on 2050/03/24 (8th July, 1993). The equity composition of the Bank is as follows:

1. State Bank of India – 50%
2. Employee Provident Fund -15%
3. Agricultural Development Bank-5%
4. General Public-30%

The services provided by Nepal SBI Bank Limited include deposits, remittances, various types of loan facilities, letter of credit, bank guarantees, retail financing (house loans, vehicle loans and education loan), ATM facility, 365 days banking etc. (<http://www.nsbl.com.np>)

Nepal Investment Bank Limited (NIBL)

Nepal Investment Bank Limited (NIBL), previously Nepal Indosuez Bank Limited, was established on 21st January 1986 as a second commercial joint venture bank with an agreement between Nepalese and French partners under the company act 1964. Initially Banque Indosuez Pares managed the bank in accordance with joint venture and technical services. With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen of Nepal, has acquired on 25th April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Limited. The name of the bank has been changed to Nepal Investment Bank Limited (NIBL) upon approval of bank's 15th Annual General Meeting, Nepal Rastra Bank and Company Registrar's office on 31st May 2002. The present shareholding pattern of NIBL is as follows:

A Group of Companies	50%
Rastriya Banijya Bank	15%
Rastriya Beema Sansthan	15%
General Public	20%
Authorized Capital	Rs.590,000,000.00
Issued Capital	Rs.295,293,000.00
Paid-Up Capital	Rs.295,293,000.00

Everest Bank Ltd. (EBL)

Everest Bank Ltd. was registered under the company act 1964 in 19th November 1993 (2049/09/03), and commercial banking transaction in 16th October 1994 (2051/07/01), the promoter of the bank decided to join hands with an Indian bank and entered into joint venture agreement in January 1997 AD with Punjab National Bank (PNB), which is one of the leading commercial bank of India, having over 100 years of successful banking experience and known for its strong system and procedure. A team of professionals are deputed by PNB under this arrangement. Now the bank has a several branches including main branch in Nepal.

On equity holding PNB has 20% equity participation in its total shareholding and also has undertaken management responsibility under a technical service agreement and other balance is maintained by the Nepali investor. Nepalese promoter holds 50% and rest 30% is held by General public.

- The main purpose of EBL is to extend professional banking services to various sectors of the society in the Kingdom of Nepal and thereby contributing in the economic development of the country.

The ownership of EBL is composed as;

Subscription	Holding %
Promoter Share Holders	50%
General Public	30%
Punjab National Banks	20%
Total	100s%

Everest Bank Ltd. is moving towards to the consumer finance and providing different types of loans like; Housing Loan, Home Equity Loan, Education Loan, Professional Loan, and Vehicle Loan etc. The authorized capital of the bank was Rs.240 million, issued capital Rs.120 millions and paid-up capital Rs.117.5645 millions in the beginning of 2051/52. The present capital structure of the EBL is shown below;

Share Structure	Amount (Rs.)
Authorized Capital	75,00,00,000
Issued Capital	46,68,00,000
Paid-up Capital	45,50,00,000

Source:- Annual Report of EBL

1.2 Statement of Problem:

Non performing assets concept has appeared as a major research gap in Nepalese commercial banking sector. There is lack of such scientific and empirical research that could identify the issues of Non performing assets in Nepalese commercial banks. In this regard, the performance of Nepalese commercial banks is to be analyzed in terms of their Non performing assets. The main features of commercial bank are mobilizing the deposit and lending them to different needy sectors. Lending or loan advances are the major source of income to commercial banks. Without loan and advances, banks neither maintain its operational expenses nor can give good interest to depositors and dividend to shareholders. Generally loan and advances of commercial banks occupy more than 40% of total assets. So it is necessary to manage the good portfolio of loan and advances in banks. In the economy of development countries, loan and advances are the major functions of commercial banks and the interest earning from them is the main source of income.

Nepalese commercial banking industry is still under the developing condition. They have to follow all the rules and regulations or the directives issued by the Rastra Bank of Nepal, the central bank of the country. The core banking business is mobilizing the deposits and utilizing it for lending to industry. Lending business is generally encouraged because it has the effect of funds being transferred from the system to productive purposes, which results into economic growth. However, lending also carries credit risk, which arises from the failure of borrowers to fulfill its contractual obligation during the course of transaction. It is well known that the bank and financial institutions in Nepal face the problem of swelling non-performing assets and the issue is becoming more and more unmanageable. The total NPA in the banking system is 14.2 percent of total loan in year 2063 B.S. (2006A.D.) while it was 18.7 percent of total loan in year 2062 B.S. (2005A.D.) While it is even worse in case of two largest commercial banks: Rastriya Banijya Bank and the Nepal Bank Limited are 45.3 and 25.1 percent respectively in the year 2063.

The following are the research question of this study:

- What is the overall impact of the NPA on the profitability of the commercial banks under the study?

- Are there any interest factors of the individual commercial banks in increment of the non-performing assets of them?
- Is there any relationship between NPA and the profitability of the commercial banks and the other non-banking assets, [NBA]
- What might be the other factors that influence the non-performing assets of the commercial banks in the banking industry of Nepal?

1.3 Objectives of the Study:

The main objective of the study is to evaluate the non performing assets of Nepal Investment Bank Ltd., Everest Bank Ltd. and Nepal SBI Bank Ltd. In order to achieve the basic objective, the following other objectives are

- To analyze the non-performing assets to total loan of the banks under study.
- To examine whether the Nepalese commercial banks are following the NRB directives regarding non performing assets or not.
- To study correlation between NPA and ROA, NPA and Total Lending of all the banks under study.
- To study and evaluate the relationship between the profitability and the non-performing assets of selected commercial banks.
- To study the proportion of NPAs to total assets, total deposits and total lending of all the banks under study.
- To provide recommendations to overcome the difficulties in managing NPA of the banks with high level of NPA.

1.4 Significance of the Study:

This study "Comparative Analysis of non performing assets" of three major commercial bank will provide a useful feedback to academic institutions, bank employees, trainees, investors, policy making bodies and those concerned with banks in the formulation of appropriate strategies for improving the performance of banks.

Research itself is very important because it aims to gain knowledge and to add the new literate in existing field. Thus, the research has its own imperative. Mainly, the study is

important for the researcher to fulfill the academic requirement of master degree. On the other, the study is important for commercial banks, researchers, scholars, investors, government and many other parties. At last, it is expected that the study will add a drop of literate in the field of commercial banks and their non performing assets.

This study mainly concerned with the analysis of the NPA to total assets, total deposits and total lending of Nepalese commercial banks. Therefore it is significant to find out the level of NPAs. It is also significant to find out whether Nepalese commercial banks have maintained loan loss provision according to NRB directives or not. Lastly it also provides literature to the scholars and new researchers who want to do further researcher in this field.

1.5 Limitation of the Study:

The studies being the partial fulfillment of master degree in business studies has some limitations of its own kind. They are:

- The study, lack of the sufficient time, resources are the major limitations. The study has been conducted to meet partial fulfillment of the requirement for the “Master of Business study of Faculty of management, T.U.
- The study mainly based on secondary data collected from different sources.
- The study mainly concentrates only on the investment policy of Nepal Investment Bank, Everest Bank and SBI Bank.
- The study has been mainly carried out based on the published financial documents such as balance sheets, Profit and loss accounts, related journals, magazines and brochures. These published documents have their own limitations.
- The study period will be covered by only five fiscal year i.e. from 2005/2006-2009/10.
- The study deals with only two commercial banks and data related to other

1.6 Organization of the Study:

This study has been organized into five chapters as prescribed by the University.

Chapter One: Introduction

Chapter Two: Review of Literature

Chapter Three: Research Methodology

Chapter Four: Presentation and Analysis of Data

Chapter Five: Summary, Conclusion and Recommendations

Chapter One contains general background of the study, statement of the research problem, objectives and scope of the study and limitation of the study. This chapter signifies the rational of this study.

Chapter Two deals with the review of literature. It includes a discussion on the conceptual framework i.e. non performing assets concept and its theories and review of major empirical work relating to the capital structure.

Chapter Three deals with research methodology. It consists of methodology adopted to achieve the objective i.e. research questions the models, specification of variables, sample selection, data collection and limitation of the study.

Chapter Four consists of presentation and analysis of data with different financial tools. An analysis of survey of the respondents' opinion on various aspects of capital structure management has been also presented.

Chapter Five consists of the summary, conclusion and recommendation findings of this study and recommendation for further research.

CHAPTER II

REVIEW OF THE LITERATURE

“Review of literature means reviewing research studies of other relevant proposition in the related area of the study so that all part studies, their conclusions and deficiencies may be know and further research can be concluded.”(Pantta & Wolf, 1999:234). This chapter deals with the literature, relevant to this study, this part of thesis will essential to know about the finding of other research which are appropriate to the study. The first part will consist conceptual framework and the remaining parts will consist the review of reports, articles, journals and dissertation.

2.1 Conceptual framework

2.1.1 Evolution of banking system in Nepal

There are several types of banks but among them commercial banks play significant contribution in the financial system of the country. They pool together the savings of the community and arrange for their productive use. They supply the financial needs of modern business by various means. They accept deposits from public on condition that they are repaid on demand or on short notice. Their business is confined to financing the short-term and medium term needs of trade and industry such as working capital financing.

Commercial Bank Act, 2031 B.S. (1974A.D.) of Nepal has defined the commercial banks as an organization, which exchanges money, accepts, grants loans and performs commercial banking functions and which is not a bank meant for co-operative, agriculture, industries or for such specific purpose. (Bank and Financial Institution Ordinance 2005)

It is the fact that financial sector plays a vital role for the economic development of a country. Even before the establishment of a banking system in Nepal, financial transactions were in practice as undertaken by some moneylenders like sahu-mahajans, zamindars, relatives, friends, and few informal organizations limited to ethnic group such

as guthi. The borrowing from the other and the informal organization was limited and based on personal understanding. At that time people deposit their gold, silver and valuable goods for the sake of security. Thus, the private moneylenders can be taken as forerunner of the concept of financial institution.

However, the private money lenders supported the economic development of a country, the transactions undertaken by them was totally based on their personal understanding. No legal restriction was against them and their monopolies in transactions were the reasons for covering the interest in personal understandings and exploiting the people. Thus, it was then realized the need to establish financial intermediaries in supporting the economic development of a country.

Nepal has been ruled over by many rulers like Kirati, Lichchhavi, Malla, Ranas, and Shahs. Mostly Kirati, Lichchhavi and Malla regimes, who were concerned with the construction of temples, pati-pouwa, chautaris, etc. At that period neither the people nor the government needed to think about the economic development of the country. According to ancient "Vanshawali" in fourteenth century, the ruler of the Kathmandu Jayasthiti Malla segregated the local domiciles into 64 different classes according to profession they had undertaken. Tankadhari was one of those classes who used to deal in coins and precious metals such as gold. These Tankadhari's were said to have carried out the borrowing and lending of money (coins). Hence, Tankadharis can be regarded as the traditional bankers of Nepal.

After long time, during the Rana regime, only handfuls prime minister thought about the economic development of the country. They established some offices in 1993 B.S. (1936 A.D.) 'Tejarath Adda' was established during the tenure of Prime Minister Ranoddip Singh Rana as a first institutionized credit house. Tejarath Adda provided loans under the security of gold and silver to the government employees and public. The government established its various branches and sub-branches at different places of the country for the sake of benefits of people. In the overall development of the banking system in Nepal, the Tejarath Adda may be regarded as the father of modern banking

institution and for a quite long time it rendered a good service to the government employees as well as to the general public. The government also implemented the rules against the vast interest rate taken by moneylenders. Thus, the government financial institution occupies an important role in the banking history of Nepal.

No financial institutions were established over a long period due to political reasons. To fulfill the growing need of economy in Nepal, banking activities were performed only after the establishment of Nepal Bank Limited in 1994 B.S. (1937A.D.) as the first commercial bank in Nepal. This bank was established under the Nepal Bank Act 1994 B.S. (1937A.D.).

At beginning, 49% of the ownership belongs to the promoters as well as general public and remaining belongs to government. The incorporation of Nepal Bank Ltd. is the real starting of the banking institution in Nepal? The bank started the act of consolidating the scattered capital since its establishment in order to mobilize it in productive sector. It developed systematic tradition in culture of modern banking system in Nepal. Such system could be able to establish a strong base for the enlistment of national economy. Beside, it also acted as central bank for more than three decades.

Nepal Rastra Bank was established in Baisakh 14, 2013 B.S. (26 April 1956 A.D.) under Nepal Rastra Bank Act, 2012 B.S. (1955 A.D.), the central bank of Nepal. It is totally owned by government. NRB is heavily assisting for the development of the whole economy. It is giving timely directives to all financial institutions operating and conducting in all over the country.

After a long period, the second commercial bank namely Rastriya Banijya Bank (RBB) has been established in 2022 B.S. (1965A.D.) with cent percent government ownership. This bank has been established under the Rastriya Banijya Bank Act 2021 B.S. (1964 A.D.) Both Nepal Bank Limited. (NBL) and Rastriya Banijya Bank (RBB) have made a remarkable contribution by providing reliable banking services to the Nepalese people. Its contribution is well noted in terms of capital formation to the small dispersed saving

into meaningful capital investment in order to flourish industry, agriculture, and commercial sector in the country.

The government introduced Commercial Bank Act in Nepal in 2033 B.S. (1976A.D.) to cover the vast field of financial sector. This act has helped to emerge number of commercial bank with a view to maintain economic interest in comfort of the public in general facilitated to provide loan for agriculture, industry, trade and make a available banking services to the country and people.

Among vacuum in the banking sector got some rays of hope only when the government forwarded the economic liberalization policy in 2039 B.S. (1982 A.D.) And decided to allow foreign banks to operate their activities in Nepal in “joint venture model”. Joint Venture Banks can be defined as an association of two or more parties having common objectives and goals so as to get maximum satisfaction. Basically at that time, it was envisioned that joint venture banks (JVBs) would support the country in various ways.

In Nepalese context the main purpose of joint venture is top develop economic forces in order to achieve distinguished result, which the partners separately could not achieve. Nowadays, joint venture banks (JVBs) are playing dynamic and vital role in economic development of the country.

The Nabil Bank Ltd. Is the first joint venture bank established in 2041 B.S. (1984 A.D.) and started its operation with modern banking services. In the same way, Nepal Indosuez Bank (currently Nepal Investment Bank), the second joint venture bank established in 2042 B.S. (1985 A.D.) with an objective to encourage efficient banking services and facilities. Likewise Standard Chartered Bank is operated in 2044 B.S. (1987 A.D.).

With the satisfactory result of joint venture banks, Nepalese promoters are highly encouraged and as a result, commercial banks are introduced with cent percent domestic investment. At present, Nepal Industrial and Commercial Bank (NIC), Nepal Investment Bank Limited, Machhapuchhre Bank Ltd., Bank of Kathmandu, Nepal Credit and

Commerce Bank Ltd., Laxmi Bank Ltd., Siddhartha Bank Ltd., Kumari Bank Ltd. came into operation with cent percent domestic investment by Nepalese promoters which are the plus point of development of banking sector of Nepal. Now, there is a strong competition between commercial bank for the existence so that the growing needs of the customers can easily achieve.

2.1.2 Concepts of Commercial Banks

Commercial Banks are those banks, which perform all kinds of banking function as accepting deposits, advancing credits, credits creation and agency functions etc. They are the most widely diversified and visible player among the financial institutions. They provide short-term credit, medium-term credits and long-term credit for trade and industry. They also operate off-balance sheet functions such as issuing guarantee, bonds, letter of credit, etc.

Commercial banks have been playing vital role in giving a direction to economy development over time by financing the requirements of trade and industry in the country. By encouraging thrift among people, banks have fostered the process of capital formation in the country. Commercial banks draw the community savings into the organized sector which can then be allocated among the different economic activities according to the priorities laid down by planning authorities in the country. In the planned economy, banks make the entire planned productive process possible by providing funds for all types of production incorporated in the plan, regardless of whether the production is in the public sector, joint sector, or in the private sector, or whether the production is undertaken by one types of organization or another. In short, the growth of the economy is tied with the growth of the commercial banks in the economy. Commercial banks make sound investment in various sectors of the economy, which boost the quality and quantity of investment as well as achieves, its own objectives of profit maximization. Thus, well-formulated and sound investment policies, coordinated and planned efforts accelerate the pace of economic growth.

2.1.3 Meaning and origin of bank

In general a bank is referred to as an institution that deals with money, currency and bullion. It collects the deposits in the form of currency and gold from the savers and supplies to the people in demand of money with different terms and conditions as to the interest and repayment. Hence it pays interest to the depositors as consideration to the money received and charges different levies in the form of processing fees, commissions, interests etc., from the people who have taken loan from it. At the same time it in the request of its customers, discounts the bills, gives guarantee, issues letter of credit, investing in different securities, underwriting of securities etc. The word BANK has been derived from Italian word, “Banco” which in Italian means a BENCH. Since the people who dealt in money used to do their work whilst sat on bench the trade that they were carrying was called as ‘Banco’, which in the due course got modified into BANK.

Now a day the function of banks are changing which has induced their principle competitors to change. The principle competitors such as other financial institutions including security dealers, brokerage firms and insurance companies are trying to be similar to bank in the services they offer.

Sayers defined the bank as, “Ordinary banking business consists of changing cash for deposits and bank deposits for cash, transferring bank deposits from one person or corporation to another, giving bank deposits in exchange for bills of exchange, government bonds, the secured of unsecured promises of businessmen to repay etc.”

Walter Leaf defined the bank as, “A bank is that institution or individual who is always ready to service money on deposits to be returned against the cheque of their depositors.”

And Horace White puts bank in his words as, “Bank is a manufacturer of credit and machine for facilitating exchanges.”

G. Crowther says, “A banker is a dealer in debt in his own and other people’s. The bankers business in then to take the debt of other people to offer his own in exchange and thereby to credit money.”

Dr. H. L. Hart exclaims, “A banker is one who, in the ordinary course of his business, receives money which he repays by honoring cheques of persons from whom or on who account he receives it.”

The first renowned bank was called the “Bank of Venice”, set up in Venice, Italy in the year 1157 A.D. The Bank of Barcelona and the Bank of Genoa were established in the year 1401 A.D. and 1407 A.D. respectively. In England the banking embarked on with English Goldsmith only after 1640 A.D. The Bank of Amsterdam was the grandest bank during the 17th Century.

2.1.4 Function of Commercial Banks

Banks can be defined according to the functions they perform. A bank is established with the prime objective of profit maximization. To achieve this, the bank carries out functional activities, “Principally, commercial banks accepts deposits, provide loan, primarily to business firms thereby facilitating the transfer of funds in the economy”. Although, in the yester years banks were viewed as acceptor of deposits then provider of loan, but modern commercial banks have to perform overall development of trade, commerce, industry, agriculture including supports for priority and deprived sectors. The growing bank needs and habits of people and competitive environment has made the banking sector challenging and their operation cannot be underemphasized in present context of market globalization. Hence, a bank is a commercial institution licensed as a taker of deposits, concerned mainly with the making and receiving payments on behalf of their customers, accepting deposits, creating money and making short-term loans to private individuals, companies and other organization.

Although profit maximization is a major objective of commercial bank, to achieve this objective commercial bank performs various functions under the mandatory rules and regulations and directives of NRB and the Commercial Bank Act 2031 B.S. (1974 A.D.).

Primary Functions

Accepting Deposits:

Accepting a deposit is the most important function of commercial banks. Commercial banks collect money from those who want to deposit in different types of accounts such as:

- Fixed Deposit Account

- Current Deposit Account
- Saving Account

Advancing of Loans:

Commercial banks provide the loans required or credit to various sectors of economy such as industry, trade, agriculture, business-deprived sector etc. In this way bank creates credit facilities. It provides loans from various procedures in different form such as:

- Overdraft
- Cash Credit
- Direct loan with collateral
- Discounting of bills of exchange
- Loans of money at call and short notice

General Utility Functions:

Commercial banks also perform general utility functions such as:

- Issuing of letter of credit to its customers.
- Issuing of bank drafts and traveler's cheque etc., for transfer of funds from one place to another.
- Dealing in foreign exchange and financing foreign trade by accepting or collecting foreign bills of exchange.
- Serving as referred to the financial standing and credit worthiness of its customers.
- Underwriting loans to be raised by public bodies and corporations.
- Providing safety vaults of lockers for the safe custody of valuables and securities of the customers.
- Acting as a trustee and executing the will of the deceased.
- Remittance of money

Agency Function:

Apart from the above functions, commercial banks also perform agency functions for which they act as agent and claim commission on some facilities such as:

- Collection of customer's money from other banks.
- Receipt and payment of dividend, interest.
- Security brokerage service.
- Financial advisory service.
- To underwrite the government and private securities.

2.1.4 Some Important Terms:

2.1.4.1 Definition of loan and advances

Loan is defined as a thing that is lent esp. a sum of money. Likewise, debt means a sum of money owed to somebody. However, in financial terms loan or debt means principal or interest available to the borrower against the security. Debt means the money that bank owes or will lend to individual or person.

Likewise, the term loan is defined as a lending. Delivery by one party to and receipt by another party of sum of money upon agreement expressed to implied, to repay it with or without interest. Any thing furnished for temporary use to a person at his request on condition that it shall be returned, or it's equivalent in kind, with or without compensation for its use. Loan includes:

- The creation of debt by lender's payment of or agreement to pay money to the debtor or to a third party for the account of the debtor.
- The creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately.
- The creation of debt pursuant to a lender credit card or similar arrangement.
- The forbearance of debt arising from a loan.(Koirala, 2006: 35 - 36)

Further, debt means 'Principal and interest provided to debtor by banks or financial institutions, with or without the pledge of immovable or moveable property of other securities of guarantees or without guarantee, and the word also mean over dues of the transactions beyond balance or fees, commission and interest incurred in that relation (Debt recovery act for Bank and Financial Institutions).

The supreme court of India has defined the debt during the decision of the case of United Bank of India vs. DRT. Sudhir Gupta states that “In the case in hand, there cannot be any dispute that the expression ‘debt’ has to be given the widest amplitude to mean any liability which is alleged as dues from any person by a bank during the course of any business activities undertaken by the bank either in cash or otherwise, whether secured or unsecured, whether payable under a decree or other of any court or otherwise and legally recoverable on the date of the application.

2.1.4.2 Concepts of Non Performing Assets:

One of the most emerging problems of the commercial banks is to the management of non-performing assets/loan. Due to the effects of non-performing assets/loan, many banks have already closed down. In this fast pace competitive age, the banks should have to operate taking in consideration that thing. Those loans, which don't repay principle and interest on time to the banks, are known as non-performing assets (NPAS). If any advances or credit facilities granted by bank to a borrower becomes non-performing. Then the bank will have to treat all the advance/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may be still exist certain advance/credit facilities having performing status

NPAs have a different meaning that varies from country to country. In some countries, it means that the loan is impaired. In some countries, it means that the payment are due but there are significant different among countries how many days a payment should be in arrears before past due status is triggered. According to current banking Act, the banks have to make provision for bad and doubtful debts. After deducting the bad and doubtful debts from the non-performing assets, net non-performing assets can be achieved.

According to current Banking Act, the banks have to make provision for bad and doubtful debts. After deducting the bad and doubtful debts from the non-performing assets, net non performing assets can be achieved.

$$\text{NPA} = (\text{NPL} + \text{NBA} + \text{RNPL} + \text{SI} + \text{UA})$$

Where;

NPA = Non Performing Assets

NPL = Non Performing Loan

NBA = Non Banking Assets

RNPL = Remaining Non Performing Loan

SI = Suspend Interest

UA = Unutilized Assets

Non-Performing Loan (NPL) can be defined as the non-productive assets of the banks. In other words, it is the loan or bad and doubtful debts that doesn't repay timely. Generally the loan, which doesn't repay within three months, is known as non-performing loan. The loan amount that doesn't covered by the collateral after selling is known as non-banking assets (NBA). Non Performing Assets also includes the suspend interest. It is the interest, which become receivable unutilized assets and those investments which don't generate any cash or incomes to the bank are also non-performing assets (NPAS). The proper management of those assets to generate income is known as management of non-performing assets.

Increasing NPAs is the emerging problem of the banks. We know that the some banks are closed down due to the uncontrollable NPAs. In USA, 1016 commercial banks were declared as unsuccessful (bankruptcy) from 1985 to 1990 and 27 banks from 1995 to 2001. However, Nepalese banks face this type of problem till now but they have to take step towards it. For this, appropriate amount of bad and doubtful debts is made provision from their incomes/profits.

2.1.5 Classification of NPA:

As per the NRB directives NPA are said as classified loans. And this includes sub-standard, doubtful and loss categories as defined by new NRB directives. The circular further says a NPA is a credit facility in respect of which interest has remained unpaid for two quarters.

According to the circulars, the loans are classified based on weakness and dependence on collateral securities into four categories and prescribed the provisioning rate as follows:

Table No. 2.1
Classification of Loan and Advances

Classifications of loan and advances	Criteria for Provisioning	Provision Rate
Pass	Not past due and past due for a period up to 3 months. [Performing loans]	1%
Substandard	Past due for a period of 3 months to 6 months	25%
Doubtful	Past due for a period of 6 month to 1 years	50%
Loss	Past due for a period of more than 1 years or advances which have least possibility of recovery.	100%

Source: Nepal Rastra Bank, Directives for commercial banks.

2.1.6 Effects of NPA on Profitability of Banks:

Under the circumstances assets that do not earn any income to the bank affect the profits in a number of ways, which are explained as follows (Koirala, 2006:38 – 40):

Profitability Impact:

- The resources locked up in NPA are borrowed at a cost and have to earn a minimum returns to service this cost.
- NPA on the one hand do not earn any income but on the other hand drain the profits earned by performing assets through the claim on provisioning requirements.
- Since they do not earn interest they bring down the yield on advances and the net interest margin or spread.
- NPA have a direct impact on assets and returns on equity, the two main parameters for measuring profitability of the commercial banks.
- Return on assets will be affected because while the total assets include the NPA they do not contribute to profits which are the numerators in the ratio.
- Return on equity is also affected as provisioning eats more and more into profits earned.

- The cost of maintaining these include administration costs, legal costs and cost of procuring the resources locked in them.
- NPA bring down the profits, affects the shareholders value and thus, adversely affect the investor confidence.

As a whole, the impact of NPA can be assessed with the following:

- Lower ROE and ROA
- Lower image and rating of banks
- Disclosure reduces investor's confidences.
- Increases costs/difficulties in raising capital.
- NPA do not generate income.
- They require provisioning.
- Borrowing cost of resources locked in
- Opportunity loss due to non-recycling of funds.
- 100% risk weight on net NPA for CRR.
- Capital gets blocked in NPA.
- Utilizes capital but does not generate income to sustain the capital that is locked.
- Recapitalization by government comes with string.
- Administration and recovery costs of NPA.
- Effects in employee morale and decision.

2.1.7 Causes and Measures of NPA:

[Country-wise Analysis]

(Source: Reddy, Prashant K ' A comparative study of NPA in india in the global context, a report page 4-8)

China

Causes

- I. Moral Hazard: The SOE's believe that there the government will bail them out in case of trouble and so they contribute to take high risks and have not really strived to achieve profitability and to improve operational efficiency.

- II. Bankruptcy laws favors borrowers and law courts are not reliable enforcement vehicles.
- III. Political and social implications of restructuring bi SOE's force the government to keep them afloat.
- IV. Banks are reluctant to lend to the private enterprises due to
 - a. Non- standard accounting practices.
 - b. While an NPA of an SOE is financially undesirable, an NPA of a private enterprise is both financially and politically undesirable.

Measures

- I. Reducing risk by strengthening banks, raising disclosure standards and spearheading reforms of the SOE's by reducing their level of debt.
- II. Laws were passed allowing the creation of asset management companies, foreign equity participation in securitization and asset-backed securitization.
- III. The government, which bore the financial loss of debt 'discounting'. Debt/equity swaps were allowed in case a growth opportunity existed.
- IV. Incentives like tax breaks, exemption from administration fees and clear-cut asset evaluation norms were implemented.

Thailand

Causes

- I. Liberalized capital and current account and external borrowings with inaccurate assessment of exchange rate risk and risk of capital flight in a crisis.
- II. A legal system that made credit recovery time consuming and difficult.
- III. Real estate speculators took massive loans projecting high growth in demand and prices of properties. When this did not materialize all the loans went bad.
- IV. Steep interest rate rise turned a lot of loans into NPAs
- V. Inability to correctly assess credit risk.

Measures:

- I. Amendments were made to the Bankruptcy Act.
- II. Corporate Debt Restructuring Plan (1998) focused on capital support facilities for bank recapitalization and setting up of AMC's.

- III. New rules governing NPA exit procedures based on international standards were introduced.
- IV. Privatization of government entities was mooted, but faced strong political oppositions for fear of a social backlash.
- V. Adoption of international standards for loan classification and provisioning.
- VI. Caps on Foreign equity ownership in financial institutions were removed.

Korea

Causes

- I. Directed Credit: Protracted periods of interest rate control and selective credit allocations gave rise to an inefficient distribution of funds. The Chaebols' focus on increasing market share and pursuing diversification with little attention to profitability caused tremendous stress on the economy.
- II. The "compressed growth" policy via aggressive, leveraged expansion worked well as long as the economy was growing and the ROI exceeded the cost of capital. This strategy backfired when slowing demand and rising input costs placed severe stress on their profitability.
- III. Lack of Monitoring-Banks relied on collaterals and guaranteed in the allocation of credit, and little attention was paid to earnings performance and cash flows.
- IV. Contagion effect from South East Asia coincided with a period of structural adjustments as well as a cyclical downturn in Korea.

Measures

- I. Speed of action:- the speedy containment of systemic risk and the domestic credit crunch problem with the injection of large public funds for bank recapitalization were critical steps towards normalizing the financial system.
- II. Corporate Restructuring Vehicles (CRVs) and debt/equity swaps were used to facilitate the resolution of bad loans.
- III. Creation of the Korea Asset Management Corporation (KAMCO) and a NPA fund to fund to finance the purchase of NPA's.

- IV. Securitization KAMCO's recoveries came through asset-backed securitization and outright sales. International investors like the Lone Star Fund participated in the process.
- V. Strengthening of Provision norms and loan classification standards based on forward-looking criteria (like future cash flow) were implemented.
- VI. The objective of the central bank was solely defined as maintaining price stability. The Financial Supervisory Commission (FSC) was created (1998) to ensure an effective supervisory system in line with universal banking practices.

Japan

Causes:

- I. Investments were made Real Estate at high prices during the boom. The recession caused prices to crash and turned a lot of these loans bad.
- II. Legal mechanisms to dispose bad loans were time consuming and expensive and NPA's remained on the balance sheet.
- III. Expansionary fiscal policy measures administered to stimulate the economy supported industrial sectors like construction and real estate, which may have further exacerbated the problem.
- IV. Crony capitalism to the Keiretsus.
- V. Weak corporate governance coupled with a non-bankruptcy doctrine was a moral hazard in Japanese economy.
- VI. Inadequate accounting systems and information flow makes assessment of loan performance outside a bank in Japan difficult.

Measures:

- I. Amendment of foreign exchange control law (1997) and the threat of suspension of banking business in case of failure to satisfy the capital adequacy ratio prescribed. Legislation to improve information flow has been passed.
- II. Accounting standards: - Major business groups established a private standard setting vehicle for Japanese accounting standards (2001) in line with international standards.

III. Government Supports: - The government's committee public funds to deal with banking sector weakness.

2.2 Review of Related Studies

2.2.1 Review of Related Articles /Journals

Shrestha, (2056) director of NRB in his article titled 'Modus Operandi of Risk Appraisal in Bank Lending' has tried to highlight different aspects of credit risk management. As per his view, as the effective risk management is central to good banking, the tradeoff between risk and return is one of the prime concern of any investment decision whether long – term or short term. He concludes, "Effective credit risk management allows a bank to reduce risks and potential NPAs. It also offers other benefits. Once a bank understands their risks and their costs, they will be determining their most profitable business, thus price products according the risk. Therefore, the bank must have an explicit credit risk strategy and support by organizational changes, risk management technique and fresh credit process and systems. There are five crucial areas that management should focus on.

- Credit sanctioning and monitoring process
 - Approach to collateral.
 - Credit risk arises from new business opportunities
 - Credit exposures relative to capital or total advances
- Concentration on correlated risk factors.

Apart from these, the bank management should regularly review all assets quality issues including portfolio composition, big borrower exposures and development in credit management policy and process." Improving risk management will not be easy or quick. However, Nepalese banker loves little choice. Hope fully, the bank adopt good risk management practices and will be able to reap both Strategic and optional benefit.

Chhetri, (2057) stated in his article titled "Non- Performing Assets: A Need for Rationalization" that to provide connation of the NPA and its potential sources,

implication of NPA in financial sector in the South East Asian Region. He has also given possible measure to contain NPA. "Loan and Advances of financial institution are meant to be serviced either part of principle or the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan settlement. Since the date becomes past due, the loan becomes non-performing assets. The book of the account with lending institution should be effectively operative by means of real transaction effected on the part of the debtor in order to remain loan performing." (Chhetri, 2057:17)

As per his opinion, the definition of NPA differs from country to country. In some of the developing countries of Asia Pacific Economic Cooperation (APEC) forum, a loan is classified as non-performing only after it has been arrear for at least 6 months; similarly, it is after three months in India, Loans thus defaulted are classified into different categories having their differing implication on the assets management of financial institution. He also stated that NPAs are classified according to international practice into three categories namely substandard, doubtful and loss depending upon the temporal position of loan default. "Thus the degree of NPA assets depends solely on the length of time the assets has been in the form of non-obliged by the loanee. The more time it has elapsed the worst condition of assets is being perceived and such assets are treated accordingly."

As per Mr. Chhetri's view, failure of business for which loan was used, defective and below standard credit appraisal system, credit program sponsored by Government, slowdown in economy/recession, diversion of fund are some of the lending to accumulation of NPAs.

He said that there is serious implication of NPAs, on financial institution. He further added that the liability of credit institution does not limit to the amount declared as NPA but extend to extra amount that requires by regulation of supervisory authority in the form of provisioning as the amount required for provisioning depends upon the level of NPAs create a psyche of worse environment especially in the financial institution like waiving interest, rescheduling the loan, writing off the loan, appointing private recovery agent, taking help of tribunals and law of land etc NPAs can be reduced.

Finally he concluded that financial institutions are beset with the burden of mounting level of NPAs in developing countries. "Such assets debar the income flow of the financial institution while claiming additional resources in the form of provisioning thereby hindering gainful investment. Rising level of NPAs can't be taken as stimulus but the vigilance demanded to solve the problem like this, eventually will generate vigor to gear up the banking and financial activities in more active way contributing to energizing growth.

Bhattarai, (2003) has presented an article about the "Non- Performing Assets (NPA) Management". According to him, a loan is a very easy term for a borrower when he has already taken and for a lender not availed. It is equally difficult for a borrower to avail and for lender to recover. From a banker's view, it is just like a stone to roll down from the top of the hill while sanctioning, but too difficult to roll back the same stone to the top of the hill while recovering. A loan not recovered within the given timeframe either in the form of interest servicing or principal repayment is called non-performing loan. There are other parameters as well to quantify a NPL. Security not to the extent of loan amount with specified safety margin, value of security not realizable, possession not as per the requirement of bank, conflict of charges are some of the reasons which causes difficulties while recovering the loan.

According to him, NPL of a bank is like a cancer in a human body, which will collapse the entire bank if not taken care in time. This is an important discipline in banking to prevent the entire NPL or avoid situation for a loan to turn into NPL. Loan for banks is very essential to generate revenue for operational expenses as well as to provide return to the shareholders.

When a loan advanced from good money turns into a bad loan, the chances of shareholders return as well as the survival of the bank is at stake. Ailing banks cannot portray a better image in public. When a public loses the confidence on a bank and does not deposit, the bank will be in the verge of extinction. Therefore, deposits are the essence for a bank. A loan disbursed as good loan does not turn into bad

overnight. It has certain course to turn into bad. An efficient bank management can recover the loan before turning it into bad and can save itself from the unwanted catastrophe

In conclusion, a borrowing may reflect one or all the above signals that may cause harm to the bank. There are few ways to protect bank from intentional defaulter but for those default caused by situations we can reschedule or restructure their facilities and help them to meet their debt obligation as per the cash flow they are having. Even an authentic loan that has been sanctioned with a good intention may turn into bad due to lack of proper management and carelessness. The bank will have to face heavy consequences in such a case. When a good loan, with all effort to protect it, turns into bad and the borrower's ability is not sufficient to repay it, he then tries to hide it from the bank and wants to be relieved temporarily. Such situations give some signals to the bank and these signals are called danger signals.

A bank must be one-step further than its customers must. It must collect all the relevant information that are required by the borrower for the establishment of a business and be rigid to give loan than to give his own money without any security. When a borrowing unit is not able to serve the debt from the source explored, the documentations are merely a decree to enforce legal action against him. Nevertheless, what gets realized when everything is lost. A jail and punishment does not satisfy the interest of bank. Therefore, he is of the view that the bank should always keep in mind the formula Know Your Customers (KYC) before giving loans.

The security given by a borrower may be ample for the exposure. However, the borrower from other source of business may not be able to generate substantial earning to service the debt. Bank has the right to auction the property and liquidate the loan but in doing so realization from the auction of the property is always less than the value of the assets. This will serve neither the purpose of bank nor the borrower instead cause loss to both.

Tiwari, (2004), the article titled ' "Financial sector hobbled with chaos, fragility" was published in the Himalayan times. He states that Nepal's financial sector is moving

like a 'sinking boat'. According to him financial institution have failed in delivering beneficial services to needy people by developing credit giving centers in rural areas with out which sustained economic growth is impossible. On the other hand banks and financial institution have enough liquidity but they are finding it difficult to find suitable places for investment.

“Problem such as insecurity lack of market research from banks, low investment opportunities, weak operational policies for carrying out financial transaction, among others have contributed to the problem of this sector .Despite central banks directives regulating banks and financial institution, private and government banks are functioning haphazardly.----- Nepal bank limited (NBL) and Rastriya Banijya Bank (RBB), the two largest banks, occupy about 50 percent of the country’s banking assets. An effective reform of these two is key to improved performance of the whole sector. The process currently underway to reform these two institutions, despite paying huge amounts to foreign experts, has not given expected results. ---- Besides NBL and RBB, the non- performing assets (NPA) of some private banks also very high. If the government and central bank allow the financial sector reforms to focus only on RBB and NBL, it might become a futile effort. The current management of RBB and NBL has not been able to reduce their NPL even after two years, which have crossed over 60%. Earlier KPMG had calculated NPL at 30- 35 percent. The central bank itself says, despite efforts NBL has high NPLs and negative capital of RS 9.75 billion”.

At last he suggests that the forthcoming budget should not remain a document merely but should address financial sector ills with a wide vision. He further recommended that in order to create a well regulated, prudent, market oriented, competitive and strong financial system in Nepal, the government should look to build up on its indigenious strength and improve upon its regional lies to improve its efficiencies

2.2.2 Review of Related Thesis:

Thapa, (2005) has concluded his study entitled “Non-performing loans of Nepalese commercial banks.” The other specific objectives of the study are:

- To know the problems of the non-performing loans and its effect in the ROA and ROE of the Nepalese commercial banks
- To find out whether the Nepalese commercial banks are following the NRB directives regarding loan loss provision for non-performing loan or not.

The major findings of the study are:

- The no. banks has been following NRB’s directives regarding the loan loss provision. He also conclude that the return on assets (ROA) and return on equity (ROE) of the bank deposed upon the NPLs.
- The high degree of negative correlation between NPL and ROA and the NPL and ROE clearly indicates that there is inverse relation between them.
- For the smooth operation of the commercial banks, the NPLs should be controlled for this banks should provide necessary training regarding loan management to the manpower’s. In order to remove, the NPLs, banks should take enough collateral so that banks can recover its loan amount.
- For the loan loss provision as per the NRB directive and to reduce the NPL, the bank management should be effective and the NRB’s monitoring and regulation is necessary.

Giri, (2006) “Non Performing Assets of Commercial Banks” main objectives to evaluate the impact of NPA on the profitability of the commercial banks. The other specific objectives of the study are:

- To analyze and identify the impact of NPA on profitability.
- To studied about the internal and the external factors that affect the non-performing assets to increase from the loan and advances.
- To study about internal factors that influence the effective management of the NPA and its increment.

The major findings of the study are:

- The relationship between the non-banking assets and the non performing assets, in which he was able to find out the internal responsible factors that contribute turning good loan into bad loans, bad intention, weak monitoring and mismanagement are the most responsible factors. Similarly, weak legal provision and credit concentration are also found as the least preferred factors in turning good loans into bad loans.
- Some factors such as lack of portfolio analysis, not having effective credit policy and shortfall on security were identified as having average effect on NPA growth.
- In connection to the external factors it has been found that recession, political and legal issues are more relevant factors in turning good loans into bad one.
- Like wise legal provision for recovery as a reason for increment in NPA in Nepalese Banks have been found the factors having less impact. Supervision and monitoring system have been identified as average factors.
- It is can be generalized that economic and industrial recession and not having strong legal provision for loan recovery are the major external factors that have major contribution for the increment of NPA.

Basnet, (2007) in his study, *“Impact of NPA on Commercial Bank”*, has the main objective to analyze and identify the impact of NPA on profitability. The other specific objectives of the study are:

- To evaluate the relationship of loan and advances with total deposit and total assets.
- To find out the level of NPA in total loan and advance and total assets and its relationship with loan and advances, total assets and loan loss provision.
- To find out the return on loan and advances and its relationship with loan loss provision.
- To evaluate the relationship between profit (loss) and loan loss provision.

The major findings of the study are:

- The average loan and advances to total assets ratio on HBL, SCBNL, NIBL, NBL, RBB and NBBL are 50.38%, 29.16%, 59.62%, 32.25%, 37.17% and 64.64% respectively during the study period. The relatively low ratio of SCBL is the indication of risk averse attitude of the management or they have the policy of investing low in the risky assets like loan and advance.
- The loan and advances to total deposit of HBL, SCBNL, NIBL, NBL, RBB and NBBL during the study period are 58.70%, 36.85%, 73.79%, 57.79%, 70.56% and 79.42% respectively. The NBBL has the highest average ratio but SCBNL has the relatively lower ratio.
- The average ratio of non-performing assets to total loan and advances of HBL, SCBNL, NIBL, NIBL, RBB and NBBL are 7.43%, 4.43%, 2.73%, 48.83%, 56.95% and 16.34% respectively. Similarly, the means 92.57%, 95.57%, 97.27%, 51.17%, 43.05% and 83.66% of loan and advances of HBL, SCBNL, NIBL, NBL, RBB and NBBL are performing loan respectively.
- The average return on total loans and advance ratio of HBL, SCBNL, NIBL, NBL, RBB and NBBL are 4.61%, 7.73%, -3.99%, -15.67% and 1.42% respectively. The return on loan and advances revealed that RBB seems to be failure to earn return on loan and advances.

Shrestha, (2008), in her study, " *Analysis of Non Performing Assets of Commercial Banks*" has selected three commercial banks SCBNL, BOK & NIBL for the analysis of Non Performing Assets. The specific objectives of the study are:

- To find out the level of non-performing assets in selected commercial bank.
- To study and find the impact of non-performing assets on the profitability of the commercial bank.

- To find out the portion of risky assets in the total assets of the commercial banks.
- To measure the relationship between NPA with total deposit and net profit.
- To find out the factors leading to accumulation of non performing assets in commercial bank.

The major findings of the study are:

- In average, the performing loan of SCBNL has covered 97.73% of the total loans and advances, whereas the non-performing loan has covered 2.27% of the total loans and advances. Similarly, in BOK the performing loan has occupied 96.25% and non-performing loan has covered 3.75% of the total loans and advances. And in NIBL, the performing loan has represented 98.78% and non-performing loan has represented 1.22% of the total loan.
- The average sub-standard loan, doubtful loan and loss loan of SCBNL are Rs. 13.66 millions, Rs. 83.07 millions, and Rs. 103.31 millions respectively, BOK are Rs. 81.83 millions, Rs. 44.59 millions, and Rs. 152.03 millions respectively, while NIBL are Rs. 7.34 millions, Rs. 9.25 millions and Rs. 104.07 millions respectively.
- In average, the non-performing asset has represented 2.33% in SCBNL, 3.93% in BOK and 1.24% in NIBL of the total performing loan of the respective bank, which has indicated that BOK has more risky investment sector than SCBNL and NIBL.
- Similarly, the non-performing assets covered 0.79% of the total assets of SCBNL, 2.40% of the total assets of BOK, and 0.80% of the total assets of NIBL, thus implying more risky assets in BOK compared to SCBNL and NIBL.
- Likewise, the non-performing asset to total deposit of SCBNL is 0.89% and that of BOK is 2.80%, and NIBL is 0.93%, which has indicated better loan management in SCBNL than in BOK and NIBL.
- In average, SCBNL has kept 2.98% of the total loans as loan loss provision and BOK has kept 3.71% of the total loans as loan loss provision and NIBL has kept 3.19% as loan loss provision. Similarly, the loan loss provision represented

141.99% and 106.40% and 288.06% of non-performing assets in SCBNL, BOK and NIBL respectively.

- Also, the net profit to non-performing assets of SCBNL is 354.74% in average and that of BOK is 87.39% in average and NIBL is 213.52% in average for the five year periods taken for research.

Khadka, (2009), entitled "*Loan Management of Commercial Banks*". with following objective in his study.

- To analyze the effectiveness of lending policy of the selected sample banks.
- To measure the performance in quality, efficiency

To meet the above objective, the sources of data of commercial bank are analyzed by using financial tools such as ratio analysis, frequency, mean, standard deviation are used. Among many Commercial banks the researcher took two banks NIBL and NBBL with five years data.

In findings, the current ratios of these banks are considerable and considerable but mean liquid fund to total deposit ratios are fewer consistencies and are not above 1 which shows the minimum deposit mobilization. Likewise, assets to total liabilities ratios are also fluctuating.

Similarly, loan and advances to total deposit ratio, mean ratio of loan and advance and investment to total deposit ratio shows the deposit mobilization in income generating sector are being nearly equal to 1. Loan and advances to shareholders equity ratio shows how well the investment made by investor. These ratios of both banks are above 10 and are fewer consistencies.

In conclusion, the overall performance of Nepal Bangladesh Bank Limited is satisfactory then Nepal Investment Bank Limited. The liquidity position of NBBL is better than that of NIBL. As loans and advances of NBBL is increasing trend deposit is also increasing trend during the study period. There is increasing trend in profit of NBBL shows that improvement in performance and success of the firm. Purpose wise loan classification show that the NBBL and NIBL banks have given priority to industrial and commercial sector lending, as well as priority and deprived sector lending. NBBL has higher lending

portion in these sectors than NIBL. From the selected bank NBBL has performed well in increasing growth ratio of deposit, loans and advances, investment and profit.

NBBL has good lending procedure, preliminary screening is done of all the loan application, credit appraisal and financial position of the business and cash flows of the proposal is given high importance, which is essential criterion for loan approval. There is proper control mechanism like delegation of authority, follow up visits and books of accounts inspection of the client, which results in good performance of the bank. The banks follow NRB guidelines of loans classification and provisioning which makes strong financial position of the bank instead of holding high volume of non-performing assets. After comparatively study of NBL and NIBL banking performance, it can be concluded that NBL has better performance than that of NIBL.

Acharya, (2010), entitled with “*A Study of Non Performing Loan & Loan Loss Provision of Commercial Bank, A Case Study of NABIL, HBL and EBL*” has made study about a part of credit risk associated with those banks. The main objectives of her study were:

- To find out the proportion of non-performing loan in the selected commercial banks.
- To find out the factors leading to accumulation of non performing loan in commercial banks
- To study and analyze the guidelines and provisions pertaining to loan classification and loan loss provisioning.
- To find out the relationship between loan and loan loss provision in the selected commercial bank.
- To study and the impact of loan loss provision on the profitability of the commercial banks.

The major finding in her study was that the EBL has the highest portion of the loan in total asset followed by NABIL and HBL. She concludes that the HBL shows the risk-averse attitude. Likewise the non-performing loan to total loan is found highest in EBL,

NABIL and HBL. Likewise the Loan Loss Provision is also highest in EBL where as the HBL has the least Loan Loss Provision.

Likewise, the EBL has the highest portion of Loss loan followed by NABIL and HBL. This study is more concentrated on non-performing loans; however, there exist lots of areas in credit risk management where further research is called for. In context of credit risk, collateral risk, concentration risk, organization risk management system can be studied.

2.3 Research Gap:

From the study of previous thesis it has found that increasing Non-performing assets is one of the major challenges faced by Nepalese commercial banks in the present context. Some researchers were done in which matter relating to loan loss provision for Non-performing assets or not. Some researcher was done what is the internal and external factors affects the Non performing assets to increase from the loan advances. The previous theses covered only upto the fiscal year 2008/09 but this thesis also based on secondary data provided by concerned Nepalese commercial banks up to the fiscal year 2009/10. Hence this thesis had attempted to fill this research gap by taking the reference of Nepal SBI Bank Limited, Everest Bank Limited, and Nepal Investment Bank Limited. This research will be able to deliver some of the present issue, latest information and data relating to Non-performing assets.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Introduction:

The chapter is related to the Research methodology applied in the entire aspect of the study. Research methodology is a research tools, which is used to test hypothesis and to come to a factual conclusion. It refers to the logical sequence of various steps to be adopted by a researcher in studying problems with certain objectives. In others words, researcher methodology describes the method and process applied in the subject of the study. The chapter includes research design population of sample. Nature and sources of data, analysis of data and tools for analysis.

3.2 Research Design:

Research design is an organized approach and not a collection of loose unrelated parts. It is an integrated system that guided the researcher in formulating, implementing and controlling the study. Research design in the plan, structure and strategy of investigations conceived so as to obtain answers to the research question and to control variances. The study is based on secondary sources of data so descriptive and analytical research design has been used.

3.3 Population and Sample:

There are altogether 31 commercial banks (domestic commercial banks and joint venture banks) functioning till to date and most of their stock and traded actively in the stock market. Here for the study or for sample Nepal Investment Bank Limited, Everest Bank Limited and SBI Bank Limited are taken in to account. Since all three sample banks are performing well and they are providing same traditional as well as modern transaction facilities, so effort is made to do the same, which have been consider as a population of the study.

3.4 Nature and Sources of Data:

This study conducted on the basis of primary and secondary data. Secondary data relating to "Investment" e.g. deposit, loan and advances and profit/loss that have been directly

obtained from the balance sheet and the P/L a/c of concerned banks annual reports, collected from number of institution and authorities like NRB budget speech, NRB published books, bank bulletin, newspaper, previous studies, security exchange board, Nepal stock exchange Ltd. All the secondary data are observed, processed and tabulating in the time as per need and objectives. Various data and information are collected from the economic journal, periodicals, bulletins magazines and other published and unpublished reports and documents from various sources.

Primary data is a data which has not been used by others. Collected fresh data is primary data. It can be prepared by different sources like opinion poll, sampling, through correspondents etc. In this study, primary data has been collected by using questionnaire method, for this interview and structured questionnaire method have been used. Questions were asked to the executive level staff of the related bank. The questions raised are of three types, yes/no questions, multiple choice questions and open end questions

3.5 Tools for Analysis:

Few statistical packages are used to process and analyze information. Secondary information collected from annual general reports of the sample banks was first tabulated in Excel spreadsheet and then analyzed using formula and charts of the same software. For these statistical tools such as correlation analysis is done and in some cases, financial tools such as Returns on assets have also been made. Suitable tools such as descriptive statistics, Mean, Standard Deviation, Correlation etc. were done wherever necessary.

Statistical tools

In this research, following statistical tools are used

Average:

Average is defined as sum of observations divided by their number in the selected sample.

$$\text{Average (mean)} = \frac{\text{Sum of observations}}{\text{Number of values}}$$

$$\bar{X} = \frac{\sum X}{N}$$

Coefficient of correlation (r):

The correlation coefficient indicates the linear relationship between two or more variables. The measures of correlation called the “correlation coefficient” can be summarized in one figure, the degree and direction of movement. It can be calculated by using the method of Karl Person’s correlation coefficient, because it is one of the widely used mathematical methods of calculation, the correlation coefficient between two variables. In symbolically, it is defined as:

$$r = \frac{N\Sigma XY - \Sigma X\Sigma Y}{\sqrt{N\Sigma X^2 - (\Sigma X)^2} \sqrt{N\Sigma Y^2 - (\Sigma Y)^2}}$$

Assumptions

- If r = 1, there is positively perfect correlation between the two variables.
- If r = -1, there is negatively perfect correlation between the two variables.
- If r = 0, the variables are uncorrelated.

The nearer the value of r to +1, the closer will be the relationship between two variables and the nearer the value of r, the lesser will be the relation.

Probable error (P.E):

The probable error of the correlation coefficient helps to interpret its value. P.E., which is the measure of testing the reliability of correlation coefficient, denotes it. If r be the calculated value of r from a sample of n pair of observation the P.E. is denoted by

$$P.E. = \frac{0.6745(1 - r^2)}{\sqrt{n}}$$

It can be interpreted to know weather its calculated value of r is significant or not in the following ways.

- If r < PE, it is Insignificants perhaps there is no evidence of correlation
- If r > 6PE, it is significant.

It is other causes, nothing can be concluded. The probable error of correlation may be used to determine the limits within which the population correlation coefficient lies. The limits for population correlation are r +PE.

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